Financial Accounting

for Bangalore University

As per CBCS Syllabus 2014–15 as Revised in March 2017 for

B.COM SEMESTER-I

About the Author

Ruqsana Anjum is currently working as an Assistant Professor at St. Joseph's College of Commerce (Autonomous), Bangalore and is a visiting faculty at ICAI (works) and various other management institutes.

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Professor Ruqsana has been actively involved in the field of academics and has a teaching experience of over fifteen years. She has authored several research articles in professional journals in the field of Finance, Accounting, Management and one minor research project in the field of Humanities. Professor Ruqsana has participated in various seminars, workshops, national and international conferences. Her acumen in research is highly appreciated and the papers presented by her at various conferences have been acclaimed in respective domains.

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Assistant Professor
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McGraw Hill Education (India) Private Limited
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McGraw Hill Education (India) Private Limited

Published by McGraw Hill Education (India) Private Limited
444/1, Sri Ekambara Naicker Industrial Estate, Alapakkam, Porur, Chennai - 600 116

Financial Accounting

Print Edition:
ISBN-13: 978-93-87572-84-3
ISBN-10: 93-87572-84-6

1 2 3 4 5 6 7 8 9 D101417 22 21 20 19 18

Printed and bound in India.

Director—Science & Engineering Portfolio: *Vibha Mahajan*
Senior Portfolio Manager: *Suman Sen*
Associate Portfolio Manager: *Laxmi Singh*

Content Development Lead: *Shalini Jha*
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Assistant Manager—Production: *Jagriti Kundu*

General Manager—Production: *Rajender P Ghansela*
Manager—Production: *Reji Kumar*

Typeset at The Composers, 260, C.A. Apt., Paschim Vihar, New Delhi 110 063 and printed and bound in India at

Cover Printer:

Visit us at: www.mheducation.co.in

Write to us at: info.india@mheducation.com

CIN: U22200TN1970PTC111531

Toll Free Number: 1800 103 5875

Dedicated to
Almighty God
&
My Mother

Preface

This book is written for the course on Financial Accounting as per the syllabus prescribed by Bangalore University for B.Com Semester I. It provides the needed inputs for students to master theory and practice of the subject in a systematic and simple language.

Due care has been taken to align different accounting treatments as per the latest provisions prescribed by the Companies Act 2013, along with relevant Indian and International Accounting Standards.

The book consists of abundant illustrations based on own creation and previous years' question papers of B.Com 'Bangalore University (Dec 2003 to 2017)' besides questions from foundation and inter level professional examinations. Latest three years' question papers (2015–2017) are solved at the end of the book which will help the students to have an insight of the examination pattern after thorough understanding of the content.

I sincerely hope that the students of all the commerce related streams—B.Com, BBA, BCA, CA (Inter), ICWA, M.Com will find this book invaluable in their preparations. While every effort has been made to provide comprehensive and up-to-date coverage of all topics, the scope for further improvement is always there as it is an on-going process. Therefore, I earnestly request the readers to send in their suggestions to enable us to make improvements in this book. These will be thankfully received and, if found useful, incorporated and acknowledged in subsequent editions.

Ruqsana Anjum

Acknowledgements

I am thankful to the Almighty God for the grace bestowed upon me to complete the book. This book would not have been possible without the sincere and sustained support of my family. All my love goes to my son, Mohammed Hamdaan, who, just at the age of five, has been very understanding and accommodating, otherwise, this book would have been a distant reality.

I owe my gratitude to a host of colleagues and friends. In this connection, the contributions made by Ms. Shoba N.S. deserves a special mention.

I gratefully acknowledge the moral support and encouragement received in my personal as well as professional endeavors from our Principal Rev. Dr. Daniel Fernandes, St. Joseph's College of Commerce.

My thanks are due to the team at McGraw Hill Education (India)—Mr. Suman Sen for providing me this opportunity and being an excellent mentor; Mr. Amit Chatterjee for his commendable cooperation and guidance at every stage of book writing; Ms. Laxmi Singh, for her support and guidance; and the entire production and marketing teams for their untiring efforts in bringing this book out in time and in a fine get-up.

I owe a special note of thanks to a host of reviewers for their valuable suggestions and knowledge sharing in the course of writing this manuscript.

I will consider myself amply rewarded, if this book is found useful by the readers.

Ruqsana Anjum

Syllabus

FINANCIAL ACCOUNTING

Bangalore University B.COM SEMESTER-1

(As per CBCS Syllabus 2014-15 as Revised in March 2017)

1.3 FINANCIAL ACCOUNTING (1st Semester) (IA-30 M + Written-70 M)	Chapter in the Book
UNIT-1: INTRODUCTION TO FINANCIAL ACCOUNTING Introduction—Meaning and Definition—Objectives of Accounting—Functions of Accounting—Users of Accounting Information—Limitations of Accounting—Accounting Principles—Accounting Concepts and Accounting Conventions—Accounting Standards: List of Indian Accounting Standards.	**Chapter 1**
UNIT 2: CONVERSION OF SINGLE-ENTRY INTO DOUBLE-ENTRY SYSTEM Single-entry system: Meaning—Features—Merits—Demerits—Types; Conversion into Double-entry system—Need for Conversion—Preparation of Statement of Affairs—Cashbook—Memorandum Trading Account—Total Debtors Account—Total Creditors Account—Bills Receivable Account—Bills Payable Account—Trading and Profit and Loss Account and Balance Sheet.	**Chapter 2**
UNIT 3: HIRE PURCHASE SYSTEM Meaning of Hire Purchase and Installment Purchase System—Difference between Hire Purchase and Installment Purchase—Important Definitions—Hire Purchase Agreement—Hire Purchase Price—Cash Price—Hire Purchase Charges—Net Hire Purchase Price—Net Cash Price—Calculation of Interest—Calculation of Cash Price—Journal Entries and Ledger Accounts in the books of Hire Purchaser and Hire Vendor (Asset Accrual Method only).	**Chapter 3**
UNIT 4: ROYALTY ACCOUNTS Meaning and definition—Technical Terms—Royalty—Landlord—Tenant—Minimum Rent—Short Workings—Recoupment of Short Working under (Fixed Period) Restrictive and Non-restrictive (Floating Period) Recoupment within the Life of the Lease—Treatment of Strike and Stoppage of work—Accounting Treatment in the books of Lessee and Lessor—Journal Entries and Ledger Accounts including Minimum Rent Account	**Chapter 4**
UNIT 5: CONVERSION OF PARTNERSHIP FIRM INTO A LIMITED COMPANY Meaning—Need for conversion—Purchase Consideration—Mode of Discharge of Purchase Consideration—Methods of calculation of Purchase Consideration—Net Payment Method—Net Assets Method—Journal Entries and Ledger Accounts in the books of Vendor—Treatment of items: Dissolution Expenses, Unrecorded Assets and Liabilities, Assets and Liabilities not taken over by the Purchasing Company, Contingent liabilities, Incorporation entries and preparation of balance sheet of the purchasing company under vertical format.	**Chapter 5**

Question Paper Pattern

FINANCIAL ACCOUNTING

Bangalore University B.COM SEMESTER-1

(As per CBCS Syllabus 2014-15 as Revised in March 2017)

(With effect from 2017-18)

Maximum Marks: **70** **Duration: 03 Hours**

Note:

1. Question paper consists of ***three*** sections-Section A, B and C
2. Question 1 carries *10 marks.*
3. Questions 2 to 6 each carries *6 marks*.
4. Questions 7 to 11 each carries *14 marks*.

Particulars	Marks	Nature of Question
SECTION-A (Conceptual Questions) **Q-1:** Answer any ***five*** sub questions out of ***seven*** $\underbrace{\text{(a) (b) (c) (d) (e) (f) (g)}}_{\text{(5Q} \times \text{2 marks)}}$	10 marks	Theory
SECTION-B (Analytical Questions) Answer any ***three*** questions out of ***five*** $\left.\begin{array}{l}\textbf{Q-2}\\\textbf{Q-3}\\\textbf{Q-4}\\\textbf{Q-5}\\\textbf{Q-6}\end{array}\right\}$ (3Q × 6 marks)	18 marks	Practical
SECTION-C (Essay Type Questions) Answer any ***three*** questions out of ***five*** $\left.\begin{array}{l}\textbf{Q-7}\\\textbf{Q-8}\\\textbf{Q-9}\\\textbf{Q-10}\\\textbf{Q-11}\end{array}\right\}$ (3Q × 14 marks)	42 marks	Practical
Gross Total	**70 Marks**	

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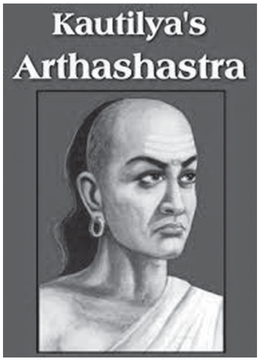
Review Questions

- **Section A (2 Marks)**
- **Section B (8 Marks)**
- **Section C (14 Marks)**

1.1 INCEPTION AND GROWTH OF ACCOUNTING



Accounting is often referred to as language of business, as it communicates financial information through financial statements. Accounting has been practised since the early phases of civilisation and has witnessed metamorphosis change over since its inception.

In the book *Arthashastra*, written by *Kautilya*, an important minister in King Chandra Gupta's court, it is evident that accounting has been in practice for more than 23 centuries. However, the modern system of accounting is on the basis of double-entry system of Book-Keeping, and this concept was coined by *Luca Pacioli*, in his writing on the principles of double-entry system in 1494 at Venice in Italy.

Over the period of time, the role of accounting has transformed from mere Book-Keeping to providing relevant information to make policy decisions and frame business plans. Accounting has now assumed the role of an information system, as it helps in collecting, measuring of business activities, processing and communicating economic information to varied users for decision-making. Whether it is business or non-business activities or whether it is manufacturing, trading or service organisation, all activities and all organisations require finance and other economic resources. Accounting is essential to account for these resources. In today's dynamic environment, accountants are compelled to reassess their roles and duties within the company, the organisation in particular and society at large. Accountants are now looking at new growth areas such as environmental accounting, forensic accounting, ecommerce, social accounting, human resource accounting and others.

1.2 MEANING OF ACCOUNTING

Accounting, as an information system, is the process of identifying, classifying, measuring, recording and communicating an organisation's economic activities to users for decision-making. In other words, it is a process that is mainly concerned with recognising, measuring, recording and communicating the relevant information concerning the economic events of a company to the users of such information.

To comprehend the nature of accounting, it is important to understand the relevant aspects of the accounting; *economic events* are the results comprising transactions that can be measured in money or money's worth. For example, purchase of raw materials for the purpose of manufacturing is an economic event, comprising a number of financial transactions, namely (i) purchase of raw materials, (ii) Carriage Inward, (iii) manufacturing, (iv) packaging, (v) Carriage Outward and others. *Identification* of the nature of transaction, whether financial or non-financial, items of financial nature will have to be recorded, whereas transactions that are non-financial in nature are

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not recorded in the company's books of accounts. Examples for non-financial transactions, such as signing of an important contract, changes in managerial policies and others are not recorded in the books of accounts as they are not measurable and hence non-financial. This is one of the limitations of Accounting. *Measurement* indicates using a suitable measurement term or unit to measure the financial transaction. If an event cannot be measured in financial terms, it will not be recorded in the books of accounts of the company, although that event significantly influences company's performance. *Recording*, the next important stage in accounting after identification and measurement, is recording of economic events in company's books of accounts in such a way that the relevant financial information is presented as per the established Accounting Standards. *Communication*, the economic events after being identified, measured and recorded are communicated in a certain form to the board, internal and the external users of the information through financial statements or reports. In short, accounting identifies transactions and events of a specific entity.

1.3 DEFINITION OF ACCOUNTING

Smith and Ashburne define Accounting as a science of recording and classifying business transactions and events, of those that are financial in nature, it further involves the act of making summaries, analysis and interpretations of the transaction and events and it also involves communication of those engaged in making informed judgements and decisions'.

American Institute of Certified Public Accountants (AICPA) defines accounting as 'The art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events, which are, in part at least, of a financial character and interpreting the results thereof'. The Accounting Principles Board of AICPA further emphasised that 'The function of accounting is to provide quantitative information, primarily financial in nature, about economic entities, that is intended to be useful in making economic decisions'.

The American Accounting Association defined accounting as 'The process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of information'.

1.4 MEANING OF BOOK-KEEPING

Book-Keeping provides a permanent record of each and every transaction on a particular date. This helps in assessing the financial soundness and reviewing business policies on the basis of past records. 'Recording of business transactions in a systematic manner in the books of account is termed Book-Keeping'. All the records necessary for the preparation of trail balance are drawn from the different books maintained by the business concerns.

Book-Keeping may be defined as "The science and art of recording, classifying and summarising business transactions in money or money's worth so accurately and systematically, in a certain set of books, regularly that the true state of business affairs can be correctly determined". In other words, 'Book-Keeping is the art of recording business transactions in a systematic manner'.

1.5 DIFFERENCE BETWEEN BOOK-KEEPING AND ACCOUNTING

Book-Keeping is an art of recording and maintaining books of accounts in such a way that the information can be quickly retrieved at any point. The clerks engaged in maintaining books often rely on electronic equipment for their recording and maintenance. Accounting on the other hand, is body of knowledge primarily concerned with maintaining a system of records and preparation of statements or reports, for easy interpretation and communication. Book-Keeping precedes accounting and accounting succeeds Book-Keeping, in the sense that the work of a bookkeeper is reviewed by an accountant. Therefore, to do so, an accountant must be well equipped with accounting concepts, technique and terminologies and must possess conceptual clarity and high analytical and interpretation skills to comprehend the accounting information.

The important differences between Book-Keeping and accounting are mentioned in the following Table 1.1.

Table 1.1 *Differences in Book-Keeping and accounting*

Basis of difference	Book-Keeping	Accounting
Nature	It mainly aims at identifying, measuring, recording and classifying financial transactions in monetary terms	Accounting aims at summarising, interpreting and communicating the recorded transactions
Objective	To maintain systematic book of accounts and prepare trail balance and final accounts from them	To ascertain the business incomes/losses and financial position
Scope	It aims at only recording, classifying and summarising of business transactions. The scope is limited compared to accounting	The scope is broader, as it covers recording, classifying and summarising of business transactions along with its analysis and interpretation
Basis	Vouchers, bills and other supporting documents are used as evidence to record business transactions in Book-Keeping	Book-Keeping acts as a base for accounting information
Level of knowledge	Fundamental knowledge of accounting is sufficient for Book-Keeping of records. It is generally done by clerks or lower level of management	In-depth and advanced knowledge and understanding are essential for analysis and interpretation of accounts. It is generally undertaken by middle and high level of management
Association	Book-Keeping precedes accounting	Accounting succeeds Book-Keeping

1.6 FUNDAMENTAL CONCEPTS OR TERMINOLOGIES

1. ***Goodwill:*** Goodwill indicates reputation of the company expressed in terms of money. In other words, it is the presumed value of the unique factors that adds importance to firm's assets and generates sales revenue and super profit to the firm. The value of firm's brand name, loyal employees and customers, advanced technology used in production and manufacturing, unique business model and managerial efficiency symbolise goodwill.
2. ***Assets:*** Assets are the resources owned by the company and are generally classified into tangible assets and intangible assets. Tangible assets are those that have physical form with measurable value employed by the business in the manufacturing of goods and rendering of services, namely land, building, plant and machinery, furniture and fixture, inventory, cash and others, whereas assets with non-physical form are termed intangible assets, for example goodwill, trademark, patents, mailing lists, franchise rights and copyrights.
3. ***Fixed Assets, Current Assets (Floating Assets) and Liquid Assets:*** The assets that are meant to be used by the firm in long run and those, the quantity of which may not vary intermittently (regularly), are termed fixed assets—for example, land, building, plant and machinery, furniture, fixtures and so on. Current assets are used by the firms for their short-term requirement, and the amount invested in those varies frequently; for this reason, they are often termed fluctuating assets—for example, debtors, inventories and cash in hand and at bank. Liquid assets are those assets that can be transformed into money or cash within a short period of time with no or little loss in value. Such type of assets are also termed monetary assets, for example, short-term investments and marketable securities.
4. ***Wasting Assets:*** Those assets, the value of which diminishes over a period of time, for example natural resources such as mines, gas and timber, are used in due course and are left with no residual value.
5. ***Investments:*** Investments take form of monetary assets that are invested outside the business with a view to generate revenue over the period of time. These assets are useful to the company only in terms of revenue generation but not in the course of production or manufacturing. The surplus funds, if any, of the company are generally invested in the shares and securities of others companies as they may provide further revenue and could also be sold at higher profits.
6. ***Non-current and Current Liabilities:*** Liabilities are the amounts due by the company to its lenders; liabilities are generally classified into non-current and current. Non-current liabilities include the ones to owners and fixed (long-term) liabilities. Liabilities to owners commonly known as 'capital' are the claims of the owners against the assets of the company. Fixed or long-term liabilities are the debts owed by the company and include debentures, public deposits, loans from banks and others. These are referred to as long term as they are generally repaid over a long period of time. On the contrary, current liabilities, also

referred to as short-term liabilities, are repayable within a short period of time, for example, Creditors, Bank Overdraft and Bills Payable and others.

7. ***Drawings:*** If an owner of a company withdraws either cash or any items of importance to the company for personal purpose, it is termed drawings.
8. ***Debtors:*** It is the amount of money owed by the external person to the company on account of business transaction (i.e. credit sales) between the company and the external person. This is a commonly followed practice in the industry, in which the company makes its sale on credit basis or allows credit period to the customers; this could be to overcome the competition.
9. ***Creditors:*** It is the amount of money owed by the company to the external person (i.e. supplier) on account of business transaction (i.e. Credit Purchases) between the company and the external person.
10. ***Depreciation:*** It is a charge against the profit made with an intention to replace the existing fixed assets. The nature of the fixed asset is such that it is subject to wear and tear as it is continuously used in the production and also that it tends to become obsolete (i.e. outdated) due to technological changes that take place. For this reason, firms generally observe a practice of creating an annual charge against the profits so that at the end of the useful life of the asset, it can be replaced by using the amount accumulated in depreciation fund. This ensures that the production and operations of the firm do not get disturbed after the expiry of useful life of the asset.
11. ***Provision:*** A particular amount of money is kept back from the company's profits for the known or probable liability or for the diminishing value of the asset, although the exact amount is not known. In other words, it is the amount of profits that has been set aside from the company's profits to cover likely or projected future liability, the exact amount of which is not known—for example, provision for bad and doubtful debts, provision for taxation, etc.

1.7 OBJECTIVES OF ACCOUNTING

The objectives of accounting differ from industry to industry and from one organisation to the other; however, the general objectives of accounting are as follows:

1. ***To maintain systematic record of business transaction:*** In large business organisations, thousands of business transactions take place in a day; it is very difficult and engaging to remember all the transactions that have taken place. Therefore, accounting helps in maintaining systematic record of all the business transactions in such a way that information can be retrieved as and when it is required.

2. ***To ascertain the results of the business operations:*** Accounting helps the managers in understanding whether the business is efficient or not. It helps in ascertaining the profits earned or losses incurred by the businesses during a particular period. Trading, Profit or Loss Account or income statement is prepared to understand the revenues accruing to an organisation and the expenses incurred to earn those revenues. The difference is arrived at as either profit or loss. With the help of this information, management will be able to take a call on the areas; it has to work on.
3. ***To ascertain the financial position of the business:*** Along with the results of the business operations, management also needs information about the financial position of the business. The financial position of a business is indicated by nature and value of assets and the nature and extent of liabilities for a particular period and availability of cash points towards the liquidity and solvency position of a firm.

   The financial statements prepared reflect the financial position of a firm and act as a barometer to assess the health of a business entity.
4. ***To ascertain solvency and liquidity position of the firm:*** Financial statements report information about how an organisation procures and expends its cash and also reveals information about its borrowings, repayments and investments. Any distribution of resources to owners in the form of dividends or any other form, its capital transactions or any other factor may significantly influence firm's solvency and liquidity.
5. ***To safeguard the business assets:*** Accounting information reveals all the necessary details about the various assets belonging to the firm and the liabilities owed by the firm; this information gives a clear picture about the assets owned, the claims/charges on the assets and the liabilities owed by the firm. This information can come handy to avoid or defend any false claim on the properties of the firm.
6. ***To facilitate business decision-making:*** Accounting records and statements provide useful financial information to the managers to pursue planning, control, evaluation and timely decision-making. Managers will be in a position to understand the different dimensions of business and take necessary steps to overcome the problems or difficulties associated with the business.
7. ***To satiate legal requirements:*** Companies are governed by regulatory framework or laws and are compulsorily required to maintain books of accounts as per the various rules, regulations and guidelines—for example, the Companies Act; Factories Act; Labour Act; Consumer Forum, Sales Tax Act; Income Tax Act and Indian Penal Code and others. The various guidelines under each of these acts have to be compulsorily adhered to by the firm to stay listed and avoid being levied with penalties of any sort.

1.8 FUNCTIONS OF ACCOUNTING

Following are the functions of accounting (Figure 1.1):

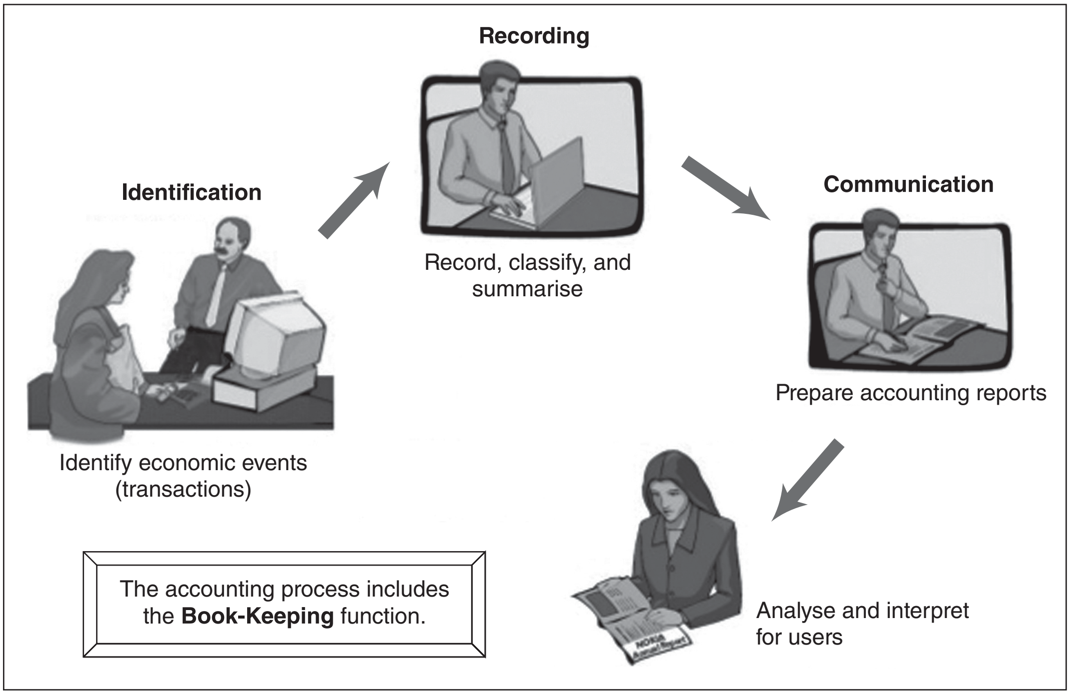

Figure 1.1 *Functions of accounting*

1. ***Record Keeping of Business Transaction:*** One of the primary functions of accounting is systematic record keeping of business transactions. It begins with identifying, recording, classifying summarising of business transactions followed by journalising and posting them to the ledger and finally preparation of final accounts. It is a means to facilitate the dissemination of information among different user groups.
2. ***Decision-making:*** Accounting helps managers to take appropriate decisions. Managers engage in comparing day-to-day operations with predetermined standards. The deviations, if any, are thoroughly examined to eliminate any such occurrence in the future. It also helps management in predicting and evaluating the nature, amount, timing and uncertainty of potential cash flows and facilitates management control. Accounting information provides guidance for judging management's ability to use its scarcely available resources in meeting its goals.
3. ***Legal Compliance:*** Accounting provides information required by various enactments or standards and the accounting system designed by the firm should adhere to all the legal

requirements as per various laws. It acts as a base and with its help various statements, documents and returns are prepared to comply with legal requirements.

4. ***Information Management:*** Accounting information is classified on the basis of the users, internal users and external users; internal users work for the organisation and are responsible for planning, organising, operating and evaluating the entity. External users do not work for the organisation and include investors, lenders, workers, competitors, customers and government and others irrespective of the size or the degree of automation; information management is the key to success of any firm as it facilitates estimation of cash requirement and forecasting future growth of the organisation. Availability of right information at the right time will help managers to take right decisions.
5. ***Communication of Final Results:*** Interested parties are supplied with meaningful information to take appropriate decisions. One of the important functions of accounting is to communicate financial results through statements, reports, documents and others, which serves those users who rely on accounting information as their principal source of information.

1.9 BRANCHES OF ACCOUNTING

The role of an accountant is to disseminate accounting information to the varied user groups. An accountant identifies, measures, records, analyses, interprets and communicates accounting information to the internal and the externals users. The information so provided is inferred, decoded and used by the management and other user groups for economic, business and investment decision-making. Therefore, the information so provided should be relevant, adequate, accurate and reliable in deciding the future course of action. The obvious varied needs of the internal and external users of accounting information have further emancipated in the development of sub-areas within the accounting discipline, namely Financial Accounting, Cost Accounting and Management Accounting.

1. ***Financial Accounting:*** This is the accounting, primarily concerned with financial matters or financial state of affairs of the business. It deals with preparation and presentation of financial statements to arrive at a measure of organisational success and financial soundness. It relates to the past period, which is monetary in nature. Financial statements, i.e. Profit or Loss Account and the Balance Sheet, specify the way in which the operations of the business are carried out during a specific period of time. The most important responsibility of financial accounting is *external reporting* to all stakeholders. The divergent users require accounting information for comparison purpose. Therefore, the financial accounting takes into account relevant principles, concepts and conventions. The importance of financial accounting is that it facilitates the board in planning, evaluating and controlling of firm's operations. It also aids in forming policies and forecasting future growth of the organisation.

   However, the limitation of financial accounting is that a *broader picture* is presented to the users; if a user prefers information job, process and product or department wise, it is not available. In short, it gives bird's eye view of the state of affairs of the firm and, hence, a closer picture is not available. The *behaviour of costs cannot be ascertained* with the help of financial accounting, as it does not distinguish between fixed cost and variable costs. The information provided by financial accounting is *historical* in nature, because of this, the usefulness of information is questionable, as the expenses are already incurred and the environment is also fast changing, as a result of which, today's scenario may not be applicable in tomorrow's environment. However, financial accounting is the basic foundation on which other branches and tools of accounting analysis are based. It acts as a base/source of information, which can be used according to the requirements of the users.

2. ***Cost Accounting:*** In view of the limitations of financial accounting, with regard to non-availability of information particularly related to cost of individual product, process, job or department, cost accounting was developed. It is a branch of accounting that aims at ascertainment, accumulation and control of costs, mainly for the purpose of stock valuation and measurement of profitability and efficiency. It provides information on allocations of costs to different departments—like jobs, processes and products—so that effective mechanism of cost control can be put into effect. It mainly aims at the estimation of future costs and also helps in making revenue decisions. The process of cost accounting is based on the data provided by the financial accounting. An effective cost accounting system highlights viable and non-viable operations specifying corrective measures to be undertaken. It helps management in making pragmatic pricing decisions under different circumstances. With the help of data generated by efficient costing system, effective comparison between the different alternative courses of action can be made.
3. ***Management Accounting:*** It is a branch of accounting that supplies all the necessary accounting information to internal users to facilitate them in rational policy decision-making and evaluation of the impact of its decisions on performance of the company. It draws all the necessary information from cost accounting, financial accounting and financial management that helps management in making strategic decisions like make or buy decisions, continue or discontinue, buy or lease, pricing decisions, budgeting, forecasting and others; unlike financial accounting and cost accounting, it also reports on qualitative and non-financial aspects of business which is very important for business decision-making. Systematic and meaningful information is reported according to the specific requirements of the decision makers. One of the important advantages of management accounting is that it foresees events and reports the same so that proactive actions are taken by the management and is also capable of presenting information firm wise or department wise. As management accounting is 'tailor-made', catering to specific requirements of the decision makers, it is not based on the well-defined principles, reporting is done according to the particular requirement of the users.

Other than the above mentioned three main branches of accounting, there are various other areas covered by accounting and they are widely practised and used by the users, namely Natural Resources Accounting, Human Resources Accounting, Tax Accounting, Environmental Accounting, Forensic

Accounting, Brand Accounting, Social Accounting and others; they further aid the managers in effective decision-making and help them stay competitive in the market.

1.10 USERS OF ACCOUNTING INFORMATION

Managers require reliable, accurate and timely accounting information for effective decision-making. The users of accounting information have divergent needs; therefore, the reports, statements or documents prepared by an accountant should cater to all their needs and requirements. The following information throws light on the different users of accounting information and the ways to exploit the same to their benefit.

1.10.1 Internal Users

1. ***Owners:*** Owners are the suppliers of capital. After employing capital in the business, they are interested in knowing its progress. They are also keen on understanding the growth and returns on their investments. As they supply capital to the firm, they require managers to account for their 'stewardship' of the business. Therefore, accounting information by way of financial statements comes handy to the owners to understand the returns and future growth prospects of their investments.

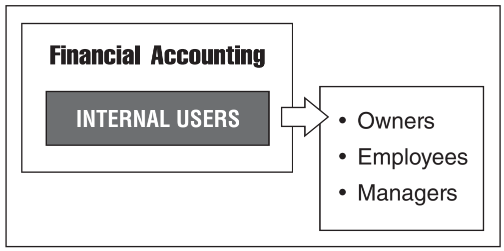

Figure 1.2 *Internal users of financial accounting*

2. ***Employees:*** Discharge of salaries and other basic emoluments largely depends on the profitability of the firm. To evaluate the worthwhileness of work in the firm, they largely rely on the accounting information. Financial statements are the principal source of information to them to make informed decisions. Their expectation does not restrict to salary, and they are also keen on other forms of salary, namely bonus, profit sharing, better working conditions and so on, and all of it is possible only if the firm earns good profits.
3. ***Management:*** The managers are interested in knowing the financial position of the firm, accounting information in financial statements forms the basis for understanding the state of affairs of the business. With the help of information procured through financial statements, managers comprehend about the strengths and weaknesses of the firm, and take necessary steps on working further on strengths and overcoming loopholes. Furthermore, it helps managers in understanding the present requirement and also working on the future course of action. It helps them to make an effective comparison with competitors in order to stay competitive in the market.

1.10.2 External Users

1. ***Investors:*** Prior to investing in the firm, investors are keen on evaluating, profitability and solvency of the firm. This is to ensure that their investments are safe as well as earning maximum returns. Investors are able to track the performance of the firm with the help of financial statements, and financial statements give them a better picture about the profitability, liquidity, solvency and future growth prospects of the firm.
2. ***Government:*** Government of any country is in charge of maintaining socio-economic balance for greater good of the society. For this reason, government tracks the progress of the companies through financial statements to levy tax and to make firms aware of the social responsibility towards the society through various joint collaborations programmes and schemes. Financial Statements help government in framing policies and implementing them.
3. ***Regulatory Authorities:*** The various regulatory authorities such as SEBI, RBI, Income Tax Authorities and others provide guidelines and restrictions making it mandatory for the companies to follow the same. Companies will avoid the practice of presenting 'rosy picture' or 'window dressing' of accounting information. They are in the obligation of compulsorily disclosing certain information to the investing public, so that they can make their investment choices more cautiously. Income Tax Authorities may require accounting information to carry out tax computations and to identify any attempts of tax evasion. The various authorities formed will require accounting information to check compliance and adherence to various guidelines laid down by them.
4. ***Customers and Common Public:*** Consumers' wish to understand the fact that the prices they pay towards the goods and services are not overpriced, and they are not exploited by the companies. They are also keen on knowing the income earned by various business houses, discharge of social responsibility, payment of taxes, contribution to the society and others. General public view the accounting information for their understanding of trend prevailing in the market, boom, depression and so on and also to make judgement about the standard of living and price index prevailing in the economy.

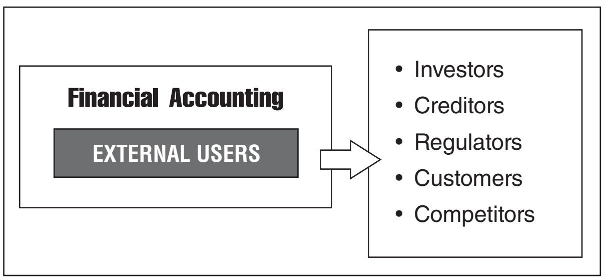

Figure 1.3 *External users of financial accounting*

5. ***Researchers:*** The researchers require information about the companies to fulfil their research objectives. They rely on the accounting information to conclude on their research findings. Many researchers undertake projects to understand the profitability, solvency, liquidity, viability of the firm and also for the purpose of comparison.
6. ***Lenders and Creditors:*** Lenders are the persons who supply capital either for long- or short term; creditors are the persons who supply goods. Their main interest lies in knowing the credibility and the financial soundness of the firm at the time of lending credit and also after credit lending; they are keen on the progress and prosperity of the firm, from the point of view of security and extension of further credit. They are able to understand the financial soundness of the firm with the help of accounting information present in the Profit and Loss Account and Balance Sheet.

1.11 ADVANTAGES OF ACCOUNTING

1. Accounting helps business houses in **maintaining complete record of information**, as large business houses have thousands of transactions in a day. Accounting helps in maintaining record of information in a systematic manner that can be easily retrieved as and when required.
2. It **supplies vital and meaningful information** about business operations to the owners, managers and stakeholders for predicting, comparing and evaluating the firm's performance, and it also facilitates in **making effective decisions** and taking timely action.
3. It provides **accurate and interpretative information** that facilitates useful comparison, to **assess the financial growth** and to **estimate the future prospects** of the firm by investors and also the managers of the firm.
4. **Accounting information** in financial statements clearly **indicates managers' ability** in effectively utilising firm's resources and achieving firm's objectives.
5. Accounting information comes handy when the firms are in the course of **filing their income tax returns** and **various other compliances** as required by the law and the other regulatory authorities.
6. It helps the manager to **understand the state of affairs** and **financial position** of the firm.
7. It enables the decision makers to **assign responsibilities** and make the departmental heads accountable for the results achieved.
8. In the event of dispute, accounting information in the financial statements can be presented as **evidence in the court of law**.
9. **In the course of sale** of company, the managers and the prospective purchaser will be able to **arrive at a conclusive purchase price** if the accounts of the company are effectively and accurately maintained.

10. **Feasibility report** as required by the lenders of capital **can be prepared** effectively with the help of accounting information by the borrowers of the capital.

1.12 LIMITATIONS OF ACCOUNTING

1. Accounting as generally understood is a **post-mortem work**. The information in the accounting reports is **historical in nature** as a result of which it fails to reflect the current financial situation of the firm.
2. The information contained in the financial reports is monetary in nature, in the sense that it can record only quantitative and financial aspects of a transaction. The **qualitative and non-financial aspects** of the transaction as employee morale, managerial efficiency and others **cannot be recorded**, although they cast a significant influence on the firm's performance; as a result of this feature, the accuracy of the accounting information is questionable.
3. The accounting statements prepared by an accountant are **highly influenced by his subjectivity** and various accounting concepts conventions. Due to this, the uniformity in the accounting reports is not assured as the subjectivity may differ from accountant to accountant and from industry to industry. As a result of this, comparison between the firms and within the firm is not possible and may not give out the reliable results.
4. **Accounting presents an overall picture of the firm** and if the manager wishes to understand the performance department wise, the financial statements **do not provide** the **information job, product, process or department wise**.
5. Transactions in accounting are **recorded at cost price**. Accounting information **does not take into consideration changes in the price levels** or **money value**. It also does not account for impact of inflation.
6. **Accounting concepts**, **conventions** and **principles are not universal** in nature; they allow alternative treatments because of which **comparability is not possible** and also application of different methods may give different results. For example, two firms within the same industry may follow different methods of stock valuation.
7. The **accounting results are open to manipulation**, in the sense that in any given year, if the firm has underperformed. Profits may be shown instead of losses by concealing costs such as depreciation, advertisement or taking excess value of closing stock. Thus, the accuracy of results is questionable.
8. Accounting information is **sometimes based on estimates**, and due to the dynamic environment, estimates are often inaccurate. For example, it is difficult to estimate scrap value or useful life of the asset for the purpose of computing depreciation.
9. As selected revenues and expenses are considered for calculation of profits and **not all revenues and expenses are considered**, results of accounting information are often biased.

1.13 BASES OF ACCOUNTING

For the purpose of accounting for business transactions, there are three main bases of accounting that are commonly used; the bases give an accountant idea about the way the revenues or expenses are to be recognised; any one of the following bases may be used in preparation of financial statements:

1. *Cash basis*
2. *Accrual or mercantile basis*
3. *Mixed or hybrid basis*

1.13.1 Cash Basis of Accounting

Under Cash basis of accounting system, only the actual cash receipts and the actual cash payments are recorded; no transaction for either receipt or payment is recorded, if it is on due or accrual basis. Government system of accounting is often cash basis and also the Receipts and Payments Accounts prepared for non-trading concerns, such as a trust, club or charitable institution and others, can be quoted as the examples of cash basis system of accounting.

It is best suited for those organisations in which majority of the transactions are on cash basis. It is very simple, realistic and verifiable system of accounting. Due to lesser judgements and estimates, it is very reliable and accurate. However, this system of accounting does not take into account the matching principle of accounting and fails to distinguish between revenue and capital expenses/ incomes. This system of accounting does not present correct picture about the state of affairs of a company, as it does not account incomes received in advance, accrued incomes, outstanding or prepaid expenses.

1.13.2 Accrual or Mercantile Basis of Accounting

Under accrual basis of accounting system, incomes and revenues are credited to the period in which they are earned, whether received or not. Likewise, expenses and losses are debited to the period in which they are incurred, whether paid or not. The profit or loss for the period is arrived at by taking the difference between the incomes earned and the expenses incurred, irrespective of cash received or paid for the transaction. Accrued incomes, incomes received in advance, outstanding expenses or prepaid expenses are taken into consideration at the time of account finalisation.

Accrual basis of accounting system follows two basic accounting principles, that is matching and revenue recognition principle. It is more scientific and exhibit correct state of affairs and true financial position of the firm. It also gives complete picture of the financial transactions of the business by recording all transactions related to the period, whether due or received. The Companies Act 1956 requires every company to maintain its books of accounts on accrual basis. However, it is very elaborate and complex system of accounting. It involves a thorough understanding of accounting knowledge to understand this system of accounting.

1.13.3 Mixed or Hybrid Basis of Accounting

Under mixed or hybrid basis of accounting system, a few items of expenditure or revenue are recorded in the books of accounts on accrual basis and certain other items are recorded on cash basis. Companies following conservative approach prefer this system of accounting by recognising income only when it is received but choose to provide for all expenses, whether paid or not. For example, a company may observe accrual basis of accounting with regard to its fishing business. However, grants and subsidies to be received from the government for export of fish are recorded only when they are actually received (cash basis). This could be due to uncertainty in respect of time and amount of receipt of grants or subsidies.

Alternatively, it could also be that all incomes are recorded on cash basis, but expenses are taken only on accrual basis. This again is the most conservative basis of accounting as net income is ascertained by matching incomes on cash basis but expenses are on accrual basis. This results in decrease in the amount of taxable income as all expenses whether incurred or not are taken into account. However, the profit or loss as per this system of accounting may not be realistic as incomes are not recorded completely or accurately.

1.14 SYSTEM OF ACCOUNTING

There are two main systems/methods of accounting:

1. *Single-entry system*
2. *Double-entry system*

1.14.1 Single-entry System of Accounting

Single-entry system of accounting is an incomplete system of recording a financial item, as it maintains only Personal Accounts of a business transaction and does not record Nominal and Real Accounts; as a result of this, trail balance or final accounts cannot be prepared due to incomplete record of business transactions. In other words, under this system, only cash book and Personal Accounts of debtors and creditors are maintained. This system of accounting is generally adopted by small organisations as the number of transactions are few and it is very simple and easy to understand and hence affordable as it is less costly.

1.14.2 Double-entry System of Accounting

Under double-entry system of accounting, the effects of transactions and other incidents are recorded in at least two accounts with equal number of debits and credits. In other words, any business transaction has a two-fold effect; effect of benefits received and effect of benefits given, the system of recording under this method is on the basis of both these aspects.

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1.15 ACCOUNTING PRINCIPLES

Accounting principles aim at conveying the same meaning regarding any given item/transaction to all its users; it refers to certain rules, procedures and conventions which represent harmony among those engaged in superior accounting practices and procedures. These are generally referred to as *generally accepted accounting principles (GAAP)*. To ensure that the accounts are reliable, financial statements are set up in conformity with these principles. Accounting principles signify the preeminent guidelines based on tradition, experience and observations. They are developed by accountants to augment the effectiveness of accounting information.

1.15.1 Definition of Accounting Principle

Canadian Institute of Chartered Accountants has defined accounting principle as 'The body of doctrines commonly associated with the theory and procedure of accounting, serving as an explanation of current practices as a guide for the selection of conventions or procedures where alternatives exist. Rules governing the formation of accounting axioms and the principles derived from them have arisen from common experiences, historical precedent, statements by individuals and professional bodies and regulations of Governmental agencies'.

The American Institute of Certified Public Accountants has analysed the word 'principle' as a general law of rule adopted or professed as a guide to action; a settled ground or basis of conduct of practice'.

According to *Dictionary of Accounting* organised by Prof. P.N. Abroal, 'Accounting Principles are those rules of action or conduct which are adopted by the accountants universally while recording accounting transactions'.

Accounting principles are ever changing, they are not static and this is because of the ever changing business scenario, government policies, customs and practices and others that the reception of accounting principles by any business house depends on how well it meets the following three basic rules, namely (i) significance, (ii) objectivity and (iii) viability/feasibility. A principle is *significant* to the extent that it results in useful and meaningful information, to those who wish to apply the same. In short, accounting principle should increase efficacy of the accounting information to its readers, otherwise it is not an accepted accounting principle. A principle is *objective*, if it supports the facts and is not influenced by the individual prejudice of those who supply the accounting information. In other words, *objectivity* denotes dependability/reliability; this also signifies that information that is reported is verifiable. A principle is *feasible*, if it promotes its application with minimum complexity and cost.

The main objective of accounting is to ensure provision of meaningful and timely information to the decision makers. For the information to be meaningful and useful, it must be appropriate and should faithfully represent a firm's economic activities. This requires beliefs that facilitate an accountant to distinguish between correct and incorrect information, in the application of accounting principles, concepts and conventions. These underlying accounting principles, concepts and conventions are termed as Generally Accepted Accounting Principles (GAAP).

The term 'GAAP' covers the conventions, procedures and rules essential to describe recognised accounting practices at a particular point of time. It covers guidelines along with comprehensive practices and procedures that form a standard to measure financial performance. In other words, GAAP consist of principles, standards and procedures that firms employ at the time of preparation of financial statements. The standards are framed by the standard setting boards to simplify the process of recording and reporting of accounting information. Generally accepted accounting principles in majority of the countries are based on *International Financial Reporting Standards (IFRSs)*, and IFRS is issued by International Accounting Standards Board (IASB). The directive issued by IASB aims at encouraging the use of single set of Global Accounting Standards, by all the corporate houses across the globe. Generally accepted accounting principles promote uniformity and consistency in reporting practices and facilitate comparison. The primary goal of GAAP is to promote harmony in the accounting and reporting practices. Off late, even the regulatory authorities insist on presentation of accounting statements on the basis of GAAP to encourage wide acceptability and recognition.

Accounting principles can be categorised into *accounting concepts* and *accounting conventions* (Figure 1.4).

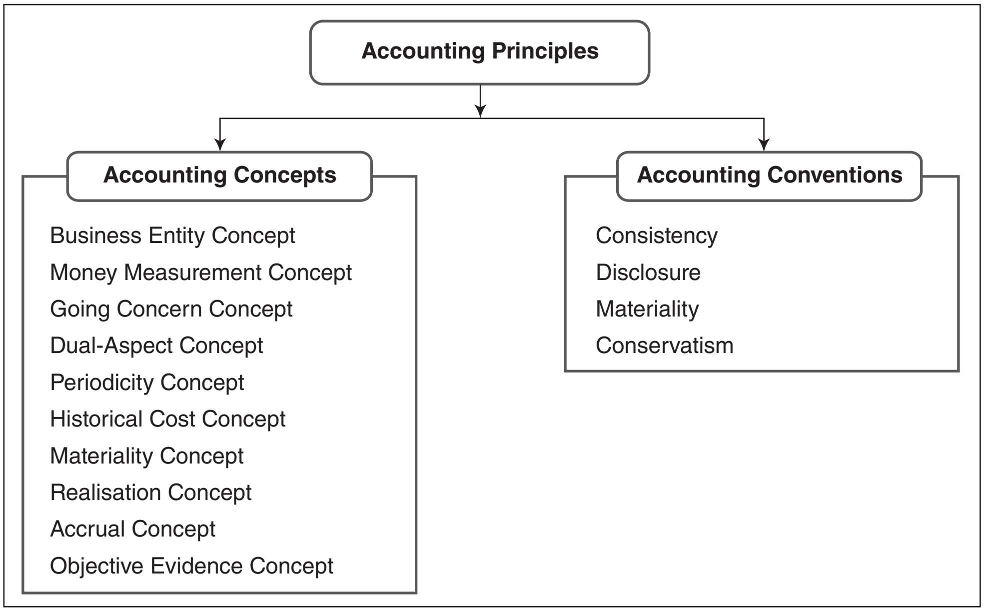

Figure 1.4 *Categorisation of accounting principles*

1.15.2 Accounting Concepts

The term 'accounting concept' is used to signify fundamental assumptions (accounting postulates) on which the knowledge of accounting is based. Any theoretical or conceptual thought giving out a methodical purpose is regarded as 'concept'. In other words, accounting concepts are common expansive suppositions (assumptions) that emphasise the quality of financial statements. Financial statements are developed on the basis of these fundamental beliefs (assumptions).

1.15.3 Accounting Conventions

Accounting conventions indicate the tradition or customs that act as a direction to the preparation of accounting statements by the accountant. It refers to a tenet of practice or statement, which by common approval is employed by the preparers of financial statement.

1.16 ACCOUNTING CONCEPTS

1.16.1 Business Entity Concept

A business entity is formed by a group of persons to accomplish their common goal. Business-entity concept in accounting indicates that a business entity is a separate unit, distinct from the persons who supply capital to it. The business-entity concept can be explained with an accounting equation, that is

$$\boxed{\textbf{Assets = Liabilities + Capital}}$$

The equation makes it obvious that the business itself owns the assets and in turn owes to various claimants. Business is kept distinct from its owner so that the business transactions are recorded by owner separately in entities name and are not mixed up with the personal concerns of the proprietor. The separation of business transactions with that of its owners is done to ensure that the results of the financial statements present true and fair view of the state of affairs of the business entity only and do not include any activity relating to the owner. Thus, in the case of Sole Proprietorship form of business organisation, Partnership Firm or joint stock company, only business transactions are recorded, no recording is made for personal transactions of the sole trader, a partner or the owner of the joint stock company. But their transactions, for example, (provision of capital to the business, withdrawal of goods from the business for personal use) with the business are recorded separately.

In the case of *Sole Proprietor form* of business organisation, there is no distinction between business or non-business assets and liabilities. Both are treated alike as the sole trader is personally liable for his business related debts and may have to dispose of his personal assets to discharge his business debts. Likewise, in the case of *Partnership Firm*, business assets of partners are used to discharge firm's liabilities, surplus, if any, will be shared among the partners to settle their personal liabilities. In the same way personal assets of the partners are utilised to pay off the personal liabilities and surplus if any will be deemed as firm's property and can be used to discharge firm's liability. In the case of *Joint Stock Company* form of business organisation, there is a clear legal distinction between the owners and the business. Owners are required to settle the debts of the company; their liability is restricted to the amount of capital they have agreed to subscribe. The effect of business-entity concept, in the case of Joint Stock Company, is to recognise its separate identity form that of its shareholders. Company's existence does not depend on the life span of its shareholder.

1.16.2 Money Measurement Concept

In accounting, only those business transactions are recorded which can be expressed in terms of money. All those transactions that cannot be expressed in terms of monetary value are not recorded in the books of accounts. In other words, an event or transaction or fact that cannot be expressed in monetary value is not recorded in the books of accounts. As money is not only recognised as a medium of exchange but also as a store of value, one of the advantages of taking money as a unit of measurement in accounting is because a number of assets and equities, which are otherwise different, can be only measured and expressed in terms of a common denominator, that is money. However, several events and facts, although crucial, cannot be recorded in the books of accounts because of the fact that they cannot be measured in monetary terms.

For example, managerial efficiency, quality of the product, technology used, employee morale, labour working conditions, signing of an important contract, significant export order and others, although wield a significant influence on the operational efficiency and profitability of the firm, yet they are not taken note of it in the books of accounts of the firm. Another limitation of money-measurement concept is that money is assumed to be unvarying or stable and any prospective change in money is conveniently ignored. In short, although money provides a common denominator for measuring, it does not account for the changes in the price levels with the passage of time. For example, a piece of land purchased in the year 2000 for ₹20 lakh and another bought for the same amount in 2017 are recorded at the same price, although the land purchased in the year 2000 may be worth two times higher than the value recorded in the books because of rise in land prices.

1.16.3 Going Concern Concept

The business is viewed as a going concern, on the assumption that the entity will continue to operate for long time unless there is a reason to the contrary. Transactions will be recorded by the accountant, on the assumption of going concern. It is because of this concept, assets are recorded at historical costs, other parties enter into business agreements, suppliers supply goods on credit basis. Another significant aspect of going-concern concept is that the emphasis is on the determination of income rather than the valuation of asset. As per the going-concern concept, the earning capacity of the firm is of greater relevance than the market value of the assets, in understanding the financial strength of the enterprise. The accountant under this concept mainly focuses on the allocation of income and expenses to the current period and does not pay much attention to the valuation of fixed assets on the basis of market value, as the assets are meant to remain in the firm and will not be liquidated.

1.16.4 Dual-Aspect Concept

Every transaction or event in accounting requires two aspects to be recorded: (i) giving of certain benefits and (ii) receiving of certain benefits. The recognition of these two aspects of every transaction is known as dual-aspect concept. The fundamental principle of double-entry system is that every debit transaction in accounting has a corresponding and equal amount of credit. This is the underlying postulation of this concept. For example, if a firm purchases goods of ₹36,000, this transaction involves two aspects. One aspect is the receipt of goods, and the other aspect is payment of cash. The accounting equation, namely Assets = Capital + Liabilities or Capital = Assets − Liabilities, will further clarify this concept. It follows from 'dual-aspect concept' that at any point of time, owners' equity and liabilities for any accounting entity will be equal to assets owned by that entity. Liabilities here relate both to the outsiders and the owners. Liabilities to the owners are considered as capital. Assets are the resources owned by a business. The total of assets will be equal to total of liabilities plus owners capital because all assets of the business are claimed by either owners or outsiders.

1.16.5 Periodicity Concept

Under periodicity concept, the life of the business is subdivided into different periods, and the result of each period is determined separately. Although as per going-concern concept, the business is expected to continue for an indefinite period of time. The ascertainment of income and financial state of affairs of the firm for a shorter and definite period will facilitate the management in taking necessary action. Each subdivided period is 'accounting period'. A year is the most common interval on account of prevailing practice, tradition and regulatory requirements. Some firms observe financial year, whereas the others follow calendar year. Standard or the usual accounting period is 1 year as it helps management to make necessary changes, take corrective measures, honour tax payments, absorb market trends and report to the stakeholders. The principle of segregation of capital and revenue expenditure is entirely dependent on accounting period concept. The revenue expenditure is charged to Profit and Loss Account, and capital expenditure will be carried forward till the benefits are utilised in the future accounting period. However, one of the serious limitations of this concept is that accountants face difficulty in allocating long-term costs.

1.16.6 Historical Cost Concept

As per historical cost concept, an asset is recorded in the books of accounts at their original purchase price and this will remain as a base amount for all future accounting and reporting purposes. For example, if a plant and machinery is purchased during the accounting year for ₹10,00,000, the asset would be recorded in the books at ₹10,00,000, although the market value at the time of recording and reporting has increased or decreased. As a result of this, the assets reflecting in the financial statement do not specify their present market value. Although assets are recorded at their original purchase price, this may not remain for all the times to come; the assets will be systematically reduced in its value by charging depreciation. The main aim of charging depreciation is to allocate cost of an asset over its useful life and not to adjust its cost.

1.16.7 Matching Concept

The most important objective of any business organisation is to earn profits by conducting business efficiently. To ascertain profits of the business, revenues have to be matched with its related costs. In other words, the profitability of any business organisation can be measured during the period only when the revenue earned during a period is compared with the expenses incurred for earning that revenue. Revenue is the amount realised from the goods sold and the services rendered. Revenue can also be income earned by way of interest on investments, dividend etc., whereas, expenses are the costs incurred relating to the revenue earned during the period. This concept is also based on accounting period concept; matching concept is very relevant to a business organisation, as this concept has necessitated the provisions of different adjustments for recording outstanding incomes and expenses and prepaid incomes and expenses and others, at the time of preparation of financial statements.

1.16.8 Realisation Concept

Realisation concept deals with revenue recognition only in the event of sale. Sale is considered complete only after the transfer of property and ownership to the buyer from the seller after the payment of agreed consideration. In other words, revenue is considered to be earned on the date at which it is realised. However, this may not hold well in the case of Hire-Purchase Sale or Contract Accounts. As in the case of Hire-Purchase Agreement, ownership is passed on to the buyer only on the payment of last instalment and in the case of contract agreement, contractor is liable to pay to the contractee only on the fulfilment of the contract.

1.16.9 Accrual Concept

As per accrual concept, revenue is recognised on its realisation instead of its actual receipt and also the costs are recognised only when they are incurred and not when they are paid. This concept makes a clear distinction between receipt of cash and the right to receive the same and payment of cash and the obligation to pay the same. This concept comes handy in making certain necessary adjustments in the preparation of financial statements. This concept measures the likely impact of every transaction on owner’s equity.

1.16.10 Objective Evidence Concept

Objective evidence concept ensures that all the accounting information should be based on the objective evidence. Objectivity means an element of reliability, verifiability and trustworthiness in the accounting information that is reported to stakeholders for their useful decision-making. Every transaction recorded and reported must have verifiable document in support of its existence. The evidence could be the invoices, vouchers, bank statement, physical checking or observation. Any organisation preparing its financial statements must ensure close adherence to this principle. There should be minimum or no scope for any kind of bias, fraud or error.

1.17 ACCOUNTING CONVENTIONS

The following accounting conventions facilitate in having a clear and meaningful information and data in accounting.

1.17.1 Consistency

Consistency refers to accounting rules, concepts, principles and practices that are being observed and applied consistently (constantly) from one year to another year without any change to facilitate comparison. It requires that the firm after finalising on the accounting policies and methods to be used for accounting information has to follow the same for some time for all the subsequent events or transactions. This is done until the time when there is a major change in the accounting system, or there is sound reason to change for better recording and reporting. This concept ensures that the results and performance of one year can be compared meaningfully with the other year. Somewhere, it also helps to eliminate personal bias as the persons engaged to do accounting may have to compulsorily follow the rules, principles, concepts or conventions. This concept in that way is not rigid, where there is a slight scope for improvement in accounting, the change can be made for meaningful recording and reporting.

1.17.2 Disclosure

Disclosure convention mainly deals with provision of accurate, reliable, complete and authentic information in financial statements that can be meaningful to the stakeholders for decision-making. In other words, that information, which is of material interest to the users, has to be included in the financial statements. The books of accounts prepared by an accountant on behalf of others should be as reliable and informative as the circumstance may permit to do so. This concept insists on the fact that all events and information that may be of material interest should be completely disclosed. While doing this, care should be taken to understand the definition of materiality, what is immaterial to the company may be of material to the outsider; non-disclosure of the same may increase the liability of an outsider.

1.17.3 Materiality

As per materiality convention, only the important information that is relevant and significant in nature will have to be disclosed in the financial statements. Whether any information has to be communicated in the financial statements purely depends on whether it is material or not. Furthermore, materiality of the information depends on the amount involved in the transaction. For example, amount expended on purchase of machinery to be used in production is material and hence needs to be disclosed as the amount involved in its purchase is huge, whereas amount spent to purchase stationery to be used in the factory is a minor expenditure and hence immaterial.

1.17.4 Conservatism

As per conservatism approach, it is a policy to safeguard the firm against all possible losses and is generally based on the rule, 'Account for no profits until earned, but provide for all losses'. For example, any amount of income is recognised only on the receipt of cash from the buyer and not upon the delivery of goods. Similarly, provision is created for fall in the value of asset, but no provision is created if there is appreciation in the value of an asset.

1.18 ACCOUNTING CYCLE

Accounting cycle refers to a step-by-step process of identifying, recording, classifying, processing and summarisation of accounting events of a business. The cycle commences with recording of transactions and ends with financial statements. With accounting cycle firms are assured of using the same record keeping guidelines as followed or practised by others firms in the same industry. The various steps in accounting cycle act as a guide to the accountant in recording transactions in an orderly manner at the time preparation of financial statements. This ensures uniformity in the way accounts are presented and possibly any error can be omitted if the business organisations are clear about their accounting cycle and its different stages. Trail balance is one of the steps involved in accounting cycle. This tool facilitates error detection and correction.

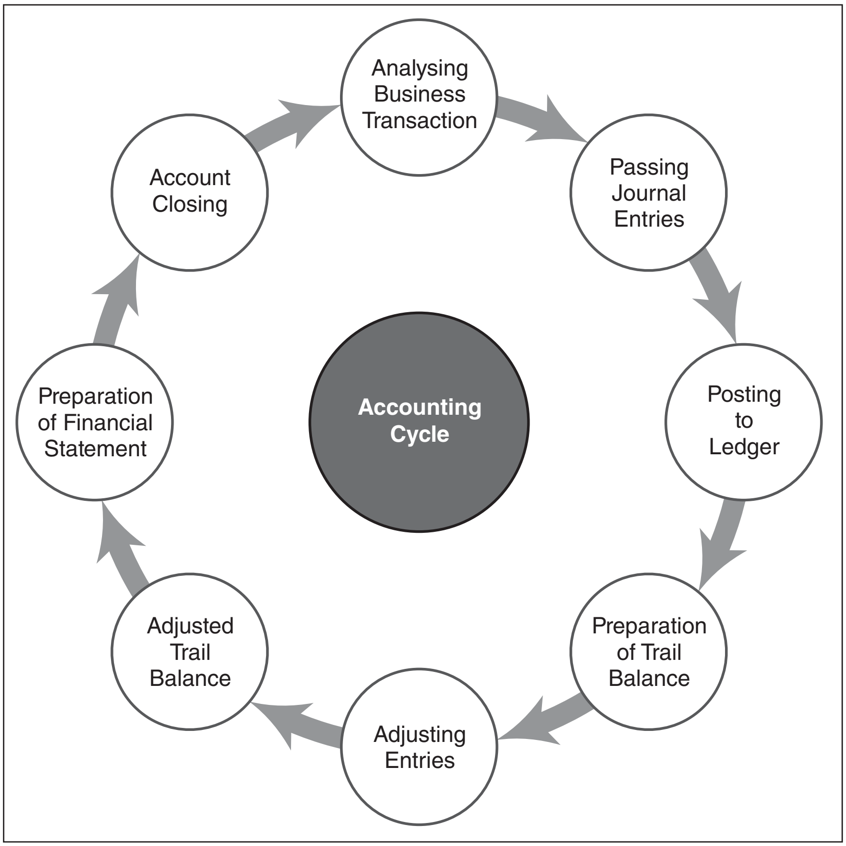

Figure 1.5 *Accounting cycle*

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1.19 ACCOUNTING STANDARDS

The accounting concepts and conventions do provide a base for the theory of accounting; they also permit a variety of options to meaningful accounting. Due to this, it hinders the comparison and evaluation of financial statements of different companies. The lack of uniformity among the accounting practices has made it difficult to compare the financial outcomes of various companies. This implies that too much discretion should not be given to the companies to present financial information as they prefer. Therefore, companies should prepare their accounting statements according to some standards commonly followed by all for easy understanding and interpretation not only locally but also globally.

1.19.1 Need for Accounting Standards

1. Accounting Standards provide a basic framework for preparing financial statements to be uniformly followed by all business organisations.
2. Standards make financial statements credible and reliable.
3. The use of Accounting Standards by the firms may boost the confidence of the users in the financial statements.
4. They make financial statements of one firm comparable with the other.

1.20 INTERNATIONAL FINANCIAL REPORTING STANDARDS

1.20.1 Introduction

International Financial Reporting Standards are universally accepted accounting language that facilitates easy understandability and comparability of company's financial statements across the world. It aims at harmonising the accounting practices to facilitate comparison. The major developments over the past few years have reinforced the reason for attaining high-quality International Accounting Standards. The growing internationalisation and free flow of capital across the globe make it imperative to record all the economic and commercial transactions in the same manner. Furthermore, commonly practised Accounting Standards certainly reduce the cost of compliance and issues concerning transparency and comparability. If the accounting information is transformed into financial statements on the basis of GAAP, it provides a platform for wider investment choice and certainly reduced cost of capital along with efficient capital market.

1.20.2 Meaning and Importance

International Financial Reporting Standards are set of high quality and globally accepted financial reporting standards, developed by IASB. They set out recognition, measurement, presentation and disclosure requirements of economic transactions and events that are relevant and need disclosure for the purpose of informed decision-making by the users of the standards. These standards are formulated to provide a foundation for resolving various accounting and reporting issues across the globe. The accounting statements prepared on the basis of IFRS provide information about the financial status, financial activities and cash flows of an entity; this information comes handy in making informed economic, financial and operational decisions. Common purpose financial reports aim at providing general informational requirements of various users, namely shareholders, creditors, suppliers, bankers, employees, government, society, researchers and others.

As mentioned earlier, IASB is in charge of formulating and publishing reporting standards. The primary objectives of IASB are to:

1. Formulate a common set of practicable, understandable and adaptable high-quality global Accounting Standards based on clear principles to make informed economic, financial and operational judgements by the wide user group across the globe.
2. Promote the use and application of accounting and reporting standards.
3. Participate, cooperate and work closely with the other national and international standard setting bodies to enable high-level convergence of IFRSs with other accounting and reporting standards.

1.20.3 Difference Between GAAP and IFRS

Generally accepted accounting principles are very flexible as changes are adapted continuously by passing of new legislations and standards but have no statutory authority in other countries other than the USA. International Financial Reporting Standards concentrate mainly on the relevant issues to ensure its applicability worldwide and generally do not override regulations relating to financial statements designed at national level (Table 1.2).

1.20.4 Current Status of IFRS Practice in India

The Ministry of Corporate Affairs (MCA) on 2 January 2015 issued road map for implementation of Ind-AS in India for all companies excluding banking, insurance and NBFCs (non-banking finance companies). The ICAI (Institute of Chartered Accountants of India) developed IFRSs converged Indian Accounting Standards (IASs) commonly referred to as Ind-AS and the standards being approved by National Advisory Committee on Accounting Standards under the MCA. This was expressly notified in Section 133 of the Companies Act 2013 by MCA.

1.20.5 Adoption of Ind-AS on Voluntary Basis

All Indian companies can voluntarily adopt Ind-AS on or after 1 April, 2015. Scheduled commercial banks, NBFCs and insurance companies are excluded from this voluntary adoption and shall adopt Ind-AS in the respective phases of applicability only. The companies adopting Ind-AS voluntarily have no option to revert to the old or some other financial reporting standards. Any company voluntarily adopting Ind-AS is not required to prepare another set of financial statements. The statements prepared as per Ind-AS are sufficient for all purposes (Tables 1.3 and 1.4).

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Table 1.2 *Difference between GAAP and IFRS*

Bases	GAAP	IFRS
Use	It is generally practised in the USA and has exclusive standards in use within the USA	It is globally accepted accounting and reporting standards
Methodology	Standards are based on a specific set of rules with very little scope to exceptions and interpretations and hence they are *rule based*	It takes into account overall patterns and is *principle based*, which gives room to many exceptions and interpretations for the same accounting situation
Inventory methods	GAAP permit LIFO method for inventory estimates	A LIFO method for inventory estimates is not followed as this leads to reporting of low-income levels
Inventory reversal	The amount written down earlier with regard to any asset cannot be reversed back. GAAP do not capture any positive changes in the market place	The amount written down earlier with regard to any asset can be reversed back
Development costs	GAAP restrict capitalisation of development costs allowing the same to be expensed only in the year in which they are actually incurred	All the development costs relating to the company can be capitalised on the fulfilment of certain criteria allowing companies to leverage depreciation on fixed assets
Intangible assets	GAAP assess intangible assets purely on the basis of fair market value	Futures economic benefits to be derived from use of intangible asset are the main criteria for assessing such assets
Income statements	Non-operating and extraordinary items are separately shown after the net-income balance of the income statement	Non-operating and extraordinary items are included in the income statement
Classification of liabilities	The debts that are to be settled within 12 months are current liabilities, whereas debts that will not be repaid within 12 months are non-current liabilities	All debts under IFRS are non-current
Fixed assets are valued on the basis of	Cost model = Historical cost − Accumulated depreciation	Revaluation model = Fair value on the current date − Accumulated depreciation − Impairment losses
Quality characteristics	Decisions are based on user-specific circumstances	Decisions are not based on user-specific circumstances

Abbreviations: GAAP: Generally Accepted Accounting Principles; IFRS: International Financial Reporting Standards; LIFO: Last In First Out.

Table 1.3 *Adoption of Ind-AS on mandatory basis*

Accounting period beginning from	Companies covered	Net worth
Phase I		
1.4.2016	1. Listed companies (also companies in the process of listing in exchanges in India or abroad)	₹500 crore or more
	2. Unlisted companies	₹500 crore or more
	3. Holding, subsidiaries, joint ventures or associates of the companies mentioned before	No net worth criteria
Phase II		
1.4.2017	1. Listed companies (also companies in the process of listing in exchanges in India or abroad)	Less than ₹500 crore
	2. Unlisted companies	₹250 crore or more but less than ₹500 crore
	3. Holding, subsidiaries, joint ventures or associates of the companies mentioned before (no net worth criteria)	No net worth criteria
Phase III		
1.4.2018	Scheduled commercial banks (excluding RRBs), insurers and insurance companies and all India term lending refinancing institutions	Less than ₹500 crore
	Holding, subsidiaries, joint ventures or associates of scheduled commercial banks (excluding RRBs)	No net worth criteria
	NBFCs	Less than ₹500 crore
	Holding, subsidiaries, joint ventures or associates of the NBFCs mentioned before	No net worth criteria
Phase IV		
1.4.2019	NBFCs (listed or in the process of listing in exchanges in India or abroad)	Less than ₹500 crore
	Unlisted NBFCs	₹250 crore or more but less than ₹500 crore
	Holding, subsidiaries, joint ventures or associates of the NBFCs mentioned before	No net worth criteria

Abbreviations: NBFCs: Non-Banking Finance Companies; RRBs: Regional Rural Banks.

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Table 1.4 *List of Indian Accounting Standards (Ind-AS)*

(Ind-AS) 101	First-time Adoption of IASs
(Ind-AS) 102	Share-based Payment
(Ind-AS) 103	Business Combinations
(Ind-AS) 104	Insurance Contracts
(Ind-AS) 105	Non-current Assets Held for Sale and Discontinued Operations
(Ind-AS) 106	Exploration for and Evaluation of Mineral Resources
(Ind-AS) 107	Financial Instruments: Disclosures
(Ind-AS) 108	Operating Segments
(Ind-AS) 109	Financial Instruments
(Ind-AS) 110	Consolidated Financial Statements
(Ind-AS) 111	Joint Arrangements
(Ind-AS) 112	Disclosure of Interests in Other Entities
(Ind-AS) 113	Fair Value Measurement
(Ind-AS) 114	Regulatory Deferral Accounts
(Ind-AS) 115	Revenue from Contracts with Customers
(Ind-AS) 1	Presentation of Financial Statements
(Ind-AS) 2	Inventories
(Ind-AS) 7	Statement of Cash Flows
(Ind-AS) 8	Accounting Policies, Changes in Accounting Estimates and Errors
(Ind-AS) 10	Events after the Reporting Period
(Ind-AS) 12	Income Taxes
(Ind-AS) 16	Property, Plant and Equipment
(Ind-AS) 17	Leases
(Ind-AS) 19	Employee Benefits
(Ind-AS) 20	Accounting for Government Grants and Disclosure of Government Assistance
(Ind-AS) 21	The Effects of Changes in Foreign Exchange Rates
(Ind-AS) 23	Borrowing Costs
(Ind-AS) 24	Related Party Disclosures
(Ind-AS) 27	Separate Financial Statements
(Ind-AS) 28	Investments in Associates and Joint Ventures
(Ind-AS) 29	Financial Reporting in Hyperinflationary Economies
(Ind-AS) 32	Financial Instruments: Presentation
(Ind-AS) 33	Earnings per Share
(Ind-AS) 34	Interim Financial Reporting
(Ind-AS) 36	Impairment of Assets
(Ind-AS) 37	Provisions, Contingent Liabilities and Contingent Assets
(Ind-AS) 38	Intangible Assets
(Ind-AS) 40	Investment Property
(Ind-AS) 41	Agriculture

Abbreviation: IAS: Indian Accounting Standard.

1.21 ROLE OF ACCOUNTANT IN TODAY'S DYNAMIC ENVIRONMENT

The role of accounting has been changing with the changes in economic development and increasing societal demands. It describes and analyses a mass of data of an enterprise through measurement, classification and summarisation and reduces those data into reports and statements, which show the financial condition and results of operations of that enterprise. Hence, it is regarded as a language of business. It also performs the service activity by providing quantitative financial information that helps the users in various ways. Accounting as an information system collects and communicates economic information about an enterprise to a wide variety of interested parties. However, accounting information relates to the past transactions and is quantitative and financial in nature, it does not provide qualitative and non-financial information. These limitations of accounting must be kept in view while making use of the accounting information.

The accountant with his specialised knowledge, extensive training and experience is not merely suitable for making accounts, rather he/she is the best equipped to provide other related services normally required by the management. This helps the management to discharge their duties more effectively thereby providing for efficient utilisation of resources. The accountants' role in the society includes the following:

1. To maintain the proper books of accounts which portray the true and fair view of the results of the business.
2. To provide information and reports to management to enable them to discharge their duties more effectively.
3. To act as auditor for attestation of accounts as per the requirement of law.
4. To act as an internal auditor to assist and strengthen the hands of the management.
5. To act as tax consultant to handle the tax matters of the business.
6. To act as management consultant to provide services regarding financial planning of the business to their clients.

Summary

- Accounting as an information system is the process of identifying, classifying, measuring, recording, and communicating an organisation's economic activities to the users for decision making. In other words, it is a process that is mainly concerned with recognising, measuring, recording, and communicating the relevant information concerning the economic events of a company to the users of such information.
- Definition of Accounting, "the art of recording, classifying and summarising in a significant manner and in terms of money, transactions and events, which are, in part at least, of a financial character and interpreting the results thereof". The Accounting Principle Board of AICPA further

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emphasized that "the function of accounting is to provide quantitative information, primarily financial in nature, about economic entities, that is intended to be useful in making economic decisions".

- Book-Keeping may be defined as the science and art of recording, classifying and summarising business transactions in money or money's worth so accurately and systematically, in a certain set of books, regularly that the true state of business affairs can be correctly determined. In other words, "Book-Keeping is the art of recording business transactions in a systematic manner".
- Book-Keeping aims at identifying, measuring, recording and classifying financial transactions in monetary terms whereas, accounting aims at summarising, interpreting and communicating the recorded transactions.
- The objectives of accounting are to maintain systematic record of business transaction, to ascertain the results of the business operations, to ascertain the financial position of the business, to ascertain solvency and liquidity position of the firm, to safeguard the business assets, to facilitate business decision making and to satiate legal requirements.
- The function of accounting primarily aims at record keeping of business transactions, decision making, legal compliance, management of information and communication of final results to the stakeholders.
- The branches of accounting are, financial accounting, cost accounting and management accounting.
- The users of accounting information are classified into, internal and external users. Internal users are owners, investors, management, lenders and creditors. The external users are employees, government, regulatory authorities, common public, consumers and researchers.
- The advantages of accounting is that it supplies vital and meaningful information about business operations to the owners, managers and stakeholders for predicting, comparing and evaluating the firm's performance and it also facilitates in making effective decisions and taking timely action. It also provides accurate and interpretative information that facilitates useful comparison, in order to assess the financial growth and to estimate the future prospects of the firm by investors and also the managers of the firm. Accounting information in financial statements clearly indicates managers' ability in effectively utilising firm's resources and achieving firm's objectives.
- Limitations of accounting are that the information contained in the financial reports is monetary in nature, in the sense that it can record only quantitative and financial aspects of a transaction. The qualitative and non-financial aspects of a transaction such as employee morale, managerial efficiency, etc., cannot be recorded although they cast a significant influence on the firm's performance, as a result of this feature, the accuracy of the accounting information is questionable. The accounting statements prepared by an accountant are highly influenced by his subjectivity and various accounting concepts' conventions. Due to this the uniformity in the accounting reports is not assured as the subjectivity may differ from accountant-to-accountant and from industry-to-industry. As a result of this, comparison between the firms and within the firm is not possible and may not give out the reliable results.

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- Bases of accounting are mainly classified into, *Cash Basis, Accrual Basis or Mercantile Basis, Mixed or Hybrid Basis*
- System of accounting is generally classified into, *Single-entry System and Double-entry System.*
- Accounting Principles are those rules of action or conduct which are adopted by the accountants universally while recording accounting transactions.
- Accounting concepts are common expansive suppositions (assumptions) that emphasize the quality of financial statements. Financial statements are developed on the basis of these fundamental beliefs (assumptions).
- Accounting concepts are, Business-entity Concept, Monet Measurement Concept, Going Concern Concept, Dual Aspect Concept, Periodicity Concept, Historical Cost Concept, Materiality Concept, Realisation Concept, Accrual Concept and Objective-evidence Concept.
- Accounting conventions indicate the tradition or customs that as a direction to the preparation of accounting statements by the accountant. It refers to a tenet of practice or statement, which by common approval is employed by the preparers of financial statement.
- Accounting conventions are Consistency, Disclosure, Materiality and Conservatism.
- Accounting cycle refers to a step-by-step process of identifying, recording, classifying, processing and summarisation of accounting events of a business. The cycle commences with recording of transactions and ends with financial statements.
- Accounting standards provide a basic framework for preparing financial statements to be uniformly followed by all business organisations. Standards make financial statements credible and reliable. The use of accounting standards by the firms may boost the confidence of the users in the financial statements.
- International financial reporting standards are universally accepted accounting language that facilitates easy understandability and comparability of company's financial statements across the world. It aims at harmonising the accounting practices to facilitate comparison.
- The primary objectives of IASB is to formulate a common set of practicable, understandable and adaptable high quality global accounting standards based on clear principles in order to make informed economic, financial and operational judgements by the wide user group across the globe.
- IFRS takes into account overall patterns and is principle based which gives room to many exceptions and interpretations for the same accounting situation. In contrast to this, GAAP are based on specific set of rules with very little scope to exceptions and interpretations and hence they are rule-based.
- The role of accountant had been changing, metamorphically, the accountant with his specialized knowledge, extensive training and experience is not merely suitable for making accounts. Rather he/she is the best equipped to provide other related services normally required by the management. This helps the management to discharge their duties more effectively thereby providing for efficient utilisation of resources.

Review Questions

Section A (2 Marks)

1. What do you mean by Accounting?
2. Explain the term 'Book-Keeping'. **(B.U., B.Com., Nov/Dec 2012)**
3. Define Accounting.
4. Write any two differences between Accounting and Book-Keeping.
5. Mention any two objectives of Accounting. **(B.U., B.Com., Nov/Dec 2016, 2013)**
6. Write any two functions of Accounting.
7. Mention the three main branches of Accounting.
8. Mention any four users of Accounting Information. **(B.U., B.Com., Nov/Dec 2012)**
9. Write any four advantages of Accounting.
10. Explain any four limitations of Accounting.
11. Mention the three main bases of Accounting.
12. Write about the two main systems of Accounting.
13. Define Accounting Principle.
14. What do you mean by Accounting Principle?
15. What are the two main categories of Accounting Principles?
16. What do you mean by Accounting Concepts?
17. What do you mean by Accounting Conventions?
18. What is Business Entity Concept?
19. Explain Money Measurement Concept.
20. Write on Going-Concern Concept.
21. Explain the term 'Dual-Aspect Concept'.
22. What is Periodicity Concept?
23. What is Historical Cost Concept?
24. Explain the term Matching Concept.
25. What is Realisation Concept?
26. Explain Accrual Concept.
27. What is Objective-Evidence Concept?
28. Explain the use of Accounting Conventions.
29. Explain Conservatism Convention.
30. Write about the convention of Full Disclosure.
31. What do you mean by Materiality Convention?
32. What do you mean by GAAP?
33. Explain IFRS.
34. Expand ICAI and IASB.

35. What are Accounting Standards? **(B.U., B.Com., Nov/Dec 2008/2014/2015)**
36. What is the need for Accounting Standards? **(B.U., B.Com., June 2006)**
37. Which is the authority issuing Accounting Standards? **(B.U., B.Com., Nov/Dec 2007/2010)**
38. Write on the applicability of Accounting Standards.
39. Mention any four Accounting Standards. **(B.U., B.Com., Nov/Dec 2016)**
40. Write on the role of Accountant in today's scenario.

Section B (8 Marks)

1. Give the meaning of Book-Keeping and Accounting and explain their differences.
2. What are the advantages and disadvantages of accounting? **(B.U., B.Com., Nov/Dec 2007, 2013)**
3. Define Accounting and its objectives and functions.
4. What are the main branches and systems of Accounting?
5. Explain the importance of Accounting to the business houses.
6. Briefly explain the limitations of Accounting.
7. What are the main bases of Accounting?
8. Who are the users of Accounting Information?
9. Bring out the differences between Accounting principles, concepts and conventions.
10. Briefly explain any four concepts of Accounting. **(B.U., B.Com., Nov/Dec 2012)**
11. Briefly explain the conventions of Accounting.
12. Explain the significance of Accounting Standards.
13. List out the uses of IFRS.
14. Write down the list of Accounting Standards.
15. Explain the applicability of Accounting Standards in India.
16. Explain the role of accountant in today's dynamic environment.

Section C (14 Marks)

1. Briefly explain the different concepts of Accounting Standards.
2. Write down the list of Ind-AS. **(B.U., B.Com., Nov/Dec 2012)**
3. Explain the current scenario of IFRS and its applicability in India.
4. Explain the challenges faced by the company with regard to accounting compliance.
5. What do you mean by Accounting Information? Explain users of Accounting Information. **(B.U., B.Com., Nov/Dec 2016)**

2 Conversion of Single-entry System into Double-entry System

Chapter Outline

Review Questions

2.1 MEANING

An accounting system, which does not take into consideration the principles of Double-entry System of Book-Keeping, is termed 'incomplete accounting system' or 'Single-entry System'. In other words, it is a system under which a few transactions are recorded as per the Double-entry System of Book-Keeping, but for most of the transactions, only one aspect, i.e. either debit or credit is recorded, and in some other cases, only personal accounts are recorded, real and nominal accounts are not taken into consideration under single entry system of Book-Keeping. Thus, Single-entry System is one in which the transactions are either not recorded or they are recorded unscientifically or incompletely.

Under this system, although the company maintains various records such as sales book, purchases book, cash book, bill receivables and payables book or Sales Return or Purchase Returns book, the postings are made only to the personal accounts, and along with this only a Cash Account is maintained to record only one aspect of the transaction. In other words, under this system only personal accounts of the debtors and creditors are maintained, but the impersonal accounts (real and nominal accounts) are not maintained; due to this the Profit and Loss Account and Balance Sheet prepared are incomplete and unreliable; hence, it is of very limited use to the firm to draw any conclusions on the state of affairs of the firm.

2.2 TYPES OF SINGLE-ENTRY SYSTEM

There are three different methods in which books are maintained under the Single-entry System of Book-Keeping, namely:

1. *Pure Single-entry System*
2. *Simple Single-entry System*
3. *Quasi Single-entry System*

2.2.1 Pure Single-entry System

Under pure Single-entry System, only the personal accounts of debtors and creditors are maintained, by ignoring the twofold aspect of the transaction. This system also ignores real and nominal accounts. Such a system is hardly of any relevance to the firms preparing it, because even the Cash Account is not maintained as per this system.

2.2.2 Simple or Conventional Single-entry System

Under simple or conventional Single-entry System, a few subsidiary books are maintained unlike pure Single-entry System, but postings are made from cash book only to those accounts that are personal. The transactions relating to real and nominal accounts are maintained only in the cash book, even this system ignores the Double-entry System of Book-Keeping.

2.2.3 Quasi Single-entry System

The only difference between simple single-and quasi Single-entry System is that simple Single-entry System maintains personal accounts and cash book, whereas quasi Single-entry System maintains personal accounts of debtors and creditors, cash book and few subsidiary books (sales book, purchase book, bills receivable and payables book and returns book). In other words, this is a system of accounting that goes beyond maintaining personal records. It also maintains a few subsidiary books along with cash book and personal accounts.

2.3 FEATURES OF SINGLE-ENTRY SYSTEM OF BOOK-KEEPING

1. Single-entry System records only one aspect of a transaction, instead of two-fold aspects.
2. This system of accounting and Book-Keeping suits small business organisations, in which the numbers of transactions are very limited; large business concerns cannot adopt this system of accounting.
3. It is a system of maintaining books of accounts and business transaction in an unscientific and incomplete manner.
4. This system maintains only personal accounts of debtors and creditors, but not the real and nominal accounts.
5. The outcome of this system is generally not reliable and accurate.

2.4 ADVANTAGES OF SINGLE-ENTRY SYSTEM

1. This system is very elaborate; it is easy to understand, less complicated and easy to maintain.
2. Single-entry System is suitable for petty business organisations that have only a few transactions to record.

2.5 DISADVANTAGES OF SINGLE-ENTRY SYSTEM

1. The statement of accounts (Profit and Loss) prepared under this system is not reliable.
2. This system does not take two-fold aspects of a transaction into account; due to this trail balance cannot be prepared.
3. This system prepares only personal accounts of debtors and creditors; it does not take into consideration the real and nominal accounts, and therefore the financial statements prepared under this system are incomplete and unreliable.
4. This system also does not facilitate comparison, because the reasons for the difference in the results cannot be ascertained due to incomplete recording of transactions.

5. Any organisation applying for loan is required to submit feasibility report to the bank or financial institution; due to non-availability of records or availability of incomplete records, it will be very difficult for the companies to avail loan or credit facility.
6. In the event of dispute, incomplete or inaccurate documents may not be accepted in the court of law as legal evidence.
7. In the event of computation of tax, determination of taxable income is difficult as profit or loss is either not prepared or prepared with incomplete information.
8. This system does not support internal check, as a result of which errors cannot be located and rectified. It also gives ways to committing of errors and frauds.
9. The stakeholders keen on understanding the whereabouts of the firm are not confident about this system as it is incomplete and not reliable.
10. In the event of sale of the business, the sole-trader may not be able to assess the correct value of assets along with goodwill, due to incomplete records.
11. It is very difficult to ascertain the financial position as the Balance Sheet is prepared with the incomplete records.

2.6 DIFFERENCES BETWEEN SINGLE-ENTRY SYSTEM AND DOUBLE-ENTRY SYSTEM

1. Single-entry System records only one aspect of the transaction in most of the cases, whereas Double-entry System records twofold aspect of the transactions.
2. Single-entry System is very easy to understand, simple to maintain and less costly, whereas Double-entry System is difficult to understand, complicated to maintain and very expensive as a large number of books of accounts are to be maintained.
3. The Single-entry System maintains incomplete record of financial transactions, whereas Double-entry System maintains complete record of transactions.
4. Single-entry System maintains only personal account, whereas Double-entry System maintains all accounts, i.e. personal, real and nominal accounts.
5. Due to incomplete recording of financial transaction, trail balance cannot be prepared under the Single-entry System. As Double-entry System maintains complete record of transactions, trail balance can be prepared facilitating the assessment of arithmetic accuracy.
6. Single-entry System maintains incomplete record of transactions due to which Profit and Loss Account and Balance Sheet cannot be prepared and if prepared may have to be prepared with incomplete records, whereas in the case of Double-entry System of Book-Keeping, Profit and Loss Account and Balance Sheet can be prepared with the help of complete record of transactions. Profit and Loss Account and Balance Sheet illustrates a true and fair view of the state of affairs of the business.

7. The method of accounting under Single-entry System is crude and unscientific and incomplete, whereas in Double-entry System of accounting, the method is scientific and hence accurate and reliable.
8. The results of the Single-entry System of Book-Keeping are incomplete and inaccurate and hence not reliable, whereas in Double-entry System, the records are complete and accurate and hence reliable.
9. Single-entry System suits only Sole Proprietor form of business organisation, whereas Double-entry System is useful to all forms of businesses.
10. Errors cannot be located and rectified under Single-entry System. In Double-entry System of Book-Keeping, errors can be easily identified and rectified due to the complete records of transaction maintained under this system.

2.7 STATEMENT OF AFFAIRS

Under Single-entry System, real accounts are not maintained; in the absence of real account, preparation of Balance Sheet is not possible. Therefore, in order to understand the financial position of the firm, a statement showing various assets and liabilities on a particular date for a particular period is prepared; this statement is termed *Statement of Affairs*. It is a statement that resembles a Balance Sheet with assets on the right-hand side and liabilities on the left-hand side. The information contained in the Statement of Affairs is not as reliable and complete as the Balance Sheet because the Assets and Liabilities in the Statement of Affairs are only approximate figures prepared without any ledger accounts.

2.8 DIFFERENCE BETWEEN STATEMENT OF AFFAIRS AND BALANCE SHEET

Statement of affairs	Balance sheet
It is prepared under Single-entry System of Book-Keeping.	It is prepared under Double-entry System of Book-Keeping.
It is prepared from incomplete records.	It is prepared from complete records.
It does not present true and fair view of the state of affairs of the concern as it is mostly prepared on the basis of rough estimates.	It presents true and fair view of the state of affairs of the concern as it is mostly prepared on the basis of ledger accounts.
It is prepared to ascertain the capital balances on a particular date.	It is prepared to know the financial position of the firm.

2.9 CONVERSION OF SINGLE-ENTRY SYSTEM INTO DOUBLE-ENTRY SYSTEM

The Single-entry System of Book-Keeping is generally opted by small business organisations, which lack thorough knowledge of accounting, as a result of which they prefer to maintain only few accounts. Such accounts are not systematic and are mostly maintained on unscientific lines. They do not present the true and fair view of state of affairs of the business as they are generally incomplete. Such type of accounting lacks uniformity and restricts comparison as they are maintained in unsystematic and unscientific manner. Due to this reason, the small business houses wish to convert their system of accounting to Double-entry System to facilitate uniformity and comparison.

The Single-entry System of accounting is generally incomplete in nature as it does not maintain complete set of books of accounts and information. It is for this reason that there is a need of converting Single-entry System into Double-entry System of Book-Keeping ensuring the accounts are complete. For this purpose, the following steps are to be performed under *Conversion Method*.

1. *Preparation of statements and accounts with an object to ascertain missing information*
2. *Preparation of Statement of Affairs as per or Net Worth Method or Capital Comparison Method*
3. *Preparation of Trading, Profit or Loss Account and Balance Sheet*

2.10 STEPS IN CONVERSION OF SINGLE-ENTRY SYSTEM INTO DOUBLE-ENTRY SYSTEM

Step 1: Preparation of statements and accounts with an object to ascertain missing information

1. Total Debtors Account
2. Bills Receivable Account
3. Total Creditors Account
4. Bills Payable Account
5. Cash Book or Bank Book
6. Fixed Assets Account

Step 2: Preparation of Statement of Affairs

1. Opening Statement of Affairs

Step 3: Preparation of Trading, Profit and Loss Account and Balance Sheet

1. Trading and Profit and Loss Account
2. Balance Sheet

2.10.1 Preparation of Statements and Accounts with an Object to Ascertain Missing Information

Step 1 aims at ascertaining the missing information which are essential in preparing the Trading, Profit and Loss Account and Balance Sheet. By finding out the missing information, the accounts can be converted from Single-entry to Double-entry. The following accounts are generally prepared to find out the missing facts and figures.

Total Debtors Account

Debtors being a current asset appear on the asset side of the Balance Sheet. This account coexists with Bills Receivable Account. This account needs to be prepared only when either the opening or the closing debtors is mentioned in the question.

Total Debtors Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d (Opening balance of debtors)	xxx	By Cash/Bank A/c (Cash Received from debtors)	xxx
To Credit Sales	xxx	By Bills Receivable A/c (Bills receivable received from debtors)	xxx
To Cash (Paid to debtors)	xxx	By Return Inwards	xxx
To Bills Receivable A/c (Bills receivable dishonoured)	xxx	By Bad Debts Written Off	xxx
To Total Creditors A/c (Bills receivable endorsed dishonoured)	xxx	By Discount Allowed	xxx
		By Allowances	xxx
	xxx	By Balance c/d (Closing balance of debtors)	xxx
	xxx		**xxx**

The following table indicates the use of missing information in preparation of other accounts and statements.

Missing information	Debit or credit side	Statements or accounts to be prepared with missing information	Debit or credit side
Opening debtors	Debit	Opening Statement of Affairs to find out opening capital	Liabilities
Closing debtors	Credit	Balance Sheet – Current assets	Asset
Cash Received from debtors	Credit	Cash or Bank A/c	Debit
Credit Sales	Debit	Trading A/c	Credit
Bad Debts	Credit	P/L A/c	Debit
Return Inwards	Credit	Trading A/c (Deducted from sales)	Credit

Bills Receivable Account

Bills Receivable Account is an item of current asset and can be prepared if information about bills receivable is mentioned in the question. This account coexists with debtors account.

Bills Receivable Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d (Opening balance of bills receivable)	xxx	By Cash/Bank A/c (Cash received against bills receivable)	xxx
To Total Debtors A/c (Bills receivable received from debtors)	xxx	By Total Debtors A/c (Bills receivable dishonoured)	xxx
		By Total Creditors A/c (Bills receivable endorsed)	xxx
		By Cash/Bank A/c (Bills receivable discounted)	xxx
		By Discount A/c (Bills receivable discounted)	xxx
		By Balance c/d (Closing balance of bills receivable)	xxx
	xxx		**xxx**

The following table indicates the use of missing information in preparation of other accounts and statements.

Missing information	Debit or credit side	Statements or accounts to be prepared with missing information	Debit or credit side
Opening bills receivable	Debit	Opening Statement of Affairs to find out opening capital	Liabilities
Closing bills receivable	Credit	Balance Sheet – Current assets	Asset
Cash received against bills receivable	Credit	Cash or Bank A/c	Debit
Bills receivable dishonoured	Credit	Total Debtors A/c	Debit
Bills receivable received from debtors	Debit	Total Debtors A/c	Credit

Total Creditors Account

Creditor being a current liability appear on the liability side of the Balance Sheet. This account co-exists with Bills Payable Account. This account needs to be prepared only when either the opening or the closing creditors is mentioned in the question.

Total Creditors Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Cash/Bank A/c (Cash paid to creditors)	xxx	By Balance b/d (Opening balance of creditors)	xxx
To Bills Payable A/c (Bills payable issued to creditors)	xxx	By Credit Purchases	xxx
To Bills receivable (Bills receivable endorsed)	xxx	By Cash (Received from creditors)	xxx
To Return Outwards	xxx	By Bills Payable A/c (Bills payable dishonoured)	xxx
To Discount Received from Creditors	xxx	By Total Debtors A/c (Bills receivable endorsed dishonoured)	xxx
To Allowances from Creditors	xxx		
To Balance c/d (Closing balance of creditors)	xxx		
	xxx		**xxx**

The following table indicates the use of missing information in preparation of other accounts and statements.

Missing information	Debit or credit side	Statements or accounts to be prepared with missing information	Debit or credit side
Opening creditors	Credit	Opening Statement of Affairs to find out opening capital	Liabilities
Closing creditors	Credit	Balance Sheet – Current Liability	Liabilities
Cash paid to creditors	Debit	Cash or Bank A/c	Debit
Credit purchases	Credit	Trading A/c	Debit
Return Outwards	Debit	Trading A/c (Deducted from purchase)	Debit

Bills Payable Account

Bills Payable Account is an item of current liability and can be prepared if information about bills payable is mentioned in the question. This account coexists with creditors account.

Bills Payable Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Cash/Bank A/c (Cash paid against bills payable)	xxx	By Balance b/d (Opening balance of bills payable)	xxx
By Total Creditors A/c (Bills payable dishonoured)	xxx	By Total Creditors A/c (Bills payable issued to creditors)	xxx
By Balance c/d (Closing balance of bills payable)	xxx		
	xxx		**xxx**

The following table indicates the use of missing information in preparation of other accounts and statements.

Missing information	Debit or credit side	Statements or accounts to be prepared with missing information	Debit or credit side
Opening bills payable	Credit	Opening Statement of Affairs to find out opening capital	Liabilities
Closing bills payable	Credit	Balance Sheet – Current Liabilities	Liabilities
Cash paid against bills payable	Debit	Cash or Bank A/c	Credit
Bills payable dishonoured	Debit	Total Creditors A/c	Credit
Bills payable received from creditors	Credit	Total Creditors A/c	Debit

Cash or Bank Account

Cash or Bank Account is a component of current asset. This account has all the information that is essential for preparation of opening Statement of Affairs and Balance Sheet.

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d (Opening balance of cash/bank)	xxx	By Balance c/d (Opening bank overdraft)	xxx
To Total Debtors A/c (Cash received from debtors)	xxx	By Total Creditors A/c (Cash paid to creditors)	xxx
To Cash Sales	xxx	By Bills Payable A/c (Cash paid against bills payable)	xxx
To Bills Receivable A/c (Cash received against bills receivable)	xxx	By Drawings	xxx
To Additional Capital	xxx	By Cash Purchase	xxx
To Sundry incomes	xxx	By Salaries	xxx
To Dividend received	xxx	By Rent	xxx
To Commission received	xxx	By Sundry Expenses	xxx
To Balance c/d (Closing bank overdraft)	xxx	By Balance c/d (Closing balance of cash/bank)	xxx
	xxx		**xxx**

The following table indicates the use of missing information in preparation of other accounts and statements.

Missing information	Debit or credit side	Statements or accounts to be prepared with missing information	Debit or credit side
Opening Cash/Bank Balance	Debit	Opening Statement of Affairs to find out opening capital	Liabilities
Closing Cash/Bank Balance	Credit	Balance Sheet – Current asset	Asset
Opening Balance of bank overdraft	Credit	Opening Statement of Affairs to find out opening capital	Liabilities
Closing Balance of bank overdraft	Debit	Balance Sheet – Current Liability	Liabilities
Cash Purchases	Credit	Trading A/c	Debit
Cash Sales	Debit	Trading A/c	Credit
Drawings	Credit	Balance Sheet – to be deducted from capital	Liabilities
Additional Capital	Debit	Balance Sheet – to be added to capital	Liabilities

Fixed Asset Account

Fixed asset account is prepared if any adjustment relating to fixed assets is mentioned in the problem. The missing information could be Depreciation, Assets purchased or Asset sold during the year. Sometimes, the missing information could also be profit or loss on sale of asset.

Fixed Asset Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d (Opening Balance of asset)	xxx	By P/L A/c (Depreciation)	xxx
To P/L A/c (Profit on sale of asset)	xxx	By P/L A/c (Loss on sale of asset)	xxx
To Cash/Bank A/c (Purchase of an asset)	xxx	To Cash/Bank A/c (Sale of asset)	xxx
		By Balance c/d (Closing balance of asset)	xxx
	xxx		**xxx**

2.10.2 Preparation of Statement of Affairs

Opening Statement of Affairs

Particulars	Amount (₹)	Particulars	Amount (₹)
Creditors	xxx	Land and building	xxx
Bills payable	xxx	Plant and machinery	xxx
Bank overdraft	xxx	Furniture	xxx
Loans	xxx	Investments	xxx
Outstanding expenses	xxx	Debtors	xxx
Prepaid incomes	xxx	Inventory	xxx
Capital (Opening capital – *Balancing figure*)	xxx	Bills receivable	xxx
		Cash in Hand	xxx
		Cash at Bank	xxx
		Prepaid expenses	xxx
		Outstanding incomes	xxx
	xxx		**xxx**

2.10.3 Preparation of Trading, Profit and Loss Account and Balance Sheet

After preparing different statements or accounts to ascertain the missing information, the next step is to prepare the financial statements, namely Memorandum Trading, Profit or Loss Account and Balance Sheet. This will result in successful conversion of Single-entry into Double-entry System.

Memorandum Trading, Profit and Loss Account

This statement prepared ensures ascertaining missing information, namely opening stock, purchases, sales or closing stock. This statement gives operating results in the form of Gross Profit or Net Profit.

Memorandum Trading, Profit and Less Account

Particulars		Amount (₹)	Particulars		Amount (₹)
To Opening Stock			By Sales		
			Cash	xxx	
			Credit	**xxx**	
To Purchases			*Less:* Sales Return	**xxx**	xxx
Cash	xxx				
Credit	xxx				
	xxx		By Closing Stock		xxx
Less: Return Inward	xxx		By Gross Loss c/d		xxx
Less: Drawings (goods)	xxx	xxx			
To wages		xxx			
To Carriage Inward		xxx			
To Manufacturing Expenses		xxx			
To Other Direct Expenses		xxx			
To Gross Profit c/d		xxx			
		xxx			**xxx**
To Gross Loss b/d		xxx	To Gross Profit b/d		xxx
To Salaries		xxx	By Discount Received		xxx
To Rent		xxx	By Interest Received		xxx
Too Bad Debts		xxx	By Sundry Incomes		xxx
To Depreciation		xxx	By Net Loss c/d		xxx
To Discount Allowed		xxx			
To Interest		xxx			
To Other Indirect Expenses		xxx			
To Net Profit c/d		xxx			
		xxx			**xxx**

2.11 ILLUSTRATIONS

Illustration 1: Ascertainment of Credit Sales

Ascertain credit sales from the following:

Particulars	₹
Opening Debtors	75,500
Cash received from debtors	6,18,500
Bills receivable received	24,000
Sales return	8,600
Bad debts	6,800
Bills receivable dishonoured	3,800
Discount allowed	2,000
Bills receivable discounted with bank	4,500

[B.U., B.Com., Nov/Dec 2015, Section B]

Solution:

Debtors A/c

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Opening Balance	75,500	By Bank	6,18,500
To Bills Receivable dishonoured	3,800	By Bills Receivable	24,000
By Credit Sales (*Balancing figure*)	**5,80,600**	By Sales Return	8,600
		By Bad debts	6,800
		By Discount	2,000
	6,59,900		**6,59,900**

Illustration 2: Ascertainment of Opening Stock

From the following information, calculate opening stock.

Particulars	₹
Purchases during the year	55,000
Sales during the year	1,25,000
Closing stock	18,000
Manufacturing expenses	12,000
Carriage Inward	2,000
Rate of Gross Profit was 25% on cost.	

[B.U., B.Com., Nov/Dec 2016, Section B]

2

Solution:

Particulars	₹	Particulars	₹
To Opening Stock (*Balancing figure*)	**49,000**	By Sales	1,25,000
To Purchases	55,000	By Closing Stock	18,000
To Manufacturing Expenses	12,000		
To Carriage Inward	2,000		
To Gross Profit (25% on Cost = 20% on Sales)	25,000		
	1,43,000		**1,43,000**

2

Illustration 3: **Ascertainment of Closing Capital**

Calculate the missing figure.

Particulars	₹
Capital at the beginning of the year	70,800
Additional capital introduced	18,800
Drawings	11,200
Net Loss	5,600
Closing capital	?

[B.U., B.Com., Nov/Dec 2014, Section B]

Solution:

Particulars	₹
Opening Capital	70,800
Less: Net Loss	5,600
Less: Drawings	11,200
Add: Additional Capital	18,800
Closing Capital	**72,800**

Illustration 4: From the following information, you are required to determine the amount of total sales:

Particulars	₹
Opening stock	80,000
Purchases	4,00,000
Closing stock	70,000

Rate of Gross Profit is $\frac{1}{6}$ on Sales

[B.U., B.Com., Nov/Dec 2013, Section A]

Solution:

$1/6^{th}$ of Sales = $1/5^{th}$ of Cost

Cost = Cost of Goods Sold = Opening Stock + Purchases − Closing Stock

= 80,000 + 4,00,000 − 70,000

= ₹4,10,000

Memorandum Trading Account

Particulars	₹	Particulars	₹
To Opening Stock	**80,000**	**By Sales** (*Balancing figure*)	**4,92,000**
To Purchases	4,00,000	By Closing Stock	70,000
To Gross Profit (1/5th of 4,10,000)	40,000		
	5,62,000		**5,62,000**

Illustration 5: **Ascertainment of Opening Stock when GP on Cost of Sales is given**

Ascertain opening stock when purchases ₹1,20,000, wages ₹40,000, sales ₹2,00,000, closing stock ₹30,000, percentage of Gross Profit on cost of sales is 25%.

[B.U., B.Com., Nov/Dec 2013, Section A]

Solution:

Cost of sale = 100
Profit = 25
Sales = 125

Therefore, profit on sales = $\left(\frac{25}{125}\times 100\right)$ = **20% on sales**

Memorandum Trading Account

Particulars	₹	Particulars	₹
To Opening Stock (*Balancing figure*)	**30,000**	By Sales	2,00,000
To Purchases	1,20,000	By Closing Stock	30,000
To Wages	40,000		
To Gross Profit (20% on sales, i.e. 2,00,000)	40,000		
	2,30,000		**2,30,000**

Illustration 6: **Problem on Preparation of Statement of Affairs**

Mr. Sumanth maintains his records under Single-entry System of Book-Keeping; he commenced his business on 1 January 2017 with an initial capital of ₹75,000. Following was his position as on 31 December 2017:

Particulars	₹
Land	55,000
Machinery	25,000
Furniture	13,000
Debtors	20,000
Stock	15,000
Bills Receivable	7,000
Cash in Hand	1,900
Cash at Bank	7,100
Creditors	38,000
Bills Payable	7,500

Determine the closing capital of Mr. Sumanth.

Solution:

Statement of Affairs of Mr. Sumanth
As on 31.12.2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	38,000	Land	55,000
Bills Payable	7,500	Machinery	25,000
Capital (*Balancing figure*)	**98,500**	Furniture	13,000
		Stock	15,000
		Debtors	20,000
		Bills Receivable	7,000
		Cash in Hand	1,900
		Cash at Bank	7,100
	1,44,000		**1,44,000**

2

Illustration 7: **Problem on the preparation of opening and closing Statement of Affairs**

The following balances appear in the books of Mr. Ashok that are kept under Single-entry System.

Particulars	1.4.2016 (₹)	31.3.2017 (₹)
Machinery	95,000	1,00,000
Furniture	35,000	35,000
Creditors	16,000	19,000
Debtors	25,000	30,000
Stock	12,000	10,000
Cash in Hand and at Bank	7,000	9,500
Outstanding Income	2,000	3,500
Income received in advance	2,500	3,600

Ascertain the opening and closing capital of Mr. Ashok.

Solution:

Statement of Affairs of Mr. Ashok
As on 1.4.2016 to 31.3.2017

Liabilities	Opening (₹)	Closing (₹)	Assets	Opening (₹)	Closing (₹)
Creditors	16,000	19,000	Machinery	95,000	1,00,000
Income received in advance	2,500	3,600	Furniture	35,000	35,000
Capital (*Balancing figure*)	**1,57,500**	**1,65,400**	Stock	12,000	10,000
			Debtors	25,000	30,000
			Cash in Hand and at Bank	7,000	9,500
			Outstanding Incomes	2,000	3,500
	1,76,000	**1,88,000**		**1,76,000**	**1,88,000**

Illustration 8: **Preparation of Statement of Affairs and Profit or Loss**

Mr. Somashekhar maintains his books under Single-entry System. The following is the information as on 31 March 2016:

Machinery ₹50,000; Debtors ₹10,000; Stock ₹16,000; Cash in Hand and at Bank ₹7,500; Prepaid Expenses ₹3,000; Creditors ₹38,000; Bills Payable ₹6,000; Bank Overdraft ₹16,000.

On 1 August 2016 Mr. Somashekhar further introduced an additional capital of ₹25,000 in his business and withdrew an amount of ₹5,600 on the same date, out of which he spent ₹4,000 on the purchase of a machine for the business.

His position on 31 March 2017 was as follows:

Machinery ₹54,000, Debtors ₹26,000, Stock ₹18,000, Cash in Hand and at Bank ₹7,000, Outstanding Expenses ₹4,000, Creditors ₹25,000, Bills Payable ₹4,000.

Depreciate machinery at the rate of 10% p.a., write off bad debts ₹1,000 and provision for doubtful debts at the rate of 5%; goods drawn for personal use amounted to ₹750; interest on capital to be provided at 10% p.a.

Prepare the statement showing profit or loss after accounting for the adjustments mentioned before.

2

Solution:

Statement of Affairs of Mr. Somashekhar

As on 31.3.2016

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	38,000	Machinery	50,000
Bills Payable	6,000	Stock	16,000
Bank Overdraft	16,000	Debtors	10,000
Capital (*Balancing figure*)	**26,500**	Cash in Hand and at Bank	7,500
		Prepaid Expenses	3,000
	86,500		**86,500**

Statement of Affairs of Mr. Somashekhar

As on 31.3.2017

Liabilities	Amount (₹)	Assets		Amount (₹)
Creditors	25,000	Machinery (50,000 + 4,000)	54,000	
		Less: Depreciation @ 10%	5,400	48,600
Bills Payable	4,000	Stock		18,000
Outstanding Expenses	4,000	Debtors		26,000
		Less: Bad debts		1,000
				25,000
		Less: Provision for doubtful debts @ 5% on 25,000	1,250	23,750
Capital (*Balancing figure*)	**64,350**	Cash in Hand and at Bank		7,000
	97,350			**97,350**

Statement of Profit or Loss of Mr. Somashekhar

For the year ended 31.3.2017

Particulars	₹	₹
Capital as at 31.3.2017 (closing)		64,350
Add: Drawings		
1. Cash (withdrawn ₹5,600 – ₹4,000 spent on machinery)	1,600	
2. Goods withdrawn for personal use	750	2,350
		66,700
Less: Additional capital introduced in the business		25,000
		41,700
Less: Capital as on 1.4.2016 (opening)		26,500
Profit before allowing interest on capital		15,200
Less: Interest on Capital @ 10% (26,500 + 25,000) (opening capital + additional capital)		5,150
Profit for the year		**10,050**

2

Illustration 9: Preparation of Statement of Affairs, Profit or Loss Account and Revised Statement of Affairs

Mr. Saket is a retailer, who has not maintained books of accounts. From the given information, ascertain his profit or loss for the year ending 31 March 2018 along with the revised Statement of Affairs:

Particulars	1.4.2017 (₹)	31.3.2018 (₹)	Particulars	1.4.2017 (₹)	31.3.2018 (₹)
Stock	14,000	20,000	Furniture	10,000	10,000
Debtors	16,000	19,500	Machinery	20,000	20,000
Bills receivable	16,000	21,000	Creditors	20,000	26,000
Cash in Hand	2,000	4,600	Bills payable	2,600	5,800
Investments	9,000	9,000	Bank overdraft	25,000	5,000

Additional information:

1. Mr. Saket has withdrawn an amount of ₹2,000 for his personal use.
2. His personal assets were discharged during the year and proceeds on the same were invested in the business ₹10,000.
3. The sundry debtors worth ₹2,500 were irrecoverable and a further provision @ 5% is to be provided towards bad and doubtful debts.
4. Depreciation on furniture and machinery is to be provided @ 10%.
5. Investments appreciated by 30%.

6. Unpaid amount of rent is ₹750.

7. Prepaid insurance amounted to ₹800.

Solution:

Statement of Affairs of Mr. Saket

As on 1.4.2017 to 31.3.2018

Liabilities	Opening (₹)	Closing (₹)	Assets	Opening (₹)	Closing (₹)
Creditors	20,000	26,000	Machinery	20,000	20,000
Bills Payable	2,600	5,800	Furniture	10,000	10,000
Bank Overdraft	25,000	5,000	Investments	9,000	9,000
Capital (*Balancing figure*)	**39,400**	**67,300**	Stock	14,000	20,000
			Debtors	16,000	19,500
			Bills Receivable	16,000	21,000
			Cash in Hand	2,000	4,600
	87,000	**1,04,100**		**87,000**	**1,04,100**

Statement of Profit or Loss of Mr. Saket

For the year ended 31.3.2018

Particulars		₹	₹
Capital as at 31.3.2018			67,300
Add: Drawings—Cash withdrawn for personal use			2,000
			69,300
Less: Additional capital introduced in the business by selling off his personal assets			10,000
			59,300
Less: Capital as on 1.4.2016			39,400
Gross Profit			19,900
Less: Expenses or losses:			
Bad Debts	2,500		
Provision for bad and doubtful debts (19,500 – 2,500 = 17,000 @ 5%)	850	3,350	
Depreciation on: Furniture (10,000 @ 10%)		1,000	
Machinery (20,000 @ 10%)		2,000	
Outstanding Expenses—Rent		750	7,100
			12,800
Add: Incomes or gains			
Appreciation in investments (9,000 @ 30%)		2,700	
Prepaid Expenses—Insurance		800	3,500
Net Profit/profit for the year			**16,300**

Revised Statement of Affairs of Mr. Saket

As on 31.3.2018

Liabilities		Amount (₹)	Assets		Amount (₹)
Creditors		26,000	Machinery	20,000	
			Less: Depreciation @ 10%	2,000	18,000
Bills Payable		5,800	Furniture	10,000	9,000
			Less: Depreciation @ 10%	1,000	
Bank Overdraft		5,000	Investments	9,000	
			Add: Appreciation @ 30%	2,700	11,700
Outstanding Expenses—Rent		750	Stock		20,000
Capital:			Debtors (₹19,500 – ₹2,500		
Opening Capital	39,400		bad debts)	17,000	
Add: Net Profit	16,300		*Less:* Provision for doubtful		16,150
			debts @ 5% on 17,000	850	
	55,700		Bills receivable		21,000
Add: Additional Capital	10,000		Cash in Hand		4,600
	65,700		Prepaid Expenses—Insurance		800
Less: Drawings	2,000	63,700			
		1,01,250			**1,01,250**

Illustration 10: **Preparation of Statement of Affairs, Profit and Loss Account and Balance Sheet**

Following is the position of Assets and Liabilities of Amit and Manohar who have not maintained complete set of records for the inception of their partnership.

Particulars	1.4.2017 (₹)	31.3.2018 (₹)
Machinery	40,000	50,000
Furniture	12,000	12,000
Debtors	46,000	64,000
Stock	40,000	50,000
Cash in Hand	5,000	10,400
Cash at Bank (Pass Book)	30,400	40,400
Creditors	64,000	46,000

Additional information:

- Capital of Amit at the beginning of the year is 20,000 more than Manohar. Interest on Capital is @ 10% on the opening capital.
- Depreciation on furniture is @ 10% whereas on machinery @ 20% on closing balances.
- Amit drew ₹6,000 p.m. and Manohar drew ₹4,000 p.m.
- Stock includes goods sold for ₹10,000 at a profit of 20% not yet delivered.

- As on 31 March 2018, A cheque was deposited but not credited by Bank ₹18,000 and cheque issued not presented for payments of ₹13,000. A bank charge of ₹400 is also debited.

Prepare Statement of Profit or Loss for the year ended in 31 March 2018 and also a Balance Sheet as on that date.

Solution:

Statement of Affairs of Amit and Manohar
As on 1.4.2017 to 31.3.2018

Liabilities	Opening (₹)	Closing (₹)	Assets	Opening (₹)	Closing (₹)
Creditors	64,000	46,000	Machinery *(*Less* Depreciation @ 20% only on closing balances 50,000 − 10,000)	40,000	40,000*
Combined Capital of Amit and Manohar (*Balancing figure*)	**1,09,400**	**1,66,600**	Furniture *(*Less* Depreciation @ 10% only on closing balances 12,000 − 1,200)	12,000	10,800*
			Stock (Working Note 2)	40,000	42,000*
			Debtors	46,000	64,000
			Cash in Hand	5,000	10,400
			Cash at Bank (Working Note 1)	30,400	45,400*
	1,73,400	**2,12,600**		**1,73,400**	**2,12,600**

Working Notes:

Working Note 1: Calculation of Cash at Bank as per cash book

Cash at Bank as on 31 March 2018 as per pass book	₹40,400
Add: Cheque deposited into bank but not yet credited by bank	₹18,000
	₹58,400
Less: Cheques issued but not yet presented for payment	₹13,000
Cash at Bank as per cash book	**₹45,400**

Working Note 2: Calculation of stock at cost

Stock		₹50,000
Less: Goods sold but not delivered	(₹10,000 × 80%)	₹8,000 (at cost)
Stock at cost		**₹42,000**

Working Note 3: Opening capital of Amit and Manohar

Total capital as on 1 April 2017 ₹1,09,400

Capital of Amit is 20,000 more than Manohar

Capital of Manohar as on 1 April 2017 = $1,09,400 - \frac{20,000}{2}$ = **₹44,700**

Capital of Amit = 44,700 + 20,000 = **₹64,700**

Note: No adjustment is required for bank charges, as entry has already been made in the Pass Book.

Statement of Profit or Loss of Amit and Manohar

For the year ended 31.3.2018

Particulars	₹	₹
Combined Capital as at 31.3.2018		1,66,600
Add: Drawings – Amit (6,000 × 12)	72,000	
Manohar (4,000 × 12)	48,000	1,20,000
		2,86,600
Less: Capital as on 1.4.2017		1,09,400
Profit for the year before interest on capital		1,77,200
Less: Interest on Capital (Working Note 3)		
Amit – 64,700 @ 10%	6,470	
Manohar – 44,700 @ 10%	4,470	10,940
Net Profit		**1,66,260**
Amit's share of profit $\left(1,66,260 \times \frac{1}{2}\right)$		83,130
Manohar's share of profit $\left(1,66,260 \times \frac{1}{2}\right)$		83,130

Balance Sheet of Amit and Manohar

as on 31.3.2018

Liabilities		₹	Assets	₹
Creditors		46,000	Machinery (*Less* Depreciation @ 20% – 50,000 − 10,000)	40,000
Amit's Capital:				
As on 1.4.2017	₹64,700		Furniture (*Less* Depreciation @ 10% – 12,000 − 1,200)	10,800
Add: Interest on Capital	₹6,470		Stock (Working Note 2)	42,000
Profit	₹83,130			
	₹1,54,300		Debtors	64,000
Less: Drawings	₹72,000	82,300	Cash in Hand	10,400
Manohar's Capital:			Cash at Bank (Working Note 1)	45,400
As on 1.4.2017	₹44,700			
Add: Interest on Capital	₹4,470			
Profit	₹83,130			
	₹1,32,300			
Less: Drawings	₹48,000	84,300		
		2,12,600		**2,12,600**

Illustration 11: **Preparation of Bills Receivable and Total Debtors Account**

From the following particulars extracted from the books of Sanjeev, who had maintained his books as per Single-entry System, prepare the Total Debtors Account and Bills Receivable Account:

Particulars	₹	Particulars	₹
Balance of total debtors as on 1.1.2017	15,000	Bills receivable dishonoured	1,500
Balance of total debtors as on 31.12.2017	18,000	Cash received against bills receivables	21,000
Balance of bills receivable as on 1.1.2017	8,000	Goods returned by debtors	4,500
Balance of bills receivable as on 31.12.2017	10,500	Discount allowed	2,700
Cash received from debtors	60,000	Bad debts	900

Hint: Prepare Bills Receivable Account to ascertain the bills receivable received from debtors; this is required while preparing Total Debtors Account.

2

Solution:

Bills Receivable Account

Particulars	₹	Particulars	₹
To Balance b/d (Opening balance of B/R)	8,000	By Cash (Received against B/R)	21,000
To Debtor's A/c (B/R received from the debtors during the year) (*Balancing figure*)	**25,000**	By Debtor's A/c (B/R dishonoured)	1,500
		By Balance c/d (Closing balance of B/R)	10,500
	33,000		**33,000**

Note:

1. When the closing balance of Bills Receivable (B/R) is not given in the problem and all other information is mentioned in the question, the balancing figure in the B/R Account will be **closing balance of B/R**. This amount will appear in the closing Balance Sheet.
2. When the opening balance of B/R is not given in the problem and all other information is mentioned in the question, the balancing figure in the B/R Account will be **opening balance of B/R** (Provided it is not a new concern). This amount will appear in the opening Statement of Affairs (for this purpose Bills Receivable Account should be prepared before preparing opening Statement of Affairs).
3. When both opening and closing balances of B/R are mentioned in the question, the balance figure will either be **cash received against B/R** (if debit side is more than the credit side) or **B/R received from debtors** (if credit side is more than the debit side). Cash received against B/R will appear on the debit side of cash book and B/R received from debtors will appear on credit side of the Total Debtors Account.

Total Debtors Account

Particulars	₹	Particulars	₹
To Balance b/d (Opening balance of debtors)	15,000	By Cash (Received from debtors)	60,000
To Bills Receivable A/c (Bills receivable dishonoured)	1,500	By Bills Receivable (B/R received from debtors as per B/R A/c)	25,000
To Credit Sales (*Balancing figure*)	**94,600**	By Sales Returns (Goods returned by debtors)	4,500
		By Bad Debts	900
		By Discount Allowed	2,700
		By Balance c/d (Closing balance of debtors)	18,000
	1,11,100		**1,11,100**

2

Note:

1. When the closing balance of total debtors is not given in the problem and all other information is mentioned in the question, the balancing figure in the Total Debtors Account will be **closing balance of total debtors**. This amount will appear in the closing Balance Sheet.
2. When the opening balance of total debtors is not given in the problem and all other information is mentioned in the question, the balancing figure in the Total Debtors Account will be **opening balance of total debtors** (Provided it is not a new concern). This amount will appear in the opening Statement of Affairs (for this purpose Total Debtors Account should be prepared before preparing opening Statement of Affairs).
3. When both opening and closing balances of total debtors are mentioned in the question, the balance figure will either be **cash received from debtors or B/R received from debtors** (if debit side is more than the credit side) or **Credit Sales** (if credit side is more than the debit side). Cash received from debtors will appear on the debit side of cash book, B/R received from debtors will appear on the debit side of Bills Receivable Account and Credit Sales will appear on credit side of the Trading Account.

Illustration 12: **Preparation of Bills Payable and Total Creditors Account**

From the following particulars supplied by Mr. Rakesh, a retailer, who maintains books under Single-entry System, calculate Bills Payable and Total Creditors Account.

Particulars	₹	Particulars	₹
Opening balance of creditors	44,000	Bills payable for the year	65,400
Opening balance of bills payable (B/P)	25,000	Return Outwards	4,000
Cash and cheque paid to creditors (including ₹6,000 to Ashok Ltd towards goods bill)	2,00,000	Freight charged by suppliers	6,000
Cash Purchases	1,80,000	Discount allowed by creditors	9,000
Closing balance of creditors	35,000	Bills payable dishonoured	3,000
Closing balance of bills payable	45,000	*Note:* Opening creditors includes ₹10,000 to Ashok Ltd	

Hint: Prepare Bills Payable Account to ascertain the Bills Payable issued to creditors; this is required while preparing Total Creditors Account.

Solution:

Bills Payable Account

Particulars	₹	Particulars	₹
To Bank A/c (B/P discharged during the year)	65,400	By Balance b/d (Opening balance of B/P)	25,000
To Creditor's A/c (B/P dishonoured)	3,000	**By Creditor's A/c (B/P issued)** (*Balancing figure*)	**88,400**
To Balance c/d (Closing balance of B/P)	45,000		
	1,13,400		**1,13,400**

Note:

1. When the closing balance of B/P is not given in the problem and all other information is mentioned in the question, the balancing figure in the B/P Account will be **closing balance of B/P**. This amount will appear in the closing Balance Sheet.
2. When the opening balance of B/P is not given in the problem and all other information is mentioned in the question, the balancing figure in the B/P Account will be **opening balance of B/P** (Provided it is not a new concern). This amount will appear in the opening Statement of Affairs (for this purpose Bills Payable Account should be prepared before preparing opening Statement of Affairs).
3. When both opening and closing balances of B/P are mentioned in the question, the balance figure will either be **Cash paid against B/P** (if debit side is more than the credit side) or **Acceptances given to creditors** (if credit side is more than the debit side). Cash paid against B/P will appear on the credit side of cash book and Acceptances given to creditors will appear on debit side of the Total Creditors Account.

Total Creditors Account

Particulars	₹	Particulars	₹
To Bank A/c (Cash and cheque paid to creditors)	2,00,000	By Balance b/d (Opening balance of Creditors)	44,000
To Bills Payable A/c (Bills payable issued to creditors as per Bills Payable A/c)	88,400	By Freight (Charged by supplier)	6,000
To Return Outwards	4,000	By Bills payable (Dishonoured)	3,000
To Discount (Allowed by creditors)	9,000	**By Credit Purchases** (*Balancing figure*)	**2,83,400**
To Balance c/d (Closing balance of creditors)	35,000		
	3,36,400		**3,36,400**

2

Note:

1. When the closing balance of total creditors is not given in the problem and all other information is mentioned in the question, the balancing figure in the Total Creditors Account will be **closing balance of total creditors**. This amount will appear in the closing Balance Sheet.
2. When the opening balance of total creditors is not given in the problem and all other information is mentioned in the question, the balancing figure in the Total Creditors Account will be **opening balance of total creditors.** (Provided it is not a new concern.) This amount will appear in the opening Statement of Affairs (for this purpose Total Creditors Account should be prepared before preparing opening Statement of Affairs).
3. When both opening and closing balances of total debtors are mentioned in the question, the balance figure will either be **cash paid to creditors or B/P accepted by creditor** (if credit side is more than the debit side) or **Credit Purchases** (if debit side is more than the credit side). Cash paid to creditors will appear on the credit side of cash book, B/P accepted by creditors will appear on the credit side of Bills Payable Account and Credit Purchases will appear on debit side of the Trading Account.

Illustration 13: Bills Receivable and Payable Account and Total Debtors and Creditors Account

From the following particulars extracted from the books of Mr. Anil Kumar, a trader, it is seen that he maintains his accounts as per Single-entry System of Book-Keeping. Prepare Total Debtors and Creditors Account along with Bills Receivable and Bills Payable Account.

Particulars	₹	Particulars	₹
Balances as on 1.1.2017		Returns to suppliers	1,750
Debtors	65,000	Returns from customers	2,760
Creditors	36,000	Cash received from customers	1,18,000
Bills receivable	8,000	Cash paid to creditors	85,000
Bills payable	5,000	Cash received against bills receivable	16,000
Balances as on 31.12.2017		Payment made against bills payable	9,000
Debtors	64,000	Cash Sales during the year	25,000
Creditors	34,000	Cash Purchases during the year	16,000
Bills receivable	3,000	Bills receivable dishonoured	800
Bills payable	4,000	Bad debts recovered previously dishonoured	900
Discount allowed by suppliers	2,800	Bad debts written off	4,600
Discount allowed to customers	4,400		

Solution:

Total Debtors Account

Particulars	₹	Particulars	₹
To Balance b/d (Opening balance of debtors)	65,000	By Cash (Received from debtors)	1,18,000
To Bills Receivable A/c (Bills receivable dishonoured)	800	By Bills receivable (B/R received from debtors as per B/R A/c)	11,800
To Credit Sales (*Balancing figure*)	**1,39,760**	By Sales Returns (Goods returned by debtors)	2,760
		By Bad Debts	4,600
		By Discount Allowed	4,400
		By Balance c/d (Closing balance of debtors)	64,000
	2,05,560		**2,05,560**

Total Creditors Account

Particulars	₹	Particulars	₹
To Cash A/c (Cash paid to creditors)	85,000	By Balance b/d (Opening balance of creditors)	36,000
To Bills Payable A/c (Bills payable issued to creditor's as per Bills Payable A/c	8,000	**By Credit Purchases** (*Balancing figure*)	**95,550**
To Return Outwards	1,750		
To Discount (Allowed by creditors)	2,800		
To Balance c/d (Closing balance of creditors)	34,000		
	1,31,550		**1,31,550**

Bills Receivable Account

Particulars	₹	Particulars	₹
To Balance b/d (Opening balance of B/R)	8,000	By Cash (Received against B/R)	16,000
To Debtors A/c (B/R received from the debtors during the year) (*Balancing figure*)	**11,800**	By Debtors A/c (B/R dishonoured)	800
		By Balance c/d (Closing balance of B/R)	3,000
	19,800		**19,800**

Bills Payable Account

Particulars	₹	Particulars	₹
To Bank A/c (B/P discharged during the year)	9,000	By Balance b/d (Opening balance of B/P)	5,000
To Balance c/d (Closing balance of B/P)	4,000	**By Creditors A/c (B/P issued)** (*Balancing figure*)	8,000
	13,000		**13,000**

Note: Bad debts recovered previously written off are not posted to Debtors Account, cash sales and cash purchases are also not posted in any of the accounts.

Illustration 14: **Draft the Bills Receivable Account and Debtors Account as well as Bills Payable and Creditors Account**

Debtors on 1.4.2010	?	Received from debtors	58,00,000
Creditors on 1.4.2010	7,20,000	Bills receivable encashed	20,00,000
Bills receivable on 1.4.2010	7,00,000	Bills receivable dishonoured	2,00,000
Bills payable on 1.4.2010	5,20,000	Bills payable paid	28,60,000
Total sales	1,60,00,000	Bills payable dishonoured	2,00,000
Total purchases	1,00,00,000	Payment to creditors	29,40,000
Cash Sales	78,60,000	Debtors 31.3.2011	9,00,000
Cash Purchases	40,00,000	Creditors on 31 March 2011	?
Discount received	20,000	Bills receivable on 31.3.2011	6,80,000
Discount allowed	40,000	Bills payable on 31.3.2011	4,60,000

[B.U., B.Com., Nov/Dec 2012, Section B]

Solution:

Bills Receivable Account

Particulars	₹	Particulars	₹
To Balance b/d	7,00,000	By Cash (Received from debtors)	20,00,000
To Debtors (*Balancing figure*)	**21,80,000**	By Debtors	2,00,000
		By Balance c/d	6,80,000
	28,80,000		**28,80,000**

Debtors Account

Particulars	₹	Particulars	₹
To Balance b/d (*Balancing figure*)	**5,80,000**	By Cash (Received from debtors)	58,00,000
To Bills Receivable Dishonoured	2,00,000	By Discount	40,000
To Credit Sales (1,60,00,000 – 78,60,000)	81,40,000	By Bills Receivable	21,80,000
		By Balance c/d	9,00,000
	89,20,000		**89,20,000**

Bills Payable Account

Particulars	₹	Particulars	₹
To Cash	28,60,000	By Balance b/d	5,20,000
To Creditors	2,00,000	**By Creditors (*Balancing figure*)**	30,00,000
To Balance c/d	4,60,000		
	35,20,000		**35,20,000**

Total Creditors Account

Particulars	₹	Particulars	₹
To Discount	20,000	By Balance b/d	7,20,000
To Cash	29,40,000	By Bills Payable Dishonoured	2,00,000
To Bills Payable	30,00,000	By Credit Purchases	**60,00,000**
To Balance c/d (*Balancing figure*)	9,60,000	(1,00,00,000 – 40,00,000)	
	69,20,000		**69,20,000**

2

Illustration 15: **Total Debtors and Total Creditors Account**

From the following information, calculate total purchases and total sales.

Particulars	₹
Opening debtors	28,000
Closing debtors	20,000
Opening creditors	16,000
Closing creditors	19,000
Cash received from debtors	12,800
Cash paid to creditors	4,000
Discount earned	400
Discount allowed	800
Bills receivable from debtors	5,000
Bills payable issued to creditors	11,600
Bad debts written off	600

[B.U., B.Com., Nov/Dec 2014, Section B]

Solution:

Total Debtors Account

Particulars	₹	Particulars	₹
To Balance b/d	28,000	By Cash Received from Debtors	12,800
To Credit Sales (*Balancing figure*)	**11,200**	By Discount Allowed	800
		By Bills Receivable	5,000
		By Bad Debts	600
		By Balance c/d	20,000
	39,200		**39,200**

Total Creditors Account

Particulars	₹	Particulars	₹
To Cash Paid to Creditors	4,000	By Balance b/d	16,000
To Discount Earned	400	**By Credit Purchases** (*Balancing figure*)	**19,000**
To Bills Payable	11,600		
To Balance c/d	19,000		
	35,000		**35,000**

Illustration 16: Memorandum Trading, Profit and Loss Account and Balance Sheet.

2

Following facts have been ascertained from the books of Mr. Mukesh, who maintains his books under Single-entry System.

Receipts and Payments A/c

Receipts	₹	Payments	₹
Debtors	1,00,000	Machinery purchased	15,000
Cash Sales	65,000	Salaries	7,000
Paid by Mukesh (additional capital)	15,000	Wages	45,000
		Drawings	9,000
		Rent	9,000
		Interest paid	1,000
		Insurance	1,200
		Electricity charges	4,000
		Sundry expenses	18,000
		Creditors	55,000

Particulars	1.4.2017 (₹)	31.3.2018 (₹)
Debtors	20,000	35,000
Creditors	15,000	12,000
Bank	5,500	?
Stock	36,000	17,500
Machinery	44,000	43,000

Mr. Mukesh maintains the practice of receiving and paying through cheque only. From the details mentioned before, calculate Trading, Profit or Loss Account and Balance Sheet for the year ended on 31 March 2018.

Solution:

Trading and Profit and Loss Account of Mr. Mukesh
For the year ended 31.3.2018

Particulars	₹	Particulars	₹
To Opening Stock	36,000	By Sales	
To Purchases (Refer Creditors A/c)	52,000	Cash	65,000
To Wages	45,000	Credit (Refer Debtors A/c)	1,15,000
To Gross Profit c/d (*Balancing figure*)	64,500	By Closing Stock	17,500
	1,97,500		**1,97,500**
To Salaries	7,000	By Gross Profit b/d	64,500
To Interest	1,000		
To Insurance	1,200		
To Rent	9,000		
To Electricity Charges	4,000		
To Sundry Expenses	18,000		
To Depreciation on Machinery (WN1)	16,000		
To Net Profit (*Balancing figure*)	**8,300**		
	64,500		**64,500**

Abbreviations: WN1: Working Note 1

Balance Sheet of Mr. Mukesh
As on 31.3.2018

Liabilities		₹	Assets		₹
Creditors		12,000	Cash at Bank		21,300
Capital as on 1.4.2017	90,500		Debtors		35,000
Add: Net Profit for the year	8,300		Closing stock		17,500
Add: Capital introduced during the year	15,000		Machinery		
			Plant	44,000	
Less: Drawings	9,000	1,04,800	*Add:* Addition during the year	15,000	
			Less: Depreciation	16,000	43,000
		1,16,800			**1,16,800**

Calculation of Credit Purchases and Credit Sales:
Creditors Account

Particulars	₹	Particulars	₹
To Bank (Paid to Creditors)	55,000	By Balance b/d	15,000
To Balance c/d	12,000	**By Credit Purchases** (*Balancing figure*)	**52,000**
	67,000		**67,000**

Debtors Account

Particulars	₹	Particulars	₹
To Balance b/d	20,000	By Bank (Received from Debtors)	1,00,000
To Credit Sales (*Balancing figure*)	**1,15,000**	By Balance c/d	35,000
	1,35,000		**1,35,000**

Working note 1 (WN 1): Calculation of Depreciation on plant

Particulars	₹
Plant as on 1.4.2017	44,000
Add: Plant purchased during the year	15,000
	59,000
Less: Plant as on 31.3.2018	43,000
Depreciation for the year	**16,000**

2

Calculation of Cash at Bank
Bank Account

Particulars	₹	Particulars	₹
To Balance b/d	5,500	By Purchase of Plant	15,000
To Debtors	1,00,000	By Drawings	9,000
To Cash Sales	65,000	By Wages	45,000
To Capital	15,000	By Salaries	7,000
		By Interest	1,000
		By Insurance	1,200
		By Rent	9,000
		By Electricity Charges	4,000
		By Sundry Expenses	18,000
		By Sundry Creditors	55,000
		By Balance c/d (*Balancing figure*)	**21,300**
	1,85,500		**1,85,500**

Calculation of Capital as on 1.4.2017
Statement of Affairs
As on 1.4.2017

Liabilities	₹	Assets	₹
Creditors	15,000	Cash at Bank	5,500
Capital (*Balancing figure*)	**90,500**	Debtors	20,000
		Stock	36,000
		Machinery	44,000
	1,05,500		**1,05,500**

Illustration 17: **Trading, Profit and Loss Account and Balance Sheet**

Mr. Mukund maintains his records as per Single-entry System. With the help of following information, prepare Trading, Profit and Loss Account along with the Balance Sheet as on 31 March 2018.

Cash Book Analysis

Particulars (Payments)	₹	Particulars (Receipts)	₹
Interest	500	Bank Balance 31.3.2018	5,500
Drawings	6,000	Cash on Hand 31.3.2018	1,000
Salaries	20,000	Cash Received from Debtors	80,000
Sundry expenses	18,000	Cash Sales	45,000
Cash paid to creditors	45,000		

Further details available are as follows:

Particulars	1.4.2017 (₹)	31.3.2018 (₹)
Stock	20,000	35,000
Creditors	20,000	16,000
Debtors	60,000	85,000
Furniture	10,000	10,000
Building	60,000	60,000

Interest on capital to be provided at 5% as on 1 April 2017, provide ₹2,500 for doubtful debts and 10% depreciation on all fixed assets.

Solution:

Trading and Profit and Loss Account of Mr. Mukund

For the year ended 31.3.2018

Particulars	₹	Particulars	₹
To Opening Stock	20,000	By Sales	
To Purchases (Refer Creditors A/c)	41,000	Cash	45,000
To Gross Profit c/d (*Balancing figure*)	1,24,000	Credit (Refer Debtors A/c)	1,05,000
		By Closing Stock	35,000
	1,85,000		**1,85,000**
To Interest	500	By Gross Profit b/d	1,24,000
To Salaries	20,000		
To Sundry Expenses	18,000		
To Interest on Capital (1,01,000 × 5%)	50,50		
To Provision for Doubtful Debts	2,500		
To Depreciation:			
Furniture (10,000 @ 10%)	1,000		
Building (60,000 @ 10%)	6,000		
To Net Profit (*Balancing figure*)	70,950		
	1,24,000		**1,24,000**

Balance Sheet of Mr. Mukund
As on 31.3.2018

Liabilities		₹	Assets	₹
Creditors		16,000	Debtors *Less:* Reserve for doubtful debts (85,000 − 2,500)	82,500
Capital as on 1.4.2017	1,01,000		Stock	35,000
Add: Net Profit for the year	70,950		Furniture *Less:* Depreciation (10,000 − 1,000)	9,000
Add: Interest on Capital	5,050		Building *Less:* Depreciation (60,000 − 6,000)	54,000
	1,77,000		Bank	5,500
Less: Drawings	6,000	1,71,000		
			Cash	1,000
		1,87,000		**1,87,000**

Creditors Account

Particulars	₹	Particulars	₹
To Bank	45,000	By Balance b/d	20,000
To Balance c/d	16,000	**By Credit Purchases** (*Balancing figure*)	**41,000**
	61,000		**61,000**

Debtors Account

Particulars	₹	Particulars	₹
To Balance b/d	60,000	By Bank	80,000
To Credit Sales (*Balancing figure*)	1,05,000	By Balance c/d	85,000
	1,65,000		**1,65,000**

Calculation of Cash at Bank
Bank Account

Particulars	₹	Particulars	₹
To Balance b/d	Nil	**By Bank Overdraft** (*Balancing figure*)	**29,000**
To Debtors	80,000	By Interest	500
To Cash Sales	45,000	By Drawings	6,000
		By Salaries	20,000
		By Sundry Expenses	18,000
		By Creditors	45,000
		By Balance c/d	
		Bank	5,500
		Cash	1,000
	1,25,000		**1,25,000**

Calculation of capital as on 1.4.2017
Statement of Affairs
As on 1.4.2017

Liabilities	₹	Assets	₹
Creditors	20,000	Debtors	60,000
Bank Overdraft	29,000	Stock	20,000
Capital (*Balancing figure*)	1,01,000	Furniture	10,000
		Building	60,000
	1,50,000		**1,50,000**

Illustration 18: **Trading, Profit and Loss Account and Balance Sheet of a Partnership Firm**

Following are the incomplete records of a Partnership Firm as on 1 April 2017.

Particulars	₹	Particulars	₹
Creditors	44,000	Cash in Hand	200
Bills payable	24,000	Bills receivable	34,000
Bank overdraft	7,000	Debtors	43,000
Outstanding expenses	4,980	Stock	49,000
Capital: Amal	1,20,000	Machinery	72,500
Bimal	80,000	Building	76,300

Cash Book

Particulars	₹	Particulars	₹
To Balance b/d (1.4.2017)	200	By Overdraft (1.4.2017)	7,000
To Cash Received from Debtors	3,00,000	By Salaries	18,000
To Bills Receivable	1,89,000	By Wages	19,200
		By Bills Payable	1,65,000
		By Payment to Creditors	1,56,000
		By Sundry Expenses	10,000
		By Drawings:	
		Amal	45,000
		Bimal	40,000
		By Balance on 31.3.2018	
		Cash in Hand	2,750
		Cash at Bank	26,250
	4,89,200		**4,89,200**

Particulars	₹
Sales	4,95,000
Purchases	3,95,000
Discount to customers	6,000
Discount received from suppliers	4,000
Bills receivable received during the year	1,90,000
Bills payable issued during the year	1,95,000
Closing stock	77,000

Provide Depreciation on machinery and building at the rate of 5% and also provision for doubtful debt @ 5% and prepare Trading and Profit or Loss Account along with the Balance Sheet for the year ended 31 March 2018.

Note: As Cash Sales and Cash Purchases are not mentioned in the cash book. The entire amount of sales and purchases given in the adjustment is treated as Credit Sales and Credit Purchases.

Solution:

Trading and Profit and Loss Account of Partners Amal and Bimal

For the year ended 31.3.2018

Particulars	₹	Particulars	₹
To Opening Stock	49,000	By Sales	4,95,000
To Purchases	3,95,000	By Closing Stock	77,000
To Wages	19,200		
To Gross Profit c/d (*Balancing figure*)	1,08,800		
	5,72,000		**5,72,000**
To Salaries	18,000	By Gross Profit b/d	1,08,800
To Sundry Expenses	10,000	By Discount Received	4,000
To Discount Allowed	6,000		
To Reserve for Doubtful Debts			
54,000 × 5%	2,700		
To Depreciation			
Machinery (72,500 × 5%)	3,625		
Building (76,300 × 5%)	3,815		
To Net Profit:			
Amal 68,680 × $\frac{1}{2}$	34,340		
Bimal 68,680 × $\frac{1}{2}$	34,340		
	1,12,800		**1,12,800**

Balance Sheet

Liabilities		₹	Assets		₹
Creditors		84,000	Cash in Hand		2,750
Bills payable		54,000	Cash at Bank		26,250
Bank Overdraft		7,000	Bills receivable		35,000
Outstanding expenses		4980	Debtors	54,000	
Amal	1,20,000		*Less:* Provision for DD	2,700	51,300
Add: Profit	34,340				
	1,54,340		Closing Stock		77,000
Less: Drawings	45,000	1,09,340	Machinery (72,500 − 3,625)		68,875
Bimal	80,000		Building (76,300 − 3,815)		72,485
Add: Profit	34,340				
	1,14,340				
Less: Drawings	40,000	74,340			
		3,33,660			**3,33,660**

Bills Payable Account

Particulars	₹	Particulars	₹
To Cash	1,65,000	By Balance b/d	24,000
To Balance c/d (*Balancing figure*)	54,000	By Creditors (B/P Issued)	1,95,000
	2,19,000		**2,19,000**

Creditors Account

Particulars	₹	Particulars	₹
To Cash (Paid to creditors)	1,56,000	By Balance b/d	44,000
To Bills Payable	1,95,000	By Credit Purchases	3,95,000
To Discount	4,000		
To Balance c/d (*Balancing figure*)	84,000		
	4,39,000		**4,39,000**

Bills Receivable Account

Particulars	₹	Particulars	₹
To Balance b/d	34,000	By Cash	1,89,000
To Debtors (B/R received)	1,90,000	By Balance c/d (*Balancing figure*)	35,000
	2,24,000		**2,24,000**

Debtors Account

Particulars	₹	Particulars	₹
To Balance b/d	43,000	By Cash (Received from debtors)	3,00,000
To Credit Sales	4,95,000	By Bills Receivable	1,90,000
		By Discount	6,000
		By Balance c/d (*Balancing figure*)	54,000
	5,38,000		**5,38,000**

Illustration 19: **Trading, Profit and Loss Account, Balance Sheet**

A trader of a petty business has maintained all his accounts in Single-entry System of Book-Keeping; he has not maintained any record of opening stock, but his Gross Profit is 25% on sales and Cash Sales for the year amounted to ₹46,000. The following information reveals his position for the year 2017–18. You are required to prepare Trading and Profit and Loss Account along with the Balance Sheet after providing 5% towards reserve for bad and doubtful debts and interest on capital at the rate of 5%.

Particulars	1.4.2017 (₹)	31.3.2018 (₹)
Machinery	34,000	36,000
Debtors	60,000	80,000
Creditors	30,000	50,000
Stock	?	80,000
Cash	10,000	?

Cash Book Summary

Particulars	₹	Particulars	₹
Salaries	6,000	Drawings	6,000
Wages	14,000	Receipt from debtors	1,00,000
Carriage Outwards	4,000	Payment to creditors	60,000
Insurance	2,000	Machinery purchase paid excess	6,000
Sundry expenses	4,000	Interest received	4,000
Domestic expenses	2,000	Cash purchases	16,000
Bad debts	2,000	Return Inward	8,000
Discount allowed	4,000	Return Outward	10,000
Discount received	6,000	Outstanding Income	2,000

Solution:

Trading and Profit and Loss Account

For the year ended 31.3.2018

Particulars		₹	Particulars		₹
To Opening Stock (*Balancing figure*)		89,000	By Sales		
			Credit	1,34,000	
			Cash	46,000	
				1,80,000	
			Less: Returns	8,000	1,72,000
To Purchases			By Closing Stock		80,000
Cash	20,000				
Credit	96,000				
	1,16,000				
Less: Returns	10,000	1,06,000			
To Wages		14,000			
To Gross Profit c/d					
1,72,000 × 25%		43,000			
		2,52,000			**2,52,000**
To Salaries		6,000	By Gross Profit b/d		43,000
To Sundry Expenses		4,000	By Discount Received		6,000
To Discount Allowed		4,000	By Interest Received		4,000
To Insurance		2,000	By Outstanding Income		2,000
To Carriage Outwards		4,000			
To Reserve for Doubtful Debts					
80,000 × 5%		4,000			
To Interest on Capital					
1,63,000 × 5%		8,150			
To Depreciation on Machinery		4,000			
To Net Profit		18,850			
		55,000			**55,000**

Balance Sheet
As on 31.3.2018

Particulars		₹	Particulars	₹
Creditors		50,000	Cash	40,000
Capital	1,63,000		Stock	80,000
Add: Profit	18,850		Sundry Debtors *Less:* Provision for doubtful debt (80,000 − 4,000)	76,000
Add: Interest on Capital	8,150			
	1,90,000		Machinery	36,000
Less: Drawings	6,000			
Domestic Expenses	2,000	1,82,000		
		2,32,000		**2,32,000**

Debtors Account

Particulars	₹	Particulars	₹
To Balance b/d	60,000	By Cash (Received from debtors)	1,00,000
To Credit Sales (*Balancing figure*)	**1,34,000**	By Bad Debts	2,000
		By Discount to Customers	4,000
		By Return Inward	8,000
		By Balance c/d	80,000
	1,94,000		**1,94,000**

Creditors Account

Particulars	₹	Particulars	₹
To Cash (Paid to creditors)	60,000	By Balance b/d	30,000
To Discount from Suppliers	6,000	**By Credit Purchases** (*Balancing figure*)	**96,000**
To Return Outwards	10,000		
To Balance c/d	50,000		
	1,26,000		**1,26,000**

Cash Account

Particulars	₹	Particulars	₹
To Balance b/d	10,000	By Cash Purchases	16,000
To Debtors	1,00,000	By Wages	14,000
To Cash Sales	46,000	By Salaries	6,000
To Interest Received	4,000	By Carriage Outwards	4,000
		By Insurance	2,000
		By Domestic Expenses	2,000
		By Sundry Expenses	4,000
		By Drawings	6,000
		By Creditors	60,000
		By Machinery Purchased	6,000
		By Balance c/d (*Balancing figure*)	**40,000**
	1,60,000		**1,60,000**

Statement of Affairs

As on 1.4.2017

Liabilities	₹	Assets	₹
Creditors	30,000	Debtors	60,000
Capital (*Balancing figure*)	1,63,000	Stock	89,000
		Cash	10,000
		Machinery	34,000
	1,93,000		**1,93,000**

Machinery Account

Particulars	₹	Particulars	₹
To Balance b/d	34,000	By Depreciation (*Balancing figure*)	4,000
To Cash (Additional machinery purchased)	6,000	By Balance c/d	36,000
	40,000		**40,000**

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Illustration 20: Prepare Profit and Loss Account and Balance Sheet as on 31 December 2017 from the given details:

Particulars	1.1.2017 (₹)	31.12.2017 (₹)	Particulars	1.1.2017 (₹)	31.12.2017 (₹)
Fixed assets	90,000	1,00,000	Cash at Bank	11,000	40,000
Stock	70,000	95,000	Debtors	?	1,30,000
Cash in Hand	41,000	24,000	Creditors	60,000	49,000
			Outstanding expenses	5,000	3,000

Other transactions during the year:

Particulars	₹	Particulars	₹
Cash received from debtors	12,15,000	Return Inward	30,000
Paid to creditors by cheque	11,81,000	Return Outward	15,000
Bad Debts	5,000	Sales	15,00,000
Discount Allowed	10,000	Salaries and wages by cheque	90,000
Discount Received	20,000	Miscellaneous cash expenses	25,000
Drawings in cash	47,000	Assets purchased by cheque	10,000
Cash withdrawals from bank	1,05,000	Cash Sales deposited into bank	?
Cash Purchases	50,000		

Solution:

Trading and Profit and Loss Account

For the year ended 31.3.2018

Particulars		₹	Particulars		₹
To Opening Stock		70,000	By Sales		
			Credit	13,00,000	
			Cash	2,00,000	
				15,00,000	
			Less: Returns	30,000	14,70,000
To Purchases			By Closing Stock		95,000
Cash	50,000				
Credit	12,05,000				
	12,55,000				
Less: Returns	15,000	12,40,000			
To Gross Profit c/d (*Balancing figure*)		2,55,000			
		15,65,000			**15,65,000**
To Salaries & Wages		90,000	By Gross Profit b/d		2,55,000
To Miscellaneous Expenses			By Discount Received		20,000
(25,000 + 3,000 − 5,000)		23,000			
To Discount Allowed		10,000			
To Bad Debts		5,000			
To Net Profit (*Balancing figure*)		1,47,000			
		2,75,000			**2,75,000**

Balance Sheet

As on 31.3.2018

Liabilities		₹	Assets	₹
Creditors		49,000	Cash in Hand	24,000
Capital	2,37,000		Cash at Bank	40,000
Add: Net Profit	1,47,000		Debtors	1,30,000
	3,84,000		Stock	95,000
Less: Drawings	47,000	3,37,000	Fixed assets (90,000 + 10,000)	1,00,000
Outstanding expenses		3,000		
		3,89,000		**3,89,000**

Cash and Bank Account

Particulars	Cash (₹)	Bank (₹)	Particulars	Cash (₹)	Bank (₹)
To Balance b/d	41,000	11,000	By Sundry Creditors	–	11,81,000
To Sundry Debtors	–	12,15,000	By Purchases	50,000	–
To Cash Sales (*Balancing figure*)	–	**2,00,000**	By Salaries and Wages	–	90,000
To Bank	1,05,000	–	By Miscellaneous Expenses	25,000	–
			By Drawings	47,000	–
			By Cash		1,05,000
			By Assets (1,00,000 − 90,000)		10,000
			By Balance c/d	24,000	40,000
	1,46,000	**14,26,000**		**1,46,000**	**14,26,000**

Debtors Account

Particulars	₹	Particulars	₹
To Balance b/d (*Balancing figure*)	**90,000**	By Bank	12,15,000
To Credit Sales (Sales − Cash Sales) = (15,00,000 − 2,00,000)	13,00,000	By Discount Allowed	10,000
		By Return Inward	30,000
		By Bad Debts	5,000
		By Balance c/d	1,30,000
	13,90,000		**13,90,000**

Creditors Account

Particulars	₹	Particulars	₹
To Bank	11,81,000	By Balance b/d	60,000
To Discount	20,000	**By Credit Purchases** (*Balancing figure*)	**12,05,000**
To Return Outward	15,000		
To Balance c/d	49,000		
	12,65,000		**12,65,000**

Statement of Affairs

Liabilities	₹	Assets	₹
Creditors	60,000	Cash in Hand	41,000
Outstanding expenses	5,000	Cash at Bank	11,000
Capital (*Balancing figure*)	**2,37,000**	Stock	70,000
		Debtors	90,000
		Fixed assets	90,000
	3,02,000		**3,02,000**

Illustration 21: Mr. Tejas does not maintain proper books of accounts. From the following information, prepare Trading and Profit and Loss Account for the year ended 31 March 2016 and the Balance Sheet as on that date.

Assets and Liabilities	1.4.2015 (₹)	31.3.2016 (₹)
Debtors	18,000	25,000
Stock	9,800	13,200
Furniture	1,000	1,500
Creditors	6,000	4,500
Cash on Hand	5,000	?

Analyses of other transactions are as follows:

Particulars	₹
Cash collected from debtors	60,800
Cash paid to creditors	44,000
Salaries	12,000
Rent	1,500
Office expenses	1,800
Drawings	3,000
Foreign capital introduced	2,000
Cash Sales	1,500
Cash Purchases	5,000
Discount received	700
Discount allowed	300
Return Inward	1,000
Bad Debts	200

[B.U., B.Com., Nov/Dec 2016, Section C]

Solution:

Trading and Profit and Loss Account

For the year ended 31.3.2016

Particulars		₹	Particulars		₹
To Opening Stock		9,800	By Sales		
			Credit	69,300	
			Cash	1,500	
				70,800	
			Less: Returns	1,000	69,800
To Purchases			By Closing Stock		13,200
Credit	43,200				
Cash	5,000	48,200			
To Gross Profit c/d (*Balancing figure*)		25,000			
		83,000			**83,000**
To Salaries		12,000	By Gross Profit b/d		25,000
To Rent		1,500	By Discount Received		700
To Bad Debts		200			
To Discount Allowed		300			
To Office Expenses		1,800			
To Net Profit (*Balancing figure*)		9,900			
		25,700			**25,700**

Balance Sheet
As on 31.3.2015

Liabilities		₹	Assets	₹
Creditors		4,500	Cash	1,500
Capital	27,800		Debtors	25,000
Add: Additional Capital	2,000		Furniture	1,500
Add: Net Profit	9,900		Closing Stock	13,200
Less: Total Drawings	(3,000)	36,700		
		41,200		**41,200**

Debtors Account

Particulars	₹	Particulars	₹
To Balance b/d	18,000	By Cash (Received from debtors)	60,800
To Credit Sales (*Balancing figure*)	**69,300**	By Bad Debts	200
		By Return Inward	1,000
		By Discount Allowed	300
		By Balance c/d	25,000
	87,300		**87,300**

Creditors Account

Particulars	₹	Particulars	₹
To Cash (Paid to creditors)	44,000	By Balance b/d	6,000
To Discount Received	700	**By Credit Purchases** (*Balancing figure*)	**43,200**
To Balance c/d	4,500		
	49,200		**49,200**

Cash Account

Particulars	₹	Particulars	₹
To Balance b/d	5,000	By Creditors	44,000
To Debtors	60,800	By Office Expenses	1,800
To Cash Sales	1,500	By Salaries	12,000
To Additional Capital	2,000	By Rent	1,500
		By Drawings	3,000
		By Cash Purchases	5,000
		By Furniture	500
		By Balance c/d (*Balancing figure*)	**1,500**
	69,300		**69,300**

Statement of Affairs
As on 1.4.2014

Liabilities	₹	Assets	₹
Creditors	6,000	Debtors	18,000
Capital (*Balancing figure*)	**27,800**	Stock	9,800
		Furniture	1,000
		Cash	5,000
	33,800		**33,800**

Illustration 22: Sri Ram, a trader, maintains his books under Single-entry System. He submits the following information.

Particulars	1.4.14 (₹)	31.3.15 (₹)
Cash	20,000	?
Debtors	72,500	80,000
Creditors	62,500	72,500
Furniture	20,000	20,000
Plant and machinery	40,000	38,000
Stock	30,000	42,000

Solution:

Cash transactions during the year 2014–15 are:

Particulars	₹
Cash from debtors	6,20,000
Cash paid to creditors	4,80,000
Wages	24,000
Salaries	16,000
Rent	18,000
Drawing	16,500
Cash Purchase	24,000
Cash Sales	36,000
Carriage Outwards	10,000

Other details:

Bad Debts	₹3,200
Purchase Return	₹6,200
Stock	worth ₹6,000 was utilised by Sri Ram for personal use

Prepare Final Accounts for the year ending 31 March 2015.

[B.U., B.Com., Nov/Dec 2015, Section C]

Solution:

Trading and Profit and Loss Account
For the year ended 31.3.2014

Particulars	₹	Particulars	₹
To Opening Stock	30,000	By Sales	
		Credit 6,30,700	
		Cash 36,000	6,66,700
To Purchases		By Closing Stock	42,000
Credit 4,96,200 24,000		By Drawings – Goods	6,000
Cash 5,20,200			
Less: Purchase Return 6,200	5,14,000		
To Wages	24,000		
To Gross Profit c/d (*Balancing figure*)	1,46,700		
	7,14,700		**7,14,700**
To Salaries	16,000	By Gross Profit b/d	1,46,700
To Rent	18,000		
To Carriage Outwards	10,000		
To Bad Debts	3,200		
To Depreciation on Machinery	2,000		
To Net Profit (*Balancing figure*)	97,500		
	1,46,700		**1,46,700**

Balance Sheet
As on 31.3.2015

Liabilities	₹	Assets	₹
Creditors	72,500	Cash	87,500
Capital 1,20,000		Debtors	80,000
Add: Profit 97,500		Furniture	20,000
Less: Total Drawings 22,500 (16,500 + 6,000)	1,95,000		
		Plant and machinery	38,000
		Closing Stock	42,000
	2,67,500		**2,67,500**

Debtors Account

Particulars	₹	Particulars	₹
To Balance b/d	72,500	By Cash (Received from debtors)	6,20,000
To Credit Sales (*Balancing figure*)	6,30,700	By Bad Debts	3,200
		By Balance c/d	80,000
	7,03,200		**7,03,200**

Creditors Account

Particulars	₹	Particulars	₹
To Cash (Paid to creditors)	4,80,000	By Balance b/d	62,500
To Purchase Returns	6,200	**By Credit Purchases** (*Balancing figure*)	**4,96,200**
To Balance c/d	72,500		
	5,58,700		**5,58,700**

Cash Account

Particulars	₹	Particulars	₹
To Balance b/d	20,000	By Creditors	4,80,000
To Debtors	6,20,000	By Wages	24,000
To Cash Sales	36,000	By Salaries	16,000
		By Rent	18,000
		By Drawings	16,500
		By Cash Purchases	24,000
		By Carriage Outwards	10,000
		By Balance c/d (*Balancing figure*)	**87,500**
	6,76,000		**6,76,000**

Statement of Affairs
As on 1.4.2014

Liabilities	₹	Assets	₹
Creditors	62,500	Debtors	72,500
Capital (*Balancing figure*)	**1,20,000**	Stock	30,000
		Furniture	20,000
		Machinery	40,000
		Cash	20,000
	1,82,500		**1,82,500**

Illustration 23: Mr. Mohan Das keeps his books by Single-entry System. From the following data, prepare Trading and Profit and Loss Account for the year ended 31 March 2014 together with Balance Sheet on that date.

Cash book analysis shows the following:

Particulars	₹	Particulars	₹
Interest	200	Bank Balance as on 31.3.2014	4,850
Drawings	4,000	Cash on Hand 31.3.2014	150
Salaries	17,000	Received from debtors	50,000
Sundry expenses	15,800	Cash Sales	30,000
Paid to creditors	30,000		

Additional information:

Particulars	1.4.2013	31.3.2014
Stock	18,000	20,440
Creditors	16,000	11,000
Debtors	44,000	60,000
Furniture	2,000	2,000
Building	30,000	30,000

Provide 5% interest on Mohan Das's interest on Capital as on 1 April 2013. Provide ₹3,000 for doubtful debts and 5% Depreciation on all fixed assets.

[B.U., B.Com., Nov/Dec 2014, Section C]

Solution:

Trading and Profit and Loss Account

For the year ended 31.3.2014

Particulars	₹	Particulars		₹
To Opening Stock	18,000	By Sales		
		Credit	66,000	
		Cash	30,000	96,000
To Purchases (Credit)	25,000	By Closing Stock		20,440
To Gross Profit c/d (*Balancing figure*)	73,440			
	1,16,440			**1,16,440**
To Salaries	17,000	By Gross Profit b/d		73,440
To Interest Charges	200			
To Business Expenses	15,800			
To Interest on Capital (70,000 × 5%)	3,500			
To Provision for Doubtful Debts	3,000			
To Depreciation on Furniture (2,000×5%)	100			
To Depreciation on Building (30,000×5%)	1,500			
To Net Profit (*Balancing figure*)	32,340			
	73,440			**73,440**

Balance Sheet

As on 31.3.2014

Liabilities		₹	Assets	₹
Creditors		11,000	Cash	4,850
Capital	70,000		Bank	150
Add: Profit	32,340		Sundry debtors *Less:* Provision for doubtful debt (60,000 − 3,000)	57,000
Add: Interest on Capital	3,500			
	1,05,840		Stock	20,440
Less: Drawings	4,000	1,01,840	Furniture *Less:* Depreciation (2,000 − 100)	1,900
			Machinery *Less:* Depreciation (30,000 − 1,500)	28,500
		1,12,840		**1,12,840**

Debtors Account

Particulars	₹	Particulars	₹
To Balance b/d	44,000	By Cash (Received from debtors)	50,000
To Credit Sales (*Balancing figure*)	66,000	By Balance c/d	60,000
	1,10,000		**1,10,000**

Creditors Account

Particulars	₹	Particulars	₹
To Cash (Paid to creditors)	30,000	By Balance b/d	16,000
To Balance c/d	11,000	**By Credit Purchases** (*Balancing figure*)	25,000
	41,000		**41,000**

Cash Account

Particulars	₹	Particulars		₹
To Balance b/d	Nil	**By Bank Overdraft** (*Balancing figure*)		8,000
To Debtors	50,000	By Interest Charge		200
To Cash Sales	30,000	By Drawings		4,000
		By Staff Salaries		17,000
		By Business Expenses		15,800
		By Creditors (Payment to creditors)		30,000
		By Balance c/d		
		Bank	4,850	
		Cash	150	5,000
	80,000			**80,000**

Statement of Affairs
As on 1.4.2013

Liabilities	₹	Assets	₹
Creditors	16,000	Debtors	44,000
Bank Overdraft	8,000	Stock	18,000
Capital (*Balancing figure*)	**70,000**	Furniture	2,000
		Machinery	30,000
	94,000		**94,000**

Illustration 24: On 31 March 2013, a fire occurred in the business premises of Mr. Nair and the records were destroyed. But the Balance Sheet as on 31 March 2012 was available from which the following details were obtained.

Fixed assets ₹75,000, Stock ₹71,250, Debtors ₹8,000, Bank ₹3,00,000, Cash ₹26,500, Creditors ₹32,000.

Summary of bank statement is as follows: cheques deposited ₹6,50,000, payments – Rent and Rates ₹29,500, Drawing ₹25,000, Creditors ₹7,00,000.

From the records available, the following balances are ascertained as at 31 March 2013, Creditors ₹85,000, Outstanding rent ₹4,800, Prepaid rates ₹2,500, Debtors ₹45,000, Cash ₹12,500, Bank ₹1,73,500.

According to Nair his details of expenses in cash is as follows: general expenses ₹500 per month, salaries ₹2,500 per month. Goods were always sold on credit and at 25% above the cost price. Depreciate fixed assets by 10%.

Insurance company agreed to pay ₹2,70,000 for stock and ₹65,000 for fixed assets. From the information available, prepare the Trading and Profit and Loss Account and Balance Sheet of Nair as on 31 March 2013.

[B.U., B.Com., Nov/Dec 2013, Section C]

Solution:

Trading and Profit and Loss Account

For the year ended 31.3.2013

Particulars	₹	Particulars	₹
To Opening Stock	71,250	By Sales	6,87,000
To Purchases (Credit)	7,53,000	By Stock Destroyed by Fire (*Balancing figure*)	2,74,650
To Gross Profit c/d (20% on sales)	1,37,400		
	9,61,650		**9,61,650**
To Loss of Stock Destroyed by Fire (2,74,650 − 2,70,000 insurance claim)	4,650	By Gross Profit b/d	1,37,400
To General Expenses (500 × 12)	6,000		
To Salaries (2500 × 12)	30,000		
To Rent and Rates 29,500 *Add:* Outstanding rent 4,800 34,300 *Less:* Prepaid rent 2,500	31,800		
To Depreciation on Fixed Assets (75,000 × 10%)	7,500		
To Loss on Sale of Fixed Assets (Opening balance − depreciation − insurance claim) (75,000 − 7,500 − 65,000)	2,500		
To Net Profit (*Balancing figure*)	54,950		
	1,37,400		**1,37,400**

Balance Sheet

As on 31.12.2006

Liabilities		₹	Assets	₹
Creditors		85,000	Cash	12,500
Opening Balance	4,48,750		Bank	1,73,500
Add: Net Profit	54,950		Debtors	45,000
	5,03,700		Claim Receivable (2,70,000 + 65,000)	3,35,000
Less: Drawings	25,000	4,78,700		
Outstanding Rent		4,800	Prepaid expenses	2,500
		5,68,500		**5,68,500**

Debtors Account

Particulars	₹	Particulars	₹
To Balance b/d	8,000	By Cash (Received from debtors)	6,50,000
To Credit Sales (*Balancing figure*)	6,87,000	By Balance c/d	45,000
	6,95,000		**6,95,000**

Creditors Account

Particulars	₹	Particulars	₹
To Cash (Paid to creditors)	7,00,000	By Balance b/d	32,000
To Balance c/d	85,000	**By Credit Purchases** (*Balancing figure*)	7,53,000
	7,85,000		**7,85,000**

Bank Account

Particulars	₹	Particulars	₹
To Balance b/d	3,00,000	By Rent and Rates	29,500
To Debtors	6,50,000	By Drawings	25,000
		By Creditors (Payment to creditors)	7,00,000
		By Cash A/c (*Balancing figure*)	**22,000**
		By Balance c/d	1,73,500
	9,50,000		**9,50,000**

Statement of Affairs

As on 31.3.2012

Liabilities	₹	Assets	₹
Creditors	32,000	Cash	26,500
Capital (*Balancing figure*)	**4,48,750**	Bank	3,00,000
		Debtors	8,000
		Stock	71,250
		Fixed assets	75,000
	4,80,750		**4,80,750**

Illustration 25: The following is the position of Mr. H. on 1 January 2006.

Balance Sheet
As on 1.1.2006

Liabilities	₹	Assets	₹
Creditors	75,000	Furniture	20,000
Capital	80,000	Debtors	90,000
		Stock	40,000
		Bank	5,000
	1,55,000		**1,55,000**

His bank transactions during the year were:

Particulars	₹
Receipt from customers	3,50,000
Drawings for personal expenses	60,000
Payment of salaries	30,000
Payment of creditors	2,20,000
Payment of rent	15,000
Miscellaneous expenses	4,000

On 31 December 2006, debtors stood at ₹95,000 and creditors at ₹64,000. No inventory of stock was taken on 31 December 2006. But the Gross Profit was estimated at 50% on sales made during the year.

Prepare P/L Account for the year and Balance Sheet on 31 December 2006.

[B.U., B.Com., Nov/Dec 2012, Section C]

Solution:

Trading and Profit and Loss Account
For the year ended 31.12.2006

Particulars	₹	Particulars	₹
To Opening Stock	40,000	By Credit Sales	3,55,000
To Purchases (Credit)	2,09,000	By Closing Stock (*Balancing figure*)	71,500
To Gross Profit c/d	1,77,500		
(50% on sales)			
	4,26,500		**4,26,500**
To Salaries	30,000	By Gross Profit b/d	1,77,500
To Rent	15,000		
To Miscellaneous Expenses	4,000		
To Net Profit (*Balancing figure*)	1,28,500		
	1,77,500		**1,77,500**

Balance Sheet
As on 31.12.2006

Liabilities		₹	Assets	₹
Creditors		64,000	Furniture	20,000
Capital	80,000		Debtors	95,000
Add: Profit	1,28,500		Stock	71,500
	2,08,500		**Bank** (*Balancing figure*)	26,000
Less: Drawings	60,000	1,48,500		
		2,12,500		**2,12,500**

Debtors Account

Particulars	₹	Particulars	₹
To Balance b/d	90,000	By Cash (Received from debtors)	3,50,000
To Credit Sales (*Balancing figure*)	3,55,000	By Balance c/d	95,000
	4,45,000		**4,45,000**

Creditors Account

Particulars	₹	Particulars	₹
To Cash (Paid to creditors)	2,20,000	By Balance b/d	75,000
To Balance c/d	64,000	By Credit Purchases (*Balancing figure*)	2,09,000
	2,84,000		**2,84,000**

2

Cash Account

Particulars	₹	Particulars	₹
To Balance b/d	5,000	By Rent	15,000
To Debtors	3,50,000	By Drawings	60,000
		By Staff Salaries	30,000
		By Miscellaneous Expenses	4,000
		By Creditors (Payment to Creditors)	2,20,000
		By Balance c/d (*Balancing figure*)	26,000
	3,55,000		**3,55,000**

Statement of Affairs

As on 1.1.2006

Liabilities	₹	Assets	₹
Creditors	75,000	Debtors	90,000
Capital (*Balancing figure*)	**80,000**	Stock	40,000
		Furniture	20,000
		Bank	5,000
	1,55,000		**1,55,000**

Illustration 26: Shivaprakash has kept his books under Single-entry System and asks you to prepare a statement showing his profit for the year ended 31 December 2009 and a revised Statement of Affairs as on that date. His financial position was as follows:

Particulars	1.1.2009 (₹)	31.12.2009 (₹)
Sundry creditors	5,500	12,500
Bank Overdraft	6,000	–
Furniture	4,000	4,000
Loose tools	1,500	1,500
Stock in trade	12,000	15,000
Sundry debtors	9,000	11,000
Cash at bank	–	1,000
Investments in 12% debentures (on 1.7.2009)	–	5,000

During the year Shivaprakash's drawings amounted to ₹8,000. Depreciate furniture by 10% and loose tools by ₹500.

[B.U., B.Com., Nov/Dec 2010, Section B]

Solution:

Statement of Affairs

As on 1.1.2009 and 31.12.2009

Liabilities	1.1.2009 (₹)	31.12.2009 (₹)	Assets	1.1.2009 (₹)	31.12.2009 (₹)
Creditors	5,500	12,500	Loose tools	1,500	1,500
Bank overdraft	6,000	–	Furniture	4,000	4,000
Capital (*Balancing figure*)	15,000	25,000	Investments in 12% debentures (1.7.2009)	–	5,000
			Stock	12,000	15,000
			Debtors	9,000	11,000
			Cash at Bank	–	1,000
	26,500	**37,500**		**26,500**	**37,500**

Profit or Loss Account

As on 31.12.2009

Particulars	₹
Closing capital	25,000
Add: Drawings	8,000
	33,000
Less: Opening Capital	15,000
Gross Profit	18,000
Less: Expenses: Depreciation on furniture	400
Depreciation on loose tools	500
Interest on 12% Debentures $\left(5{,}000 \times \frac{12}{100} \times \frac{6}{12}\right)$	300
Net Profit	**16,800**

Revised Statement of Affairs

As on 1.1.2009 and 31.12.2009

Liabilities	31.12.2009 (₹)	Assets	31.12.2009 (₹)
Creditors	12,500	Loose tools (1,500 − 500)	1,000
Capital (15,000 + 16,800 − 8,000) Opening Capital + Net Profit − Drawings)	23,800	Furniture (4,000 − 400)	3,600
		Investments in 12% Debentures (1.7.2009) (5,000 − 300)	4,700
		Stock	15,000
		Debtors	11,000
		Cash at Bank	1,000
	36,300		**36,300**

Summary

- As per Single-entry System of Book-Keeping only personal accounts of the debtors and creditors are maintained, but the impersonal accounts (real and nominal accounts) are not maintained; due to this the Profit and Loss Account and Balance Sheet prepared are incomplete and unreliable.
- There are three different methods in which books are maintained under the Single-entry System of Book-Keeping, namely:
    1. Pure Single-entry System
    2. Simple Single-entry System
    3. Quasi Single-entry System
- This system of accounting and Book-Keeping suits small business organisations, in which the numbers of transactions are very limited; large business concerns cannot adopt this system of accounting.
- It is a system of maintaining books of accounts and business transaction in an unscientific and incomplete manner.
- This system maintains only personal accounts of debtors and creditors, but not the real and nominal accounts.
- Advantages of Single-entry System are that it is very elaborate, easy to understand, less complicated and easy to maintain. Single-entry System is suitable for petty business organisations that have only a few transactions to record.

(Contd.)

- Disadvantages of Single-entry System are that this system does not take two-fold aspects of a transaction into account; due to this trail balance cannot be prepared. This system also does not facilitate comparison, because the reasons for the difference in the results cannot be ascertained due to incomplete recording of transactions.
- Differences between Single-entry and Double-entry System are: Single-entry System records only one aspect of the transaction in most of the cases, whereas, Double-entry System records two-fold aspect of the transactions. The Single-entry System maintains incomplete record of financial transactions, whereas Double-entry System maintains complete record of transactions.
- In order under the financial position of the firm, a statement showing various assets and liabilities on a particular date for a particular period is prepared; this statement is termed *Statement of Affairs*.
- The differences between Statement of Affairs and Balance Sheet are: Single-entry System is prepared under Single-entry System of Book-Keeping, whereas, Balance Sheet is prepared under Double-entry System of Book-Keeping. Statement of Affairs is prepared to ascertain the capital balances on a particular date. Whereas, Balance Sheet is prepared to know the financial position of the firm.
- There is a need of converting Single-entry System into Double-entry System of Book-Keeping ensuring the accounts are complete. For this purpose, the following steps are to be performed under *Conversion Method*:
  1. *Preparation of statements and accounts with an object to ascertain missing information*
  2. *Preparation of Trading, Profit or Loss Account and Balance Sheet*
  3. *Preparation of Statement of Affairs Method/Net Worth Method/Capital Comparison Method.*

2

Review Questions

Section A (2 Marks)

1. Define Single-entry System. **[B.U., B.Com., Nov/Dec 2016]**
2. Explain the term Single-entry System.
3. Write any four features of Single-entry System.
4. Mention the types of Single-entry System.
5. Write any four advantages of Single-entry System.
6. Mention any four disadvantages of Single-entry System.
7. Give any two advantages of converting the books of accounts from Single-entry System to Double-entry System. **[B.U., B.Com., Nov/Dec 2015, 2012]**
8. What are the differences between Single-entry System and Double-entry System?
9. What are the methods of ascertaining profit or loss under Single-entry System?
10. What do you mean by Statement of Affairs method?

11. What do you understand by conversion method?
12. How do you ascertain the value of credit sales?
13. How do you ascertain the value of Credit Purchases?
14. Write any two differences between Statement of Affairs and Balance Sheet.
[B.U., B.Com., Nov/Dec 2013]
15. Write down the proforma of Statement of Affairs.
16. Write down the proforma of Total Debtors Account.
17. Write down the proforma of Total Creditors Account.
18. Write down the bills receivable proforma. **[B.U., B.Com., Nov/Dec 2012]**
19. Write down the bills payables proforma.

Section B (8 Marks)

1. What do you mean by Single-entry System? Explain the different types of Single-entry System.
2. Explain the advantages and disadvantages of Single-entry System.
[B.U., B.Com., Nov/Dec 2005, 2016]
3. Briefly explain the features of Single-entry System.
4. Distinguish between Single-entry System and Double-entry Systems. **[B.U., B.Com., Nov/Dec 2014]**
5. Write the steps involved in ascertainment of profits under Single-entry System.
6. Briefly explain the different methods of converting Single-entry System into Double-entry System.
7. What is Statement of Affairs? How is it different from Balance Sheet?
[B.U., B.Com., Nov/Dec 2013]
8. What are the steps involved in conversion of Single-entry System into Double-entry System under conversion method?
9. Write down the proforma for Total Debtors Account and Bills Receivable Account.
[B.U., B.Com., Nov/Dec 2012]
10. Write down the proforma for Total Creditors Account and Bills Payable Account.
11. Give a specimen of Cash Account.
12. Write a specimen of Statement of Affairs Account with imaginary figures.

Section C (14 Marks)

1. From the following information, calculate total sales.

Particulars	₹
Cash Sales	81,400
Debtors at the end	53,500
Bills receivable at the end	13,800
Bills receivable dishonoured	3,200
Returns Inward	17,000
Bad debts written off	5,500
Cash received for debtors	1,32,000
Bills receivable endorsed during the year	41,250
Debtors in the beginning	65,750
Bills receivable in the beginning	16,200

(Ans: Total Sales ₹2,20,450; Credit Sales ₹1,39,050)

2. From the following particulars =, ascertain the amount of credit sales and Credit Purchases for the year ended 31 March 2017.

Particulars	₹
Opening Bills Receivable	60,000
Closing Bills Receivable	1,80,000
Opening Bills Payable	1,40,000
Closing Bills Payable	1,00,000
Closing Sundry Debtors	9,80,000
Closing Sundry Creditors	9,20,000
Opening Sundry Debtors	8,00,000
Opening Sundry Creditors	4,00,000
Cash received from customers	14,50,000
Cash paid to creditors	5,60,000
Received for bills receivable	80,000
Bills Payable Net	1,20,000
Discount allowed to customers	20,000
Discount Earned	10,000
Bad Debts	30,000
Sales Return	60,000
Purchase Return	80,000

(Ans: Credit Sales ₹19,40,000; Credit Purchases ₹12,50,000)

3. From the particulars supplied by Mr. Sunder, you are required to calculate Statement of Profit or Loss.

Particulars	Opening Balances (₹)	Closing Balances (₹)
Cash	4,000	3,000
Bank	10,000	5,000 (Overdraft)
Debtors	80,000	75,000
Stock	30,000	28,000
Creditors	42,000	37,000
Machinery	10,000	15,000
Furniture	1,000	1,000

Drawings by the proprietor were at the rate of ₹750 per month. He had also introduced fresh capital into the business of ₹3,000

(Ans: Loss ₹7,000; Capital on 1.1.2017 ₹93,000 and as on 31.12.2017 ₹83,000)

4. The books of Mr. Chetan are maintained under Single-entry System. Prepare Trading and Profit or Loss Account:

Particulars	1.1.2017 (₹)	31.12.2017 (₹)
Building	10,000	10,000
Debtors	96,200	?
Creditors	?	40,000
Stock	40,000	50,000
Cash	16,800	49,900

Cash Book summary

Particulars	₹
Receipts from debtors	2,72,000
Dividend received from investment	4,000
Expenses	39,300
Drawing	9,200
Paid to creditors	2,24,000
Discount allowed by them	2,400

Total sales were ₹2,80,800; Gross Profit was maintained at 25% on sales.

(Ans: Closing Debtors ₹75,400, Credit Sales ₹2,51,200, Creditors ₹45,000, Credit Purchases ₹2,20,600, Cash Sales ₹29,600, Capital ₹1,17,200; Gross Profit ₹70,200; Profit ₹33,300 and Balance Sheet ₹1,85,300)

5. Ashish, a retailer, provides you the following information. Prepare Trading and Profit and Loss Account for the year ended 31 March 2018 and Balance Sheet as at that date.

Particulars	1.4.2017 (₹)	31.3.2018 (₹)
Cash	4,000	?
Machinery	18,000	18,000
Stock	8,000	7,000
Debtors	2,000	3,000
Creditors	5,000	4,660

Cash book for the year ended showed the following:

Particulars	₹
Wages	6,000
Sundry expenses	2,500
Advertising	1,120
Rent and rates	2,500
Carriage Inwards	2,460
Cash received form debtors	82,500
Cash paid to creditors	64,340
Drawings	3,120

Ashish drew goods worth ₹780 from his business for his own consumption. Purchase Returns and Sales Returns for the year amounted to ₹2,000 and 1,000, respectively. Depreciate machinery by 5%.

(Ans: Gross Profit ₹73,440, Net Profit ₹33,440, Balance Sheet ₹1,14,340)

6. Mr. Naresh started his business on 1 April 2017 with ₹15,000 of his own and ₹10,000 borrowed from his friend. He purchased a building for ₹10,000, furniture for ₹2,000, machinery for ₹8,000 and deposited ₹2,500 in a bank as Fixed Deposits at 10% interest. The balance cash was retained as working capital. The following is the cash transaction during the year.

Particulars	₹
Collection from debtors	15,000
Cash Sales	20,000
Cash Purchases	10,000
Payment to creditors	6,000
Purchase of motor cycle	3,000
Purchase of cycle for his son	500
Salary	1,500
Business expenses	2,000

His friend's loan was repaid together with interest @ 6% on 31 March 2018.

On 31 March 2018, his position was as follows:

Particulars	₹
Debtors	12,500
Creditors	17,500
Bills Receivable	5,000
Bills Payable	2,500

There was no record of closing stock, but the usual trend is that Gross Profit is always at the rate of 50% on sales. During the year, Purchases Returns were ₹1,000, Sales Returns were ₹2,000, bad debts ₹500, outstanding salaries ₹250 and prepaid expenses were ₹50. Prepare final accounts.

(Ans: Gross Profit ₹10,820, Net Profit ₹3,800, Balance Sheet ₹31,560)

7. Mr. Ankit carries on a small business, but he does not maintain a complete set of books of accounts; all his payments and receipts are by way of cheque. The following are the particulars obtained from his record.

   Receipts and payments for the year ended 31 December 2018

Receipts	₹	Payments	₹
Cash from debtors	32,250	Furniture	1,250
Cash sales	8,250	Drawings	3,000
Additional capital	5,000	Wages	13,450
		Salaries	2,650
		Rent	2,400
		Sundry expenses	5,200
		Paid to creditors	15,250

Assets and Liabilities	1.1.2017 (₹)	31.12.2018 (₹)
Furniture	15,000	15,500
Debtors	7,500	12,250
Stock	12,500	6,250
Sales Returns	4,000	–
Bills receivable dishonoured during the year	100	–
Bank	1,250	?
Sundry creditors	5,050	4,800
Reserve for doubtful debts	500	–

From the particulars mentioned before, prepare Trading and Profit and Loss Account for the year ended 31 December 2018 and the Balance Sheet as on that date.

(Ans: Gross Profit ₹26,500, Net Profit ₹21,950, Balance Sheet ₹53,700)

8. Mr. Shivam commenced business as cloth merchant on 1 January 2017 with a capital of ₹2,000, on the same day; he purchased furniture for ₹600. The books are maintained by Single-entry System. From the following particulars, prepare Trading and Profit and Loss Account for the year ending 31 December 2017 and a Balance Sheet as on that date.

Particulars	₹
Sales (including cash sales of ₹1,400)	3,400
Purchases (including Cash Purchases of ₹800)	3,000
Shivam's drawings	240
Salaries	400
Bad debts written off	100
Business expenses	140
Closing stock	1,300
Closing debtors	1,040
Closing creditors	720

Mr. Shivam took cloth costing ₹100 from the shop for private use, paid ₹40 cash to his son, but omitted to record these transactions in his books. Provide Depreciation on furniture at 10% per annum.

(Ans: Gross Profit ₹10,550, Net Loss ₹950, Balance Sheet ₹37,050)

9. On 31 March 2018, a fire occurred in the business premises of Mr. Goutam and the records were destroyed. But the Balance Sheet as on 31 March 2017 was available from which the following details were obtained.

Particulars	₹
Fixed assets	75,000
Stock	71,250
Debtors	8,000
Bank	3,00,000
Cash	26,500
Creditors	32,000

Summary of bank statement is as follows:

Particulars	₹
Cheques deposited	6,50,000
Rent	29,500
Drawings	25,000
Creditors	7,00,000

From the records available, the following balances are ascertained as at 31 March 2018.

Particulars	₹
Creditors	85,000
Outstanding rent	4,800
Prepaid rates	2,500
Debtors	45,000
Cash	12,500
Bank	1,73,500

According to Mr. Goutam, his detail of expenses in cash is as follows:

General expenses ₹500 per month

Salaries ₹2,500 per month

Goods were always sold on credit and at 25% above the cost price. Depreciate fixed assets by 10%.

Insurance company agreed to pay ₹2,70,000 for stock and ₹65,000 for fixed assets. From the information available, prepare the Trading and Profit and Loss Account and Balance Sheet of Mr. Goutam as on 31 December 2018.

(Ans: Gross Profit ₹1,800, Net Profit ₹1,100, Balance Sheet ₹3,440)

10. Jai Chand does not maintain regular books but only keeps records of his transactions. He furnishes the following information for the year ended 30 September 2017.

Debtors collection in cash ₹1,50,000

Cash Sales ₹96,000

Abstract of Bank Account

As on 30.09.2017

Particulars	₹	Particulars	₹
To Cash Deposited out of collections	2,93,550	By Overdraft as on 1.10.2016	24,000
		By Interest and Bank Charges	450
		By Drawings	12,000
		By Salaries	51,000
		By General Expenses	47,550
		By Payment to Creditors	90,000
		By Balance as on 30.9.2017	14,550
	2,93,550		2,93,550

Other balances as on 1 October 2016 are as follows:

Particulars	₹
Stock	54,000
Debtors	1,32,000
Furniture	6,000
Building	90,000
Creditors	48,000
Cash in Hand	500

He purchased an old scooter for ₹6,000 on 1 July 2017. Besides the cash balances with the cashier, the following are the other balances as on 30 September 2017.

Particulars	₹
Stock	61,200
Debtors	1,80,000
Creditors	33,000

Prepare Trading and Profit and Loss Account for the year ended 30 September 2017 and the Balance Sheet as on that date after providing for Depreciation at 10% p.a. on all fixed assets.

(Ans: Gross Profit ₹137,400, Net Profit ₹54,950, Balance Sheet ₹5,68,500)

11. The following information is obtained from the books of Rajan Ltd. who maintained the same under Single-entry System.

Receipts	₹	Payments	₹
Cash received from debtors	1,76,250	New plant bought	6,250
Cash Sales	41,250	Drawings	15,000
Additional capital by Mr. Rajan	25,000	Salaries	11,250
		Wages	67,250
		Interest Paid	750
		Rent Paid	13,250
		Light and power	4,750
		Sundry Expenses	21,250
		Sundry Creditors	76,250

Mr. Rajan banks all receipts and makes all payments by means of cheques.

Assets and Liabilities	1.1.2017	31.3.2017
Creditors	25,250	24,000
Debtors	37,500	61,250
Bank	6,250	?
Stock	62,500	31,250
Plant	75,000	73,150

Prepare Trading and Profit and Loss and Balance Sheet.

(Ans: Gross Profit ₹2,26,200, Net Profit ₹1,17,450, Balance Sheet ₹3,48,950)

12. The following is the statement of Mr. Nagpal as on 31 December 2016.

Liabilities	₹	Assets	₹
Trade Creditors	45,400	Cash at Bank	32,500
Expenses Payable	3,000	Cash in Hand	1,000
Capital	1,92,200	Trade Debtors	73,600
		Stock	91,000
		Furniture	42,500
	2,40,600		**2,40,600**

Mr. Nagpal has kept incomplete records, but he informs you that on 31 December 2017, his trade debtors (including bad debts ₹3,500) were ₹82,500, whereas he owed for goods ₹52,600 and for expenses ₹3,700. He estimates the value of stock at ₹92,600 and that of furniture at ₹40,000. Analysis of his bank pay-in book and passbook shows the following:

Paid into bank: Cash Sales ₹67,300; received from credit customers ₹3,26,500; sales of personal saving certificate ₹3,500; drawn from bank for goods ₹2,16,000; business expenses ₹83,500; for self ₹46,000, income tax ₹12,300. In addition, he states that cash taking ₹12,500 has not been banked. He paid cash for petty business expenses ₹8,100 and ₹3,800 for Cash Purchases.

Prepare Trading and Profit and Loss Account for the year ended 31 December 2017 and a Balance Sheet on that date showing full working.

(Ans: Gross Profit ₹63,000, Net Profit ₹8,400, Balance Sheet ₹1,98,400)

13. Manju does not maintain regular accounts. From the following information provided by him, prepare Trading and Profit and Loss Account for the year ended 31 March 2017 and also a Balance Sheet as on that date.

Balances as on 1 April 2016

Particulars	₹	Particulars	₹
Cash in Hand	4,000	Debtors	23,000
Cash at Bank	28,000	Stock	35,000
Creditors	15,000	Fixed Assets	20,000

During the year, creditors were paid ₹26,000 in cash and ₹1,55,000 by cheques. The balances on 31 March 2017 were debtors ₹27,000 and creditors ₹35,000.

All expenses chargeable to Profit and Loss Account were disbursed by cheques except petty expenses amounting to ₹7,500 paid in cash. Outstanding expenses at close were ₹2,000. Closing stock on 31 March 2017 was ₹75,000. Net Profit for the year was ₹41,000 after allowing 10% Depreciation on fixed assets. Manju's drawings during the year were ₹10,000 in cash and ₹14,000 by cheques.

(Ans: Gross Profit ₹1,89,800, Net Profit ₹91,500, Balance Sheet ₹2,85,200)

14. Mr. Keshav keeps his books under Single-entry System. He gives the following details.

Balance Sheet as on 1 January 2017:

Liabilities	₹	Assets	₹
Creditors	18,000	Debtors	10,000
Bills payable	1,800	Stock	15,000
Keshav's Capital	44,700	Plant	20,000
		Building	16,000
		Cash	1,000
		Bills receivable	500
		Furniture	2,000

Cash transactions for the year

Particulars	₹	Particulars	₹
Opening balance	1,000	Bills payable	1,000
Received from debtors	30,200	Paid to creditors	17,800
Cash Sales	10,000	Cash Purchases	2,000
Bills receivables	300	Office expenses	11,500
		Wages	5,000
		Carriages Inward	1,500
		Taxes	500
		Salaries	1,200
		Printing	800
		Drawings	8,000
		Closing balances	2,200

Summary of other transactions

Particulars	₹	Particulars	₹
Credit Sales	45,500	Returns Outwards	500
Discount allowed	500	Bills receivable received	700
Credit Purchases	20,000	Bad debts	400
Discount received	1,000	Bills payable accepted	2,000
Returns Inwards	600	Stock on Hand 31.12.2017	20,500

Provide 5% reserve for doubtful debts and depreciate plant and machinery by 10% and building by 5%. You are required to prepare Trading and Profit and Loss Account for the year ended 31.12.2017 and the Balance Sheet as on that date.

(Ans: Gross Profit ₹88,000, Net Profit ₹41,000, Balance Sheet ₹1,49,000)

3

Hire-Purchase System

Chapter Outline

Review Questions

- **Section A (2 Marks)**
- **Section B (8 Marks)**
- **Section C (14 Marks)**

3.1 INTRODUCTION

In the current scenario, business has become very competitive and challenging for the houses to retain their customers, as the customers have a wide range of options available in terms of products and services as well as sellers. Every seller is engaged in adopting different policies and strategies to retain their customers and to keep them contented; hence, sellers are forced to sell their products or services either on cash or credit basis. If goods are sold on credit basis, the terms agreed between the buyer and the seller could be lump sum payment on a mutually agreed upon future date or in installments spread over a specified period of time. If goods are sold by the seller to the buyer on credit basis and the payment for the same is agreed to be settled by the buyer in installments over a specified period of time, it is termed as 'hire-purchase system' or 'installment-purchase system'.

Under Hire-Purchase arrangement, the buyer of the assets acquires the lawful right to use the asset for a specific agreed period in return for hire rentals. At the end of the Hire-Purchase period, the user of the assets can exercise an option of either owning the asset or leasing the same. Therefore, under this system, the transaction may result in purchasing or hiring of goods by the purchaser, hence, it is conceptually termed as 'hire-purchase system'.

3.2 MEANING OF HIRE-PURCHASE SYSTEM

It is a system wherein a buyer of goods or asset acquires the right to use the asset but not the ownership, the ownership remains with the Hire Vendor (seller). Under such type of contract, the lawful right is acquired by the Hire Purchaser (buyer) on payment of initial deposit [down payment (DP)], and the remaining balance amount is agreed to be paid in annual installment over the agreed period of time. The ownership will be passed on to the buyer only on the settlement of final installment. Furthermore, if the buyer fails to pay any of the installments, the seller has the right to repossess the asset and the money paid by the buyer on earlier installments will be accounted as 'Hire Charges'.

3.3 DEFINITION OF HIRE-PURCHASE SYSTEM

Under the hire-purchase system, goods are delivered to a person who agrees to pay the owner by equal periodical installments; such installments are to be treated as hire of these goods until a certain fixed amount has been paid, when these goods become the property of the hirer. – **J.R. Batliboi**

Under the hire-purchase system, goods are delivered to the buyer (called the "Hire Purchaser") in return for his undertaking to pay agreed amounts at specified intervals for a certain period, and on the understanding that at the end of that period when the payments are completed, the goods become his absolute property. – **B.G. Vickery**

By hire purchase, it is meant to be the system under which property or a Chattel is acquired by payments made in installments, during the period of which title in the property remains with the hire vendor. The payments made till the final installment is regarded as being purely in respect of hire, and the title in the property does not pass to the hire purchaser until such final payment or some other consideration provided for in the contract has been fulfilled. – **Pickles**

3.4 FEATURES OF HIRE-PURCHASE SYSTEM

The following are the important characteristics features of hire-purchase system:

1. It is an **agreement** or contract between Hire Purchaser and Hire Seller to use the asset by the Hire Purchaser.
2. The payments towards the use of the assets are made in the form of **annual installments** by the Hire Purchaser.
3. The annual installment paid by the Hire Purchaser to the Hire Vendor comprises **Principal Amount and Interest**.
4. The **right to use** the asset is transferred to the Hire Purchaser immediately on the signing of the agreement; ownership of the asset remains with the Hire Vendor.
5. The **ownership** of the asset is transferred to the Hire Purchaser only after the **payment of last installment.** This transaction results in *Purchase*.
6. On the non-payment of any installment the Hire Seller has the option to **repossess** the asset, and all the installments paid earlier by the Hire Purchaser will be treated as **Hire Charges**. This transaction results in *Hire*.
7. Any **loss or damage** to the asset has to be borne by the Hire Seller.
8. The purchaser under this agreement is given only the option to use the asset; it restricts the purchaser from **subletting or leasing** the asset to other parties until the payment of last installment is made.

3.5 RIGHTS OF HIRE VENDOR

1. Right to receive DP and the remaining balance in installments as agreed upon.
2. Right to collect interest along with the principal in the form of installments.
3. If Hire Purchaser defaults on installment payments, Hire Vendor has the right to repossess the asset.

4. After repossession of the asset, the vendor has the right to treat the earlier paid installments as Hire Charges.

3.6 RIGHTS OF HIRE PURCHASER

1. Right to acquire possession of the asset on payment of initial deposit or DP.
2. Right to use the asset on payment of installments.
3. Right to claim ownership of the asset on payment of last installment.
4. Right to return asset if he/she wishes to terminate the agreement.

3.7 MEANING OF INSTALLMENT-PURCHASE SYSTEM

It is a system under which the buyer is given the ownership as well as the possession of the asset or goods right at the time of signing of agreement. In other words, it is a system in which the buyer of the goods acquires right and ownership of the assets immediately on the signing of the agreement, unlike in the case of hire-purchase system. The buyer under this system immediately debits asset or goods account with full cash price (CP), and credits sellers account with the installment price and debits interest suspense account with the difference between CP and installment price. At the end of each year, interest suspense account is credited with the interest of current year; furthermore, interest account is closed after making a transfer of interest to Profit and Loss Account. At the end of the installment agreement period, debit, if any, in interest suspense account reflects on the asset side of the Balance Sheet.

3.8 DEFINITION OF INSTALLMENT-PURCHASE SYSTEM

Installment-purchase system is a system under there is an agreement to purchase and pay by installments, the goods which become the property of the Purchaser immediately when he receives the delivery of the same. – **J.B. Batliboi**

3.9 DIFFERENCE BETWEEN HIRE-PURCHASE SYSTEMS AND INSTALLMENT-PURCHASE SYSTEMS

Differences between the hire-purchase system and the instalment-purchase system are highlighted through Table 3.1.

Table 3.1 *Difference between Hire-purchase System and Installment-purchase System*

Basis of difference	Hire-Purchase System	Installment-Purchase System
Nature of agreement	This system results in transaction that is **Hire** in nature	This system results in transaction that is **Purchase** in nature
Transfer of ownership	The transfer of ownership takes place only on the payment of last installment	The ownership gets transferred immediately at the time of signing of agreement
Position of purchaser	The status of the Hire Purchaser is that of a bailee (agent)	The status of the Hire Purchaser is not that of bailee
Repossession of Asset	As it is not an outright credit sale, the Hire Vendor has the right to repossess the asset on the non-payment of installment by the Hire Purchaser	As it is an outright credit sale, the Hire Vendor has no right to repossess the asset
Bearing of loss or damages to asset	As Hire Purchaser is not the owner of the asset, any risk of loss or damage has to be borne by the Hire Vendor	As purchaser is the owner of the asset, any risk of loss or damages have to be borne by the purchaser and not the seller
Right to sell/lease or sublet the asset	The Hire Purchaser cannot exercise the right to sell/lease or sublet the asset until the payment of last installment	As the buyer has the ownership, he/she is restrained from selling, leasing or subletting the asset
Return of goods	Return of assets is not restricted under this system	As the ownership is already passed on asset, it cannot be returned by the buyer

3.10 MEANING OF HIRE-PURCHASE AGREEMENT

Hire-Purchase Agreement is a binding contract between the Hire Purchasers and the Hire Vendor. The transaction between them begins with signing of agreement consisting of all the requisite terms and conditions relating to Hire-Purchase Price (HPP), CP, interest amount, date of commencement of transaction, the number of installments to be paid by the Hire Purchaser and detailed description of the goods that are Hire Purchased by the purchaser.

According to Sec 2 of Hire Purchase Act of 1972, Hire-Purchase Agreement is an agreement under which the goods are let on hire and the hirer has an option to purchase the goods as per the terms of agreement. As per the agreement, the goods will be delivered by the owner to the buyer in return for agreed monthly installments and the buyer becomes a lawful owner of the asset only on the payment of last installment. The agreement also includes a provision relating to termination of the agreement by giving a prior notice to the Hire Vendor. However, this attracts payment of additional charges in the form of penalty by the Hire Purchaser to the Hire Vendor. The Hire Purchaser is also required to return the goods or assets Hire Purchased. The Hire Vendor in return may forfeit the amount already paid by the Hire Purchaser and collect the balance amount due, if any, from the Hire Purchaser.

3.11 MEANING OF HIRE-PURCHASE PRICE AND NET HIRE-PURCHASE PRICE

Hire-Purchase Price is an amount payable by the Hire Purchaser as per the terms agreed upon in the Hire-Purchase Agreement. It comprises CP and Hire Charge (also termed interest), whereas Net HPP refers to HPP exclusive of delivery charges, insurance expense and registration charges, if any included in the price.

3.12 MEANING OF HIRE-PURCHASE CHARGES (INTEREST)

Hire-Purchase Charge is the amount of interest charged on the CP of the asset as per the Hire-Purchase agreement and is mostly calculated as a percentage of CP. It is the difference between the Net HPP and the Net CP of the asset.

3.13 CONCEPT OF CASH PRICE AND NET CASH PRICE

Cash price refers to the price at which the asset is actually sold to the buyer as per the 'Sale Contract'. This price is exclusive of interest charges or Hire Charges. Net CP is exclusive of DP or initial deposit paid by the Hire Purchaser at the time of entering into Hire-Purchase agreement. This is the price on which the interest amount is calculated.

3

3.14 REBATE

If the Hire Purchaser agrees to pay the balance amount in lump sum instead of installments, he/she is eligible to claim rebate from the Hire Vendor. Hire Purchaser may have to express his intention to the Hire Vendor by giving a notice beforehand to the seller. The calculation of rebate is as follows:

$$\textit{Rebate} = \textit{2/3}^{rd} \textit{ of Interest} \times \left(\frac{\text{Remaining Balance Installments}}{\text{Total Number of Agreed Installments}}\right)$$

3.15 ACCOUNTING TREATMENT IN THE BOOKS OF HIRE-PURCHASER

The Hire Purchaser can record the Hire-Purchase transactions in the books of accounts on the basis of the following methods

1. ***Asset Accrual Method:*** The asset is recorded at the (purchase price) CP actually paid.
2. ***Outright Property Method:*** The asset is recorded at full CP.
3. ***Interest Suspense Method:*** This method records the transaction by debiting the total interest to interest suspense account right in the beginning and subsequently, the interest due at the end of the period is credited to interest suspense account.

3.16 ASSET ACCRUAL METHOD

Under Asset Accrual Method, the asset account is debited with the amount of DP made towards the asset and the balance is paid in subsequent installments. Each installment comprises two portions – one representing the purchase price (commonly termed CP) and the other represents interest amount on the balance due. The asset is debited with the purchase price paid in each installment. As per this method, the buyer is the owner of the asset up to the value of the purchase price paid by him/her either by way of DP or CP included in installments. Therefore, the ownership of the asset will accrue to the buyer only with the installment paid towards principal.

3.16.1 Accounting Treatment in the Books of Hire Purchaser as per Asset Accrual Method

Step 1 – Calculation of Interest under Hire-Purchase System

Step 2 – Drafting of Journal Entries and Preparation of Ledger Accounts in the Books of Hire Purchaser and Hire Vendor as per Asset Accrual Method

As per the Asset Accrual Method, the accounting treatment with respect to Hire Purchase comprises drafting the journal entries and preparation of ledger accounts discussed as follows:

Journal Entries in the books of Hire Purchaser

Sl. no.	Circumstances	Journal entry	
	At the time of purchase of asset		
1.	When the asset is purchased	No journal entry is passed	
2.	When the Down Payment is paid	*Asset A/c* To Bank A/c	*Dr.*
	At the end of every year		
3.	When the installment money is payable	*Asset A/c* *Interest A/c* *To Hire Vendor A/c*	*Dr.* *Dr.*
4.	When the installment money is paid	*Hire Vendor A/c* *To Bank A/c*	*Dr.*
5.	When depreciation is charged on asset	*Depreciation A/c* *To Asset A/c*	*Dr.*
6.	When interest and depreciation accounts are closed by transferring the same to P/L A/c	*Profit and Loss A/c* *To Interest A/c* *To Depreciation A/c*	*Dr.*

Note: The entries mentioned in the table need to be passed every year till the completion of contract/agreement.

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Ledger Accounts in the Books of Hire Purchaser

The following ledger accounts are prepared in the books of Hire Purchaser:

1. Asset Account
2. Hire Vendor Account
3. Interest Account
4. Depreciation Account

Pro forma for all the accounts is mentioned as follows:

In the Books of Hire Purchaser
Asset Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Bank A/c (Down Payment)	xxx	1st year	By Depreciation A/c	xxx
	To Hire Vendor A/c (1st installment – Cash Price)	xxx		By Balance c/d (*Balancing figure*)	xxx
		xxx			**xxx**
2nd year	To Balance b/d	xxx	2nd year	By Depreciation A/c	xxx
	To Hire Vendor A/c (2nd installment – Cash Price)	xxx		By Balance c/d (*Balancing figure*)	xxx
		xxx			**xxx**
3rd year	To Balance b/d	xxx	3rd year	By Depreciation A/c	xxx
	To Hire Vendor A/c (3rd installment – Cash Price)	xxx		By Balance c/d (*Balancing figure*)	xxx
		xxx			**xxx**

Note: Hire-Purchase period assumed to be 3 years.

Hire Vendor Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Bank A/c (Down Payment)	xxx	1st year	By Asset A/c (Cash Price)	xxx
	To Bank (1st installment)	xxx		By Interest A/c	xxx
		xxx			**xxx**
2nd year	To Bank (2nd installment)	xxx	2nd year	By Asset A/c (Cash Price)	xxx
				By Interest A/c	xxx
		xxx			**xxx**
3rd year	To Bank (3rd installment)	xxx	3rd year	By Asset A/c (Cash Price)	xxx
				By Interest A/c	xxx
		xxx			**xxx**

Interest Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Hire vendor A/c	xxx	1st year	By P/L A/c (transfer)	xxx
		xxx			**xxx**
2nd year	To Hire vendor A/c	xxx	2nd year	By P/L A/c (transfer)	xxx
		xxx			**xxx**
3rd year	To Hire vendor A/c	xxx	3rd year	By P/L A/c (transfer)	xxx
		xxx			**xxx**

Depreciation Account

Dr. **Cr.**

date	Particulars	₹	Date	Particulars	₹
1st year	To Asset A/c	xxx	1st year	By P/L A/c (transfer)	xxx
		xxx			**xxx**
2nd year	To Asset A/c	xxx	2nd year	By P/L A/c (transfer)	xxx
		xxx			**xxx**
3rd year	To Asset A/c	xxx	3rd year	By P/L A/c (transfer)	xxx
		xxx			**xxx**

3.16.2 Accounting Treatment in the Books of Hire Vendor as per Asset Accrual Method

As per the Asset Accrual Method, the accounting treatment with respect to Hire Purchase comprises drafting the journal entries and preparation of ledger accounts discussed as follows:

Journal Entries in the Books of Hire Vendor

Sl. no.	Circumstances	Journal entry
	At the time of sale of asset	
1.	When the asset is sold	*Hire Purchaser's A/c Dr.* *To Sales A/c*
2.	When the Down Payment is received	*Bank A/c Dr.* *To Hire Purchaser's A/c*
	At the end of every year	
3.	When the installment money is due	*Hire Purchaser A/c Dr.* *To Interest A/c*
4.	When the installment money is received	*Bank A/c Dr.* *To Hire Purchaser's A/c*
5.	When interest account is closed by transferring to P/L A/c	*Interest A/c Dr.* *To P/L A/c*

Note: The entries mentioned in the table need to be passed every year till the completion of contract/agreement.

Ledger accounts in the Books of Hire Vendor

The following ledger accounts are prepared in the books of Hire Vendor:

1. Hire Purchaser's Account
2. Interest Account

Proforma for all the accounts is mentioned as follows:

In the Books of Hire Vendor
Hire Purchaser's Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Sales A/c (Cash Price)	xxx	1st year	By Bank A/c	xxx
	To Interest A/c (1st installment)	xxx		By Balance c/d (*Balancing figure*)	xxx
		xxx			**xxx**
1st year	To Balance b/d	xxx	1st year	By Bank A/c	xxx
	To Interest A/c (2nd installment)	xxx		By Balance c/d (*Balancing figure*)	xxx
		xxx			**xxx**
1st year	To Balance b/d	xxx	1st year	By Bank A/c	xxx
	To Interest A/c (3rd installment)	xxx		By Balance c/d (*Balancing figure*)	xxx
		xxx			**xxx**

Note: Hire-Purchase period assumed to be 3 years.

Interest Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	By P/L A/c (Transfer)	xxx	1st year	By Hire Purchaser A/c	xxx
		xxx			**xxx**
2nd year	By P/L A/c (Transfer)	xxx	2nd year	By Hire Purchaser A/c	xxx
		xxx			**xxx**
3rd year	By P/L A/c (Transfer)	xxx	3rd year	By Hire Purchaser A/c	xxx
		xxx			**xxx**

3.16.3 Procedure for Calculation of Installment Amount, Interest, Cash Price and Depreciation

The journal entries mentioned before and ledger accounts can be prepared only if there is information about installment amount, interest, CP and depreciation. This information is either mentioned in the question or is required to be calculated. If the information has to be calculated, the following is the procedure for calculation.

Calculation of Installment amount, interest and cash price, when cash price is mentioned in the problem

Particulars	Amount (₹)
Cash Price of the Asset	xxx
Less: Down Payment	xxx
Remaining balance	xxx
Add: 1st installment interest as a % of remaining balance	xxx
	xxx
Less: 1st year installment	xxx
Remaining balance	xxx
Add: 2nd installment interest as a % of remaining balance	xxx
	xxx
Less: 2nd year installment	xxx
Remaining balance	xxx
Add: 3rd installment interest as a % of remaining balance	xxx
	xxx
Less: 3rd year installment	xxx
Remaining balance	xxx

Calculation of Installment amount, Interest and Cash Price, when Cash Price is <u>not</u> Mentioned in the Problem

No. of installments	Closing balance	Yearly installment	Total amount	Interest $\left(\frac{\text{Rate}}{100+\text{Rate}}\right)$	Principal
	a	b	c = a + b	d	e = c − d
3	–	xxx	xxx	xxx	xxx
2	xxx	xxx	xxx	xxx	xxx
1	xxx	xxx	xxx	xxx	**xxx (Opening balance)**
				Add: Down Payment (if any)	**xxx**
				Cash Price	**xxx**

Alternatively

Particulars	Amount (₹)
3rd installment	xxx
Less: 3rd year installment interest $\left(\text{Amount} \times \dfrac{\text{Rate}}{100} + \text{Rate}\right)$	xxx
Balance	xxx
Add: 2nd year installment	xxx
Balance	xxx
Less: 2nd year installment interest $\left(\text{Amount} \times \dfrac{\text{Rate}}{100} + \text{Rate}\right)$	xxx
Balance	xxx
Add: 1st year installment	xxx
Balance	xxx
Less: 1st year installment interest $\left(\text{Amount} \times \dfrac{\text{Rate}}{100} + \text{Rate}\right)$	xxx
Balance	xxx
Add: Down Payment (if any)	xxx
CASH PRICE	xxx

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Calculation of Depreciation

The asset bought under this system is generally in the nature of a non-current or fixed asset; this requires charging of depreciation in the books of Hire Purchaser. Furthermore, there are two commonly followed methods of depreciation:

1. ***Straight Line Method:*** Under this method, depreciation is calculated on the CP of the asset at the beginning of the year and the same amount is charged every year till the expiry of the life of the asset.
2. ***Diminishing Balance Method or Reducing Balance Method:*** This method requires calculation of depreciation on the remaining balance of CP every year after reducing the previous year depreciation. Like this, it reduces every year till the expiry of the life of the asset.

3.17 DEFAULT AND REPOSSESSION

As per the terms of Hire-Purchase Agreement, the Hire Purchaser will assume the ownership of the asset only on the payment of last installment. If Hire Purchaser defaults any payment of installment, the Hire Vendor has the right to take back the asset in its actual form from the Hire Purchaser. In this case, the payments made earlier by the Hire Purchaser will not be refunded; instead they will be treated as 'Hire Charges'. The very act of recovery of asset from the Hire Purchaser due to default in the payment of installments is termed 'Repossession'. The repossession of asset can take place either partially or completely. In other words, the vendor may repossess the asset in full or just a part of the asset, as the case may be. The repossessed assets can be further sold to some other customer after the required repairing and reconditioning.

3.17.1 Accounting Treatment In the Books of Hire Purchaser in Case of Default and Repossession

The entries in the following table are to be passed in the year in which the repossession takes place.

In the Books of Hire Purchaser

Sl. no.	Circumstances	Journal entry
1.	When the installment amount is due	*Asset A/c Dr.* *Interest A/c Dr.* *To Hire Vendor A/c*
2.	When the installment amount in not paid due to default	No entry as no payment has been made on account of default by the hire purchaser
3.	When depreciation is charged on asset	*Depreciation A/c Dr.* *To Asset A/c*
4.	When transfer of interest and depreciation	*Profit and Loss A/c Dr.* *To Interest A/c* *To Depreciation A/c*
5.	When the agreed value of goods repossessed is transferred	*Hire Vendor's A/c Dr.* *To Asset A/c*
6.	When loss on repossessed asset is transferred to P/L A/c	*Profit and Loss A/c Dr.* *To Asset A/c*
7.	When profit on repossessed asset is transferred to P/L A/c	*Asset A/c Dr.* *To Profit and Loss A/c*
8.	When Hire Vendor's Account is closed	*Hire Vendor's A/c Dr.* *To Bank A/c*

In the books of Hire Vendor

The following entries are to be passed in the year in which the repossession takes place.

Sl. no.	Circumstances	Journal entry
1.	When the asset is repossessed	*Repossessed Stock A/c Dr.* *To Hire Purchaser A/c*
2.	When *Repossessed stock* is repaired or reconditioned	*Repossessed Stock A/c Dr.* *To Bank A/c*
3.	When *Repossessed stock* is sold	*Bank A/c Dr.* *To Repossessed Stock A/c*
4.	When profit accrues on the sale of *Repossessed stock*	*Repossessed Stock A/c Dr.* *To P/L A/c*
5.	When loss accrues on the sale of *Repossessed stock*	*P/L A/c Dr.* *To Repossessed Stock A/c*

3

3.18 ILLUSTRATIONS

Illustration 1: Calculation of Interest when Hire-Purchase Price is more than the Cash Price

Calculate the amount of interest and principal included in each installment

CP	₹2,00,000
DP	₹50,000

Balance in three installments of ₹60,000 each payable at the end of each year.

[B.U., B.Com., Nov/Dec 2016, Section B]

Solution:

Calculation of Interest when HPP > CP (or when HPP is including Interest)

Particulars	Amount (₹)
Cash Price	2,00,000
Less: Down Payment	50,000
Remaining balance	1,50,000
Add: 1st year installment interest @ 10% on remaining balance	15,000
	1,65,000
Less: 1st year installment	60,000
Remaining balance	1,05,000
Add: 2nd year installment interest @ 10% on remaining balance	10,500
	1,15,500
Less: 2nd year installment	60,000
Remaining balance	55,500
Add: 3rd year installment interest (*Balancing figure*) (60,000 − 55,500)	4,500
	60,000
Less: 3rd year installment	60,000
	–

Note: In the absence of information interest is assumed at 10% p.a.

Illustration 2: Calculation of Interest when Hire-Purchase Price is more than the Cash Price

On 1 January 2013, Mr. Raj bought a motor bike from Prestige Automobiles on hire-purchase system. The CP of the vehicle was agreed at ₹42,500, and the payment was agreed to be made as follows:

₹10,000 at the time of making initial payment and the balance in three annual installments of ₹12,000 each. Prestige Automobiles has agreed to charge interest at the rate 5% p.a. Calculate the interest for each year.

Hint: How to identify if HPP includes interest or not:

1. If HPP = CP then, HPP is exclusive of interest
2. If HPP > CP then, HPP is inclusive of interest

Solution:

Calculation of Interest when HPP > CP (or when HPP includes Interest)

Particulars	Amount (₹)
Cash Price	42,500
Less: Down Payment	10,000
Remaining balance	32,500
Add: 1st year installment interest @ 5% on remaining balance $\left(32500 \times \frac{5}{105}\right)$	1,548
	34,048
Less: 1st year installment	12,000
Remaining balance	22,048
Add: 2nd year installment interest @ 10% on remaining balance	1,050
	23,098
Less: 2nd year installment	12,000
Remaining balance	11,098
Add: 3rd year installment interest (*Balancing figure*) (12,000 − 11,098)	902
	12,000
Less: 3rd year installment	12,000
	–

Illustration 3: **Calculation of Interest when Hire-Purchase Price is equal to the Cash Price**

Mr. Ajay purchased a printing machine on Hire Purchase from Sujay Enterprises for this, the CP of the asset was agreed at ₹54,000, DP being ₹10,000, and the balance amount is payable in four equal installments along with interest at the rate of 10% on the balance outstanding CP. Ascertain the amount of interest payable and the value of each installment.

Hint: How to identify if HPP includes interest or not:

1. If HPP = CP then, HPP is exclusive of interest
2. If HPP > CP then, HPP is inclusive of interest

Solution:

In this case HPP = CP, i.e.

HPP = DP + 3 Installments = CP

$10{,}000 + (11{,}000 \times 4) = 54{,}000$

Therefore, HPP is exclusive of interest

Calculation of value of each installment:

Value of each installment without interest

$$= CP - \frac{DP}{4}$$

$$= 54{,}000 - 10{,}000 = \frac{44{,}000}{4}$$

$$\mathbf{= 11{,}000}$$

Calculation of interest when HPP = CP (or when HPP is excluding interest)

Particulars	Amount (₹)
Cash Price	54,000
Less: Down Payment	10,000
Balance	44,000
Add: Interest @ 10% on Cash Price	4,400
Balance	48,400
Less: 1st year installment (11,000 + 4,400)	15,400
Balance	33,000
Add: Interest @ 10% on Cash Price	3,300
Balance	36,300
Less: 2nd year installment (11,000 + 3,300)	14,300
Balance	22,000
Add: Interest @ 10% on Cash Price	2,200
Balance	24,200
Less: 3rd year installment (11,000 + 2,200)	13,200
Balance	11,000
Add: Interest @ 10% on Cash Price	1,100
Balance	12,100
Less: 3rd year installment (11,000 + 1,100)	12,100
	–

Calculation of value of each installment with interest

No. of installments	Value of each installment without interest (₹)	Interest (₹)	Value of each installment with interest (₹)
1	11,000	4,400	15,400
2	11,000	3,300	14,300
3	11,000	2,200	13,200
4	11,000	1,100	12,100
Total	**44,000**	**11,000**	**55,000**
Add: Down Payment	10,000	–	10,000
	54,000 (CP)	**11,000 (Interest)**	**65,000 (HPP)**

Abbreviations: CP: Cash Price; HPP: Hire-Purchase Price.

Illustration 4: **Calculation of value of each installment when HPP is exclusive of interest**

Calculate the value of each installment when CP is 20,000; DP is equal to 25% of CP; the remaining balance of CP is payable in three equal installments along with interest at the rate of 10% on the outstanding CP.

Hint: How to identify if HPP includes interest or not:

1. If HPP = CP then, HPP is exclusive of interest
2. If HPP > CP then, HPP is inclusive of interest

Solution:

In this case HPP = CP, i.e.

HPP = DP + 3 Installments = CP

5,000 + (5,000 × 3) = 20,000

Therefore, HPP is exclusive of interest

Calculation of value of each installment:

Value of each installment without interest

$$= CP - \frac{DP}{3}$$

$$= 20{,}000 - 5000 = \frac{15{,}000}{3}$$

$$\mathbf{= 5{,}000}$$

3

Calculation of Interest when HPP = CP (or when HPP is excluding interest)

Particulars	Amount (₹)
Cash Price	20,000
Less: Down Payment (@ 20% on Cash Price)	5,000
	15,000
Add: Interest @ 10% on Cash Price	1,500
	16,500
Less: 1st year installment (5,000 + 1,500)	6,500
	10,000
Add: Interest @ 10% on Cash Price	1,000
	11,000
Less: 2nd year installment (5,000 + 1,000)	6,000
	5,000
Add: Interest @ 10% on Cash Price	500
	5,500
Less: 3rd year installment (5,000 + 500)	5,500
	–

Calculation of value of each installment with interest

No. of installments	Value of each installment without interest (₹)	Interest (₹)	Value of each installment with interest (₹)
1	5,000	1,500	6,500
2	5,000	1,000	6,000
3	5,000	500	5,500
Total	**15,000**	**3,000**	**18,000**
Add: Down Payment	5,000	–	5,000
	20,000 (CP)	**3,000 (Interest)**	**23,000 (HPP)**

Abbreviations: CP: Cash Price; HPP: Hire-Purchase Price.

Illustration 5: Calculation of interest when rate of interest is not given

On 1 January 2014 Tejas Coffee Works bought a coffee curing machine from Global enterprises on hire-purchase system. ₹15,000 was to be paid at the time of entering into agreement and the balance in five equal annual installments of ₹30,000 each. The CP of the machine was agreed at ₹1,50,000. Calculate the interest for each year from the information mentioned before.

Solution:

Calculation of total interest charged:

Step 1: Calculation of total interest charged

Total Interest Charged = HPP* (DP + Total Installments) − CP

= 1,65,000 − 1,50,000

Total Interest Charged = 15,000

*HPP = 15,000 (DP) + 30,000 × 5 (Total Installments)

*HPP = 1,65,000

Step 2: Calculation of Amount due Ratio:

No. of installments	1	2	3	4	5
Installment money due	HPP − Down Payment = 1,65,000 − 15,000 = 1,50,000	Balance − 1st installment = 1,50,000 − 30,000 = 1,20,000	Balance − 2nd installment = 1,20,000 − 30,000 = 90,000	Balance − 3rd installment = 90,000 − 30,000 = 60,000	Balance − 4th installment = 60,000 − 30,000 = 30,000
Amount due Ratio	1,50,000	1,20,000	90,000	60,000	30,000
	150:120:90:60:30 or 5:4:3:2:1				
Calculation of interest included in each installment	$15,000 \times \frac{5}{15}$ **= 5,000**	$15,000 \times \frac{4}{15}$ **= 4,000**	$15,000 \times \frac{3}{15}$ **= 3,000**	$15,000 \times \frac{2}{15}$ **= 2,000**	$15,000 \times \frac{1}{15}$ **= 1,000**

Illustration 6: **Calculation of interest when rate of interest is not given**

Calculate the interest included in each installments, CP ₹60,000; DP ₹18,000; three annual installments of ₹24,000, ₹18,000 and ₹12,000 respectively payable at the end of each year.

[B.U., B.Com., Nov/Dec 2015, Section B]

Solution:

Calculation of total interest charged:

Step 1: Calculation of total interest charged

Total Interest Charged = HPP* (DP + Total Installments) − CP

= 72,000 − 60,000

Total Interest Charged = 12,000

*HPP = 18,000 (DP) + 24,000 (1st Installment) + 18,000 (2nd Installment) + 12,000 (3rd Installment) (Total Installments)

*HPP = 72,000

Step 2: Calculation of Amount due Ratio:

No. of installments	1	2	3
Installment money due	HPP − Down Payment = 72,000 − 18,000 = 54,000	Balance − 1st installment = 54,000 − 24,000 = 30,000	Balance − 2nd installment = 30,000 − 18,000 = 12,000
Amount due Ratio	54,000	30,000	12,000
	54:30:12 or 9:5:2		
Calculation of interest included in each installment	$12,000 \times \frac{9}{16}$ **= 6,750**	$12,000 \times \frac{5}{16}$ **= 3,750**	$12,000 \times \frac{2}{16}$ **= 1,500**

Illustration 7: **Calculation of interest when rate of interest is not given**

Calculate the amount of interest included in each installment, CP ₹1,00,000, DP ₹25,000; three installments of ₹30,000 each payable at the end of each year.

[B.U., B.Com., Nov/Dec 2004, Section B]

Solution:

Step 1: Calculation of total interest charged

Total Interest Charged = HPP* (DP + Total Installments) − CP

= 1,15,000 − 1,00,000

Total Interest Charged = 15,000

*HPP = 25,000 (DP) + 90,000 (30,000 × 3 Installments)

*HPP = 1,15,000

Step 2: Calculation of Amount due Ratio:

No. of installments	1	2	3
Installment money due	HPP − Down Payment = 1,15,000 − 25,000 = 90,000	Balance − 1st installment = 90,000 − 30,000 = 60,000	Balance − 2nd installment = 60,000 − 30,000 = 30,000
Amount due Ratio	90,000	60,000	30,000
	9:6:3 or 3:2:1		
Calculation of interest included in each installment	$15{,}000 \times \frac{3}{6}$ **= 7,500**	$15{,}000 \times \frac{2}{6}$ **= 5,000**	$15{,}000 \times \frac{1}{6}$ **= 2,500**

Illustration 8: Calculation of interest when rate of interest is not given

Calculate the amount of interest included in each installment. CP ₹1,50,000, DP ₹45,000 annual installment of ₹60,000, ₹45,000 and ₹30,000 payable at the end of each year.

[B.U., B.Com., Nov/Dec 2007/2011, Section B]

Solution:

Calculation of Total Interest charged:

Step 1: Calculation of total interest charged

Total Interest Charged = HPP* (DP + Total Installments) − CP

= 1,80,000 − 1,50,000

Total Interest Charged = 30,000

*HPP = 45,000 (DP) + 60,000 (1st Installment) + 45,000 (2nd Installment) + 30,000 (3rd Installment) (Total Installments)

*HPP = 1, 80,000

Step 2: Calculation of Amount due Ratio:

No. of installments	1	2	3
Installment money due	HPP − Down Payment = 1,80,000 − 45,000 = 1,35,000	Balance − 1st installment = 1,35,000 − 60,000 = 75,000	Balance − 2nd installment = 75,000 − 45,000 = 30,000
Amount due Ratio	1,35,000	75,000	30,000
	135:75:30 or 27:15:6		
Calculation of interest included in each installment	$30{,}000 \times \frac{27}{48}$ **= 16,875**	$30{,}000 \times \frac{15}{48}$ **= 9,375**	$30{,}000 \times \frac{6}{48}$ **= 3,750**

Illustration 9: **Calculation of interest when down payment is not given**

A radio set with the CP of ₹1,620 is acquired on hire-purchase system payable in three installments of ₹600 each. How do you apportion each installment between revenue and capital?

[B.U., B.Com., Nov/Dec 2005, Section B]

Solution:

Calculation of total interest charged:

Step 1: Calculation of total interest charged

Total Interest Charged = HPP* (DP + Total Installments) − CP

= 1,800 − 1,620

Total Interest Charged = 180

*HPP = DP + Installments

*HPP = 0 + 600 × 3

*HPP = 1,800

Step 2: Calculation of Amount due Ratio:

No. of installments	1	2	3
Installment money due	HPP − Down Payment = 1,800 − 0 = 1,800	Balance − 1st installment = 1,800 − 600 = 1,200	Balance − 2nd installment = 1,200 − 600 = 600
Amount due Ratio	1,800	1,200	600
		18:12:6 or 3:2:1	
Calculation of interest included in each installment	$180 \times \frac{3}{6}$ **= 90**	$180 \times \frac{2}{6}$ **= 60**	$180 \times \frac{1}{6}$ **= 30**

Illustration 10: **Calculation of Installment amount and true rate of interest**

A TV dealer sells an LED TV, the CP of which is ₹30,000 and decides to charge 10% nominal interest. If the price is to be paid in three equal installments, determine the Installment amount and calculate the true rate of interest and verify. **[B.U., B.Com., Nov/Dec 2013, Section B]**

Solution:

Calculation of installment amount and true rate of interest

HPP = CP + Interest

HPP = 30,000 + 9,000 (30,000 × 10% × 3)

HPP = 39,000

$$\text{Installment Amount} = \frac{\text{HPP}}{3} = \frac{39{,}000}{3}$$

Installment Amount = 13,000

$$\textbf{True Rate of Interest} = \frac{(\text{Nominal Rate of Interest} \times 2 \times \text{Total No. of Installments})}{(\text{Total No. of Installments} + 1)}$$

$$\text{True Rate of Interest} = \frac{(10\% \times 2 \times 3)}{(3+1)} = \mathbf{15\%}$$

Illustration 11: When cash price is not given

Calculate the CP of an asset from the following:

₹3,000 paid at the time of agreement
₹21,600 paid at the time of first year
₹20,700 paid at the time of second year
₹19,800 paid at the time of third year
₹18,900 paid at the time of fourth year
Rate of interest is 5% p.a.
Rate of depreciation is 25% p.a. **[B.U., B.Com., Apr 2001, Section B]**

Solution:

Calculation of cash price

No. of installments	Year-end balance (₹) a	Yearly installment (₹) b	Total amount (₹) c = a + b	Interest $\left(\frac{5}{105}\right)$ (₹) d	Principal (₹) e = c – d
4	–	18,900	18,900	900	18,000
3	18,000	19,800	37,800	1,800	36,000
2	36,000	20,700	56,700	2,700	54,000
1	54,000	21,600	75,600	3,600	72,000

Therefore, CP = 72,000 + 3,000 (DP)

CP = 75,000

Alternatively,
Calculation of CP

4^{th} installment	18,900
(−) Interest $\left(18{,}900 \times \frac{5}{105}\right)$	900
	18,000
Add: 3^{rd} installment	19,800
	37,800
(−) Interest $\left(37{,}800 \times \frac{5}{105}\right)$	1,800
	36,000
Add: 2^{nd} installment	20,700
	56,700
(−) Interest $\left(56{,}700 \times \frac{5}{105}\right)$	2,700
	54,000
Add: 1^{st} installment	21,600
	75,600
(−) Interest $\left(75{,}600 \times \frac{5}{105}\right)$	3,600
	72,000
Add: Down Payment	3,000
Cash Price	**75,000**

3

Illustration 12: **When Cash Price is not given and quarterly installments are given**

Calculate CP of an asset from the following data:

DP – ₹4,000

1^{st} Installment –₹28,800 (payable at the end of 1^{st} quarter of the year)
2^{nd} Installment – ₹27,600 (payable at the end of 2^{nd} quarter of the year)
3^{rd} Installment – ₹26,400 (payable at the end of 3^{rd} quarter of the year)
4^{th} Installment – ₹25,200 (payable at the end of 4^{th} quarter of the year)

Rate of Interest = 20% p.a.

Rate of Depreciation = 10% p.a. on the basis of straight line method

Solution:

No. of installments	Quarter-end balance a	Quarterly installment b	Total amount c = a + b	Interest $\left(\frac{5}{105}\right)^*$ d	Opening balance principal e = c – d
4	–	25,200	25,200	1,200	24,000
3	24,000	26,400	50,400	2,400	48,000
2	48,000	27,600	75,600	3,600	72,000
1	72,000	28,800	1,00,800	4,800	96,000

Therefore, CP = 96,000 + 4,000 (DP)

CP = 1,00,000

***Note = Rate of Interest = 20% p.a./4 Quarters = 5% Per Quarter.**

Illustration 13: When Cash Price is not given

Calculate the CP of an asset sold under hire system from the following details: DP ₹6,000; first half-yearly installment ₹14,400; second half-yearly installment ₹13,300; third half-yearly installment ₹12,200; fourth half-yearly installment ₹12,100; rate of interest at 20% p.a.

[B.U., B.Com., Oct 2004, Section B]

Solution:

No. of installments	Quarter-end balance a	Half-yearly installment b	Total amount c = a + b	Interest $\left(\frac{10}{110}\right)^*$ d	Opening balance principal e = c – d
4	–	12,100	12,100	1,100	11.000
3	11,000	12,200	23,200	2,109	21,091
2	21,091	13,300	34,391	3,126	31,265
1	31,265	14,400	45,665	4,151	41,514

Therefore, CP = 41,514 + 6,000 (DP)

CP = 47,514

***Note = Rate of Interest = 20% p.a./2 = 10%.**

Calculation of value of each installment with interest

No. of installments	Value of each installment without interest	Interest	Value of each installment with interest
1	10,249	4,151	14.400
2	10,174	3,126	13,300
3	10,091	2,109	12,200
4	11,000	1,100	12,100
Total	**41,514**	**10,486**	**52,000**
Add: Down Payment	6,000	–	6,000
	47,514 (CP)	**10,486 (Interest)**	**58,000 (HPP)**

Abbreviations: CP: Cash Price; HPP: Hire-Purchase Price.

Illustration 14: **Calculation of Cash Price with the help of annuity values when annual installments are constant**

Sunder and Co. purchased a machine from Chander Machine Tools on 1 January 2016 on Hire-Purchase basis with an agreement to pay ₹10,000 at the time of signing of agreement and the balance in equal annual installments of ₹15,000 each. Interest was agreed to be charged at 10% p.a. Calculate CP of the machine.

Note: Present value of annuity of ₹1 per annum at 10% ₹2.4869.

Solution:

CP of Installment = Annuity Value × Installment + DP

= 2.4869 × 15,000 + 10,000

CP = ₹47,304

Illustration 15: **Calculation of cash price with the help of annuity values when annual installments are not constant**

Gopal & Bros. purchased electronic equipment from Pai Electronics on hire-purchase system. The payment was made as follows:

At the time of signing of agreement ₹26,750 as the DP; ₹37,000, ₹42,500 and ₹23,500 at the end of first, second and third year, respectively. The rate of interest to be charged is agreed at 8% p.a. The annuity table shows that the present value of ₹1 for first, second and third year is 0.9259, 0.8574 and 0.7938, respectively. Calculate the CP of the machine.

Solution:

Calculation of Cash Price

Particulars	Amount (₹)	Present value of ₹1 @ 8%	Present value of installment (₹)
Down Payment	26,750	1.0000	26,750
1st installment	37,000	0.9259	34,258
2nd installment	42,500	0.8573	36,435
3rd installment	23,500	0.7938	18,654
Total Cash Price of the electronic equipment			**1,19,097**

Illustration 16: **Drafting journal entries in the books of Hire Purchaser**

Mr. Sampath purchased a plant on Hire-Purchase basis from Tribhuvan Machines Ltd. on 1 April 2014. The CP of the plant was ₹85,000 and the payment was agreed to be paid as follows:

At the time of signing the agreement, it was finalised ₹10,000 as DP, and the balance would be paid in three installments of ₹30,000, each at the end of every year. Mr. Sampath wishes to write off 15% depreciation annually on diminishing balance method. The Hire Vendor agrees to charge 10% interest.

Draft Journal entries in the books of Mr. Sampath as per Asset Accrual Method.

3

Solution:

Calculation of interest when HPP > CP (or when HPP is including interest)

Particulars	Amount (₹)
Cash Price	85,000
Less: Down Payment	10,000
Remaining balance	75,000
Add: 1st year installment interest @ 10% on remaining balance	7,500
	82,500
Less: 1st year installment	30,000
Remaining balance	52,500
Add: 2nd year installment interest @ 10% on remaining balance	5,250
	57,750
Less: 2nd year installment	30,000
Remaining balance	27,750
Add: 3rd year installment interest (*Balancing figure*) (30,000 − 27,750)	2,250
	30,000
Less: 3rd year installment	30,000
	–

Calculation of depreciation (diminishing balance method)

Particulars	Amount (₹)
Cash Price	85,000
Less: 1st year depreciation @ 15% of 85,000	12,750
Balance	72,250
Less: 2nd year depreciation @ 15% of 72,250	10,838
Balance	61,412
Less: 3rd year depreciation @ 15% of 61,412	9,212
Written down value of the asset at the end of 3rd year	52,200

Analysis table

No. of installments	Date of installment	Installment amount (CP + interest) (₹)	Interest (as calculated before) (₹)	Cash Price (installment money − interest) (₹)	Depreciation (as calculated before) (₹)
Down Payment	1.4.2014	10,000	–	10,000	–
1st	31.3.2015	30,000	7,500	22,500	12,750
2nd	31.3.2016	30,000	5,250	24,750	10,838
3rd	31.3.2017	30,000	2,250	27,750	9,212
		Total HPP = ₹1,00,000	**Total Interest = ₹15,000**	**Total CP = ₹85,000**	

Abbreviations: CP: Cash Price; HPP: Hire-Purchase Price.

In the books of Mr. Sampath (Hire Purchaser)
Journal entries

Date	Particulars	LF	Debit (₹)	Credit (₹)
31.3.2015	Plant A/c Dr.		22,500	–
	Interest A/c Dr.		7,500	–
	To Hire Vendor A/c		–	30,000
	(Being 1st installment payable)			
31.3.2015	Hire Vendor A/c Dr.		30,000	–
	To Cash/Bank A/c		–	30,000
	(Being 1st installment paid)			
31.3.2015	Depreciation A/c Dr.		12,750	–
	To Plant A/c		–	12,750
	(Being 1st year depreciation charged on plant)			
31.3.2015	Profit and Loss A/c Dr.		20,250	–
	To Interest A/c		–	7,500
	To Depreciation A/c		–	12,750
	(Being payment of interest and depreciation charged are transferred to Profit and Loss A/c)			
31.3.2016	Plant A/c Dr.		24,750	–
	Interest A/c Dr.		5,250	–
	To Hire Vendor A/c		–	30,000
	(Being 2nd installment payable)			
31.3.2016	Hire Vendor A/c Dr.		30,000	–
	To Cash/Bank A/c		–	30,000
	(Being 2nd installment paid)			
31.3.2016	Depreciation A/c Dr.		10,838	–
	To Plant A/c		–	10,838
	(Being 2nd year depreciation charged on plant)			
31.3.2016	Profit and Loss A/c Dr.		16,088	–
	To Interest A/c		–	5,250
	To Depreciation A/c		–	10,838
	(Being payment of interest and depreciation charged are transferred to Profit and Loss A/c)			
31.3.2017	Plant A/c Dr.		27,750	–
	Interest A/c Dr.		2,250	–
	To Hire Vendor A/c		–	30,000
	(Being 3rd installment payable)			

(Contd.)

3

Date	Particulars		LF	Debit (₹)	Credit (₹)
31.3.2017	Hire Vendor A/c	Dr.		30,000	–
	To Cash/Bank A/c			–	30,000
	(Being 3rd installment paid)				
31.3.2017	Depreciation A/c	Dr.		9,212	–
	To Plant A/c			–	9,212
	(Being 3rd year depreciation charged on plant)				
31.3.2017	Profit and Loss A/c	Dr.		11,462	–
	To Interest A/c			–	2,250
	To Depreciation A/c			–	9,212
	(Being payment of interest and depreciation charged are transferred to Profit and Loss A/c)				

Illustration 17: **Drafting journal entries in the books of Hire Purchaser**

Mr. Rajesh purchased a Machine on Hire-Purchase basis from Rakesh Industrial Equipment Corporation on 1 January 2015. The CP of the machine was ₹35,000 and the payment was agreed to be paid as follows:

At the time of signing the agreement ₹5,000 and the balance in three installments of ₹10,000 at the end of each year at 10% interest p.a. Mr. Rajesh wishes to write off 10% depreciation annually on diminishing balance method.

Draft journal entries in the books of Mr. Rajesh as per Asset Accrual Method.

3

Solution:

Calculation of Interest when HPP = CP (or when HPP is exclusive of interest)

Particulars	Amount (₹)
Cash Price	35,000
Less: Down Payment	5,000
Remaining balance	30,000
Add: 1st year installment interest @ 10% on remaining balance	3,000
	33,000
Less: 1st year installment (10,000 + 3,000)	13,000
Remaining balance	20,000
Add: 2nd year installment interest @ 10% on remaining balance	2,000
	22,000
Less: 2nd year installment (10,000 + 2,000)	12,000
Remaining balance	10,000
Add: 3rd year installment interest @10% on remaining balance	1,000
	11,000
Less: 3rd year installment (10,000 + 1,000)	11,000
	–

Calculation of depreciation (diminishing balance method)

Particulars	Amount (₹)
Cash Price	35,000
Less: 1st year depreciation @ 10% of 35,000	3,500
Balance	31,500
Less: 2nd year depreciation @ 10% of 31,500	3,150
Balance	28,350
Less: 3rd year depreciation @ 10% of 28,350	2,835
Written down value of the asset at the end of 3rd year	25,515

Analysis table

No. of installments	Date of installment	Installment amount (CP + interest) (₹)	Interest (as calculated before) (₹)	Cash Price (installment money − interest) (₹)	Depreciation (as calculated before) (₹)
Down Payment	1.1.2015	5,000	–	5,000	–
1st	31.12.2015	10,000	3,000	7,000	3,500
2nd	31.12.2016	10,000	2,000	8,000	3,150
3rd	31.12.2017	10,000	1,000	9,000	2,835
		Total HPP = ₹35,000	**Total Interest = ₹6,000**	**Total CP = ₹29,000**	

Abbreviations: CP: Cash Price; HPP: Hire-Purchase Price.
Drafting journal entries in the books of Mr. Rajesh

In the books of Mr. Rajesh (Hire Purchaser)
Journal entries

Date	Particulars	LF	Debit (₹)	Credit (₹)
31.12.2015	Machinery A/c Dr.		7,000	–
	Interest A/c Dr.		3,000	–
	To Hire Vendor A/c		–	10,000
	(Being 1st installment payable)			
31.12.2015	Hire Vendor A/c Dr.		10,000	–
	To Cash/Bank A/c		–	10,000
	(Being 1st installment paid)			
31.12.2015	Depreciation A/c Dr.		3,500	–
	To Machinery A/c		–	3,500
	(Being 1st year depreciation charged on machinery)			
31.12.2015	Profit and Loss A/c Dr.		6,500	–
	To Interest A/c		–	3,000
	To Depreciation A/c		–	3,500
	(Being payment of interest and depreciation charged are transferred to Profit and Loss A/c)			

(Contd.)

3

Date	Particulars		LF	Debit (₹)	Credit (₹)
31.12.2016	Machinery A/c	Dr.		8,000	–
	Interest A/c	Dr.		2,000	–
	To Hire Vendor A/c			–	10,000
	(Being 2nd installment payable)				
31.12.2016	Hire Vendor A/c	Dr.		10,000	–
	To Cash/Bank A/c			–	10,000
	(Being 2nd installment paid)				
31.12.2016	Depreciation A/c	Dr.		3,150	–
	To Machinery A/c			–	3,150
	(Being 2nd year depreciation charged on machinery)				
31.12.2016	Profit and Loss A/c	Dr.		5,150	–
	To Interest A/c			–	2,000
	To Depreciation A/c			–	3,150
	(Being payment of interest and depreciation charged are transferred to Profit and Loss A/c)				
31.12.2017	Machinery A/c	Dr.		9,000	–
	Interest A/c	Dr.		1,000	–
	To Hire Vendor A/c			–	10,000
	(Being 3rd installment payable)				
31.12.2017	Hire Vendor A/c	Dr.		10,000	–
	To Cash/Bank A/c			–	10,000
	(Being 3rd installment paid)				
31.12.2017	Depreciation A/c	Dr.		2,835	–
	To Machinery A/c			–	2,835
	(Being 3rd year depreciation charged on machinery)				
31.12.2017	Profit and Loss A/c	Dr.		3,835	–
	To Interest A/c			–	1,000
	To Depreciation A/c			–	2,835
	(Being payment of interest and depreciation charged are transferred to Profit and Loss A/c)				

3

Illustration 18: Ledger accounts in the books of Hire Purchaser

On 1 June 2013 Mr. Suraj bought a Motor Lorry from Hindustan Locomotives Ltd. under hire-purchase system. The CP of the asset is ₹20,000; the payment was agreed as follows: ₹4,000 to be paid on signing of the agreement, ₹5,600 at the end of first year, ₹5,200 at the end of second year, ₹4,800 at the end of 3rd year and ₹4,400 at the end of fourth year. Depreciation to be charged at the rate of 20% p.a. on diminishing balance method.

Prepare necessary ledger accounts in the books of Hire Vendor.

Solution:

Total Interest Charged = HPP* (DP + Total Installments) − CP
= 24,000 − 20,000

Total Interest Charged = 4,000

*HPP = DP + 4 Installments

*HPP = 4,000 + 5,600 + 5,200 + 4,800 + 4,400

*HPP = 24,000

(As interest rate is not mentioned in the question, Amount due Ratio is calculated to ascertain each installment interest)

Calculation of Amount due Ratio

No. of installments	**1**	**2**	**3**	**4**
Installment money due	HPP − DP = 24,000 − 4,000 = 20,000	Balance − 1st installment = 20,000 − 5,600 = 14,400	Balance − 2nd installment = 14,400 − 5,200 = 9,200	Balance − 3rd installment 9,200 − 4,800 = 4,400
Amount due Ratio	20,000	14,400	9,200	4,400
	50:36:23:11			
Calculation of interest included in each installment	$4,000 \times \frac{50}{120}$ **= 1,667**	$4,000 \times \frac{36}{120}$ **= 1,200**	$4,000 \times \frac{23}{120}$ **= 767**	$4,000 \times \frac{11}{120}$ **= 366**

Calculation of depreciation (diminishing balance method)

Particulars	**Amount (₹)**
Cash Price (Excluding Down Payment)	20,000
Less: 1st year depreciation @ 20% of 20,000	4,000
Balance	16,000
Less: 2nd year depreciation @ 20% of 16,000	3,200
Balance	12,800
Less: 3rd year depreciation @ 20% of 12,800	2,560
Balance	10,240
Less: 4th year depreciation @ 20% of 10,240	2,048
Written down value of the asset at the end of 4th year	8,192

Analysis table

No. of installments	Date of installment	Installment amount (CP + interest) (₹)	Interest (as calculated before) (₹)	Cash Price (installment money − interest) (₹)	Depreciation (as calculated before) (₹)
Down payment	1.6.2013	4,000	–	4,000	–
1st	31.5.2014	5,600	1,667	3,933	4,000
2nd	31.5.2015	5,200	1,200	4,000	3,200
3rd	31.5.2016	4,800	767	4,033	2,835
4th	31.5.2017	4,400	366	4,034	1,993
		Total HPP = ₹24,000	**Total Interest = ₹4,000**	**Total CP = ₹20,000**	

Abbreviations: CP: Cash Price; HPP: Hire-Purchase Price.

Ledger accounts in the books of Mr. Suraj (Hire Purchaser)
Motor Lorry A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.6.2013	To Bank A/c (DP)	4,000	31.5.2014	By Depreciation A/c	4,000
31.5.2014	To Hire Vendor A/c	3,933	31.5.2014	By Balance c/d	3,933
		7,933			**7,933**
1.6.2014	To Balance b/d	3,933	31.5.2015	By Depreciation A/c	3,200
31.5.2015	To Hire Vendor A/c	4,000	31.5.2015	By Balance c/d	4,733
		7,933			**7,933**
1.6.2015	To Balance b/d	4,733	31.5.2016	By Depreciation A/c	2,835
31.5.2016	To Hire Vendor A/c	4,033	31.5.2016	By Balance c/d	5,931
		8,766			**8,766**
1.6.2016	To Balance b/d	5,931	31.5.2017	By Depreciation A/c	1,993
31.5.2017	To Hire Vendor A/c	4,034	31.5.2017	By Balance c/d	7,972
		9,965			**9,965**
1.6.2017	To Balance b/d	7,972			

Hindustan Locomotives Ltd.'s A/c (Hire Vendor A/c)

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.5.2014	To Bank A/c	5,600	31.5.2014	By Motor Lorry A/c	3,933
			31.5.2014	By Interest A/c	1,667
		5,600			**5,600**
31.5.2015	To Bank A/c	5,200	31.5.2015	By Motor Lorry A/c	4,000
			31.5.2015	By Interest A/c	1,200
		5,200			**5,600**
31.5.2016	To Bank A/c	4,800	31.5.2016	By Motor Lorry A/c	4,033
			31.5.2016	By Interest A/c	767
		4,800			**4,800**
31.5.2017	To Bank A/c	4,400	31.5.2017	By Motor Lorry A/c	4,034
			31.5.2017	By Interest A/c	366
		4,400			**4,400**

Interest A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.5.2014	To Hindustan Locomotives Ltd.'s A/c	1,667	31.5.2014	By P/L A/c	1,667
		1,667			**1,667**
31.5.2015	To Hindustan Locomotives Ltd.'s A/c	1,200	31.5.2015	By P/L A/c	1,200
		1,200			**1,200**
31.5.2016	To Hindustan Locomotives Ltd.'s A/c	767	31.5.2016	By P/L A/c	767
		767			**767**
31.5.2017	To Hindustan Locomotives Ltd.'s A/c	366	31.5.2017	By P/L A/c	366
		366			**366**

3

Depreciation A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.5.2014	To Motor Lorry A/c	4,000	31.5.2014	By P/L A/c	4,000
		4,000			**4,000**
31.5.2015	To Motor Lorry A/c	3,200	31.5.2015	By P/L A/c	3,200
		3,200			**3,200**
31.5.2016	To Motor Lorry A/c	2,835	31.5.2016	By P/L A/c	2,835
		2,835			**2,835**
31.5.2017	To Motor Lorry A/c	1,993	31.5.2017	By P/L A/c	1,993
		1,993			**1,993**

Illustration 19: Ascertainment of Cash Price and preparing of ledger accounts

Mr. Sugam purchased motor lorry from Rathnam Transport Company on hire-purchase system on 1 January 2014. He pays ₹10,000 as DP and ₹12,000, ₹10,000 and ₹8,000 at the end of first, second and third year, respectively. Interest is charged by the Hire Vendor at 10% p.a., and Sugam writes off depreciation at 10% p.a. on diminishing balance method.

Prepare necessary ledger accounts in the books of Mr. Sugam under Asset Accrual Method

3

Solution:

No. of installments	Quarter-end balance (₹) a	Quarterly installment (₹) b	Total amount (₹) c = a + b	Interest $\left(\frac{10}{110}\right)$ (₹) d	Opening balance principal (₹)
3	–	8,000	8,000	727	7,273
2	7,273	10,000	17,273	1,570	15,703
1	15,703	12,000	27,703	2,518	25,185

Therefore, CP = 25,185 + 10,000 (DP).

CP = 35,185

Calculation of depreciation (diminishing balance method)

Particulars	Amount (₹)
Cash Price	35,185
Less: 1st year depreciation @ 10% of 35,185	3,519
Balance	31,666
Less: 2nd year depreciation @ 10% of 31,666	3,167
Balance	28,499
Less: 3rd year depreciation @ 10% of 28,499	2,850
Written down value of the asset at the end of 3rd year	**25,649**

Analysis table

No. of installments	Date of installment	Installment amount (CP + interest) (₹)	Interest (as calculated before) (₹)	Cash Price (installment money − interest) (₹)	Depreciation (as calculated before) (₹)
Down payment	1.1.2014	10,000	–	10,000	–
1st	31.12.2014	12,000	2,518	9,482	3,519
2nd	31.12.2015	10,000	1,570	8,430	3,167
3rd	31.12.2016	8,000	727	7,273	2,850
		Total HPP = ₹40,000	**Total Interest = ₹4,815**	**Total CP = ₹35,185**	

Abbreviations: CP: Cash Price; HPP: Hire-Purchase Price.

Ledger accounts in the books of Mr. Sugam (Hire Purchaser)
Motor Lorry A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Bank A/c (DP)	10,000	31.12.2014	By Depreciation A/c	3,519
31.12.2014	To Hire Vendor A/c	9,482	31.12.2014	By Balance c/d	15,963
		19,482			**19,482**
1.1.2015	To Balance b/d	15,963	31.12.2015	By Depreciation A/c	3,167
31.12.2015	To Hire Vendor A/c	8,430	31.12.2015	By Balance c/d	21,226
		24,393			**24,393**
1.1.2016	To Balance b/d	21,226	31.12.2016	By Depreciation A/c	2,850
31.12.2016	To Hire Vendor A/c	7,273	31.12.2016	By Balance c/d	25,649
		28,499			**28,499**
1.1.2017	To Balance b/d	25,649			

Rathnam Transport Company A/c (Hire Vendor A/c)

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Bank A/c	12,000	31.12.2014	By Motor Lorry A/c	9,482
			31.12.2014	By Interest A/c	2,518
		12,000			**12,000**
31.12.2015	To Bank A/c	10,000	31.12.2015	By Motor Lorry A/c	8,430
			31.12.2015	By Interest A/c	1,570
		10,000			**10,000**
31.12.2016	To Bank A/c	8,000	31.12.2016	By Motor Lorry A/c	7,273
			31.12.2016	By Interest A/c	727
		8,000			**8,000**

3

Interest A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Rathnam Transport Company's A/c	2,518	31.12.2014	By P/L A/c	2,518
		2,518			**2,518**
31.12.2015	To Rathnam Transport Company's A/c	1,570	31.12.2015	By P/L A/c	1,570
		1,570			**1,570**
31.12.2016	To Rathnam Transport Company's A/c	727	31.12.2016	By P/L A/c	727
		727			**727**

Depreciation A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Motor Lorry A/c	3,519	31.12.2014	By P/L A/c	3,519
		3,519			**3,519**
31.12.2015	To Motor Lorry A/c	3,167	31.12.2015	By P/L A/c	3,167
		3,167			**3,167**
31.12.2016	To Motor Lorry A/c	2,850	31.12.2016	By P/L A/c	2,850
		2,850			**2,850**

Illustration 20: **Calculation of cash price using present value of annuity**

On 1 January 2013 Eshwar purchased Motor Vehicle from Sanjay Motors on hire-purchase system. He agrees to pay the same in five annual installments of ₹7,500 each. The interest rate is charged at 6% p.a. from the annuity values drawn from annuity table. It is observed that the present value of annuity for ₹1 is ₹4.21236 at 6%. The depreciation will be charged at 10% p.a. on diminishing balance method.

From the information mentioned above, ascertain the CP and pass the necessary journal entries in the books of Mr. Eshwar under Asset Accrual Method.

Solution:

Calculation of Cash Price

$$\text{Amount of Installment} \times \text{Annuity Value} = 7{,}500 \times 4.21236$$

$$CP = ₹31{,}593$$

Calculation of interest when HPP > CP (or when HPP is inclusive of interest)

Particulars	Amount (₹)
Cash Price	31,593
Less: Down Payment	NIL
Remaining balance	31,593
Add: 1^{st} year installment interest @ 6% on 31,593	1,896
	33,489
Less: 1^{st} year installment	7,500
Remaining balance	25,989
Add: 2^{nd} year installment interest @ 6% on 25,989	1,559
	27,548
Less: 2^{nd} year installment	7,500
Remaining balance	20,048
Add: 3^{rd} year installment interest @ 6% on 20,048	1,203
	21,251
Less: 3^{rd} year installment	7,500
Remaining balance	13,751
Add: 4^{th} year installment interest @ 6% on 13,751	825
	14,576
Less: 4^{th} year installment	7,500
Remaining balance	7,076
Add: 5^{th} year installment interest (7,500 − 7,076) (*Balancing figure*)	424
	7,500
Less: 5^{th} year installment	7,500
Remaining balance	–

Calculation of depreciation (diminishing balance method)

Particulars	Amount (₹)
Cash Price	31,593
Less: 1^{st} year depreciation @ 10% of 31,593	3,159
Balance	28,434
Less: 2^{nd} year depreciation @ 10% of 28,434	2,843
Balance	25,591
Less: 3^{rd} year depreciation @ 10% of 25,591	2,559
Balance	23,032
Less: 4^{th} year depreciation @ 10% of 23,032	2,303
Balance	20,729
Less: 5^{th} year depreciation @ 10% of 20,729	2,073
Written down value of the asset at the end of 5^{th} year	**18,656**

3

Analysis table

No. of installments	Date of installment	Installment amount (CP + interest) (₹)	Interest (as calculated before) (₹)	Cash Price (installment money − interest) (₹)	Depreciation (as calculated before) (₹)
Down Payment	1.1.2013	NIL	–	NIL	–
1st	31.12.2013	7,500	1,896	5,604	3,159
2nd	31.12.2014	7,500	1,559	5,941	2,843
3rd	31.12.2015	7,500	1,203	6,297	2,559
4th	31.12.2016	7,500	825	6,675	2,303
5th	31.12.2017	7,500	424	7,076	2,073
		Total HPP = ₹37,500	**Total Interest = ₹5,907**	**Total CP = ₹31,593**	

Abbreviations: CP: Cash Price; HPP: Hire-Purchase Price.

In the books of Mr. Eshwar (Hire Purchaser)
Journal entries

Date	Particulars		LF	Debit (₹)	Credit (₹)
31.12.2013	Motor Vehicle A/c	Dr.		5,604	–
	Interest A/c	Dr.		1,896	–
	To Hire Vendor A/c			–	7,500
	(Being 1st installment payable)				
31.12.2013	Hire Vendor A/c	Dr.		7,500	–
	To Cash/Bank A/c			–	7,500
	(Being 1st installment paid)				
31.12.2013	Depreciation A/c	Dr.		3,159	–
	To Machinery A/c			–	3,159
	(Being 1st year depreciation charged on machinery)				
31.12.2013	Profit and Loss A/c	Dr.		5,055	–
	To Interest A/c			–	1,896
	To Depreciation A/c			–	3,159
	(Being payment of interest and depreciation charged are transferred to Profit and Loss A/c)				
31.12.2014	Motor Vehicle A/c	Dr.		5,941	–
	Interest A/c	Dr.		1,559	–
	To Hire Vendor A/c			–	7,500
	(Being 2nd installment payable)				
31.12.2014	Hire Vendor A/c	Dr.		7,500	–
	To Cash/Bank A/c			–	7,500
	(Being 2nd installment paid)				

(Contd.)

Date	Particulars		LF	Debit (₹)	Credit (₹)
31.12.2014	Depreciation A/c	Dr.		2,843	–
	To Machinery A/c			–	2,843
	(Being 2nd year depreciation charged on machinery)				
31.12.2014	Profit and Loss A/c	Dr.		4,402	–
	To Interest A/c			–	1,559
	To Depreciation A/c			–	2,843
	(Being payment of interest and depreciation charged are transferred to Profit and Loss A/c)				
31.12.2015	Motor Vehicle A/c	Dr.		6,297	–
	Interest A/c	Dr.		1,203	–
	To Hire Vendor A/c			–	7,500
	(Being 3rd installment payable)				
31.12.2015	Hire Vendor A/c	Dr.		7,500	–
	To Cash/Bank A/c			–	7,500
	(Being 3rd installment paid)				
31.12.2015	Depreciation A/c	Dr.		2,559	–
	To Machinery A/c			–	2,559
	(Being 3rd year depreciation charged on machinery)				
31.12.2015	Profit and Loss A/c	Dr.		3,762	–
	To Interest A/c			–	1,203
	To Depreciation A/c			–	2,559
	(Being payment of interest and depreciation charged are transferred to Profit and Loss A/c)				
31.12.2016	Motor Vehicle A/c	Dr.		6,675	–
	Interest A/c	Dr.		825	–
	To Hire Vendor A/c			–	7,500
	(Being 4th installment payable)				
31.12.2016	Hire Vendor A/c	Dr.		7,500	–
	To Cash/Bank A/c			–	7,500
	(Being 4th installment paid)				
31.12.2016	Depreciation A/c	Dr.		2,303	–
	To Machinery A/c			–	2,303
	(Being 4th year depreciation charged on machinery)				
31.12.2016	Profit and Loss A/c	Dr.		3,128	–
	To Interest A/c			–	825
	To Depreciation A/c			–	2,303
	(Being payment of interest and depreciation charged are transferred to Profit and Loss A/c)				

(Contd.)

Date	Particulars		LF	Debit (₹)	Credit (₹)
31.12.2017	Motor Vehicle A/c	Dr.		7,076	–
	Interest A/c	Dr.		424	–
	To Hire Vendor A/c			–	7,500
	(Being 5th installment payable)				
31.12.2017	Hire Vendor A/c	Dr.		7,500	–
	To Cash/Bank A/c			–	7,500
	(Being 5th installment paid)				
31.12.2017	Depreciation A/c	Dr.		2,073	–
	To Machinery A/c			–	2,073
	(Being 5th year depreciation charged on machinery)				
31.12.2017	Profit and Loss A/c	Dr.		2,497	–
	To Interest A/c			–	424
	To Depreciation A/c			–	2,073
	(Being payment of interest and depreciation charged are transferred to Profit and Loss A/c)				

Illustration 21: Calculation of cash price using present value of annuity

Ram purchased a truck from Shyam Motors on Hire-Purchase basis; the payment is made as follows:

DP – ₹27,000, first installment – ₹25,000, second installment – ₹30,000, third installment – ₹35,000, fourth installment – ₹40,000, fifth installment – ₹45,000 at the end of first, second, third, fourth and fifth year, respectively. The rate of interest to be charged by Shyam Motors is 6% p.a. The annuity table shows that the present value of ₹1 for first, second, third, fourth and fifth year is 0.9434, 0.8900, 0.8396, 0.7921 and 0.7473, respectively. The depreciation will be charged at 15% on straight line method.

Prepare ledger accounts in the books of Mr. Ram under Asset Accrual Method

Solution:

Calculation of Cash Price

	Amount (₹)	Present value of ₹1 @ 5%	Present value of installment (₹)
Down Payment	25,000	1.000	25,000
1st year	20,000	0.9434	18,868
2nd year	25,000	0.8900	22,250
3rd year	30,000	0.8396	25,188
4th year	35,000	0.7921	27,724
5th year	40,000	0.7473	29,892
Total Cash Price			**1,48,922**

Calculation of Interest when HPP > CP (or when HPP is inclusive of Interest)

Particulars	Amount (₹)
Cash Price	1,48,922
Less: Down Payment	25,000
Remaining balance	1,23,922
Add: 1st year installment interest @ 6% on 1,23,922	7,435
	1,31,357
Less: 1st year installment	20,000
Remaining balance	1,11,357
Add: 2nd year installment interest @ 6% on 1,11,357	6,681
	1,18,038
Less: 2nd year installment	25,000
Remaining balance	93,038
Add: 3rd year installment interest @ 6% on 93,038	5,582
	98,620
Less: 3rd year installment	30,000
Remaining balance	68,620
Add: 4th year installment interest @ 6% on 68,620	4,117
	72,737
Less: 4th year installment	35,000
Remaining balance	37,737
Add: 5th year installment interest (40,000 − 37,737) (*Balancing figure*)	2,263
	40,000
Less: 5th year installment	40,000
Remaining balance	–

Calculation of depreciation (straight line method)

Particulars	Amount (₹)
Cash Price	1,48,922
Depreciation @ 15% p.a. every year on 1,48,922	22,338

Analysis table

No. of installments	Installment amount (CP + interest) (₹)	Interest (as calculated before) (₹)	Cash Price (installment money − interest) (₹)	Depreciation (as calculated before) (₹)
Down payment	25,000	–	25,000	–
1st	20,000	7,435	12,565	22,338
2nd	25,000	6,681	18,319	22,338
3rd	30,000	5,582	24,418	22,338
4th	35,000	4,117	30,883	22,338
5th	40,000	2,263	37,737	22,338
	Total HPP = ₹1,75,000	**Total Interest = ₹26,078**	**Total CP = ₹1,48,922**	

Abbreviations: CP: Cash Price; HPP: Hire-Purchase Price.

Ledger accounts in the books of Mr. Ram (Hire Purchaser)
In the books of Mr. Ram
Truck A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Bank A/c (DP)	25,000	1st year	By Depreciation A/c	22,338
	To Hire Vendor A/c	12,565		By Balance c/d	15,227
		37,565			**37,565**
2nd year	To Balance b/d	15,227	2nd year	By Depreciation A/c	22,338
	To Hire Vendor A/c	18,319		By Balance c/d	11,208
		33,546			**33,546**
3rd year	To Balance b/d	11,208	3rd year	By Depreciation A/c	22,338
	To Hire Vendor A/c	24,418		By Balance c/d	13,288
		35,626			**35,626**
4th year	To Balance b/d	13,288	4th year	By Depreciation A/c	22,338
	To Hire Vendor A/c	30,883		By Balance c/d	21,833
		44,171			**44,171**
5th year	To Balance b/d	21,833	5th year	By Depreciation A/c	22,338
	To Hire Vendor A/c	37,737		By Balance c/d	37,232
		59,570			**59,570**
6th year	To Balance b/d	37,232			

Shyam Motors A/c (Hire Vendor A/c)

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Bank A/c	20,000	1st year	By Truck A/c	12,565
				By Interest A/c	7,435
		20,000			**20,000**
2nd year	To Bank A/c	25,000	2nd year	By Truck A/c	18,319
				By Interest A/c	6,681
		25,000			**25,000**
3rd year	To Bank A/c	30,000	3rd year	By Truck A/c	24,418
				By Interest A/c	5,582
		30,000			**30,000**
4th year	To Bank A/c	35,000	4th year	By Truck A/c	30,883
				By Interest A/c	4,117
		35,000			**35,000**
5th year	To Bank A/c	40,000	5th year	By Truck A/c	37,737
				By Interest A/c	2,263
		40,000			**40,000**

Interest A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Shyam Motors A/c	7,435	1st year	By P/L A/c	7,435
		7,435			**7,435**
2nd year	To Shyam Motors A/c	6,681	2nd year	By P/L A/c	6,681
		6,681			**6,681**
3rd year	To Shyam Motors A/c	5,582	3rd year	By P/L A/c	5,582
		5,582			**5,582**
4th year	To Shyam Motors A/c	4,117	4th year	By P/L A/c	4,117
		4,117			**4,117**
5th year	To Shyam Motors A/c	2,263	5th year	By P/L A/c	2,263
		2,263			**2,263**

Depreciation A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Truck A/c	22,338	1st year	By P/L A/c	22,338
		22,338			**22,338**
2nd year	To Truck A/c	22,338	2nd year	By P/L A/c	22,338
		22,338			**22,338**
3rd year	To Truck A/c	22,338	3rd year	By P/L A/c	22,338
		22,338			**22,338**
4th year	To Truck A/c	22,338	4th year	By P/L A/c	22,338
		22,338			**22,338**
5th year	To Truck A/c	22,338	5th year	By P/L A/c	22,338
		22,338			**22,338**

Illustration 22: **Journal entries and ledger accounts in the books of Hire Vendor**

On 1 January 2014, SK Engineering Works bought an Electric Motor from JK Machine tools Ltd. on Hire-Purchase basis. The CP of the Motor was ₹37,000 and the payment was to be made as follows: ₹7,000 on signing of the agreement and the balance in three half-yearly installments of ₹12,000 each at 20% p.a. interest to be charged by the Hire Vendor.

Prepare ledger accounts and pass the necessary journal entries in the books of JK Machine Tools Ltd.

Solution:

Calculation of interest when HPP > CP (or when HPP is inclusive of interest)

Particulars	Amount (₹)
Cash Price	37,000
Less: Down Payment	7,000
Remaining balance	30,000
Add: 1st half-yearly installment interest @ 10% on 30,000	3,000
	33,000
Less: 1st half-yearly installment	12,000
Remaining balance	21,000
Add: 2nd half-yearly installment interest @ 10% on 21,000	2,100
	23,100
Less: 2nd half-yearly installment	12,000
Remaining balance	11,100
Add: 3rd half-yearly installment interest (12,000 − 11,100) (*Balancing figure*)	900
	12,000
Less: 3rd half-yearly installment	12,000
	–

3

Analysis table

No. of installments	Date of installment	Installment amount (CP + interest) (₹)	Interest (as calculated before) (₹)	Cash Price (installment money − interest) (₹)
Down Payment	1.1.2014	7,000	–	7,000
1st	30.6.2014	12,000	3,000	9,000
2nd	1.1.2015	12,000	2,100	9,900
3rd	30.6.2015	12,000	900	11,100
		Total HPP = ₹43,000	**Total Interest = ₹6,000**	**Total CP = ₹37,000**

Abbreviations: CP: Cash Price; HPP: Hire-Purchase Price.
Note: Interest is charged half yearly i.e., 20% ÷ 2 = 10%

In the books of Mr. JK Machine Tools Ltd. (Hire Vendor)
Journal entries

Date	Particulars	LF	Debit (₹)	Credit (₹)
1.1.2014	SK Engineering Works A/c (CP) Dr.		37,000	–
	To Sales A/c		–	37,000
	(Being Asset sold on Hire-Purchase basis)			
1.1.2014	Bank A/c Dr.		7,000	–
	To SK Engineering Works A/c		–	7,000
	(Being Down Payment received)			
30.6.2014	SK Engineering Works A/c Dr.		3,000	–
	To Interest A/c		–	3,000
	(Being 1st half-yearly installment interest due)			
30.6.2014	Bank A/c Dr..		12,000	–
	To SK Engineering Works A/c		–	12,000
	(Being 1st half-yearly installment received)			
30.6.2014	Interest A/c Dr..		3,000	–
	To P/L A/c		–	3,000
	(Being 1st half-yearly installment received and transferred to P/L A/c)			
31.12.2014	SK Engineering Works A/c Dr..		2,100	–
	To Interest A/c		–	2,100
	(Being 2nd half-yearly installment interest due)			
31.12.2014	Bank A/c Dr..		12,000	–
	To SK Engineering Works A/c		–	12,000
	(Being 2nd half-yearly installment received)			
31.12.2014	Interest A/c Dr..		2,100	–
	To P/L A/c		–	2,100
	(Being 2nd half-yearly installment received and transferred to P/L A/c)			
30.6.2015	SK Engineering Works A/c Dr..		900	–
	To Interest A/c		–	900
	(Being 3rd half-yearly installment interest due)			
30.6.2015	Bank A/c Dr..		12,000	–
	To SK Engineering Works A/c		–	12,000
	(Being 3rd half-yearly installment received)			
30.6.2015	Interest A/c Dr..		900	–
	To P/L A/c		–	900
	(Being 3rd half-yearly installment received and transferred to P/L A/c)			

(Contd.)

SK Engineering Works A/c (Hire Purchaser A/c)

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Sales (CP) A/c	37,000	1.1.2016	By Bank A/c (DP)	7,000
30.6.2014	To Interest A/c	3,000	30.6.2014	By Bank A/c (Installment)	12,000
			30.6.2014	By Bal c/d (*Balancing figure*)	21,000
		40,000			**40,000**
1.7.2014	To Balance b/d	21,000	31.12.2014	By Bank A/c (Installment)	12,000
31.12.2014	To Interest A/c	2,100	31.12.2014	By Bal c/d (*Balancing figure*)	11,100
		23,100			**23,100**
1.1.2015	To Balance b/d	11,100	30.6.2015	By Bank A/c (Installment)	12,000
30.6.2015	To Interest A/c	900	30.6.2015		
		12,000			**12,000**

Abbreviations: CP: Cash Price; DP: Down Payment.

Interest A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
30.6.2014	To P/L A/c	3,000	30.6.2014	By SK Engineering Works A/c	3,000
		3,000			**3,000**
31.12.2014	To P/L A/c	2,100	31.12.2014	By SK Engineering Works A/c	2,100
		2,100			**2,100**
30.6.2015	To P/L A/c	900	30.6.2015	By SK Engineering Works A/c	900
		900			**900**

Illustration 23: **Journal entries and ledger accounts in the books of Hire Purchase**

Shreekanth Oil Company bought an oil-dispensing machine on hire-purchase system from Sreeganesh Oil Corporation on 1 January 2016. The CP was agreed at ₹2,22,600. It was further agreed that ₹60,000 would be paid as initial payment and the balance in 3 quarterly installments of ₹60,000 each. Sreeganesh has accepted to charge interest at 5% per quarter. The depreciation will be written off at 10% p.a. on straight line method.

Solution:

Calculation of interest when HPP > CP (or when HPP is inclusive of interest)

Particulars	Amount (₹)
Cash Price	2,22,600
Less: Down Payment	60,000
Remaining balance	1,62,600
Add: 1st Quarterly installment interest @ 5% on 1,62,600	8,130
	1,70,730
Less: 1st quarterly installment	60,000
Remaining balance	1,10,730
Add: 2nd Quarterly installment interest @ 5% on 1,10,730	5,537
	1,16,267
Less: 2nd quarterly installment	60,000
Remaining balance	56,267
Add: 3rd Quarterly installment interest (60,000 − 56,267) (*Balancing figure*)	3,733
	60,000
Less: 3rd half-yearly installment	60,000
	–

3

Calculation of depreciation (straight line method)

Note: **Although interest is charged quarterly, depreciation will be charged annually.**

Particulars	Amount (₹)
Cash Price	2,22,600
Less: Depreciation as on 31.12.2016 @ 10% p.a.	22,260
Written down value as on 31.12.2016	2,00,340

Analysis table

No. of installments	Date of installment	Installment amount (CP + interest) (₹)	Interest (as calculated before) (₹)	Cash Price (installment money − interest) (₹)	Depreciation (as calculated before) (₹)
Down Payment	1.1.2016	60,000	–	60,000	–
1st Quarter	31.3.2016	60,000	8,130	51,870	
2nd Quarter	30.6.2016	60,000	5,537	54,463	
3rd Quarter	30.9.2016	60,000	3,733	56,267	
4th Quarter	31.12.2016	–	–	–	22,260
		Total HPP = ₹2,40,000	**Total Interest = ₹17,400**	**Total CP = ₹2,22,600**	

Abbreviations: CP: Cash Price; HPP: Hire-Purchase Price.

In the books of Shreekanth Oil Company (Hire Purchaser)
Journal entries

Date	Particulars		LF	Debit (₹)	Credit (₹)
1.1.2016	Machinery A/c	Dr.		60,000	
	To Bank A/c				60,000
	(Being Down Payment paid)				
31.3.2016	Machinery A/c	Dr.		51,870	–
	Interest A/c	Dr.		8,130	–
	To Hire Vendor A/c			–	60,000
	(Being 1st installment payable)				
31.3.2016	Hire Vendor A/c	Dr.		60,000	–
	To Cash/Bank A/c			–	60,000
	(Being 1st installment paid)				
31.3.2016	Profit and Loss A/c	Dr.		8,130	–
	To Interest A/c			–	8,130
	(Being payment of interest charged are transferred to Profit and Loss A/c)				
30.6.2016	Machinery A/c	Dr.		54,463	–
	Interest A/c	Dr.		5,537	–
	To Hire Vendor A/c			–	60,000
	(Being 1st installment payable)				
30.3.2016	Hire Vendor A/c	Dr.		60,000	–
	To Cash/Bank A/c			–	60,000
	(Being 1st installment paid)				
30.3.2016	Profit and Loss A/c	Dr.		5,537	–
	To Interest A/c			–	5,537
	(Being payment of interest charged are transferred to Profit and Loss A/c)				
30.9.2016	Machinery A/c	Dr.		56,267	–
	Interest A/c	Dr.		3,733	–
	To Hire Vendor A/c			–	60,000
	(Being 1st installment payable)				
30.9.2016	Hire Vendor A/c	Dr.		60,000	–
	To Cash/Bank A/c			–	60,000
	(Being 1st installment paid)				
30.9.2016	Profit and Loss A/c	Dr.		3,733	–
	To Interest A/c			–	3,733
	(Being payment of interest charged are transferred to Profit and Loss A/c)				

Ledger accounts in the books of Shreekanth Oil Company (Hire Purchaser)

Machine A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2016	To Bank A/c (DP)	60,000	31.3.2016	By Balance c/d	68,130
31.3.2016	To Hire Vendor A/c	8,130			
		68,130			**68,130**
1.4.2016	To Balance b/d	68,130	30.6.2016	By Balance c/d	73,667
30.6.2016	To Hire Vendor A/c	5,537			
		73,667			**73,667**
1.7.2016	To Balance b/d	73,667	30.9.2016	By Balance c/d	77,400
30.9.2016	To Hire Vendor A/c	3,733			
		77,400			**77,400**
1.10.2016	To Balance b/d	77,400	31.12.2016	By Depreciation A/c	22,260
			31.12.2016	By Balance A/c	55,140
		77,400			**77,400**
1.1.2017	To Balance b/d	55,140			

Sreeganesh Oil Corporation A/c (Hire Vendor)

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2016	To Bank A/c	60,000	31.3.2016	By Machine A/c	51,870
			31.3.2016	By Interest A/c	8,130
		60,000			**60,000**
30.6.2016	To Bank A/c	60,000	30.6.2016	By Machine A/c	54,463
			30.6.2016	By Interest A/c	5,537
		60,000			**60,000**
30.9.2016	To Bank A/c	60,000	30.9.2016	By Machine A/c	56,267
			30.9.2016	By Interest A/c	3,733
		60,000			**60,000**

Interest A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2016	To Sreeganesh Oil Corporation A/c	8,130	31.3.2016	By P/L A/c	8,130
		8,130			**8,130**
30.6.2016	To Sreeganesh Oil Corporation A/c	5,537	30.6.2016	By P/L A/c	5,537
		5,537			**5,537**
30.9.2016	To Sreeganesh Oil Corporation A/c	3,733	30.9.2016	By P/L A/c	3,733
		3,733			**3,733**

Depreciation A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2016	To Machine A/c	22,260	31.12.2016	By P/L A/c	22,260
		22,260			**22,260**

Illustration 24: **Preparation of ledger accounts in the books of Hire Purchaser**

Raman purchased a machine costing ₹2,40,000 on 1 April 2013 from Bangalore Machines Ltd. under hire-purchase system. The terms agreed were ₹60,000 as DP and the balance in three equal annual installments along with interest at the rate of 20% p.a. on the outstanding CP. Depreciation is to be charged at 15% p.a. diminishing balance method, prepare necessary ledger accounts in the books of Raman till 31 March 2016 under Asset Accrual Method.

[B.U., B.Com., Nov/Dec 2016, Section C]

Solution:

Calculation of interest when HPP = CP (or when HPP is exclusive of interest)

Particulars	Amount (₹)
Cash Price	2,40,000
Less: Down Payment	60,000
Remaining balance	1,80,000
Add: 1st year installment interest @ 20% on 1,80,000	36,000
	2,16,000
Less: 1st year installment (60,000 + 36,000)	96,000
Remaining balance	1,20,000
Add: 2nd year installment interest @ 20% on 1,20,000	24,000
	1,44,000
Less: 2nd year installment (60,000 + 24,000)	84,000
Remaining balance	60,000
Add: 3rd year installment interest @ 20% on 60,000	12,000
	72,000
Less: 3rd year installment (60,000 + 12,000)	72,000
	–

Calculation of depreciation (diminishing balance method)

Particulars	Amount (₹)
Cash Price	2,40,000
Less: 1st year depreciation @ 15% of 2,40,000	36,000
Balance	2,04,000
Less: 2nd year depreciation @ 15% of 2,04,000	30,600
Balance	1,73,400
Less: 3rd year depreciation @ 15% of 1,73,400	26,010
Written down value of the asset at the end of 5th year	**1,47,390**

3

Analysis table

No. of installments	Installment amount (CP + interest)	Interest (as calculated before)	Cash Price (installment money − interest)
Down Payment	60,000	–	60,000
1^{st}	60,000	36,000	24,000
2^{nd}	60,000	24,000	36,000
3^{rd}	60,000	12,000	48,000
	Total HPP = ₹2,40,000	**Total Interest = ₹72,000**	**Total CP = ₹1,68,000**

Abbreviations: CP: Cash Price; HPP: Hire-Purchase Price.

Ledger accounts in the books of Mr. Raman (Hire Purchaser)

Asset A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2013	To Bank A/c (DP)	60,000	31.3.2014	By Depreciation A/c	36,000
31.3.2014	To Bangalore Machines A/c	24,000	31.3.2014	By Balance c/d	48,000
		84,000			**84,000**
1.4.2014	To Balance b/d	48,000	31.3.2015	By Depreciation A/c	30,600
31.3.2015	To Bangalore Machines A/c	36,000	31.3.2015	By Balance c/d	53,400
		84,000			**84,000**
1.4.2016	To Balance b/d	53,400	31.3.2017	By Depreciation A/c	26,010
31.3.2017	To Bangalore Machines A/c	48,000	31.3.2017	By Balance c/d	75,390
		1,01,400			**1,01,400**
1.4.2017	To Balance b/d	75,390			

Abbreviation: DP: Down Payment.

Bangalore Machines Ltd. A/c (Hire Vendor)

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Bank A/c	96,000	31.3.2015	By Machinery A/c	60,000
			31.3.2015	By Interest A/c	36,000
		96,000			**96,000**
31.3.2016	To Bank A/c	84,000	31.3.2016	By Machinery A/c	60,000
			31.3.2016	By Interest A/c	24,000
		84,000			**84,000**
31.3.2017	To Bank A/c	72,000	31.3.2017	By Machinery A/c	60,000
			31.3.2017	By Interest A/c	12,000
		72,000			**72,000**

Interest A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Bangalore Machines Ltd. A/c	36,000	31.3.2015	By P/L A/c	36,000
		36,000			**36,000**
31.3.2016	To Bangalore Machines Ltd. A/c	24,000	31.3.2016	By P/L A/c	24,000
		24,000			**24,000**
31.3.2017	To Bangalore Machines Ltd. A/c	12,000	31.3.2017	By P/L A/c	12,000
		12,000			**12,000**

Depreciation A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Machinery A/c	36,000	31.3.2015	By P/L A/c	36,000
		36,000			**36,000**
31.3.2016	To Machinery A/c	30,600	31.3.2016	By P/L A/c	30,600
		30,600			**30,600**
31.3.2017	To Machinery A/c	26,010	31.3.2017	By P/L A/c	26,010
		26,010			**26,010**

3

Illustration 25: **Preparation of ledger accounts in the books of Hire Purchaser**

Muthappa purchased a plant costing ₹1,60,000 on 1 April 2010 from Muthamma Electronics Ltd. under hire-purchase system. The terms agreed were ₹40,000 as DP and balance to be given in three equal installments together with interest at 20% p.a. of outstanding CP. Depreciation is to be charged at 15% p.a. under straight line method. Prepare the necessary ledger accounts in the books of Muthappa under Asset Accrual Method. **[B.U., B.Com., Nov/Dec 2014, Section C]**

Solution:

Calculation of interest when HPP = CP (or when HPP is exclusive of interest)

Particulars	Amount (₹)
Cash Price *Less:* Down Payment	1,60,000 40,000
Remaining balance *Add:* 1st year installment interest @ 20% on 1,20,000	1,20,000 24,000
 Less: 1st year installment (40,000 + 24,000)	1,44,000 64,000
Remaining balance *Add:* 2nd year installment interest @ 20% on 80,000	80,000 16,000
 Less: 2nd year installment (40,000 + 16,000)	96,000 56,000
Remaining balance *Add:* 3rd year installment interest @ 20% on 40,000	40,000 8,000
 Less: 3rd year installment (40,000 + 8,000)	48,000 48,000
Remaining balance	–

Calculation of depreciation (straight line method)

Particulars	Amount (₹)
Cash Price	1,60,000
Depreciation @ 15% p.a. every year on 1,60,000	24,000

Analysis table

No. of installments	Installment amount (CP + interest)	Interest (as calculated before)	Cash Price (installment money − interest)	Depreciation (as calculated before)
Down payment	40,000	–	40,000	–
1^{st}	40,000	24,000	16,000	24,000
2^{nd}	40,000	18,000	22,000	24,000
3^{rd}	40,000	8,000	32,000	24,000
	Total HPP = ₹1,60,000	**Total Interest = ₹50,000**	**Total CP = ₹1,10,000**	

Abbreviations: CP: Cash Price; HPP: Hire-Purchase Price.

Ledger accounts in the books of Mr. Muthappa (Hire Purchaser)
Plant A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2010	To Bank A/c (DP)	40,000	31.3.2010	By Depreciation A/c	24,000
31.3.2010	To Muthamma Electronics A/c	16,000	31.3.2010	By Balance c/d	32,000
		56,000			**80,000**
1.4.2011	To Balance b/d	32,000	31.3.2011	By Depreciation A/c	24,000
31.3.2011	To Muthamma Electronics A/c	22,000	31.3.2011	By Balance c/d	30,000
		54,000			**54,000**
1.4.2012	To Balance b/d	30,000	31.3.2012	By Depreciation A/c	24,000
31.3.2012	To Muthamma Electronics A/c	32,000	31.3.2012	By Balance c/d	38,000
		62,000			**62,000**
1.4.2013	To Balance b/d	38,000			

Muthamma Electronics A/c (Hire Vendor A/c)

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2010	To Bank A/c	64,000	31.3.2010	By Plant A/c	40,000
				By Interest A/c	24,000
		64,000			**60,000**
31.3.2011	To Bank A/c	56,000	31.3.2011	By Plant A/c	40,000
				By Interest A/c	16,000
		56,000			**56,000**
31.3.2012	To Bank A/c	48,000	31.3.2012	By Plant A/c	40,000
				By Interest A/c	8,000
		48,000			**48,000**

Interest A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2010	To Muthamma Electronics A/c	24,000	31.3.2010	By P/L A/c	24,000
		24,000			**24,000**
31.3.2011	To Muthamma Electronics A/c	16,000	31.3.2011	By P/L A/c	16,000
		16,000			**16,000**
31.3.2012	To Muthamma Electronics A/c	8,000	31.3.2012	By P/L A/c	8,000
		8,000			**8,000**

Depreciation A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2010	To Machinery A/c	24,000	31.3.2010	By P/L A/c	24,000
		24,000			**24,000**
31.3.2011	To Machinery A/c	24,000	31.3.2011	By P/L A/c	24,000
		24,000			**24,000**
31.3.2012	To Machinery A/c	24,000	31.3.2012	By P/L A/c	24,000
		24,000			**24,000**

Illustration 26: **Preparation of ledger accounts in the books of Hire Purchaser**

Mr. Mahesh purchased a Ford Car on hire-purchase system. The total CP of the car is ₹15,98,000 payable ₹4,00,000 as DP, and three installments of ₹6,00,000, ₹5,00,000 and ₹2,00,000 payable at the end of first, second and third year, respectively. Interest is charged at 5% p.a. Rate of depreciation is 25% p.a. on diminishing balance method. Prepare necessary accounts in the books of Sri Mahesh.

[B.U., B.Com., Nov/Dec 2013, Section C]

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Solution:

Calculation of interest when HPP > CP (or when HPP is inclusive of interest)

Particulars	Amount (₹)
Cash Price	15,98,000
Less: Down Payment	4,00,000
Remaining balance	11,98,000
Add: 1st year installment interest @ 5% on 11,98,000	59,900
	12,57,900
Less: 1st year installment	6,00,000
Remaining balance	6,57,900
Add: 2nd year installment interest @ 5% on 6,57,900	32,895
	6,90,795
Less: 2nd year installment	5,00,000
Remaining balance	1,90,795
Add: 3rd year installment interest (2,00,000 − 1,90,795) (*Balancing figure*)	9,205
	2,00,000
Less: 3rd year installment	2,00,000
	–

Calculation of depreciation (diminishing balance method)

Particulars	Amount (₹)
Cash Price	15,98,000
Less: 1st year depreciation @ 25% of 15,98,000	3,99,500
Balance	11,98,500
Less: 2nd year depreciation @ 25% of 11,98,500	2,99,625
Balance	8,98,875
Less: 3rd year depreciation @ 25% of 8,98,875	2,24,719
Written down value of the asset at the end of 3rd year	**6,74,156**

Analysis table

No. of installments	Installment amount (CP + interest)	Interest (as calculated before)	Cash Price (installment money − interest)	Depreciation (as calculated before)
Down Payment	4,00,000	–	4,00,000	–
1st	6,00,000	59,900	5,40,100	3,99,500
2nd	5,00,000	32,895	4,67,105	2,99,625
3rd	2,00,000	9,205	1,90,795	2,24,719
	Total HPP = ₹17,00,000	**Total Interest = ₹1,02,000**	**Total CP = ₹15,98,000**	

Abbreviations: CP: Cash Price; HPP: Hire-Purchase Price.

3

Ledger accounts in the books of Mr. Mahesh (Hire Purchaser)

Ford Car A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Bank A/c (DP)	4,00,000	1st year	By Depreciation A/c	3,99,500
	To Hire Vendor A/c	5,40,100		By Balance c/d	5,40,600
		9,40,100			**9,40,100**
2nd year	To Balance b/d	5,40,600	2nd year	By Depreciation A/c	2,99,625
	To Hire Vendor A/c	4,67,105		By Balance c/d	7,08,080
		10,07,705			**10,07,705**
3rd year	To Balance b/d	7,08,080	3rd year	By Depreciation A/c	2,24,719
				By Balance c/d	
	To Hire Vendor A/c	1,90,795			6,74,156
		8,98,875			**8,98,875**
4th year	To Balance b/d	6,73,656			

Hire Vendor A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Bank A/c (Installment)	6,00,000	1st year	By Ford Car A/c	59,900
				By Interest A/c	5,40,100
		6,00,000			**6,00,000**
2nd year	To Bank A/c	5,00,000	2nd year	By Machinery A/c	4,67,105
				By Interest A/c	32,895
		5,00,000			**5,00,000**
3rd year	To Bank A/c	2,00,000	3rd year	By Machinery A/c	1,90,795
				By Interest A/c	9,205
		2,00,000			**2,00,000**

Abbreviation: DP: Down Payment.

Interest A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Bangalore Machines Ltd. A/c	59,900	1st year	By P/L A/c	59,900
		59,900			**59,900**
2nd year	To Bangalore Machines Ltd. A/c	32,895	2nd year	By P/L A/c	32,895
		32,895			**32,895**
3rd year	To Bangalore Machines Ltd. A/c	9,205	3rd year	By P/L A/c	9,205
		9,205			**9,205**

3

Depreciation A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Ford Car A/c	3,99,500	1st year	By P/L A/c	3,99,500
		3,99,500			**3,99,500**
2nd year	To Ford Car A/c	2,99,625	2nd year	By P/L A/c	2,99,625
		2,99,625			**2,99,625**
3rd year	To Ford Car A/c	2,24,719	3rd year	By P/L A/c	2,24,719
		2,24,719			**2,24,719**

Illustration 27: **Preparation of ledger accounts in the books of Hire Purchaser**

On 1st January 2014, Ms. Jayanthy purchased a washing machine from Royal enterprises on Hire-Purchase basis. The Cash Price of the machine was ₹60,000, payable ₹12,000 on signing the agreement and the balance in four annual installments of ₹12,000 plus interest at 15% p.a. payable on 31st December each year. Jayanthy writes off depreciation at 10% p.a. on Diminishing Balance Method. Show the necessary ledger accounts in the books of Jayanthy.

[B.U., B.Com., Nov/Dec 2015, Section C]

Solution:

Calculation of interest

Particulars	Amount (₹)
Cash Price	60,000
Less: Down Payment	12,000
Remaining balance	48,000
Add: 1st year installment interest @ 15% on 48,000	7,200
	55,200
Less: 1st year installment (12,000 + 7,200)	19,200
Remaining balance	36,000
Add: 2nd year installment interest @ 15% on 36,000	5,400
	41,400
Less: 2nd year installment (12,000 + 5,400)	17,400
Remaining balance	24,000
Add: 3rd year installment interest @ 15% on 24,000	3,600
	27,600
Less: 3rd year installment (12,000 + 3,600)	15,600
Remaining balance	12,000
Add: 4th year installment interest @ 15% on 12,000	1,800
	13,800
Less: 4th year installment (12,000 + 1,800)	13,800
	–

3

Calculation of depreciation (diminishing balance method)

Particulars	Amount (₹)
Cash Price	60,000
Less: 1st year depreciation @ 10% of 60,000	6,000
Balance	54,000
Less: 2nd year depreciation @ 10% of 54,000	5,400
Balance	48,600
Less: 3rd year depreciation @ 10% of 48,600	4,860
Balance	43,740
Less: 4th year depreciation @ 10% of 43,740	4,374
Written down value of the asset at the end of 4th year	**39,366**

Analysis table

No. of installments	Installment amount (CP + interest) (₹)	Interest (as calculated before) (₹)	Cash Price (installment money − interest) (₹)
Down Payment	12,000	–	12,000
1st	12,000	7,200	4,800
2nd	12,000	5,400	6,600
3rd	12,000	3,600	8,400
4th	12,000	1,800	10,200
	Total HPP = ₹60,000	**Total Interest = ₹18,000**	**Total CP = ₹42,000**

3

Abbreviations: CP: Cash Price; HPP: Hire-Purchase Price.

Ledger accounts in the books of Ms. Jayanthi (Hire Purchaser)
Washing Machine A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Bank A/c (DP)	12,000	1st year	By Depreciation A/c	6,000
	To Royal Enterprises A/c	12,000		By Balance c/d	18,000
		24,000			**24,000**
2nd year	To Balance b/d	18,000	2nd year	By Depreciation A/c	5,400
				By Balance c/d	
	To Royal Enterprises A/c	12,000			24,600
		30,000			**30,000**
3rd year	To Balance b/d	24,600	3rd year	By Depreciation A/c	4,860
				By Balance c/d	
	To Royal Enterprises A/c	12,000			31,740
		36,600			**36,600**
4th year	To Balance b/d	31,740	4th year	By Depreciation A/c	4,374
				By Balance c/d	
	To Royal Enterprises A/c	12,000			39,366
		43,740			**43,740**

Royal Enterprises A/c (Hire Vendor)

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
1st year	To Bank A/c (DP)	12,000	1st year	By Washing Machine A/c	12,000
	To Bank a/c (Installment)	19,200		By Washing Machine A/c	12,000
				By Interest A/c	7,200
		31,200			**31,200**
2nd year	To Bank A/c	17,400	2nd year	By Washing Machine A/c	12,000
				By Interest A/c	5,400
		17,400			**17,400**
3rd year	To Bank A/c	15,600	3rd year	By Washing Machine A/c	12,000
				By Interest A/c	3,600
		15,600			**15,600**
4th year	To Bank A/c	13,800	**4th** year	By Washing Machine A/c	12,000
				By Interest A/c	1,800
		13,800			**13,800**

Interest A/c

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
1st year	To Washing Machine A/c	7,200	1st year	By P/L A/c	7,200
		7,200			**7,200**
2nd year	To Washing Machine A/c	5,400	2nd year	By P/L A/c	5,400
		5,400			**5,400**
3rd year	To Washing Machine A/c	3,600	3rd year	By P/L A/c	3,600
		3,600			**3,600**
4th year	To Washing Machine A/c	1,800	4th year	By P/L A/c	1,800
		1,800			**1,800**

Depreciation A/c

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
1st year	To Washing Machine A/c	6,000	1st year	By P/L A/c	6,000
		6,000			**6,000**
2nd year	To Washing Machine A/c	5,400	2nd year	By P/L A/c	5,400
		5,400			**5,400**
3rd year	To Washing Machine A/c	4,860	3rd year	By P/L A/c	4,860
		4,860			**4,860**
4th year	To Washing Machine A/c	4,374	4th year	By P/L A/c	4,374
		4,374			**4,374**

Summary

- Under Hire Purchase arrangement, the buyer of the assets acquires the lawful right to use the asset for a specific agreed upon period in return for hire rentals. At the end of the Hire Purchase Period the user of the assets can exercise an option of either owning the asset or leasing the same.
- Hire Purchase is defined as a system under which property or a Chattel is acquired by payments made in installments, during the period of which title in the property remains with the Hire Vendor. The payments made till the final installment is regarded as being purely in respect of hire, and the title in the property does not pass to the hire purchaser until such final payment or some other consideration provided for in the contract has been fulfilled.
- Features of Hire Purchase agreement are, the right to use the asset is transferred to the hire purchaser immediately on the signing of the agreement, ownership of the asset remains with the Hire Vendor. The ownership of the asset is transferred to the hire purchaser only after the payment of last installment.
- Vendor's rights are to receive down payment and the remaining balance in installments as agreed upon. He can also exercise right to collect interest along with the principal in the form of installments. If hire purchaser defaults on installment payments, Hire Vendor has the right to repossess the asset. After repossession of the asset the vendor has the right to treat the earlier paid installments as Hire Charges.
- Hire purchaser's rights are to acquire possession of the asset on payment of initial deposit or down payment. He/she can claim ownership of the asset on payment of last installment. He/she also has right to return asset if he wishes to terminate the agreement.
- Installment purchase system is a system under which a buyer is given the ownership as well as the possession of the asset or goods right at the time of signing of agreement.
- The difference between Hire Purchase and Installment Purchase System is that, the transfers of ownership in case of Hire Purchase take place only on the payment of last installment whereas, in case of Installment Purchase System, the ownership gets transferred immediately at the time of signing of agreement.
- Hire Purchase Agreement is a binding contract between the hire purchasers and Hire Vendor. The transaction between them begins with signing of agreement consisting of all the requisite terms and condition relating to Hire Purchase Price, Cash Price, interest amount, date of commencement of transaction, the number of installments to be paid by the hire purchaser and in detail description of the goods that are hire purchased by the purchaser.
- Hire Purchase Price is an amount payable by the hire purchaser as per the terms agreed upon in the Hire Purchase Agreement. It comprises of cash price and hire charge (also termed as interest).
- Net hire purchase price refers to hire purchase price exclusive of delivery charges, insurance expense and registration charges if any included in the price.

(Contd.)

- A hire purchase charge is the amount of interest charged on the cash price of the asset as per the Hire Purchase Agreement. It is mostly calculated as a percentage of cash price. It is the difference between the Net Hire Purchase Price and the Net Cash Price of the asset.
- Cash Price refers to the price at which the asset in actually sold to the buyer as per the 'Sale Contract'. This price is exclusive of Interest Charges or Hire Charges.
- Net Cash Price is the cash price exclusive of down payment or initial deposit paid by the hire purchaser at the time of entering into hire purchase agreement. This is price on which the interest amount is calculated.
- Methods of recording hire purchase transaction are: Asset Accrual Method, Outright Property method and Interest Suspense Method
- Rebate if any, is calculated in the books of hire purchaser as follows:

$$\text{Rebate} = 2/3^{rd} \text{ of interest} \times (\text{Remaining balance installments} \div \text{total number of agreed installments})$$

- If hire purchaser defaults any payment of installment, the Hire Vendor has the right to take back the asset in its actual form from the hire purchaser. In this case, the payments made earlier by the hire purchaser will not be refunded; instead they will be treated as 'Hire Charges'.
- The very act of recovery of asset from the hire purchaser due to default in the payment of installments is termed as "Repossession". The repossession of asset can take place either partially or completely.
- Formula for calculation of true rate of interest is:

$$\text{True Rate of Interest} = \frac{\text{Nominal Rate of Interest} \times 2 \times \text{Total number of installments}}{\text{Total number of installments} + 1}$$

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Review Questions

Section A (2 Marks)

1. What do you mean by hire?
2. Who is a hirer? **[B.U., B.Com., Nov/Dec 2010]**
3. Give the meaning of Hire Purchase.
4. What is hire-purchase system. **[B.U., B.Com., Nov/Dec 2014]**
5. Explain the essential features of Hire-Purchase System. **[B.U., B.Com., Nov/Dec 2005/2009/2012/2013]**
6. Who is a Hire Purchaser? **[B.U., B.Com., Nov/Dec 2015]**

7. Identify any two differences between hire-purchase system and installment-purchase system. **[B.U., B.Com., Nov/Dec 2004/2006/2009/2011]**
8. What do you mean by a Hire-Purchase Agreement? **[B.U., B.Com., Nov/Dec 2013]**
9. Why is Hire-Purchase price always higher than the cash price?
10. Explain the term Down Payment. **[B.U., B.Com., Nov/Dec 2009/2013/2015/2016]**
11. What is Net Cash Price?
12. Explain the rights of Hire Seller. **[B.U., B.Com., Nov/Dec 2010]**
13. Explain the term repossession. **[B.U., B.Com., Nov/Dec 2006/2012]**
14. What is deposit or Down Payment?
15. Explain the meaning of Net Cash Price.
16. Give the meaning of Net Hire-Purchase Price.
17. Explain the term Hire Charges.
18. What do you mean by default?
19. Explain the term repossession in hire-purchase system.
20. Distinguish between complete and partial repossession.

Section B (8 Marks)

1. Explain the remedies a Hire Seller has, if any installment is not paid by the Hire Purchaser. **[B.U., B.Com., Nov/Dec 2011/2012]**
2. Discuss on the computation of installment price under the hire-purchase system. **[B.U., B.Com., Nov/Dec 2012]**
3. Write short notes on
   (a) Cash price,
   (b) Net Cash Price,
   (c) Hire-Purchase Price.
4. Explain the rights of Hire Purchaser and Hire Vendor in detail.
5. Bring out the differences between Sale and Hire Purchase.
6. Distinguish between hire-purchase and installment-purchase system.
7. Write the accounting treatment with regard to default and repossession.
8. Pass the journal entries in the books of Hire Purchaser with imaginary figures.
9. Prepare the necessary ledger accounts in the books of Hire Purchaser with imaginary figures.
10. Briefly explain the features of hire-purchase system.

Section C (14 Marks)

1. Calculate the value of each installment from following details:

   Cash price ₹12,000

   Down payment – 20% of cash price

   Balance of cash price is payable in three equal installments together with interest at 10% on the outstanding cash price. **[B.U., B.Com., Nov/Dec 2004]**

   (Ans: 1st installment ₹4,160, 2nd installment ₹3,840, 3rd installment ₹3,540)

2. Calculate the cash price of an asset from the following:
   ₹3,000 paid at the time of agreement
   ₹21,600 paid at the time of 1st year
   ₹20,700 paid at the time of 2nd year
   ₹19,800 paid at the time of 3rd year
   ₹18,900 paid at the time of 4th year
   Rate of interest is 5% p.a.
   Rate of depreciation is 25% p.a. **[B.U., B.Com., April 2001]**
   (Ans: Cash Price of the asset is ₹75,000)
3. Calculate the cash price of an asset and interest for the following details

Particulars	Amount
Down Payment	1,500
1st installment payable at the end of first year	10,800
2nd installment payable at the end of first year	10,350
3rd installment payable at the end of first year	9,900
4th installment payable at the end of first year	9,450
Rate of interest 5% p.a.	
Rate of depreciation 20% p.a. (straight line method)	

[B.U., B.Com., Oct/Nov 2000]
(Ans: Cash Price ₹37,500 and interest ₹4,500)

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4. Calculate the cash price of an asset from the following details: Down payment ₹6,000 1st installment (payable at the end of 1st quarter of the year) ₹7,200, 2nd installment (payable at the end of 2nd quarter of the year) ₹6,900, 3rd installment (payable at the end of 3rd quarter of the year) ₹6,600, 4th installment (payable at the end of 4th quarter of the year) ₹6,300.
   [B.U., B.Com., Nov/Dec 2016]
   (Ans: Cash Price ₹30,000)
5. Calculate the cash price of an asset from the following:
   ₹10,000 paid at the time of agreement
   ₹72,000 at the end of 1st year
   ₹69,000 at the end of 2nd year
   ₹66,000 at the end of 3rd year
   ₹63,000 at the end of 4th year
   Rate of interest is 12% p.a.
   Rate of depreciation is 25% p.a. **[B.U., B.Com., Nov/Dec 2011]**
   (Ans: Cash Price ₹2,16,308)
6. On 1 January 2006 Ruchi Oil Company purchased an oil machine on the hire-purchase system. The cash price of the machine was ₹2,23,500 and payment was to be made as follows: A down payment of ₹60,000 was to be made at the time of signing the agreement and the balance in three installments of ₹60,000 each at the end of each year. A rate of 5% interest is charged by the vendor company per

year. Ruchi Oil Company has decided to write off 10% p.a. on the diminishing balance of the cash price. Prepare the necessary ledger accounts in the books of Ruchi Oil Company.

[B.U., B.Com., Nov/Dec 2011]

(Ans: Cash Price of the each installment ₹51,825, ₹54,416 and ₹57,259 for 1st, 2nd and 3rd installment, respectively, whereas interest chargeable ₹8,175, 5,584 and ₹2,863 1st, 2nd and 3rd installment, respectively)

7. Prepare the purchaser's account in the books of the vendor under hire-purchase system from the following particulars: cash price ₹60,000, total interest payable ₹15,000, amount payable ₹15,000 down and balance in three equal annual installments. Date of purchase was 1 April 2010. The books were closed on 31 March every year. **[B.U., B.Com., Nov/Dec 2005]**

   (Ans: Total HPP = ₹75,000, value of each installment ₹20,000, interest ₹15,000)

8. Calculate the amount interest included in each installment; cash price ₹38,000, down payment ₹10,000, four installments of ₹10,000 each are payable at the end of each year.

   [B.U., B.Com., Oct/Nov 2012]

   (Ans: Total interest charged ₹12,000 Amount due Ratio 4:3:2:1 and installment interest ₹4,800, 3,600, 2,400 and ₹1,200, respectively)

9. HB Transport Company bought a minibus, the cash price of which was ₹3,00,000. It agreed to pay ₹80,000 on signing the contract on 1 January 2012 and the balance in three quarterly installments of ₹80,000 each at the end of each quarter. Rate of interest is 20% p.a. The company has agreed to charge depreciation at 10% p.a. on straight line method. Pass necessary journal entries in the books of Hire Purchaser under Asset Accrual Method.

   (Ans: Total HPP = ₹3, 20,000, total cash price ₹3,00,000, total interest chargeable 20,000)

10. AK Company bought an asset on hire-purchase system from JK Company on 1 January 2001; the cash price of the asset being ₹2,63,500 and the payment was to be made as follows down payment ₹1,00,000 and the balance in three yearly installments of ₹60,000 each the vendor charged interest at 5% p.a. AK Company decides to write off depreciation at 20% on diminishing balance method. Show the necessary journal entries in the books of AK Company under Asset Accrual Method.

    (Ans: Total HPP = ₹2,80,000, total interest chargeable 16,500)

11. M Ltd. purchased a machine on hire-purchase system. He/she paid an amount of ₹24,000 at the time of entering into contract, and interest to be charged at 10% p.a. and depreciation also at 10% p.a. on reducing balance method. The remaining amount was paid as follows:

    1st installment ₹25,300

    2nd installment ₹30,500

    3rd installment ₹33,000

    Pass journal entries in the books of Manohar and also show the necessary accounts.

    (Ans: Total Cash Price = ₹97,000, total interest chargeable 15,800)

12. P Ltd. purchased a machine costing ₹24,000 on 1 April 2011 from Z Ltd. agreeing to pay ₹4,000 as down payment and the balance in four installments of ₹5,000 with 5% interest payable at the end of each year. P Ltd. wishes to write off 10% depreciation on reducing balance method, prepare necessary ledger accounts in the books for 4 years.

    (Ans: Total HPP = ₹24,000, total interest chargeable 2,500)

4 Royalty Accounts

Chapter Outline

Review Questions

- **Section A (2 Marks)**
- **Section B (8 Marks)**
- **Section C (14 Marks)**

4.1 INTRODUCTION

Business houses work under dynamic environment; due to which they witness changes in their business organisations on a day-to-day basis. In order to be prepared to tackle with these changes, capital is required at every stage. Therefore, the houses are reluctant to block their capital in the purchase of asset, property or rights. Even if they are willing to purchase assets, the subsequent changes in the business environment are so rapid that the assets purchased today may be of no or very less use due to the changing habits, preferences or technologies. It is for this reason that the houses prefer to use someone's property's or rights upon payment of some consideration instead of purchasing the same. When business houses pay a certain amount as per the agreement for acquiring 'special right' for the purpose of using other's property or asset, the amount paid to use 'special rights' is termed *Royalty.*

4.2 MEANING OF ROYALTY

Royalty is an amount of periodical consideration paid to the owner of an asset or right, such as mine, quarry, copyright or patent. It is the sum payable by one person (lessee) to another (lessor) in respect of use of some form of privilege or right. For example, a landlord may have an exclusive right or privilege over the mine or the quarry in his/her land or an author has exclusive right over the copyrights of his/her manuscript or a patent holder (termed patentee) may enjoy exclusive privilege over his/her patents. If an individual, firm or company wishes to acquire those special rights to be used for the purpose of generating revenue, it may acquire the same by paying a certain amount termed 'Royalty'.

4.3 DEFINITION OF ROYALTY

Royalty is the remuneration payable to a person in respect of the use of an asset, whether hired or purchased from such person, calculated by reference to or varying with quantities produced or sold as a result of such asset. – ***William Pickles***

Section (9)(1)(vi) of Companies Act explains, Royalty as any amount of consideration paid for transfer or use of any right or imparting of any information concerning the working of any patent, invention, model, design, secret formula or process or trade mark or similar property; it also includes rendering of any services in connection with the activities referred to before.

4.4 TYPES OF ROYALTIES

Among the different types of royalties, the following ones are very popular among the individuals and business organisations:

1. Mining
2. Patent
3. Copyright
4. Trade mark
5. Brick making
6. Oil-wells
7. Royalties in respect of machines and their use, secret formula or process or technical know-how

4.5 TERMINOLOGIES USED IN ROYALTY ACCOUNTS

4.5.1 Minimum Rent, Dead Rent or Fixed Rent, or Flat Rent or Contract Rent

This is the minimum amount of rent payable by the lessee to the lessor irrespective of production or sales achieved by the lessee. Lessor will under no circumstance receive an amount less than the amount of minimum rent mentioned in the royalty agreement. In any given year, if royalty is less than the amount of minimum rent, it is the amount of minimum rent that has to be paid by the user (lessee) of the asset. If the amount of royalty is more than the minimum rent, the lessee will have to pay the royalty amount. The main purpose of fixing minimum rent in the royalty agreement is to protect lessor's interest and reducing the risk of loss. Even if the royalty is less in any given year, the lessor can be rest assured to receive minimum rent at least in that year.

Sometimes, the minimum rent clause itself is not provided for in the agreement or minimum rent clause is made inapplicable to a particular year. Under such a circumstance, the amount to be discharged by the lessee to the lessor is restricted to actual amount of royalty for the year.

4.5.2 Royalty Agreement

It is an agreement entered into between the owner and the user to use the asset, property or right in manufacturing or commercial operations for the purpose of generating income. The agreement consists of all the provisions relating to the periodical amount to be paid by the user, duration for which the asset can be used by the lessee. Considering the amount of minimum rent to be paid and liability of the user upon non-payment of royalty due to labour unrest, strike, lockout, stoppage of work and others, this agreement binds both the parties to deliver the transaction as per the legitimate legal framework. It also facilitates redressal and settlement of disputes between the lessor and the lessee.

4.5.3 Lessee

Lessee is the 'user' of the asset, property or right owned by the lessor. A lessee agrees to make periodical payment for obtaining special rights from lessor and uses the asset, property or right obtained from the lessor for generating revenue. For example, tenant is the lessee in the case of mining royalty agreement, publisher is the lessee in the case of copyright royalty agreement, and patentor is the lessee in the case of patent royalty agreement.

4.5.4 Lessor

Lessor is the original 'owner' who lends out his/her exclusive rights over some property or asset on lease to another individual for an agreed amount of consideration is called a lessor or landlord or patentee. For example, a landlord is the lessor of the mine or quarry in his/her land, author is the lessor in the case of copyright royalty agreement, and patentee is the lessor in the case of patent royalty agreement.

4.6 DIFFERENCE BETWEEN RENT AND ROYALTY

Differences between rent and royalty have been highlighted through Table 4.1.

Table 4.1 *Difference between rent and royalty*

Royalty	Rent
The parties to royalty agreement are lessee and lessor	The parties to rental agreement are owner and tenant
Royalty is the amount of consideration payable for the use of special right in a tangible or intangible asset	Rent is the amount of consideration payable for use of some tangible asset
Royalty is paid on the basis of yield or production	Rent is paid generally on some periodical basis, namely per day, per week, per month or per year
Minimum rent clause exists in royalty agreement	There is no such clause in rental agreement
Amount of royalty payable varies on the basis of production and other factors	Amount of rent is generally fixed in nature

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4.7 SHORT-WORKINGS AND RECOUPMENT OF SHORT-WORKINGS AND TREATMENT OF SURPLUS AFTER RECOUPMENT

4.7.1 Short-workings

According to the royalty agreement, the lessee is required to pay to the lessor a minimum agreed amount irrespective of low or no output in any given year. As such, in the year of low or no output, the minimum rent required to be paid by the lessee to the lessor for that year will be more than the actual royalty for that year. The excess of minimum rent over actual royalty of any particular year is termed short-working, deficiency or shortage. The excess of minimum rent over actual royalty is treated as 'short-working' by the lessee, whereas lessor treats it as 'short-working suspense' or 'short-workings allowable'.

If royalty is less than minimum rent, the amount of minimum rent will be paid by the lessee to the lessor. If royalty is more than minimum rent, amount of short-working of the earlier periods may be recouped (recover) out of the excess royalty over minimum rent. The amount of short-working which may be recouped is known as 'redeemable short-workings.'

4.7.2 Recoupment of Short-workings

According to the minimum rent clause of royalty agreement, the lessee is required to pay minimum rent whenever short-workings are there. These short-workings arising in a year can be recouped by the lessee out of the surplus royalties of the later years. In other words, short-working recoupment refers to recovering the short-working of any year, from the excess royalty of the succeeding years.

The royalty agreement comes with a provision in favour of lessee to recoup (recover) the short-workings over a stipulated period of time or without any limitation of time (i.e. throughout the lease period). The recoupment of short-working may also be restricted (fixed) or unrestricted (floating).

1. If the right of recoupment of short-workings mentioned in the royalty agreement is for a certain period, say 3, 5 or 7 years starting from the date of royalty agreement, it is referred to as *Restricted or Fixed*. As per this type of recoupment, the lessee is required to recoup only up to the period specified; no short-working can be recouped after the specified period even if there is surplus.
2. As per the royalty agreement, if the lessee is required to recoup within the next, subsequent or following 2 or 3 years from the year of occurrence of short-working, it is referred to as *Unrestricted or Floating*. As per this type of recoupment, the lessee is required to recoup only within the next 2 or 3 years from the year of occurrence of short-working; no short-working can be recouped after the specified period even if there is surplus.
3. If the lessee is required to recoup during the first 4 years or any other period of the lease, recoupment will take place only during the first 4 years and not afterwards; as per this type of recoupment, any unrecovered balance of short-working is treated as loss will be transferred to *Profit and Loss Account.* Any short-workings in the future years will also be transferred to Profit and Loss Account of the concerning year. In the case of lessor, unrecovered short-workings are treated as gain the same will credited to Profit and Loss Account and the debit being given to *Short-working Suspense Account*.
4. As per the agreement, the lessee may also not be allowed to recoup short-workings in future years. In such a case, the short-workings of each of the years should be treated as *irrecoverable short-workings*.
5. Short-workings that are recoverable will reflect in Balance Sheets of both lessor and lessee. It appears as an *Asset* in the Balance Sheet of lessee, whereas in the Balance Sheet of lessor it appears as a *Liability*.

6. In any given year, if there is some *Surplus* left after the recoupment of the short-workings completely, then that surplus royalty should be discharged to the landlord along with the minimum rent of the year.

4.8 STRIKE, STOPPAGE OF WORK OR LOCKOUT

Sometimes, the lessee may be confronted with problems such as fall in the output or sales; this could be due to labour unrest, stoppage of work due to strike, accident, lockout or any kind or unforeseen contingency. Under such circumstance, it is not advisable to expect lessee to pay the minimum rent when there is actually no or low output. For this reason, a special allowance is made or a clause is inserted in the agreement to protect the interest of the lessee. The special allowance in the case of abnormal output or sales due to unforeseen reasons could take any of the following forms:

1. In the year in which there is no or low output, the minimum rent for the year is usually reduced in proportion to the period of stoppage of work.
2. The rental obligation by the lessee for that year will be the actual royalties (i.e. the amount that can be paid by the lessee).

4.9 SUBLEASE

If the terms of the royalty agreement provide so, lessee has an option to sublease whole or a part of the asset, property or right to another person for some consideration. Such an arrangement is termed *sublease*. The person to whom the sublease is granted is known as sub-lessee. The lessee at the time of payment of royalty to the lessor is also required to add the amount the amount received towards sublease of asset, property or right from the sub-lessee. The status of the original lessee will be two-fold:

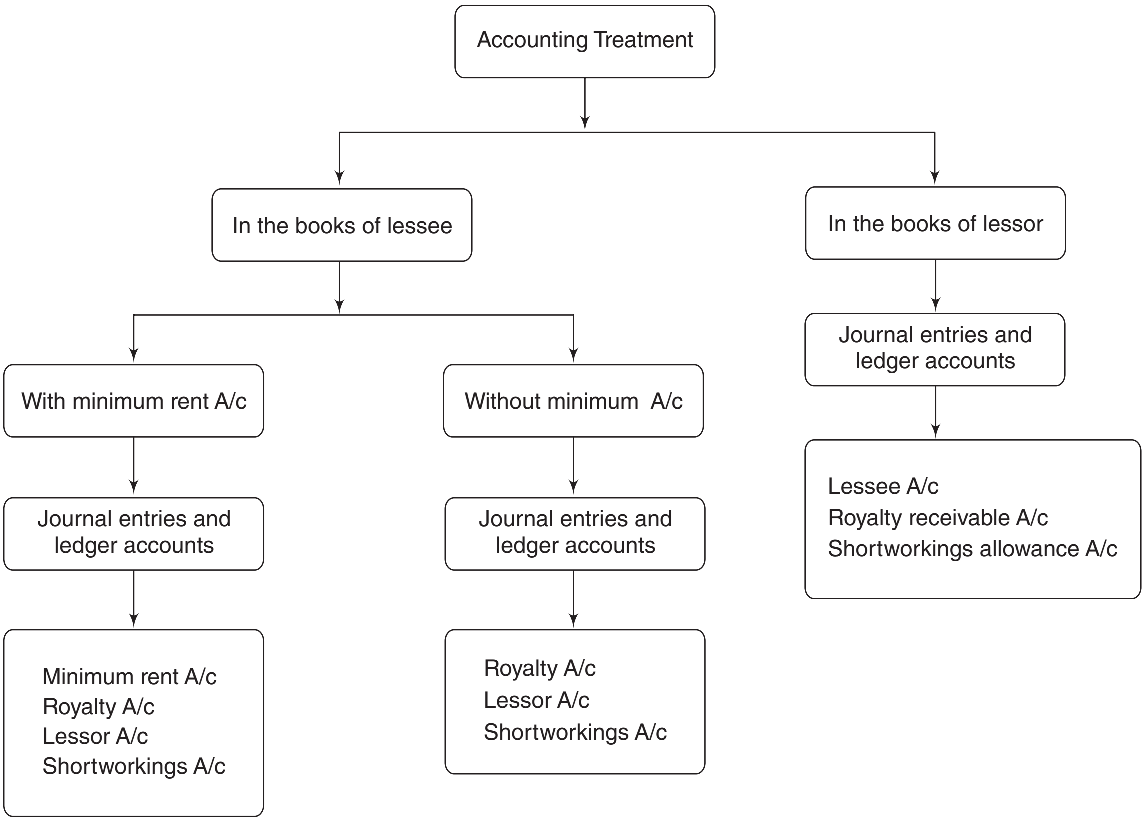
1. In the capacity of lessee paying royalties to the lessor;
2. In the capacity of a sub-lessor receiving royalties from the sub-lessee.

Accounts to be maintained are mentioned in Table 4.2.

Table 4.2 *Accounts to be prepared in the capacity of lessee and sub-lessor*

In the capacity of lessee	In the capacity of a sub-lessor
Royalties Payable A/c	Royalties Receivable A/c
Short-workings A/c	Short-workings A/c
Landlord A/c	Sub-lessee's A/c

4.10 ACCOUNTING TREATMENT IN BOOKS OF LESSOR AND LESSEE WITH OR WITHOUT MINIMUM RENT ACCOUNT—DRAFTING OF JOURNAL ENTRIES AND PREPARATION OF LEDGER ACCOUNTS



4.10.1 Accounting Treatment in the Books of Lessee

The accounting treatment in the books of lessee is generally based on any of the two following methods:

1. With Minimum Rent Account
2. Without Minimum Rent Account

Journal Entries and Ledger Accounts in the Books of Lessee—with Minimum Rent Account

Journal entries in the books of lessee

S. No.	Circumstances	Journal entry
1.	For minimum rent payable	*When royalties are less than minimum rent* *Minimum Rent A/c Dr.* *To Lessor A/c* *When royalties are equal to minimum rent* *Royalty A/c Dr.* *To Lessor A/c* *When royalties are more than minimum rent and Short-workings are recovered* *Royalty A/c Dr.* *To Short-workings A/c* *To Lessor A/c* *When royalties are more than minimum rent and Short-workings are not recovered* *Royalty A/c Dr.* *To Lessor A/c*
2.	Segregating of minimum rent into royalty and short-workings	*Royalty A/c Dr.* *Short-workings A/c Dr.* *To Minimum rent A/c*
3.	Payment of minimum rent to lessor	*Lessor A/c Dr.* *To Bank A/c*
4.	Transfer of royalty	*When royalty is calculated on sales* *Profit and Loss A/c Dr.* *To Royalty A/c* *When royalty is calculated on production* *Production A/c Dr.* *To Royalty A/c*
5.	Transfer of short-workings irrecovered	*Profit and Loss A/c Dr.* *To Short-workings A/c*

Ledger Accounts in the books of lessee
Minimum Rent Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Lessor A/c (For minimum rent due)	xxx	1st year	By Royalty A/c (Royalty in MR)	xxx
				By Short-workings A/c (Short-workings in MR)	xxx
		xxx			**xxx**

Royalty Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Minimum Rent A/c (Year 1 royalty)	xxx	1st year	By Production/P/L A/c (Transfer)	xxx
		xxx			**xxx**
2nd year	To Lessor A/c (Payment of royalty)	xxx	2nd year	By Production/P/L A/c (Transfer)	xxx
	To Short-workings A/c (Recoupment of short-workings)	xxx			
		xxx			**xxx**

Lessor Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Bank A/c (Payment made)	xxx	1st year	By Minimum Rent A/c (When MR is paid)	xxx
		xxx			**xxx**
2nd year	To Bank A/c (Payment made)	xxx	2nd year	By Royalty A/c (When royalty is paid)	xxx
		xxx			**xxx**

Short-workings Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Minimum Rent A/c (Short-working created)	xxx	1st year	By Balance c/d (*Balancing figure*)	xxx
		xxx			**xxx**
2nd year	To Balance b/d	xxx	2nd year	By Royalty A/c (Recoupment of short-workings)	xxx
				By Profit and Loss A/c (Short-workings irrecovered)	xxx
				By Balance c/d (*Balancing figure*)	xxx
		xxx			**xxx**

Journal Entries and Ledger Accounts in the Books of Lessee--without Minimum Rent Account

Journal entries in the books of lessee

S. No.	Circumstances	Journal entry
1.	For royalty payable	*<u>When royalties are paid without short-workings</u>* *Royalty A/c Dr.* *To Lessor A/c* *<u>When royalties are paid with short-workings</u>* *Royalty A/c Dr.* *Short-workings A/c Dr.* *To Lessor A/c* *<u>When royalties are paid with recoupment of short-workings</u>* *Royalty A/c Dr.* *To Short-workings A/c* *To Lessor A/c*
2.	Payment of royalty to lessor	*Lessor A/c Dr.* *To Bank A/c*
3.	Transfer of royalty	*<u>When royalty is calculated on sales</u>* *Profit and Loss A/c Dr.* *To Royalty A/c* *<u>When royalty is calculated on production</u>* *Production A/c Dr.* *To Royalty A/c*
4.	Transfer of short-workings irrecovered	*Profit and Loss A/c Dr.* *To Short-workings A/c*

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Ledger Accounts in the books of lessee
Royalty Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Lessor A/c (Year 1 royalty)	xxx	1st year	By Production/P/L A/c (Transfer)	xxx
		xxx			**xxx**
2nd year	To Lessor A/c (Year 2 royalty)	xxx	2nd year	By Production/P/L A/c (Transfer)	xxx
	To Short-workings A/c (Recoupment of short-workings)	xxx			
		xxx			**xxx**

Lessor Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Bank A/c (Payment made)	xxx	1st year	By Royalty A/c By Short-workings A/c	xxx xxx
		xxx			**xxx**
2nd year	To Bank A/c (Payment made)	xxx	2nd year	By Royalty A/c (When royalty is paid)	xxx
		xxx			**xxx**

Short-workings Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Lessor A/c (Occurrence of short-workings)	xxx	1st year	By Balance c/d (*Balancing figure*)	xxx
		xxx			**xxx**
2nd year	To Balance b/d	xxx	2nd year	By Royalty A/c (Recoup-ment of short-workings) By Profit and Loss A/c (Short-workings irrecovered) By Balance c/d (*Balancing figure*)	xxx xxx xxx
		xxx			**xxx**

4.10.2 Accounting Treatment in the Books of Lessor

Accounting treatment in the books of lessor is by drafting journal entries and preparation of Ledger Accounts.

Journal Entries and Ledger Accounts in the books of Lessor

Journal entries in the books of lessor

S. No.	Circumstances	Journal entry
1.	For royalty receivable	*When royalties are less than minimum rent* *Lessee's A/c Dr.* *To Short-workings Suspense A/c* *To Royalty Receivables A/c* *When royalties are equal to minimum rent* *Lessee A/c Dr.* *To Royalty Receivables A/c* *When royalties are more than minimum rent* *Lessee's A/c Dr.* *Short-workings Suspense A/c Dr.* *To Royalty Receivable A/c*

(Contd.)

S. No.	Circumstances	Journal entry
2.	Royalty received	*Bank A/c* *Dr.* *To Lessee's A/c*
3.	Transfer of royalty	*Royalty Receivable A/c* *Dr.* *To P/L A/c*
4.	Transfer of short-workings irrecovered	*Short-workings Suspense A/c* *Dr.* *To P/L A/c*

Ledger Accounts in the books of lessor
Lessee's Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Short-workings Suspense A/c	xxx	1st year	By Bank A/c (Royalty received)	xxx
	To Royalty Receivable A/c	xxx			
		xxx			**xxx**
2nd year	To Royalty A/c	xxx	2nd year	By Bank A/c (Royalty received)	xxx
		xxx			**xxx**

Short-working Suspense Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Balance c/d (*Balancing figure*)	xxx	1st year	By Lessee's A/c (Occurrence of short-working)	xxx
		xxx			**xxx**
2nd year	To Royalty Receivable A/c (Recoupment of short-workings)	xxx	2nd year	By Balance b/d	xxx
	To Profit and Loss A/c (Short-workings irrecoverable)	xxx			
	To Balance c/d (*Balancing figure*)	xxx			
		xxx			**xxx**

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Royalty Receivable Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1st year	To Profit and Loss A/c	xxx	1st year	By Lessee's A/c	xxx
		xxx			**xxx**
2nd year	To Profit and Loss A/c	xxx	2nd year	By Lessee's A/c	xxx
				By Short-working Suspense A/c	xxx
		xxx			**xxx**

4.11 ILLUSTRATIONS

Illustration 1: Preparation of table of analysis

Prepare an analysis table from the following details:

1. Minimum rent ₹20,000 p.a.
2. Royalty payable ₹5.00 per ton
3. Short-workings can be recoverable during the first 3 years of the lease only
4. The products for the past 4 years were as follows:
   2012 – 2,000 tons
   2013 – 3,000 tons
   2014 – 4,000 tons
   2015 – 4,500 tons

[B.U., B.Com., Nov/Dec 2016, Section B]

Solution:

Year	Output (tons)	Royalty (₹5 per ton)	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered	Short-working irrecovered (₹)	Payment made to lessor (₹)
2012	2,000	10,000	20,000	–	10,000	–	–	20,000
2013	3,000	15,000	20,000	–	5,000	–	–	20,000
2014	4,000	20,000	20,000	–	–	–	15,000	20,000
2015	4,500	22,500	20,000	2,500	–	–	–	22,500

Illustration 2: Preparation of table of analysis

Prepare a table of analysis from the following details: royalty payable = 50 paise per ton of output; minimum rent ₹7,500 p.a.; right of recoupment of short-workings = up to 3 years; output during the first 3 years = 10,000, 14,000 and 18,000, respectively.

[B.U., B.Com., Nov/Dec 2004, 2016, Section B]

Solution:

Table of analysis

Year	Output (tons)	Royalty (₹0.50)	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered (₹)	Short-working irrecovered (₹)	Payment made to lessor (₹)
1	10,000	5,000	7,500	–	2,500			7,500*
2	14,000	7,000	7,500	–	500			7,500
3	18,000	9,000	7,500	1,500	–	1,500	1,500 (loss)	7,500

**Note:* As the recoupment tenure is fixed for first 3 years of lease agreement, the short-working is 3,000, whereas the surplus available is only 1,500; therefore, the balance 1,500 is irrecoverable short-workings and will be transferred to Profit and Loss Account.

Illustration 3: Preparation of table of analysis

Prepare royalty analysis table from the following details:

1. Minimum rent 75,000 p.a.
2. Royalty payable ₹5 per ton of output
3. Short-workings of the year can be recouped on the next 2 years out of excess royalty
4. Outputs for the first 5 years were:

Year	1	2	3	4	5
Output in tons	10,000	12,200	20,800	25,500	35,500

[B.U., B.Com., Nov/Dec 2014, Section B]

Solution:

Table of analysis

Year	Output (tons)	Royalty (₹5 per ton)	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered (₹)	Short-working irrecovered	Payment made to lessor (₹)
1	10,000	50,000	75,000	–	25,000			75,000
2	12,200	61,000	75,000	–	14,000			75,000
3	20,800	1,04,000	75,000	29,000	–	29,000	–	75,000
4	25,500	1,27,500	75,000	52,500	–	10,000	–	1,17,500*
5	35,500	1,77,500	75,000	1,02,500	–	–	–	1,77,500

**Note:* Out of total short-workings 39,000, 29,000 is recouped in the third year and the balance 10,000 is recouped in the fourth year.

*1,17,500 is arrived at as follows (MR = 75,000 + surplus = 52,500 − short-working recovered = 10,000)

Illustration 4: **Preparation of table of analysis**

On 1 January 2013, Brilliant Limited, patentees of new type of electric motors, issued a licence to Excellent Limited for the manufacture and sale of motors for 5 years on the following terms and conditions:

1. Excellent Limited to pay a royalty of ₹200 for every motor manufactured
2. Minimum rent is ₹1,00,000 per year
3. Short-working if any is allowed to recouped in the next year only
4. Sales and closing stock of motors of Excellent Limited for 5 years is as follows:

Year	2013	2014	2015	2016	2017
Sales (units)	400	800	1,200	1,100	460
Closing stock (units)	100	200	140	300	40

Prepare analytical table.

Solution:

Calculation of production (units)

Year	Sales + Closing stock − Opening stock = Production			
2013	400	+100	−0	= 500
2014	800	+200	−100	= 900
2015	1,200	+140	−200	= 1,140
2016	1,100	+300	−140	= 1,260
2017	460	+40	−300	= 200

Note: Closing stock of the first year will be the opening stock of the next year.

Table of analysis

Year	Output (tons)	Royalty (₹200 per ton)	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered	Short-working irrecovered	Payment made to lessor (₹)
1	500	1,00,000	1,00,000	–	–	–	–	1,00,000
2	900	1,80,000	1,00,000	80,000	–	–	–	1,80,000
3	1,140	2,28,000	1,00,000	1,28,000	–	–	–	2,28,000
4	1,260	2,52,000	1,00,000	1,52,000	–	–	–	2,52,000
5	200	40,000	1,00,000	–	60,000	–	–	1,00,000

Illustration 5: **Calculation of the amount of royalty**

Calculate the amount of royalty when:

1. Rate of royalty is ₹100 per copy sold
2. Other particulars

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Year	No. of copies printed	Closing stock
2011	2,000	100
2012	3,000	200

[B.U., B.Com., Nov/Dec 2013, Section A]

Solution:

Royalty = Number of copies sold × Rate of royalty

Year	Number of copies sold Sales = Production − Closing stock + Opening stock	(Rate (₹)	Amount of royalty (₹)
2011	2,000 − 100 = 1,900	100	1,90,000
2012	3,000 − 200 + 100 = 2,900	100	2,90,000
	Total		**4,80,000**

Illustration 6: Preparation of analytical table and Minimum Rent Account

Sunrise Ltd. patented solar cooker and gave the same to Moonshine Ltd. to manufacture and sell under a licence for 5 years. The other details are mentioned as follows:

1. Royalty of ₹10 paid for each cooker sold.
2. A minimum rent of ₹40,000 is payable p.a.
3. Right to recoup short-workings of any year in the following 2 years
4. The cookers sold are mentioned as follows:

Year	2014	2015	2016	2017
No. of cookers sold	3,000	3,500	4,500	6,000

Prepare table of analysis and Minimum Rent Account

Solution:

Table of analysis

Year	No. of cookers sold	Royalty (₹10 per cooker sold)	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered (₹)	Short-working irrecovered (₹)	Payment made to lessor (₹)
2014	3,000	30,000	40,000	–	10,000	–	–	40,000
2015	3,500	35,000	40,000	–	5,000	–	–	40,000
2016	4,500	45,000	40,000	5,000	–	5,000	5,000	40,000
2017	6,000	60,000	40,000	20,000	–	5,000	–	55,000

Minimum Rent Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014	To Lessor A/c	40,000	2014	By Royalty A/c By Short-workings A/c (Occurrence of SW)	30,000 10,000
		40,000			**40,000**
2015	To Lessor A/c	40,000	2015	By Royalty A/c By Short-workings A/c (Occurrence of SW)	35,000 5,000
		40,000			**40,000**

Note: Minimum Rent Account has to be prepared only for the year 2014 and 2015 as the payment to lessor involves minimum rent rather than actual royalty.

Illustration 7: **Preparation of table of analysis and Short-workings Account with and without Minimum Rent Account**

From the following details prepare Short-workings Account:

1. Minimum rent ₹1,00,000 p.a.
2. Royalty ₹10 per ton
3. Short-workings can be recouped during the first 4 years only
4. Output for the first 5 years is mentioned as follows:

Year	2008	2009	2010	2011	2012
Output in tons	2,000	5,000	15,000	20,000	25,000

[B.U., B.Com., Nov/Dec 2013, Section B]

Solution:

Table of analysis

Year	Output in tons	Royalty (₹10 per tons)	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered (₹)	Short-working irrecovered	Payment made to lessor (₹)
2008	2,000	20,000	1,00,000	–	80,000	–	–	1,00,000
2009	5,000	50,000	1,00,000	–	50,000	–	–	1,00,000
2010	15,000	1,50,000	1,00,000	50,000	–	50,000	–	1,00,000
2011	20,000	2,00,000	1,00,000	1,00,000	–	80,000	–	1,20,000
2012	25,000	2,50,000	1,00,000	1,50,000	–	–	–	2,50,000

Short-workings Account (with Minimum Rent Account)

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2008	To Minimum Rent A/c	80,000	2008	By Balance c/d (*Balancing figure*)	80,000
		80,000			**80,000**
2009	To Balance b/d To Minimum Rent A/c	80,000 50,000	2009	By Balance c/d (*Balancing figure*)	1,30,000
		1,30,000			**1,30,000**
2010	To Balance b/d	1,30,000	2010	By Royalty A/c (SW recovered) By Balance c/d (*Balancing figure*)	50,000 80,000
		1,30,000			**1,30,000**
2011	To Balance b/d	80,000		By Royalty A/c (*Balancing figure*) (SW recovered)	80,000
		80,000			**80,000**

Short-workings Account (without Minimum Rent Account)

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2008	To Lessor A/c	80,000	2008	By Balance c/d (*Balancing figure*)	80,000
		80,000			**80,000**
2009	To Balance b/d To Lessor A/c	80,000 50,000	2009	By Balance c/d (*Balancing figure*)	1,30,000
		1,30,000			**1,30,000**
2010	To Balance b/d	1,30,000	2010	By Royalty A/c (SW recovered) By Balance c/d (*Balancing figure*)	50,000 80,000
		1,30,000			**1,30,000**
2011	To Balance b/d	80,000	2011	By Royalty A/c (*Balancing figure*) (SW recovered)	80,000
		80,000			**80,000**

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Illustration 8: Preparation of table of analysis and Short-workings Account with Minimum Rent Account

Coal Mines Co. took a lease from a landlord for a period of 10 years from 1 January 2000 on a royalty of ₹50 per ton of coal raised with a minimum rent of ₹1,00,000 p.a. and power to recoup short-workings during the first 4 years of the period of lease.

The annual output was as follows:

Year	2000	2001	2002	2003	2004
Output in tons	1,000	1,500	2,000	3,000	4,000

Prepare table of analysis and Short-workings Account in the books of the lessee (Coal Mines Co.).

[B.U., B.Com., Nov/Dec 2011, Section B]

Solution:

Table of analysis

Year	Output in tons	Royalty (₹50 per ton of coal)	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered (₹)	Short-working irrecovered (₹)	Payment made to lessor (₹)
2000	1,000	50,000	1,00,000	–	50,000	–	–	1,00,000
2001	1,500	75,000	1,00,000	–	25,000	–	–	1,00,000
2002	2,000	1,00,000	1,00,000	–	–	–	–	1,00,000
2003	3,000	1,50,000	1,00,000	50,000	–	50,000	25,000	1,00,000
2004	4,000	2,00,000	1,00,000	1,00,000	–	–	–	2,00,000

Short-workings Account (with Minimum Rent Account)

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2000	To Minimum Rent A/c	50,000	2000	By Balance c/d (*Balancing figure*)	50,000
		50,000			**50,000**
2001	To Balance b/d To Minimum Rent A/c	50,000 25,000	2001	By Balance c/d (*Balancing figure*)	75,000
		75,000			**75,000**
2002	To Balance b/d	75,000	2002	By Balance c/d (*Balancing figure*)	75,000
		75,000			**75,000**
2003	To Balance b/d	75,000	2003	By Royalty A/c (SW recovered) By P/L A/c (*Balancing figure*) (SW irrecovered)	50,000 25,000
		75,000			**75,000**

Illustration 9: **Preparation of table of analysis and Lessor Account from the following details:**

1. Minimum rent ₹15,000 p.a.

2. Royalty payable ₹5 per ton
3. Short-workings to be recouped within the next 3 years
4. During the period of strike and lockout, minimum rent is to be reduced in proportion to the period of strike and lockout
5. The output for the period of 5 years is mentioned as follows:

Year	2013	2014	2015	2016	2017
Output (in tons)	1,500	2,000	3,000	4,000	5,200
		(lockout for 1 month)			(Strike for 4 months)

Solution:

Table of analysis

Year	Output in tons (₹)	Royalty (₹5 per ton)	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered (₹)	Short-working irrecovered (₹)	Payment made to lessor (₹)
2013	1,500	7,500	15,000		7,500	–	–	15,000
2014	2,000	10,000	15,000		5,000	–	–	15,000
2015	3,000	15,000	13,750*	1,250	–	1,250	–	13,750
2016	4,000	20,000	15,000	5,000	–	5,000	1,250	15,000
2017	5,200	26,000	10,000*	11,000	–	5,000	–	21,000**

**Note:* Minimum rent is reduced in proportion to period of lockout and strike on 2015 and 2017, respectively.

$$\left(15000 \times \frac{11}{12}\right) = 13,750$$

**₹21,000 (Royalty ₹26,000 − SWR ₹5,000)

Lessor Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
2013	To Bank A/c	15,000	2013	By Royalty A/c	7,500
				By Short-workings A/c	7,500
		15,000			**15,000**
2014	To Bank A/c	15,000	2014	By Royalty A/c	10,000
				By Short-workings A/c	5,000
		15,000			**15,000**
2015	To Bank A/c	13,750	2015	By Royalty A/c	13,750
		13,750			**13,750**
2016	To Bank A/c	15,000	2016	By Royalty A/c	15,000
		15,000			**15,000**
2017	To Bank A/c	21,000	2017	By Royalty A/c	21,000
		21,000			**21,000**

Illustration 10: **Journalising transactions and preparation of Ledger Accounts without Minimum Rent Account and fixed recoupment**

On 1 January 2013 Akash Mining Company entered into an agreement with the owner of the coal mine on the following terms:

1. A royalty of ₹15 per ton of coal raised
2. A minimum rent of ₹45,000 per annum
3. The recovery of short-workings with in a period of first 4 years
4. The output during the first 5 years was:

Year	2013	2014	2015	2016	2017
Output in tons	1,900	2,050	2,800	3,600	4,600

Journalise the transactions and prepare the following accounts in the books of Akash Mining Company

1. Royalty Account
2. Lessor Account
3. Short-workings Account

Solution:

Table of analysis

Year	Output in tonnes	Royalty (₹15 per ton)	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered (₹)	Short-working irrecovered (₹)	Payment made to lessor (₹)
2013	1,900	28,500	45,000	–	16,500	–	–	45,000
2014	2,050	30,750	45,000	–	14,250	–	–	45,000
2015	2,800	42,000	45,000	–	3,000	–	–	45,000
2016	3,600	54,000	45,000	9,000	–	9,000	24,750	45,000
2017	4,600	69,000	45,000	24,000	–	–	–	69,000

In the books of Akash Mining Company
Journal entries

Date	Particulars		LF	Debit (₹)	Credit (₹)
2013	Royalty A/c	Dr.		28,500	–
	Short-workings A/c	Dr.		16,500	–
	To Landlord/Lessor A/c			–	45,000
	(Being royalty due in the year 2013 along with short-workings)				
2013	Landlord A/c	Dr.		45,000	–
	To Cash/Bank A/c			–	45,000
	(Being royalty paid)				

(Contd.)

Date	Particulars		LF	Debit (₹)	Credit (₹)
2013	Production A/c	Dr.		28,500	–
	To Royalty A/c			–	28,500
	(Being transfer of royalty to Production A/c)				
2014	Royalty A/c	Dr.		30,750	
	Short-workings A/c	Dr.		14,250	
	To Landlord/Lessor A/c			–	45,000
	(Being royalty due in the year 2014 along with short-workings)				
2014	Landlord A/c	Dr.		45,000	–
	To Cash/Bank A/c				45,000
	(Being royalty paid)				
2014	Production A/c	Dr.		30,750	–
	To Royalty A/c			–	30,750
	(Being transfer of royalty to Production A/c)				
2015	Royalty A/c	Dr.		42,000	–
	Short-workings A/c	Dr.		3,000	–
	To Landlord/Lessor A/c				45,000
	(Being royalty due in the year 2015 along with short-workings)				
2015	Landlord A/c	Dr.		45,000	–
	To Cash/Bank A/c			–	45,000
	(Being royalty paid)				
2015	Production A/c	Dr.		42,000	–
	To Royalty A/c			–	42,000
	(Being transfer of royalty to Production A/c)				
2016	Royalty A/c	Dr.		54,000	–
	To Short-workings A/c				9,000
	To Landlord/Lessor A/c				45,000
	(Being royalty due in the year 2016 and short-workings recovered)				
2016	Landlord A/c	Dr.		45,000	–
	To Cash/Bank A/c			–	45,000
	(Being royalty paid)				
2016	Production A/c	Dr.		42,000	–
	To Royalty A/c			–	42,000
	(Being transfer of royalty to Production A/c)				
2016	Profit and Loss A/c	Dr.		24,750	–
	To Short-workings A/c			–	24,750
	(Being short-workings irrecoverable transferred to P/L A/c)				
2017	Royalty A/c	Dr.		69,000	–
	To Landlord/Lessor A/c			–	69,000
	(Being royalty due in the year 2017)				

(Contd.)

4

Date	Particulars	LF	Debit (₹)	Credit (₹)
2017	Landlord A/c Dr.		69,000	–
	To Cash/Bank A/c		–	69,000
	(Being royalty paid)			
2017	Production A/c Dr.		69,000	–
	To Royalty A/c		–	69,000
	(Being transfer of royalty to Production A/c)			

Ledger Accounts in the books of Akash Mining Company

Royalty Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013	To Landlord/Lessor A/c	28,500	2013	By Production A/c	28,500
		28,500			**28,500**
2014	To Landlord/Lessor A/c	30,750	2014	By Production A/c	30,750
		30,750			**30,750**
2015	To Landlord/Lessor A/c	42,000	2015	By Production A/c	42,000
		42,000			**42,000**
2016	To Landlord/Lessor A/c	45,000	2016	By Production A/c	54,000
	To Short-working A/c	9,000			
		54,000			**54,000**
2017	To Landlord/Lessor A/c	69,000	2017	By Production A/c	69,000
		69,000			**69,000**

Landlord/Lessor Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013	To Bank A/c	45,000	2013	By Royalty A/c	28,500
				By Short-workings A/c	16,500
		45,000			**45,000**
2014	To Bank A/c	45,000	2014	By Royalty A/c	30,750
				By Short-workings A/c	14,250
		45,000			**45,000**
2015	To Bank A/c	45,000	2015	By Royalty A/c	42,000
				By Short-workings A/c	3,000
		45,000			**45,000**
2016	To Bank A/c	45,000	2016	By Royalty A/c	45,000
		45,000			**45,000**
2017	To Bank A/c	69,000	2017	By Royalty A/c	69,000
		69,000			**69,000**

Short-workings Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013	To Landlord A/c	16,500	2013	By Balance c/d	16,500
		16,500			**16,500**
2014	To Balance b/d To Landlord A/c	16,500 14,250	2014	By Balance c/d	30,750
		14,250			**14,250**
2015	To Balance b/d To Landlord A/c	30,750 3,000	2015	By Balance c/d	33,750
		33,750			**33,750**
2016	To Balance c/d	33,750	2016	By Royalty A/c (SW recovered) By P/L A/c	9,000 24,750
		33,750			**33,750**

Illustration 11: **Journalising transactions without Minimum Rent Account and floating recoupment**

Mr. Bhuvan had a few patent rights in his name. He granted licence to Mr. Bhushan to use one of his patent rights over a period of 10 years on the payment of royalty. The following are the relevant particulars.

Year	2014	2015	2016	2017
Royalty (₹)	5,000	5,750	6,250	7,100
Minimum rent (₹)	5,800	6,000	5,750	6,250

The short-workings if any can be recouped within next 2 years only. Draft the journal entries in the books of Mr. Bhushan.

4

Solution:

Table of Analysis

Year	Royalty (₹)	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered (₹)	Short-working irrecovered (₹)	Payment made to lessor (₹)
2014	5,000	5,800	–	800	–	–	5,800
2015	5,750	6,000	–	250	–	–	6,000
2016	6,250	5,750	500	–	500	300	5,750
2017	7,100	6,250	850	–	250	–	6,850

In the books of Mr. Bhushan
Journal entries

Date	Particulars		LF	Debit (₹)	Credit (₹)
2014	Royalty A/c	Dr.		5,000	–
	Short-workings A/c	Dr.		800	–
	To Lessor A/c			–	5,800
	(Being royalty due in the year 2014 along with short-workings)				
2014	Lessor A/c	Dr.		5,800	–
	To Cash/Bank A/c			–	5,800
	(Being royalty paid)				
2014	Profit and Loss A/c	Dr.		5,000	–
	To Royalty A/c			–	5,000
	(Being transfer of royalty to P/L A/c)				
2015	Royalty A/c	Dr.		5,750	
	Short-workings A/c	Dr.		250	
	To Lessor A/c			–	6,000
	(Being royalty due in the year 2015 along with short-workings)				
2015	Lessor A/c…	Dr.		6,000	–
	To Cash/Bank A/c				6,000
	(Being royalty paid)				
2015	Profit and Loss A/c	Dr.		5,750	–
	To Royalty A/c			–	5,750
	(Being transfer of royalty to P/L A/c)				
2016	Royalty A/c	Dr.		6,250	–
	To Short-workings A/c				500
	To Lessor A/c				5,750
	(Being royalty due in the year 2016 and short-workings recovered)				
2016	Lessor A/c	Dr.		5,750	–
	To Cash/Bank A/c			–	5,750
	(Being royalty paid)				
2016	Profit and Loss A/c	Dr.		6,250	–
	To Royalty A/c			–	6,250
	(Being transfer of royalty to P/L A/c)				
2016	Profit and Loss A/c	Dr.		300	–
	To Short-workings A/c			–	300
	(Being short-workings irrecoverable transferred to P/L A/c)				

(Contd.)

4

Date	Particulars		LF	Debit (₹)	Credit (₹)
2017	Royalty A/c	Dr.		7,100	–
	To Short-workings A/c				250
	To Lessor A/c				6,850
	(Being royalty due in the year 2017 and short-workings recovered)				
2017	Lessor A/c	Dr.		6,850	–
	To Cash/Bank A/c			–	6,850
	(Being royalty paid)				
2017	Profit and Loss A/c	Dr.		7,100	–
	To Royalty A/c			–	7,100
	(Being transfer of royalty to P/L A/c)				

Note: Profit and loss a/c is used instead of production a/c as royalty is calculated on sales.

Illustration 12: Journalising transactions without Minimum Rent Account with no provision for recovery of short-workings and payment of penalty for delay by the lessor

Mr. Suresh Gaikwad authored a book on International Financial and Reporting standards and got the same published with Skyline Publishers on the following terms:

1. Royalties would be @10% of the sales proceeds achieved every year
2. Minimum payment of ₹10,000 p.a.
3. As per the agreement between Mr. Suresh Gaikwad and Skyline Publishers, the author is expected to revise the book and submit the same within a period of 6 months of the request. If the author delays submitting the revised edition on time, he is required to pay penalty of ₹350 per month for the period of delay; furthermore, in the year of delay, minimum payment becomes inapplicable.
4. The following are the details about the number of copies sold and the sale price of each copy:

Year	2013	2014	2015	2016	2017
No. of copies sold	1,200	1,600	2,000	2,500	2,200
Sale price of each copy	75	75	75	120	120

The publisher requested the author to submit revised edition by 31 December 2014. The same was submitted by the author on 30 November 2015. Another round of revision was requested by the publisher to be submitted by 31 December 2016, which the author submitted by 31 October 2017.

Draft journal entries in the books Skyline Publishers.

Solution:

Calculation of Royalty Payable

Year	No. of copies sold	Sale price of each copy (₹)	Total sales (₹)	Royalty @10% of sales (₹)
2013	1,200	75	90,000	9,000
2014	1,600	75	1,20,000	12,000
2015	2,000	75	1,50,000	15,000
2016	2,500	120	3,00,000	30,000
2017	2,200	120	2,64,000	26,400

Table of Analysis

Year	Royalty (₹)	Minimum payment (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered	Short-working irrecovered (₹)	Payment made to lessor (₹)
2013	9,000	10,000	–	1,000	–	1,000	10,000
2014	12,000	10,000	2,000	–	–	–	12,000
2015	15,000	–*	–	–	–	–	11,150**
2016	30,000	10,000	20,000	–	–	–	30,000
2017	26,400	–*	–	–	–	–	22,900**

*No **minimum payment is inapplicable** in the year of delay in submission of manuscript by Mr. Suresh.
**Penalty @ ₹350 per month to be deducted from the amount to be paid to the lessor as calculated as follows:

Year	Delay in submission in months	Penalty @ ₹350 p.m.	Amount payable to lessor (₹)	Amount paid to lessor after deducting penalty (₹)
2015	11 months (1.1.2015 to 30.11.2015)	3,850	15,000	15,000 − 3,850 = 11,150
2017	10 months (1.1.2017 to 31.10.2017)	3,500	26,400	26,400 − 3,500 = 22,900

In the books of Skyline Publishers
Journal entries

Date	Particulars		LF	Debit (₹)	Credit (₹)
2013	Royalty A/c	Dr.		9,000	–
	Short-workings A/c	Dr.		1,000	–
	To Mr. Suresh's A/c			–	10,000
	(Being royalty due in the year 2013 along with short-workings)				
2013	Mr. Suresh's A/c	Dr.		10,000	–
	To Cash/Bank A/c			–	10,000
	(Being royalty paid)				
2013	Profit and Loss A/c	Dr.		9,000	–
	To Royalty A/c			–	9,000
	(Being transfer of royalty to P/L A/c)				
2013	Profit and Loss A/c	Dr.		1,000	–
	To Short-workings A/c			–	1,000
	(Being short-workings irrecoverable transferred to P/L A/c)				

(Contd.)

Date	Particulars		LF	Debit (₹)	Credit (₹)
2014	Royalty A/c	Dr.		12,000	
	To Mr. Suresh's A/c			–	12,000
	(Being royalty due in the year 2014)				
2014	Mr. Suresh's A/c	Dr.		12,000	–
	To Cash/Bank A/c				12,000
	(Being royalty paid)				
2014	Profit and Loss A/c	Dr.		12,000	–
	To Royalty A/c			–	12,000
	(Being transfer of royalty to P/L A/c)				
2015	Royalty A/c	Dr.		15,000	
	To Mr. Suresh's A/c				15,000
	(Being royalty due in the year 2015)				
2015	Mr. Suresh's A/c	Dr.		15,000	–
	To Damages Recovered A/c				3,850
	To Cash/Bank A/c			–	11,150
	(Being royalty paid after deducting damages by way of penalty @ ₹350 per month from 1/1/2015 to 30/11/2015)				
2015	Profit and Loss A/c	Dr.		15,000	–
	To Royalty A/c			–	15,000
	(Being transfer of royalty to P/L A/c)				
2016	Royalty A/c	Dr.		30,000	
	To Mr. Suresh's A/c			–	30,000
	(Being royalty due in the year 2016)				
2016	Mr. Suresh's A/c	Dr.		30,000	–
	To Cash/Bank A/c				30,000
	(Being royalty paid)				
2016	Profit and Loss A/c	Dr.		30,000	–
	To Royalty A/c			–	30,000
	(Being transfer of royalty to P/L A/c)				
2017	Royalty A/c	Dr.		26,400	
	To Mr. Suresh's A/c				26,400
	(Being royalty due in the year 2017)				
2017	Mr. Suresh's A/c	Dr.		26,400	–
	To Damages Recovered A/c				3,500
	To Cash/Bank A/c			–	22,900
	(Being royalty paid after deducting damages by way of penalty @ ₹350 per month from 1/1/2017 to 31/10/2017)				
2017	Profit and Loss A/c	Dr.		26,400	–
	To Royalty A/c			–	26,400
	(Being transfer of royalty to P/L A/c)				

Note: As the royalty calculated is on sales, the royalty is transferred to Profit and Loss Account and not Production Account.

Illustration 13: **Journalising transactions with Minimum Rent Account and floating recoupment**

Sugam Collieries Ltd. leased a mine from Mr. Bharath for royalty payable @ ₹1 per ton. Each year's excess of minimum rent over royalties is recoverable out of the royalties of the next 2 years. In the event of strike, minimum rent would stand reduced proportionate to the time actually worked.

The annual output for the 5 years ending is:

Year	2013	2014	2015	2016 (Strike for 3 months)	2017
Production in tons	1,500	5,000	16,000	21,000	32,000
Minimum rent (₹)	2,500	3,000	17,000	25,000	30,000

You are required to pass journal entries in the books of Sugam Collieries Ltd. under minimum rent method.

Solution:

Table of analysis

Year	Royalty @ ₹1 per ton	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered (₹)	Short-working irrecovered	Payment made to lessor (₹)
2013	1,500	2,500	–	1,000	–	–	2,500
2014	5,000	3,000	2,000	–	1,000	–	4,000
2015	16,000	17,000	–	1,000	–	–	17,000
2016	21,000	18,750*	2,250	–	1,000	–	20,000
2017	32,000	30,000	2,000	–	–	–	32,000

***Minimum rent for the period of strike** $\left(25{,}000 \times \frac{3}{12} = ₹6{,}250\right) \Rightarrow (25{,}000 - 6{,}250 = 18{,}750)$.

In the books of Sugam Collieries Ltd.
Journal entries

Date	Particulars		LF	Debit (₹)	Credit (₹)
2013	Minimum Rent A/c	Dr.		2,500	–
	To Mr. Bharath's A/c			–	2,500
	(Being the minimum rent due)				
2013	Royalty A/c	Dr.		1,500	–
	Short-workings A/c	Dr.		1,000	
	To Minimum Rent A/c			–	2,500
	(Being minimum rent apportioned among royalty and short-working)				
2013	Mr. Bharath's A/c	Dr.		2,500	
	To Cash/Bank A/c				2,500
	(Being minimum rent paid)				
2013	Production A/c	Dr.		1,500	–
	To Royalty A/c			–	1,500
	(Being transfer of royalty to Production A/c)				

(Contd.)

4

Date	Particulars		LF	Debit (₹)	Credit (₹)
2014	Royalty A/c	Dr.		5,000	
	To Short-workings A/c				1,000
	To Mr. Bharath's A/c				4,000
	(Being royalty due in the year 2014 and short-workings recovered)				
2014	Mr. Bharath's A/c	Dr.		4,000	–
	To Cash/Bank A/c				4,000
	(Being royalty paid)				
2014	Production A/c	Dr.		5,000	–
	To Royalty A/c			–	5,000
	(Being transfer of royalty to Production A/c)				
2015	Minimum Rent A/c	Dr.		17,000	–
	To Mr. Bharath's A/c			–	17,000
	(Being the minimum rent due)				
2015	Royalty A/c	Dr.		16,000	–
	Short-workings A/c	Dr.		1,000	
	To Minimum Rent A/c			–	17,000
	(Being minimum rent apportioned among royalty and short-working)				
2015	Mr. Bharath's A/c	Dr.		17,000	
	To Cash/Bank A/c				17,000
	(Being royalty paid)				
2015	Production A/c	Dr.		16,000	–
	To Royalty A/c			–	16,000
	(Being transfer of royalty to Production A/c)				
2016	Royalty A/c	Dr.		21,000	
	To Short-workings A/c				1,000
	To Mr. Bharath's A/c				20,000
	(Being royalty due in the year 2016 and short-workings recovered)				(18,750 + 1,250)
2016	Mr. Bharath's A/c	Dr.		20,000	–
	To Cash/Bank A/c				20,000
	(Being royalty paid)				
2016	Production A/c	Dr.		21,000	–
	To Royalty A/c			–	21,000
	(Being transfer of royalty to Production A/c)				
2017	Royalty A/c	Dr.		32,000	–
	To Mr. Bharath's A/c			–	32,000
	(Being royalty due)				
2017	Mr. Bharath's A/c	Dr.		32,000	–
	To Cash/Bank A/c			–	32,000
	(Being royalty paid)				
2017	Production A/c	Dr.		32,000	–
	To Royalty A/c			–	32,000
	(Being transfer of royalty to Production A/c)				

4

Illustration 14: **Journalising transactions with Minimum Rent Account and with a provision to discharge all rental obligations with actual royalty in the event of strike**

Mr. Suman obtained a lease of some granite-bearing land at a minimum rent of ₹4,000 p.a. Short-workings, if any, are recoverable during the next 5 years succeeding the year in respect of which such excess was paid. In the event of strike, if actual royalty was less than the dead rent, it was to discharge all rental obligations. Pass necessary journal entries in the books of Mr. Suman and prepare Ledger Accounts with Minimum Rent Account.

Year	2011	2012	2013	2014	2015	2016 (Year of strike)
Royalty	—	1,000	1,500	5,500	6,600	3,850
Minimum rent	1,500	1,500	4,000	4,000	4,000	4,000

Solution:

Table of analysis

Year	Royalty (₹)	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered (₹)	Short-working irrecovered (₹)	Payment made to lessor (₹)
2011	–	1,500	–	1,500	–	–	1,500
2012	1,000	1,500	–	500	–	–	1,500
2013	1,500	4,000	–	2,500	–	–	4,000
2014	5,500	4,000	1,500	–	1,500	–	4,000
2015	6,600	4,000	2,600	–	2,600	400	4,000
2016	3,850	3,850	–	–	–	–	3,850

Note: In the year 2016 (year of strike), Royalty is discharged instead of minimum rent.

In the books of Mr. Suman
Journal entries

Date	Particulars	LF	Debit (₹)	Credit (₹)
2011	Minimum Rent A/c Dr.		1,500	–
	To Lessor's A/c		–	1,500
	(Being the minimum rent due)			
2011	Short-workings A/c Dr.		1,500	
	To Minimum Rent A/c		–	1,500
	(Being royalty paid)			
2011	Lessor's A/c Dr.		1,500	
	To Cash/Bank A/c			1,500
	(Being amount paid to landlord)			
2012	Minimum Rent A/c Dr.		500	–
	To Lessor A/c		–	500
	(Being the minimum rent due)			

(Contd.)

Date	Particulars		LF	Debit (₹)	Credit (₹)
2012	Royalty A/c	Dr.		1,000	
	Short-workings A/c	Dr.		500	
	To Lessor's A/c				1,500
	(Being minimum rent apportioned among royalty and Short-workings A/c)				
2012	Lessor's A/c	Dr.		1,500	–
	To Cash/Bank A/c				1,500
	(Being royalty paid)				
2012	Production A/c	Dr.		1,000	–
	To Royalty A/c			–	1,000
	(Being transfer of royalty to Production A/c)				
2013	Minimum Rent A/c	Dr.		4,000	–
	To Lessor's A/c			–	4,000
	(Being the minimum rent due)				
2013	Royalty A/c	Dr.		1,500	–
	Short-workings A/c	Dr.		2,500	
	To Minimum Rent A/c			–	4,000
	(Being minimum rent apportioned among royalty and Short-workings A/c)				
2013	Lessor's A/c	Dr.		4,000	–
	To Cash/Bank A/c			–	4,000
	(Being royalty paid)				
2013	Production A/c	Dr.		1,500	–
	To Royalty A/c			–	1,500
	(Being transfer of royalty to Production A/c)				
2014	Royalty A/c	Dr.		5,500	
	To Short-workings A/c				1,500
	To Lessor's A/c				4,000
	(Being royalty due in the year 2014 and short-workings recovered)				
2014	Lessor's A/c…	Dr.		4,000	–
	To Cash/Bank A/c			–	4,000
	(Being royalty paid)				
2014	Production A/c	Dr.		5,500	–
	To Royalty A/c			–	5,500
	(Being transfer of royalty to Production A/c)				

(Contd.)

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Date	Particulars	LF	Debit (₹)	Credit (₹)
2015	Royalty A/c Dr.		6,600	
	To Short-workings A/c			2,600
	To Lessor's A/c			4,000
	(Being royalty due in the year 2014 and short-workings recovered)			
2015	Lessor's A/c… Dr.		4,000	–
	To Cash/Bank A/c		–	4,000
	(Being royalty paid)			
2015	Production A/c Dr.		6,600	–
	To Royalty A/c		–	6,000
	(Being transfer of royalty to Production A/c)			
2015	Profit and Loss A/c Dr.		400	–
	To Short-workings A/c		–	400
	(Being short-workings irrecoverable transferred to Profit and Loss A/c)			
2016	Royalty A/c Dr.		3,850	–
Year of strike	To Lessor's A/c		–	3,850
	(Being royalty due)			
2016	Lessor's A/c… Dr.		3,850	–
	To Cash/Bank A/c		–	3,850
	(Being royalty paid)			
2016	Production A/c Dr.		3,850	–
	To Royalty A/c		–	3,850
	(Being transfer of royalty to Production A/c)			

Ledger Accounts in the books of Mr. Suman

Minimum Rent Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2011	To Landlord/Lessor A/c	1,500	2011	By Short-workings A/c	1,500
		1,500			**1,500**
2012	To Landlord/Lessor A/c	1,500	2012	By Royalties A/c	1,000
				By Short-workings A/c	500
		1,500			**1,500**
2013	To Landlord/Lessor A/c	4,000	2013	By Royalties A/c	1,500
				By Short-workings A/c	2,500
		4,000			**4,000**

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Royalty Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2012	To Minimum Rent A/c	1,000	2012	By Production A/c	1,000
		1,000			**1,000**
2013	To Minimum Rent A/c	1,500	2013	By Production A/c	1,500
		1,500			**1,500**
2014	To Landlord/Lessor A/c To Short-workings A/c	4,000 1,500	2014	By Production A/c	5,500
		5,500			**5,500**
2015	To Landlord/Lessor A/c To Short-workings A/c	4,000 2,600	2015	By Production A/c	6,600
		6,600			**6,600**
2016	To Landlord/Lessor A/c	3,850	2016	By Production A/c	3,850
		3,850			**3,850**

Landlord/Lessor Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2011	To Bank A/c	1,500	2011	By Minimum Rent A/c	1,500
		15,00			**15,00**
2012	To Bank A/c	1,500	2012	By Minimum Rent A/c	1,500
		1,500			**1,500**
2013	To Bank A/c	4,000	2013	By Minimum Rent A/c	4,000
		4,000			**4,000**
2014	To Bank A/c	4,000	2014	By Royalty A/c	4,000
		4,000			**4,000**
2015	To Bank A/c	4,000	2015	By Royalty A/c	4,000
		4,000			**4,000**
2016	To Bank A/c	3,850	2016	By Royalty A/c	3,850
		3,850			**3,850**

Short-workings Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2011	To Minimum Rent A/c	1,500	2010	By Balance c/d	1,500
		1,500			**1,500**
2011	To Balance b/d To Minimum Rent A/c	1,500 500	2011	By Balance c/d	2,000
		2,000			**2,000**
2012	To Balance b/d To Minimum Rent A/c	2,000 2,500	2012	By Balance c/d	4,500
		4,500			**4,500**
2013	To Balance b/d	4,500	2013	By Royalty A/c (SW recovered) By Balance c/d	1,500 3,000
		4,500			**4,500**
2013	To Balance b/d	3,000		By Royalty A/c (SW recovered) By P/L A/c (SW not recovered)	2,600 400
		3,000			**3,000**

Illustration 15: **Preparation of Ledger Accounts with Minimum Rent Account and fixed recoupment**

On 1 January 2007, Yogeshwar obtained a mining lease on the term that a royalty of ₹5 per ton of output is payable subject to a minimum rent of ₹24,000 p.a.; the recoupment of short-workings was limited to a period of first 3 years of the lease. Following information is given.

Year	2007	2008	2009	2010
Output in tons	3,000	3,500	5,000	7,000

Show the necessary Ledger Accounts in the books of Yogeshwar.

[B.U., B.Com., Nov/Dec 2012, Section C]

Solution:

Table of analysis

Year	Output in tons	Royalty (₹5 per ton)	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered (₹)	Short-working irrecovered (₹)	Payment made to lessor (₹)
2007	3,000	15,000	24,000	–	9,000	–	–	24,000
2008	3,500	17,500	24,000	–	6,500	–	–	24,000
2009	5,000	25,000	24,000	1,000	–	1,000	14,500	24,000
2010	7,000	35,000	24,000	11,000	–	–	–	35,000

Ledger Accounts in the books of Yogeshwar

Minimum Rent Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2007	To Landlord/Lessor A/c	24,000	2007	By Royalties A/c By Short-workings A/c	15,000 9,000
		24,000			**24,000**
2008	To Landlord/Lessor A/c	24,000	2008	By Royalties A/c By Short-workings A/c	17,500 6,500
		24,000			**24,000**

Royalty Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2007	To Minimum Rent A/c	15,000	2007	By Production A/c	15,000
		15,000			**15,000**
2008	To Minimum Rent A/c	17,500	2008	By Production A/c	17,500
		17,500			**17,500**
2009	To Landlord/Lessor A/c To Short-workings A/c (SW recovered)	24,000 1,000	2009	By Production A/c	25,000
		25,000			**25,000**
2010	To Landlord/Lessor A/c To Short-workings A/c (SW recovered)	24,000 11,000	2010	By Production A/c	35,000
		35,000			**35,000**

Landlord/Lessor Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2007	To Bank A/c	24,000	2007	By Minimum Rent A/c	24,000
		24,000			**24,000**
2008	To Bank A/c	24,000	2008	By Minimum Rent A/c	24,000
		24,000			**24,000**
2009	To Bank A/c	24,000	2009	By Royalty A/c	24,000
		24,000			**24,000**
2010	To Bank A/c	35,000	2010	By Royalty A/c	35,000
		35,000			**35,000**

Short-workings Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2007	To Minimum Rent A/c	9,000	2007	By Balance c/d	9,000
		9,000			**9,000**
2008	To Balance b/d To Minimum Rent A/c	9,000 6,500	2008	By Balance c/d	15,500
		15,500			**15,000**
2009	To Balance b/d	15,500	2009	By Royalty A/c By P/L A/c	1,000 14,500
		15,500			**15,500**

Illustration 16: **Preparation of Ledger Accounts with Minimum Rent Account and floating recoupment**

BM Co. obtained a mine on lease for a period of 30 years beginning from 1 January 2008 on the following terms:

1. To pay minimum rent of ₹24,000 per year
2. Each year's excess of minimum rent over the actual royalties can be recovered during the subsequent 2 years
3. Due to accident or strike, minimum rent is reduced by 25% for that year
4. Royalty was to be calculated at ₹50 per tonne
5. Production during 4 years from 2008 to 2011 was as follows:

Year	2008	2009	2010	2011 (Strike for 3 months)
Production in tons	280	360	600	440

Open the following accounts in the books of the company
Minimum Account
Royalty Account
Short-workings Account
Landlord Account

[B.U., B.Com., Nov/Dec 2013, Section C]

Solution:

Table of analysis

Year	Output in tons	Royalty (₹50 per ton)	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered (₹)	Short-working irrecovered (₹)	Payment made to lessor (₹)
2008	280	14,000	24,000		10,000	–	–	24,000
2009	360	18,000	24,000		6,000	–	–	24,000
2010	600	30,000	24,000	6,000	–	6,000	4,000	24,000
2011	440	22,000	18,000*	4,000	–	4,000	2,000	18,000

*2011 minimum rent is reduced by 25% (24,000 − 25% of 24,000 = ₹18,000).

Ledger Accounts in the books of Yogeshwar

Minimum Rent Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2008	To Landlord/Lessor A/c	24,000	2008	By Royalties A/c By Short-workings A/c	14,000 10,000
		24,000			**24,000**
2009	To Landlord/Lessor A/c	24,000	2009	By Royalties A/c By Short-workings A/c	18,000 6,000
		24,000			**24,000**

Royalty Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2008	To Minimum Rent A/c	14,000	2008	By Production A/c	14,000
		14,000			**14,000**
2009	To Minimum Rent A/c	18,000	2009	By Production A/c	18,000
		18,000			**18,000**
2010	To Landlord/Lessor A/c To Short-workings A/c	24,000 6,000	2010	By Production A/c	30,000
		30,000			**30,000**
2011	To Landlord/Lessor A/c To Short-workings A/c	18,000 4,000	2011	By Production A/c	22,000
		22,000			**22,000**

Landlord/Lessor Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2008	To Bank A/c	24,000	2008	By Minimum Rent A/c	24,000
		24,000			**24,000**
2009	To Bank A/c	24,000	2009	By Minimum Rent A/c	24,000
		24,000			**24,000**
2010	To Bank A/c	24,000	2010	By Royalty A/c	24,000
		24,000			**24,000**
2011	To Bank A/c	18,000	2011	By Royalty A/c	18,000
		18,000			**18,000**

Short-workings Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2008	To Minimum Rent A/c	10,000	2008	By Balance c/d	10,000
		10,000			**10,000**
2009	To Balance b/d To Minimum Rent A/c	10,000 6,000	2009	By Balance c/d	16,000
		16,000			**16,000**
2010	To Balance b/d	16,000	2010	By Royalty A/c By P/L A/c By Balance c/d	6,000 4,000 6,000
		16,000			**16,000**
2011	To Balance b/d	6,000	2011	By Royalty A/c By P/L A/c	4,000 2,000
		6,000			**6,000**

Illustration 17: **Preparation of Ledger Accounts with Minimum Rent Account and floating recoupment**

Hemanth leased an oil well from Venkat Oil Ltd. on 1 January 2010. The minimum rent was ₹2,00,000 and royalty was ₹20 per ton of crude oil raised. The short-workings were recoverable in the succeeding 2 years of such short-workings.

The outputs during the first 4 years were 5,500, 8,000, 11,250 and 12,500 tonnes. Prepare Minimum Rent Account, Royalty Account, Short-workings Account and Venkat Oil Ltd. Account in the books of Hemanth.

[B.U., B.Com., Nov/Dec 2014, Section C]

Solution:

Table of Analysis

Year	Output in tons	Royalty (₹20 per ton)	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered (₹)	Short-working irrecovered (₹)	Payment made to lessor (₹)
2010	5,500	1,10,000	2,00,000	–	90,000	–	–	2,00,000
2011	8,000	1,60,000	2,00,000	–	40,000	–	–	2,00,000
2012	11,250	2,25,000	2,00,000	25,000	–	25,000	65,000	2,00,000
2013	12,500	2,50,000	2,00,000	50,000	–	40,000	–	2,10,000

Ledger Accounts in the books of Hemanth

Minimum Rent Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
2010	To Venkat Oil Ltd. A/c	2,00,000	2010	By Royalties A/c By Short-workings A/c	1,10,000 90,000
		2,00,000			**2,00,000**
2011	To Venkat Oil Ltd. A/c	2,00,000	2011	By Royalties A/c By Short-workings A/c	1,60,000 40,000
		2,00,000			**2,00,000**

Royalty Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
2010	To Minimum Rent A/c	1,10,000	2010	By Production A/c	1,10,000
		1,10,000			**1,10,000**
2011	To Minimum Rent A/c	1,60,000	2011	By Production A/c	1,60,000
		1,60,000			**1,60,000**
2012	To Venkat Oil Ltd. A/c To Short-workings A/c	2,00,000 25,000	2012	By Production A/c	2,25,000
		2,25,000			**2,25,000**
2013	To Venkat Oil Ltd. A/c To Short-workings A/c	2,10,000 40,000	2013	By Production A/c	2,50,000
		2,50,000			**2,50,000**

Venkat Oil Ltd. Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
2010	To Bank A/c	2,00,000	2010	By Minimum Rent A/c	2,00,000
		2,00,000			**2,00,000**
2011	To Bank A/c	2,00,000	2011	By Minimum Rent A/c	2,00,000
		2,00,000			**2,00,000**
2012	To Bank A/c	2,00,000	2012	By Royalty A/c	2,00,000
		2,00,000			**2,00,000**
2013	To Bank A/c	2,10,000	2013	By Royalty A/c	2,10,000
		2,10,000			**2,10,000**

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Short-workings Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2010	To Minimum Rent A/c	90,000	2010	By Balance c/d	90,000
		90,000			**90,000**
2011	To Balance b/d To Minimum Rent A/c	90,000 40,000	2011	By Balance c/d	1,30,000
		1,30,000			**1,30,000**
2012	To Balance b/d	1,30,000	2012	By Royalty A/c By P/L A/c By Balance c/d	25,000 65,000 40,000
		1,30,000			**1,30,000**
2013	To Balance b/d	40,000	2013	By Royalty A/c	40,000
		40,000			**40,000**

Illustration 18: **Preparation of Ledger Accounts with Minimum Rent Account and fixed recoupment**

X Co. Ltd. took a lease from a landlord for a period of 25 years from 1 January 2010 on a royalty of ₹2 per ton of coal raised with a minimum rent of ₹20,000 and power to recoup short-workings during the first 4 years of the lease. The annual output was as follows:

Year	2010	2011	2012	2013	2014
Output in tons	5,000	8,000	10,000	15,000	20,000

[B.U., B.Com., Nov/Dec 2016, Section C]

Solution:

Table of Analysis

Year	Output in tons	Royalty (₹2 per ton)	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered (₹)	Short-working irrecovered (₹)	Payment made to lessor (₹)
2010	5,000	10,000	20,000	–	10,000	–	–	20,000
2011	8,000	16,000	20,000	–	4,000	–	–	20,000
2012	10,000	20,000	20,000	–	–	–	–	20,000
2013	15,000	30,000	20,000	10,000	–	10,000	4,000	20,000
2014	20,000	40,000	20,000	20,000	–	–	–	40,000

Ledger Accounts in the books of X Co. Ltd.

Minimum Rent Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2010	To Landlord/Lessor A/c	20,000	2010	By Royalties A/c	10,000
				By Short-workings A/c	10,000
		20,000			**20,000**
2011	To Landlord/Lessor A/c	20,000	2011	By Royalties A/c	16,000
				By Short-workings A/c	4,000
		20,000			**20,000**

Royalty Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2010	To Minimum Rent A/c	10,000	2010	By Production A/c	10,000
		10,000			**10,000**
2011	To Minimum Rent A/c	16,000	2011	By Production A/c	16,000
		16,000			**16,000**
2012	To Landlord/Lessor A/c	20,000	2012	By Production A/c	20,000
		20,000			**20,000**
2013	To Landlord/Lessor A/c	10,000	2013	By Production A/c	10,000
	To Short-workings A/c	20,000			20,000
		30,000			**30,000**
2014	To Landlord/Lessor A/c	40,000	2014	By Production A/c	40,000
		40,000			**40,000**

Landlord/Lessor Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2010	To Bank A/c	20,000	2010	By Minimum Rent A/c	20,000
		20,000			**20,000**
2011	To Bank A/c	20,000	2011	By Minimum Rent A/c	20,000
		20,000			**20,000**
2012	To Bank A/c	20,000	2012	By Royalty A/c	20,000
		20,000			**20,000**
2013	To Bank A/c	20,000	2013	By Royalty A/c	20,000
		20,000			**20,000**
2014	To Bank A/c	40,000	2013	By Royalty A/c	40,000
		40,000			**40,000**

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Short-workings Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2010	To Minimum Rent A/c	10,000	2010	By Balance c/d	10,000
		10,000			**10,000**
2011	To Balance b/d To Minimum Rent A/c	10,000 4,000	2011	By Balance c/d	14,000
		14,000			**14,000**
2012	To Balance b/d	14,000	2012	By Balance c/d	14,000
		14,000			**14,000**
2013	To Balance b/d	14,000	2013	By Royalty A/c By P/L A/c	10,000 4,000
		14,000			**14,000**

Illustration 19: **Preparation of Ledger Accounts without Minimum Rent Account and floating recoupment (royalty is calculated on sales when production and closing stock in units are given)**

Mr. X patented an automatic washing machine, and he granted M/s Y & Co., a licence to manufacture and sell washing machines for 10 years on the following terms:

1. M/s Y & Co., to pay a royalty of ₹100 for every washing machine sold, with a minimum rent of ₹50,000 per year
2. M/s Y & Co. could recoup the short-workings arising in any year against surplus royalties payable in the next 2 years.

The production and closing stock for the first 4 years were as follows:

Year	I	II	III	IV
Production (units)	250	450	550	650
Closing stock (units)	50	100	50	100

Prepare Royalty Account, X's Account and Short-workings Account in the books of M/s Y & Co.

Solution:

Calculation of Number of Units Sold

Year	Opening stock +	Production −	Closing stock	= Sales
I	0+	250−	50	= 200
II	50+	450−	100	= 400
III	100+	550−	50	= 600
IV	50+	650−	100	= 600

Table of Analysis

Year	Output in tons	Royalty (₹100 per ton)	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered (₹)	Short-working irrecovered (₹)	Payment made to lessor (₹)
I	200	20,000	50,000	–	30,000	–	–	50,000
II	400	40,000	50,000	–	10,000	–	–	50,000
III	600	60,000	50,000	10,000	–	10,000	20,000	50,000
IV	600	60,000	50,000	10,000	–	10,000	–	50,000

Ledger Accounts in the Books of M/s Y & Co.
Royalty Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
I	To Landlord/Lessor A/c	20,000	I	By Production A/c	20,000
		20,000			**20,000**
II	To Landlord/Lessor A/c	40,000	II	By Production A/c	40,000
		40,000			**40,000**
III	To Landlord/Lessor A/c	50,000	III	By Production A/c	60,000
	To Short-workings A/c	10,000			
		60,000			**60,000**
IV	To Landlord/Lessor A/c	50,000	IV	By Production A/c	60,000
	To Short-workings A/c	10,000			
		60,000			**60,000**

Mr. X's Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
I	To Bank A/c	50,000	I	By Royalty A/c	20,000
				By Short-workings A/c	30,000
		50,000			**50,000**
II	To Bank A/c	50,000	II	By Royalty A/c	40,000
				By Short-workings A/c	10,000
		50,000			**50,000**
III	To Bank A/c	50,000	III	By Royalty A/c	50,000
		50,000			**50,000**
IV	To Bank A/c	50,000	IV	By Royalty A/c	50,000
		50,000			**50,000**

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Short-workings Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
I	To Landlord A/c	30,000	I	By Balance c/d	30,000
		16,500			**16,500**
II	To Balance b/d To Landlord A/c	30,000 10,000	II	By Balance c/d	40,000
		40,000			**40,000**
III	To Balance b/d	40,000	III	By Royalty A/c By P/L A/c By Balance c/d	10,000 20,000 10,000
		33,750			**33,750**
IV	To Balance b/d	10,000		By Royalty A/c	10,000
		10,000			**10,000**

Illustration 20: Drafting journal entries and preparation of Ledger Accounts in the books of lessor/landlord

ABC Co. is lessee of a mine on a royalty of ₹1 per ton of coal raised with minimum rent of ₹8,000 per annum with power to recoup short-workings, during the first 2 years of the lease only. The output for the first 3 years is as follows: 5,000 tons in 2015; 9,000 tons in 2016 and 8,000 tons on 2017. Pass the necessary journal entries and Ledger Accounts in the books of lessor/landlord.

Solution:

Table of Analysis

Year	Output in tons	Royalty (₹1 per ton)	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered (₹)	Short-working irrecovered (₹)	Payment made to lessor (₹)
2015	5,000	5,000	8,000	–	3,000	–	–	8,000
2016	9,000	9,000	8,000	1,000	–	1,000	2,000	8,000
2017	8,000	8,000	8,000	–	–	–	–	8,000

Journal Entries in the Books of Landlord

Date	Particulars	LF	Debit (₹)	Credit (₹)
2015	ABC Co. A/c Dr. To Short-workings Suspense A/c To Royalty Receivables A/c *(Being royalty receivable due along with short-workings)*		8,000	– 3,000 5,000
2015	Bank A/c Dr. To ABC Co. A/c *(Being royalty received)*		8,000 –	 8,000

(Contd.)

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Date	Particulars		LF	Debit (₹)	Credit (₹)
2015	Royalty Receivables A/c	Dr.		5,000	–
	To Profit and Loss A/c			–	5,000
	(Being royalty received transferred to Profit and Loss A/c)				
2016	ABC Co. A/c	Dr.		8,000	
	Short-workings Suspense A/c	Dr.		1,000	
	To Royalty Receivables A/c				9,000
	(Being minimum rent apportioned among royalty and Short-workings A/c)				
2016	Bank A/c	Dr.		8,000	
	To ABC Co. A/c			–	8,000
	(Being royalty received)				
2016	Royalty Receivables A/c	Dr.		9,000	–
	To Profit and Loss A/c			–	9,000
	(Being royalty received transferred to Profit and Loss A/c)				
2016	Short-workings Suspense A/c	Dr.		2,000	–
	To Profit and Loss A/c			–	2,000
	(Being short-workings irrecoverable transferred to P/L A/c)				
2017	ABC Co. A/c	Dr.		8,000	–
	To Royalty Receivables A/c				8,000
	(Being royalty receivable due along with short-workings)				
2017	Bank A/c	Dr.		8,000	–
	To ABC Co. A/c			–	8,000
	(Being royalty received)				
2017	Royalty Receivables A/c	Dr.		8,000	–
	To Profit and Loss A/c			–	8,000
	(Being royalty received transferred to Profit and Loss A/c)				

Ledger Accounts in the Books of Landlord/Lessor

Royalty Receivables Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015	To Profit and Loss A/c	5,000	2015	By ABC Co.'s A/c	5,000
		5,000			**5,000**
2016	To Profit and Loss A/c	9,000	2016	By ABC Co.'s A/c	8,000
				By Short-workings Suspense A/c	1,000
		9,000			**9,000**
2017	To Profit and Loss A/c	8,000	2017	By ABC Co.'s A/c	8,000
		8,000			**8,000**

Short-working Suspense Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015	By Balance c/d	3,000	2015	By ABC Co.'s A/c	3,000
		3,000			**3,000**
2016	To Royalty Receivable A/c To Balance c/d	1,000 2,000	2016	By Balance b/d	3,000
		3,000			**3,000**
2017	To P/L A/c	2,000	2017	By Balance b/d	2,000
		2,000			**2,000**

ABC Co. A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015	To Short-workings Suspense A/c To Royalty Receivable A/c	3,000 5,000	2015	By Bank A/c	8,000
		8,000			**8,000**
2016	To Royalty Receivable A/c	8,000	2016	By Bank A/c	8,000
		8,000			**8,000**
2016	To Royalty Receivable A/c	8,000	2016	By Bank A/c	8,000
		8,000			**8,000**

Illustration 21: **Drafting journal entries and preparation of Ledger Accounts in the books of lessor/landlord**

Susheel Ltd. leased a mine from Mr. Amit at a royalty of ₹50 per ton with a minimum rent of ₹10,000 per annum. Each year's excess of minimum rent over royalties is recoverable out of royalties of the next 5 years.

In the event of strike, the minimum rent not being reached, it was agreed that minimum rent would stand reduced proportionate to the time actually worked. In the year 2016, the company witnessed strike by mine workers for a period of 4 months. The management and the union workers resolved the same and resumed after 4 months.

Year	2012	2013	2014	2015	2016	2017
Royalty (₹)	3,500	10,000	12,500	18,000	4,000	28,000

Write journal entries and prepare Ledger Accounts in the books of Mr. Amit.

Solution:

Table of Analysis

Year	Royalty (₹)	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered (₹)	Short-working irrecovered (₹)	Payment made to lessor (₹)
2012	3,500	10,000		6,500		–	10,000
2013	10,000	10,000	–	–		–	10,000
2014	12,500	10,000	2,500		2,500		10,000
2015	18,000	10,000	8,000		4,000	–	14,000
2016	4,000	6,667*	12,000	2,667		–	6,667
2017	28,000	10,000	8,000		2,667	–	25,333

***Minimum rent for the year 2016 is ₹6,667** $\left(\mathbf{10{,}000 \times \frac{8}{12}}\right)$.

Journal Entries in the Books of Landlord

Date	Particulars		LF	Debit (₹)	Credit (₹)
2012	Susheel Ltd. A/c	Dr.		10,000	–
	To Short-workings Suspense A/c				6,500
	To Royalty Receivables A/c				3,500
	(Being royalty receivable due along with short-workings)				
2012	Bank A/c	Dr.		10,000	–
	To Susheel Ltd. A/c			–	10,000
	(Being royalty received)				
2012	Royalty Receivables A/c	Dr.		3,500	–
	To Profit and Loss A/c			–	3,500
	(Being royalty received transferred to Profit and Loss A/c)				
2013	Susheel Ltd. A/c	Dr.		10,000	–
	To Royalty Receivables A/c				10,000
	(Being royalty receivable due along with short-workings)				
2013	Bank A/c	Dr.		10,000	–
	To Susheel Ltd. A/c			–	10,000
	(Being royalty received)				
2013	Royalty Receivables A/c	Dr.		10,000	–
	To Profit and Loss A/c			–	10,000
	(Being royalty received transferred to Profit and Loss A/c)				
2014	Susheel Ltd. A/c	Dr.		10,000	
	Short-workings Suspense A/c	Dr.		2,500	
	To Royalty Receivables A/c				12,500
	(Being minimum rent apportioned among royalty and Short-workings A/c)				

(Contd.)

Date	Particulars	LF	Debit (₹)	Credit (₹)
2014	Bank A/c Dr.		20,000	–
	To Susheel Ltd. A/c		–	20,000
	(Being royalty received)			
2014	Royalty Receivables A/c Dr.		12,500	–
	To Profit and Loss A/c		–	12,500
	(Being royalty received transferred to Profit and Loss A/c)			
2015	Susheel Ltd. A/c Dr.		10,000	
	Short-workings Suspense A/c Dr.		4,000	
	To Royalty Receivables A/c			14,000
	(Being minimum rent apportioned among royalty and Short-workings A/c)			
2015	Bank A/c Dr.		10,000	–
	To Susheel Ltd. A/c		–	10,000
	(Being royalty received)			
2015	Royalty Receivables A/c Dr.		14,000	–
	To Profit and Loss A/c		–	14,000
	(Being royalty received transferred to Profit and Loss A/c)			
2016	Susheel Ltd. A/c Dr.		6,667	–
	To Short-workings Suspense A/c			2,667
	To Royalty Receivables A/c			4,000
	(Being royalty receivable due along with short-workings)			
2016	Bank A/c Dr.		6,667	–
	To Susheel Ltd. A/c		–	6,667
	(Being royalty received)			
2016	Royalty Receivables A/c Dr.		4,000	–
	To Profit and Loss A/c		–	4,000
	(Being royalty received transferred to Profit and Loss A/c)			
2017	Susheel Ltd. A/c Dr.		25,333	
	Short-workings Suspense A/c Dr.		2,667	
	To Royalty Receivables A/c			28,000
	(Being minimum rent apportioned among royalty and Short-workings A/c)			
2017	Bank A/c Dr.		25,333	–
	To Susheel Ltd. A/c		–	25,333
	(Being royalty received)			
2017	Royalty Receivables A/c Dr.		28,000	–
	To Profit and Loss A/c		–	28,000
	(Being royalty received transferred to Profit and Loss A/c)			

Ledger Accounts in the Books of Landlord/Lessor
Royalty Receivables Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2012	To Profit and Loss A/c	3,500	2015	By Susheel Ltd.'s A/c	5,000
		3,500			**5,000**
2013	To Profit and Loss A/c	10,000	2016	By Susheel Ltd.'s A/c	10,000
		10,000			**10,000**
2014	To Profit and Loss A/c	12,500	2017	By Susheel Ltd.'s A/c By Short-workings Suspense A/c	10,000 2,500
		12,500			**12,500**
2015	To Profit and Loss A/c	18,000		By Susheel Ltd.'s A/c By Short-workings Suspense A/c	14,000 4,000
		18,000			**18,000**
2016	To Profit and Loss A/c	4,000	2015	By Susheel Ltd.'s A/c	4,000
		4,000			**40,000**
2017	To Profit and Loss A/c	28,000		By Susheel Ltd.'s A/c By Short-workings Suspense A/c	25,333 2,667
		28,000			**28,000**

Short-working Suspense Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2012	By Balance c/d	6,500	2012	By Susheel Ltd.'s A/c	6,500
		6,500			**6,500**
2013	By Balance c/d	6,500	2013	By Balance b/d	6,500
		6,500			**6,500**
2014	To Royalty Receivable A/c To Balance c/d	2,500 4,000	2014	By Balance b/d	6,500
		2,000			**6,500**
2015	To Royalty Receivable A/c	4,000	2015	By Balance b/d	4,000
		4,000			**4,000**
2016	By Balance c/d	2,667	2016	By Susheel Ltd.'s A/c	2,667
		2,667			**2,667**
2017	To Royalty Receivable A/c	2,667	2017	By Balance b/d	2,667
		2,667			**2,667**

Susheel Ltd. Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2012	To Short-workings Suspense A/c	6,500	2012	By Bank A/c	10,000
	To Royalty Receivable A/c	3,500			
		10,000			**10,000**
2013	To Royalty Receivable A/c	10,000	2013	By Bank A/c	10,000
		10,000			**10,000**
2014	To Royalty Receivable A/c	10,000	2014	By Bank A/c	10,000
		10,000			**10,000**
2015	To Royalty Receivable A/c	14,000	2014	By Bank A/c	14,000
		14,000			**14,000**
2016	To Short-workings Suspense A/c	2,667	2012	By Bank A/c	6,667
	To Royalty Receivable A/c	4,000			
		6,667			**6,667**
2017	To Royalty Receivable A/c	25,333	2014	By Bank A/c	25,333
Delay		**25,333**			**25,333**

Illustration 22: **Ledger Accounts in the books of lessor and lessee**

Mr. Shekhar wrote a book on costing methods and got it published from Brilliant Publishers on the following terms:

The publishers were to pay royalty at 10% of the sales proceeds of each year subject to a minimum of ₹35,000 a year. The deficiency in sales, if any, of 1 year could be recouped out of the excess in the immediate next year.

The publishers have the right to ask for revision of the book, which the author was obliged to complete in 6 months. Otherwise, the rule of minimum rent was not to apply in that year.

The details of sales are given as follows:

Year	2013	2014	2015	2016	2017
No. of copies sold	2,500	3,000	4,000	5,000	5,000
Price per copy	100	100	100	125	125

The publishers sent in a request for revision on 1 January 2016. The author forwarded the revised manuscript to the publisher on 1 November 2016.

Prepare Ledger Accounts in the books of Mr. Shekhar and Brilliant Publishers.

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Solution:

Calculation of Royalty Payable

Year	No. of copies sold	Sale price of each copy (₹)	Total sales (₹)	Royalty @ 10% of sales (₹)
2013	2,500	100	2,50,000	25,000
2014	3,000	100	3,00,000	30,000
2015	4,000	100	4,00,000	40,000
2016	5,000	125	6,25,000	62,500
2017	5,000	125	6,25,000	62,500

Table of Analysis

Year	Royalty (₹)	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered (₹)	Short-working irrecovered (₹)	Payment made to lessor (₹)
2013	25,000	35,000	–	10,000			35,000
2014	30,000	35,000	–	5,000		10,000	35,000
2015	40,000	35,000	5,000	–	5,000	–	35,000
2016	62,500	62,500	–	–	–	–	62,500
2017	62,500	35,000	27,500	–	–	–	62,500

Note: As the revised manuscript was not forwarded by the author to the publisher within 6 months of such request, minimum rent was not to apply in that year (2016).

Ledger Accounts in the Books of Mr. Shekhar
Royalty Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
2013	To Brilliant Publishers A/c	25,000	2013	By Production A/c	25,000
		25,000			**25,000**
2014	To Brilliant Publishers A/c	30,000	2014	By Production A/c	30,000
		30,000			**30,000**
2015	To Brilliant Publishers A/c To Short-workings A/c	35,000 5,000	2015	By Production A/c	40,000
		40,000			**40,000**
2016	To Brilliant Publishers A/c	62,500	2016	By Production A/c	62,500
		62,500			**62,500**
2017	To Brilliant Publishers A/c	62,500	2017	By Production A/c	62,500
		62,500			**62,500**

Brilliant Publisher's Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013	To Bank A/c	25,000	2013	By Royalty A/c By Short-workings A/c	15,000 10,000
		25,000			**25,000**
2014	To Bank A/c	30,000	2014	By Royalty A/c By Short-workings A/c	25,000 5,000
		30,000			**30,000**
2015	To Bank A/c	40,000	2015	By Royalty A/c	40,000
		40,000			**40,000**
2016	To Bank A/c	62,500	2016	By Royalty A/c	50,000
		62,500			**62,500**
2017	To Bank A/c	62,500	2016	By Royalty A/c	62,500
		62,500			**62,500**

Short-workings Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
I	To Brilliant Publishers A/c	10,000	I	By Balance c/d	10,000
		10,000			**10,000**
II	To Balance b/d To Brilliant Publishers A/c	10,000 5,000	II	By P/L A/c By Balance c/d	10,000 5,000
		15,000			**15,000**
III	To Balance b/d	5,000	III	By Royalty A/c	5,000
		5,000			**5,000**

Ledger Accounts in the Books of Brilliant Publishers
Royalty Receivables Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013	To Profit and Loss A/c	25,000	2015	By Shekhar's A/c	25,000
		25,000			**25,000**
2014	To Profit and Loss A/c	30,000	2016	By Shekhar's A/c	30,000
		30,000			**30,000**
2015	To Profit and Loss A/c	40,000	2017	By Shekhar's A/c By Short-workings Suspense A/c	35,000 5,000
		40,000			**40,000**
2016	To Profit and Loss A/c	62,500		By Shekhar's A/c	62,500
		62,500			**62,500**
2017	To Profit and Loss A/c	62,500	2015	By Shekhar's A/c	62,500
		62,500			**62,500**

Short-working Suspense Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2012	To Balance c/d	10,000	2012	By Shekhar's A/c	10,000
		10,000			**10,000**
2013	To P/L A/c To Balance c/d	10,000 5,000	2013	By Balance b/d By Shekhar's A/c	10,000 5,000
		15,000			**15,000**
2014	To Royalty Receivable A/c	5,000	2014	To Balance b/d	5,000
		5,000			**5,000**

Shekhar's Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013	To Short-workings Suspense A/c To Royalty Receivable A/c	10,000 25,000	2013	By Bank A/c	35,000
		35,000			**35,000**
2014	To Short-workings Suspense A/c To Royalty Receivable A/c	5,000 30,000	2014	By Bank A/c	35,000
		35,000			**35,000**
2015	To Royalty Receivable A/c	35,000	2015	By Bank A/c	35,000
		35,000			**35,000**
2016	To Royalty Receivable A/c	62,500	2016	By Bank A/c	62,500
		62,500			**62,500**
2017	To Royalty Receivable A/c	62,500	2017	By Bank A/c	62,500
		62,500			**62,500**

4

Illustration 23: Sublease

HM Labs developed anti-bacterial cream and got it patented. On 1 January 2013, it issued licence to Vivek Pharmas for it commercial production and sale of the product. On the same day Vivek Pharmas granted a sub-licence to Medicare Pharmas for the same purpose. The terms and conditions were agreed upon as mentioned in the following:

Lease – Royalty @ ₹5 per unit produced; minimum rent ₹35,000 p.a.

Sublease – Royalty @ ₹10 per unit produced; minimum rent ₹20,000 p.a.

Recoupment of short-workings allowed 2 years following the year of short-working applicable to both the parties.

With the help of the following information prepare Royalty Account and Short-workings Account in the books of Vivek Pharmas for the entire period.

Year	Vivek Pharmas		Medicare Pharmas	
	Sales (units)	Closing stock (units)	Sales (units)	Closing stock (units)
2013	3,000	500	1,000	200
2014	6,000	800	1,500	500
2015	8,000	1,000	3,000	700

Solution:

In the Books of Vivek Pharmas
Royalty Payable to HM Labs

Year	Sales + Closing stock − Opening stock = Production			
2013	3,000	+500	−0	=3,500
2014	6,000	+800	−500	=6,300
2015	8,000	+1,000	−800	=8,200

Year	Output in units	Royalty (₹5 per unit)	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered (₹)	Short-working irrecovered (₹)	Payment made to lessor (₹)
2013	3,500	17,500	35,000	–	17,500	–	–	35,000
2014	6,300	31,500	35,000	–	3,500	–	–	35,000
2015	8,200	41,000	35,000	6,000	–	6,000	15,000	35,000

Royalty Receivable from Medicare Pharmas

Year	Sales + Closing stock − Opening stock = Production			
2013	1,000	+200	−0	=1,200
2014	1,500	+500	−200	=1,800
2015	3,000	+700	−500	=3,200

Year	Output in units	Royalty (₹10 per unit)	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered (₹)	Short-working irrecovered (₹)	Payment made to lessor (₹)
2013	1,200	12,000	20,000		8,000	–	–	20,000
2014	1,800	18,000	20,000	–	2,000	–	–	20,000
2015	3,200	32,000	20,000	12,000	–	10,000	–	22,000

Royalty Payable Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013	To HM Labs A/c	17,500	2013	By P/L A/c	17,500
		17,500			**17,500**
2014	To HM Labs A/c	31,500	2014	By P/L A/c	31,500
		31,500			**31,500**
2015	To Short-workings A/c To HM Labs A/c	6,000 35,000	2015	By P/L A/c	41,000
		41,000			**41,000**

Short-working Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013	To HM Labs A/c	17,500	2013	By Balance c/d	17,500
		17,500			**17,500**
2014	To Balance b/d To HM Labs A/c	17,500 3,500	2014	By Balance c/d	21,000
		21,000			**21,000**
2015	To Balance b/d	21,000	2015	By Royalties A/c By P/L A/c	6,000 15,000
		21,000			**21,000**

HM Labs Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013	To Bank A/c	35,000	2013	By Royalties Payable A/c By Short-workings A/c	17,500 17,500
		35,000			**35,000**
2014	To Bank A/c	35,000	2014	By Royalties Payable A/c By Short-workings A/c	31,500 3,500
		35,000			**35,000**
2015	To Bank A/c	35,000	2015	By Royalties Payable A/c	35,000
		35,000			**35,000**

4

Royalty Receivable Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013	To Profit and Loss A/c	12,000	2013	By Medicare Pharma A/c	12,000
		12,000			**20,000**
2014	To Profit and Loss A/c	18,000	2014	By Medicare Pharma A/c	18,000
		18,000			**20,000**
2015	To Profit and Loss A/c	32,000	2015	By Medicare Pharma A/c By Short-working Suspense A/c	22,000 10,000
		32,000			**32,000**

Short-working Suspense Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013	To Balance c/d	8,000	2013	By Medicare Pharma A/c	8,000
		12,000			**20,000**
2014	To Balance c/d	10,000	2014	By Balance b/d By Medicare Pharma A/c	8,000 2,000
		10,000			**10,000**
2015	To Royalty Receivables A/c	10,000	2015	By Balance b/d	10,000
		10,000			**10,000**

Medicare Pharmas Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013	To Short-workings Suspense A/c To Royalties Receivables A/c	8,000 12,000	2013	By Bank A/c	20,000
		20,000			**20,000**
2014	To Short-workings Suspense A/c To Royalties Receivables A/c	2,000 18,000	2014	By Bank A/c	20,000
		20,000			**20,000**
2015	To Royalty Receivables A/c	32,000	2015	By Short-workings Suspense A/c By Bank A/c	10,000 22,000
		32,000			**32,000**

4

Illustration 24: **Sublease**

On 1 January 2013, Mr. Sawan Kumar obtained a mining lease and from that date he subleased a part of the mine to Mr. Pawan Kumar. Show Ledger Accounts in the books of Mr. Sawan Kumar from the following data:

Year	Lease (tons)	Sublease (tons)
2013	1,500	1,000
2014	4,000	4,500
2015	18,000	10,000
2016	15,000	3,000 (strike)
2017	8,000	15,000
Royalty per ton	₹3.00	₹4.00
Minimum rent p.a.	₹35,000	₹25,000
S/W Recoverable in the following	3 years	2 years

In the case of strike, royalty earned will discharge all rental obligations for the year only.

Solution:

In the Books of Mr. Sawan Kumar
Royalties Payable Account

Year	Output in units	Royalty (₹3 per ton)	Minimum rent (₹)	Surplus (royalty-MR) (₹)	Short-working (MR-royalty) (₹)	Short-working recovered (₹)	Short-working irrecovered (₹)	Payment made to lessor (₹)
2013	2,500*	7,500	35,000	–	27,500	–	–	35,000
2014	8,500	25,500	35,000	–	9,500	–	–	35,000
2015	28,000	84,000	35,000	49,000	–	37,000	–	47,000
2016	18,000	54,000	35,000	19,000	–	–	–	54,000
2017	23,000	69,000	35,000	34,000	–	–	–	69,000

*Output = Lease + Sublease i.e., year 2013 = 1,500 + 1,000 = 2,500

Year	Output in units	Royalty (₹4 per unit)	Minimum rent	Surplus (royalty-MR)	Short-working (MR-royalty)	Short-working recovered	Short-working irrecovered	Payment made to lessor
2013	1,000	4,000	25,000	–	21,000	–	–	25,000
2014	4,500	18,000	25,000	–	7,000	–	–	25,000
2015	10,000	40,000	25,000	15,000	–	15,000	6,000	25,000
2016	3,000	12,000	12,000	–	–	–	7,000	12,000
2017	15,000	60,000	25,000	35,000	–	–	–	60,000

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Royalty Payable Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013	To Landlord A/c	7,500	2013	By Production A/c	7,500
		7,500			**7,500**
2014	To Landlord A/c	25,500	2014	By Production A/c	25,500
		25,500			**25,500**
2015	To Landlord A/c	47,000	2015	By Production A/c	84,000
	To Short-workings A/c	37,000			
		84,000			**84,000**
2016	To Landlord A/c	54,000	2016	By Production A/c	54,000
		54,000			**54,000**
2017	To Landlord A/c	69,000	2017	By Production A/c	69,000
		69,000			**69,000**

Short-working Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013	To Landlord A/c	27,500	2013	By Balance c/d	27,500
		27,500			**27,500**
2014	To Balance b/d	27,500	2014	By Balance c/d	37,000
	To Landlord A/c	9,500			
		37,000			**37,000**
2015	To Balance b/d	37,000	2015	By Royalties Payable A/c	37,000
		37,000			**37,000**

Landlord Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013	To Bank A/c	35,000	2013	By Royalties Payable A/c	7,500
				By Short-workings A/c	27,500
		35,000			**35,000**
2014	To Bank A/c	35,000	2014	By Royalties Payable A/c	25,500
				By Short-workings A/c	9,500
		35,000			**35,000**
2015	To Bank A/c	47,000	2015	By Royalties Payable A/c	47,000
		47,000			**47,000**
2016	To Bank A/c	54,000	2015	By Royalties Payable A/c	54,000
		54,000			**54,000**
2017	To Bank A/c	69,000	2015	By Royalties Payable A/c	69,000
		69,000			**69,000**

Royalty Receivable Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
2013	To Profit and Loss A/c	4,000	2013	By Pawan Kumar's A/c	4,000
		4,000			**4,000**
2014	To Profit and Loss A/c	18,000	2014	By Pawan Kumar's A/c	18,000
		18,000			**18,000**
2015	To Profit and Loss A/c	40,000	2015	By Pawan Kumar's A/c	25,000
				By Short-working Suspense A/c	15,000
		40,000			**40,000**
2016	To Profit and Loss A/c	12,000	2016	By Pawan Kumar's A/c	12,000
		12,000			**12,000**
2017	To Profit and Loss A/c	60,000	2017	By Pawan Kumar's A/c	60,000
		60,000			**60,000**

Short-working Suspense Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
2013	To Balance c/d	21,000	2013	By Pawan Kumar's A/c	21,000
		21,000			**21,000**
2014	To Profit and Loss A/c	28,000	2014	By Balance b/d	21,000
				By Medicare Pharma A/c	7,000
		28,000			**10,000**
2015	To Royalty Receivables A/c	15,000	2015	By Balance b/d	28,000
	To Profit and Loss A/c	6,000			
	To Balance c/d	7,000			
		28,000			**28,000**
2016	To P/L A/c	7,000	2016	By Balance b/d	7,000
		7,000			**7,000**

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Pawan Kumar's Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013	To Short-workings Suspense A/c	21,000	2013	By Bank A/c	25,000
	To Royalties Receivables A/c	4,000			
		25,000			**25,000**
2014	To Short-workings Suspense A/c	7,000	2014	By Bank A/c	25,000
	To Royalties Receivables A/c	18,000			
		25,000			**25,000**
2015	To Royalty Receivables A/c	40,000	2015	By Short-workings Suspense A/c	15,000
				By Bank A/c	25,000
		40,000			**40,000**
2016	To Royalty Receivables A/c	12,000	2016	By Bank A/c	12,000
		12,000			**12,000**
2017	To Royalty Receivables A/c	60,000	2017	By Bank A/c	60,000
		60,000			**60,000**

Summary

- Royalty is an amount of periodical consideration paid to the owner of an asset or right, like mine, quarry, copyright or patent. It is the sum payable by one person (lessee) to another person (lessor) in respect of use of some form of privilege or right.
- Royalty is defined as, "The remuneration payable to a person in respect of the use of an asset, whether hired or purchased from such person, calculated by reference to or varying with quantities produced or sold as a result of such asset".
- Minimum rent is the minimum amount of rent payable by the lessee to the lessor irrespective of production or sales achieved by the lessee. Lessor will under no circumstance receive an amount less than the amount of minimum rent mentioned in the royalty agreement.
- Royalty agreement is an agreement entered into between the owner and the user, to use the asset, property or right in manufacturing or commercial operations for the purpose or generating income.

(*Contd.*)

- Lessee is the 'user' of an asset, property or right owned by the lessor. He agrees to make periodical payment for obtaining special rights from lessor and uses the asset, property or right obtained from the lessor for generating revenue.
- Lessor is the original 'owner' who lends out his exclusive rights over some property or asset on lease to another individual for an agreed amount of consideration is called as a lessor or landlord or patentee.
- The excess of minimum rent over actual royalty of any particular year is termed as short working, deficiency or shortage. The excess of minimum rent over actual royalty is treated as 'Short working' by the lessee. Whereas, lessor treats it as 'Short working suspense' or 'Short workings allowable'
- Short working recoupment refers to recovering the short working of any year, from the excess royalty of the succeeding years.
- If the right of recoupment of short workings mentioned in the royalty agreement is for a certain period say, 3,5 or 7 years starting from the date of royalty agreement, it is referred to as *'Restricted or Fixed'*.
- As per the royalty agreement, if the lessee is required to recoup within the next, subsequent or following two or three years from the year of occurrence of short working. It is referred to as *'Unrestricted or Floating*'.
- In the year in which there is no or low output, the minimum rent for the year is usually reduced in proportion to the period of stoppage of work.
- If the terms of the royalty agreement provides so, lessee has an option to sub-lease whole or a part of the asset, property or right to another person for some consideration. Such an arrangement is termed *as "Sub-Lease"*.

Review Questions

Section A (2 Marks)

1. What is Royalty? **[B.U., B.Com., Nov/Dec 2004/2006/2007/2010/2015/2016]**
2. What is minimum rent? **[B.U., B.Com., April/May 1998/1999, Nov/Dec 2009]**
3. What do you mean by Short-workings? **[B.U., B.Com., Nov/Dec 2003/2006/2010]**
4. Explain the term irrecoverable Short-workings. **[B.U., B.Com., Nov/Dec 2005/2011]**
5. Write an entry in the books of lessor for irrecoverable Short-workings. **[B.U., B.Com., Nov/Dec 2006/2007/2012]**

6. How is irrecoupable Short-workings Account closed? **[B.U., B.Com., Nov/Dec 2001/2007/2011]**
7. How is strike treated in Royalty Accounts? **[B.U., B.Com., Nov/Dec 2010]**
8. Explain the term recoupment of Short-workings. **[B.U., B.Com., Nov/Dec 2012/2014/2015]**
9. Why is minimum rent clause included in the royalty agreement? **[B.U., B.Com., Nov/Dec 2005/2012]**
10. Write journal entry for Short-workings irrecoverable. **[B.U., B.Com., Nov/Dec 2004/2006/2007]**
11. Pass the journal entry to record irrecoverable Short-workings in the books of tenant. **[B.U., B.Com., Nov/Dec 2012]**
12. Pass the journal entry when there is no royalty and Minimum Rent Account is opened. **[B.U., B.Com., Nov/Dec 2013]**
13. Distinguish between royalty and rent. **[B.U., B.Com., Nov/Dec 2013]**
14. Who is a lessor?
15. Who is a landlord?
16. What is surplus in Royalty Accounts?
17. Distinguish between fixed and floating recoupment.
18. Explain the term life time recoupment.
19. What is the impact of strike on royalty agreement?
20. What is royalty agreement?
21. What is sublease?

Section B (8 Marks)

1. Write a note on recoupment of short-workings.
2. Briefly explain accounting treatment with respect to sublease.
3. Prepare an analytical table of Royalty from the following details:
   Minimum rent ₹25000 pa
   Royalty of ₹2 per ton of ore raised
   Short-workings are recoverable during the first three years of the lease only.
   The output for the first 4 years is as follows:

Year	1	2	3	4
Output in tons	3000	10000	30000	35000

[B.U., B.Com., Nov/Dec 2015, Section B]

(Ans: Surplus = 3rd Year = 35000; 2nd Year = 50000; Short-workings of Year 1 and 2 are 19000 and 5000 respectively; Short-workings recouped in year 3 ₹24000, actual amount paid to lessor ₹25000 in Years 1 and 2, and ₹36000 and 75000 in the year 3 and 4 respectively)

4. Prepare royalty analysis table from the following details:
   a. Minimum rent 10,000 p.a.
   b. Royalty payable ₹1 per ton of ore raised
   c. Short-workings are recoverable during the first 3 years of the lease only

d. Output for the first 4 years were:

Year	1990	1991	1992	1993
Output in tons	2,000	5,000	15,000	20,000

[B.U., B.Com., Nov/Dec 2006, Section B]

(Ans: Surplus = 1992 ₹5,000; 1993 ₹10,000 short-workings 1990 ₹8,000; 1991 ₹5,000; short-workings recouped 1992 ₹5,000; short-workings irrecoverable 1990 ₹8,000; actual payments made to lessor ₹10,000 in 1990, 1991 and 1992 and ₹20,000 in 1993)

5. Prepare an analytical table from the following details:
   a. Minimum rent 30,000 p.a.
   b. Royalty payable ₹2 per ton
   c. Short-workings are recoverable during the first 3 years of the lease
   d. Output for the first 4 years were:

Year	2007	2008	2009	2010
Output in tons	4,000	8,000	16,000	4,000

[B.U., B.Com., Nov/Dec 2007, Section B]

(Ans: Surplus = 2009 ₹2,000; short-workings 2007 ₹22,000; 2008 ₹14,000; 2010 ₹22,000; short-workings recouped 2009 ₹2,000; short-workings irrecoverable 2009 ₹34,000, ₹22,000; actual payments made to lessor ₹30,000 in all the years)

6. Prepare an analytical table from the following details:
   a. Minimum rent 20,000 p.a.
   b. Royalty payable ₹5 per ton
   c. Short-workings are recoverable during the first 4 years of the lease only
   d. Output for the first 4 years were:

Year	2007	2008	2009	2010
Output in tons	2,000	3,000	4,000	4,500

[B.U., BBM, Nov/Dec 2008, Section B]

(Ans: Surplus = 2010 ₹2,500; short-workings 2007 ₹10,000; 2008 ₹5,000; short-workings recouped 2010 ₹2,500; short-workings irrecoverable 2010 ₹12,500; actual payments made to lessor ₹20,000 in all the years)

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7. Prepare an analytical table from the following details:
   a. Minimum rent 15,000 p.a.
   b. Royalty payable ₹0.75 per ton of output
   c. Short-workings can be recouped in the subsequent 2 years out of excess royalty.
   d. Output for the first 4 years were:

Year	1	2	3	4
Output in tons	10,000	12,000	28,000	25,000

[B.U., B.Com., Nov/Dec 2009, Section B]

(Ans: Surplus = 6,000 and 3,750 in the 3rd and 4th year; ₹2,000; short-workings ₹7,500 and ₹6,000 in the 1st and 2nd year. Short-workings recouped 6,000 and 3,750 in the 3rd and 4th year; short-workings irrecoverable 1,500 and 2,250 in the 3rd and 4th year; actual payments made to lessor ₹15,000 in all the years)

8. The Bangalore Company obtained a mine on lease for a period of 20 years from 1 June 2007 on the following terms:
   a. Minimum rent ₹24,000 per year
   b. The short-workings to be recovered during the subsequent 2 years
   c. In the year of strike, minimum rent is to be reduced by 25%
   d. Royalty was to be calculated to 0.50 paise per ton. Production during the 4 years from 2007 to 2010 was as follows:

Year	2007	2008	2009	2010
Production in tons	28,000	36,000	60,000	44,000 (strike for 3 months)

Prepare analytical table and Minimum Rent Account.

[B.U., BBM, Nov/Dec 2006, Section B]

Note: On account of strike for 3 months in the year 2010, minimum rent has been reduced to ₹18,000 in proportion to the period of strike, and Minimum Rent Account has to be prepared only for the year 2007 and 2008 as the payment to lessor involves minimum rent rather than actual royalty.

(Ans: Surplus = 6,000 and 4,000 in the year 2009 and 2010, respectively; short-workings ₹10,000 and ₹6,000 in the year 2007 and 2008, respectively. Short-workings recouped 6,000 and 4,000 in the year 2009 and 2010, respectively; short-workings irrecoverable 4,000 and 2,000 in the year 2009 and 2010, respectively; actual payments made to lessor ₹24,000 in the year 2007, 2008 and 2009 and in the year 2010 ₹18,000)

9. A Mining Co. took a lease from a landlord for a period of 20 years from 1 July 2010. On a royalty of ₹10 per ton of iron ore raised with a minimum rent of ₹20,000 and power to recoup short-workings during the first 4 years of the lease. The annual output was as under:

Year	I	II	III	IV	V
Output in tons	1,000	1,500	2,000	2,250	2,500

Prepare Short-workings Account in the books of Mining Company.

[B.U., B.Com., Nov/Dec 2015, Section B]

(Ans: Surplus = ₹2,500 in 5th year; short-workings ₹10,000 and ₹5,000 in the 1st and 2nd year. Short-workings recouped ₹2,500 in 4th year; short-workings irrecoverable ₹12,500 in 4th year transferred to P/L Account; actual payments made to lessor ₹20,000 in the first 4 years and ₹25,000 in the 5th year)

10. Sri Ram Mines and Co. took a lease from a landlord for a period of 20 years from 1 July 2006 on a royalty of ₹10 per ton of iron ore raised with rent of ₹40,000 and power to recoup short-workings during the first 4 years of the lease. The annual output was as follows:

Year	2006	2007	2008	2009	2010
Output in tons	2,000	3,000	4,000	4,500	5,000

Prepare Short-workings Account in the books of Sri Ram Mines

[B.U., B.Com., Nov/Dec 2012, Section B]

(Ans: Surplus = ₹5,000 and ₹10,000 in the year 2009 and 2010; short-workings ₹20,000 and ₹10,000 in the year 2006 and 2007. Short-workings recouped ₹5,000 in the year 2009; short-workings irrecoverable ₹25,000 in the year 2009 transferred to P/L Account; actual payments made to lessor ₹40,000 in the first 4 years and ₹50,000 in the 5th year)

Section C (14 Marks)

1. A mining company leased a property from X at a royalty of ₹10 per ton with a minimum rent over royalty is recoverable out of royalties of next 3 years. The results of the workings are as follows:

Year	I	II	III	IV	V
Output in tons	2,000	3,000	4,000	5,600	6,000

Prepare necessary Ledger Accounts in the books of the company for 5 years

[B.U., B.Com., Nov/Dec 2015, Section C]

(Ans: Surplus = ₹4,000 in the 2nd year; short-workings ₹4,000 in the 1st year. Short-workings recouped ₹4,000 in the 2nd year; actual payments made to lessor ₹24,000, 26,000, 40,000, 56,000 and 60,000, respectively, in the 1st, 2nd, 3rd, 4th and 5th year, respectively)

2. Mr. Mahesh wrote a book and got it published with Chand and Company Ltd. on the terms that royalties will be paid @ ₹5 per copy sold subject to a minimum rent of ₹15,000 with a right of recoupment of short-workings over the first 3 years of the royalty agreement. From the following details write up:
   a. Minimum Rent Account
   b. Royalty Account
   c. Short-workings Account
   d. Mr. Mahesh's Account

Year	2000	2001	2002	2003
No. of copies printed	2,000	3,000	4,000	5,000
Closing stock	100	200	400	500

[B.U., B.Com., Nov/Dec 2005, Section C]

3. Mr. Ramanujan patented an automatic door closer and granted to Mr. Raju the licence to manufacture and sell the closers for 10 years on the following terms.
   a. Raju to pay a Royalty of ₹5 for every closer sold with a minimum rent of ₹2,500 p.a.
   b. Raju could set off the short-workings arising in any year against surplus royalties payable in the next 2 years
   c. From the second year onwards, the dead rent is agreed upon at ₹2,000 instead of ₹2,500 and all the other terms being unchanged. The other details are:

Year	Production (units)	Closing stock (units)
1	125	25
2	225	50
3	285	35
4	515	50

Show Ledger Accounts in the books of Raju and Company, including Minimum Rent Account.

[B.U., B.Com., Nov/Dec 2006, Section C]

(Ans: Sales are 100, 200, 300 and 500 for the 1st, 2nd, 3rd and 4th year, respectively; surplus = ₹500 in the fourth year; short-workings ₹2,000; 1,000 and 500 in the 1st, 2nd and 3rd year, respectively. Short-workings recouped ₹500 in the 4th year; short-workings irrecoverable ₹2,000 and ₹500 in the 3rd and 4th year transferred to P/L Account; actual payments made to lessor 2,500 in the 1st year and ₹2,000 in the 2nd, 3rd and 4th year, respectively)

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4. Jaishree granite obtained a lease of some granite bearing land on 1 January 2004, the terms being a royalty of ₹700 per m granite raised, subject to minimum rent of ₹20,00,000 per annum with a right of recoupment of short-workings over the first 3 years of the lease. The following are the particulars.

Year	2004	2005	2006	2007
Sales in meter	2,200″	3,300″	4,800″	6,000″
Closing stock/m	300	500	600	700

You are required to prepare Royalty Account, Short-workings Account. Landlord Account to record the transactions mentioned before.

[B.U., B.Com., Nov/Dec 2007, Section C]

(Ans: Outputs are 2,500; 3,500; 4,900 and 6,100 m, respectively. Surplus ₹4,50,000; 14,30,000 and ₹22,70,000, respectively, for the year 2005, 2006 and 2007; short-workings ₹2,50,000 in the year 2004. Short-workings recouped ₹2,50,000 in the second year; actual payments made to lessor 20,00,000; 22,00,000; 34,30,000 and 42,70,000, respectively, in the year 2004, 2005, 2006 and 2007)

5. Z Co. Ltd. took a lease from a landlord for a period of 25 years from 1 January 2006 on a royalty of ₹2 per ton of coal raised with a minimum rent of ₹20,000 and power to recoup short-workings during the first 4 years of the lease. The annual output was as follows:

Year	2006	2007	2008	2009	2010
Output in tons	5,000	8,000	10,000	15,000	20,000

You are required to pass journal entries in the books of Z Co. Ltd.

[B.U., B.Com., Nov/Dec 2008, Section C]

(Ans: Surplus ₹10,000 and ₹20,000 in the year 2009 and 2010, respectively; short-workings ₹10,000 and ₹4,000 in the year 2006 and 2007. Short-workings recouped ₹10,000 in the year 2009; actual payments made to lessor ₹20,000 in the year 2006 to 2009 and ₹40,000 in the year 2010)

6. Sunil took lease of an oil well from Ajay Oil Ltd., on 1 January 2010. The minimum rent was ₹2,00,000 and royalty ₹20 per ton of crude oil raised. The short-workings were recoverable in the succeeding 2 years of such short-workings but on the condition that if during the next year of any short-workings, the lessee is unable to recover the same either fully or partly, he will lose the right to recover 50% of such unrecoverable amount of short-workings. The outputs during the first 4 years were 5,500 tons, 8,000 tons, 11,250 tons and 12,500 tons, respectively. You are required to pass journal entries in the books of Sunil under with minimum rent method.

[B.U., B.Com., Nov/Dec 2004, Section C]

(Ans: Surplus ₹25,000 and 50,000 in the 3rd and 4th year, respectively; short-workings ₹90,000 and ₹40,000, respectively, in 1st and 2nd year; short-workings recouped ₹25,000 and ₹20,000 in the 3rd and 4th year, respectively. 500 in the 4th year; short-workings irrecoverable ₹45,000 and ₹40,000 in the 2nd and 3rd year, respectively. Actual payments made to lessor ₹2,00,000 for the 1st, 2nd and 3rd year, respectively, and ₹2,30,000 in the 4th year)

7. Mr. Mahesh wrote a book and got it published with M/s Popular Publishers on the terms that royalty will be paid at ₹5 per copy sold subject to a minimum of ₹15,000 with a right to recoup short-workings over the first 3 years.

Year	1992	1993	1994	1995
No. of copies printed	2,000	3,000	4,000	5,000
Closing stock	100	200	400	500

Pass journal entries in the books of M/s Popular Publishers and follow with minimum rent method.

[B.U., B.Com., Nov/Dec 2005, Section C]

(Sales ₹1,900; 2,900; 3,800 and 4,800 for the year 1992, 1993, 1994 and 1995, respectively; surplus ₹4,000 and 9,500 in the year 1994 and 1995; short-workings ₹5,500 and ₹500 in the year 1992 and 1993. Short-workings recouped ₹4,000 in the year 1994; short-workings irrecoverable ₹2,000. Actual payments made to lessor ₹15,000 for the year 1992 to 1993 whereas in the year 1995, ₹24,500)

8. Nischal Mines Company took a lease from a landlord for a period of 10 years from 1 January 2005 on a royalty of ₹10 per ton of coal raised with a dead rent of ₹40,000 and power to recoup short-workings during the first 4 years of lease.

The annual output was as follows:

Year	2005	2006	2007	2008	2009
Output (tons)	2,000	3,000	4,000	4,500	5,000

Prepare Minimum Rent Account, Royalties Account, Short-workings Account and Landlord Account in the books of Nischal Mines Company.

[B.U., B.Com., Nov/Dec 2010, Section C]

(Surplus ₹5,000 and 10,000 in the year 2008 and 2009; short-workings ₹20,000 and ₹10,000 in the year 2005 and 2006. Short-workings recouped ₹5,000 in the year 2008; short-workings irrecoverable ₹25,000 in the year 2008. Actual payments made to lessor ₹40,000 for the year 2005 to 2008, whereas in the year 2009 ₹50,000)

4

5

Conversion of Partnership Firm into a Limited Company

Chapter Outline

Review Questions

- **Section A (2 Marks)**
- **Section B (8 Marks)**
- **Section C (14 Marks)**

5.1 INTRODUCTION

Every business organisation at the time of its formation has very limited access to capital and resources, etc. For this purpose, Sole Proprietorship form of business seems to be an easier option, wherein the requirements of capital, workforce and other resources are very limited to start off with. As the businesses prospers, the capital requirement increases along with other resources; due to which the businesses establish themselves as Partnership Firms—the benefits of partnership form of business organisations are better compared to sole proprietorship form. But over a period of time with the challenging business environment and available business opportunities, businesses further wish to expand into joint-stock company form of business organisations because such organisations have multiple benefits. There are a lot of accounting issues and challenges when it comes to incorporation of accounting entries of conversion of Sole Proprietorship form of business organisation to partnership form of business organisation and conversion of partnership form of business organisation to joint-stock company form of business organisation. The accounting treatment pertains to calculation of purchase consideration payable by the purchasing company to the selling company, settlement of purchase consideration payable by the purchasing company and incorporating entries along with treatment of specific items.

5.2 MEANING

Sale or conversion of existing Partnership Firm into a joint-stock company refers to taking over of or transforming a Partnership Firm into a joint-stock company as the benefits accruing to a joint-stock company form of business organisation are better than the Partnership Firm in many different ways. The sale or conversion of Partnership Firm into joint-stock company will be for a consideration, which will be payable in various forms, such as cash, equity shares and debentures.

The company willing to sell or get the firm converted is called as vendor firm, whereas the firm willing to purchase or convert the firm is generally known as purchasing firm.

5.3 OBJECTIVES

The following are the objectives of sale or conversion of Partnership Firm into a limited company.

1. ***To increase the capital:*** The joint-stock company form of business organisation can raise its capital by various different sources, namely shares, debentures, bonds and loans. The above mentioned options for a firm as such are very limited. It is for this reason that the firms prefer to convert themselves into joint-stock companies for wider access to capital.
2. ***To enjoy the benefit of limited liability:*** The liability in this joint stock form of business organisation is limited to the extent of the face value of shares invested and not beyond that. Unlike in the case of Sole Proprietorship and Partnership Firm, in which owners'/partners' liability is unlimited.

3. ***To increase the scale of operations:*** This form of business organisations helps in reducing the cost considerably due to the advantages that accrue to the company as a result of large-scale operations.
4. ***To attain perpetual succession:*** Sole Proprietorship form of business may come to an end in the event of death of the owner, and firm may come to an end if partners die or walk out of the partnership, but joint-stock company form of business organisation has continuous existence till the company wishes to liquidate.
5. ***To enjoy the status of legal entity:*** Joint-stock firm is distinct from its members, to the extent that it enjoys separate legal entity or existence in the eyes of law.
6. ***To increase the managerial skills:*** In the case of Sole Proprietorship form of business, the business is solely and wholly managed by proprietor or owner, whereas in the case of Partnership Firm, management is restricted to the skills and knowledge possessed by the partners. But the access to managerial skills in the case of joint-stock company is wider as the board of directors keep changing after their term; therefore, new managers come with new talent and skills that may benefit the company in a bigger way.

5.4 ACCOUNTING TREATMENT FOR CONVERSION/SALE OF PARTNERSHIP FIRM INTO A JOINT-STOCK COMPANY

The accounting treatment in the books of purchasing firm and vendor firm for the purpose of Conversion/sale of Partnership Firm into a joint-stock company is done in the following steps as shown in Figure 5.1.

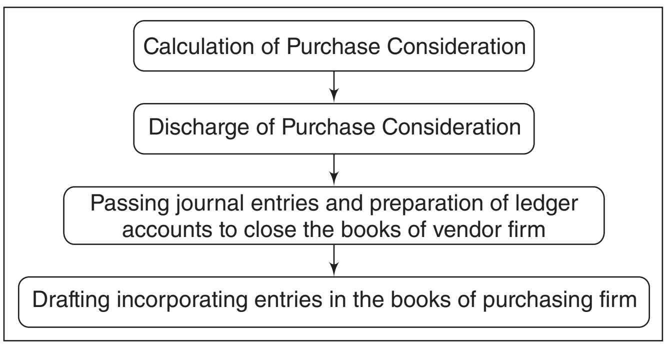

Figure 5.1 *Steps of conversion of Partnership Firm into a joint-stock company*

5.5 MEANING OF PURCHASE CONSIDERATION

At the time of Conversion/sale of Partnership Firm into a joint-stock company, the vendor firm is required to close its books of accounts and transfer all the assets and liabilities to the purchasing company. The purchasing company pays an amount to vendor firm for purchase or conversion of business; this amount is termed ‘purchase consideration’. In other words, purchase consideration is the amount of consideration received by the vendor firm from the purchasing company for the assets and liabilities received.

5.6 METHODS OF COMPUTING PURCHASE CONSIDERATION

The purchase consideration payable by the purchasing company to the vendor firm is calculated as per any of the following methods:

1. Lump Sum Method
2. Net Assets Method
3. Net Payment Method

1. ***Lump Sum Method:*** In this method, a fixed amount or a lump sum amount is paid by the purchasing company to the vendor firm for the assets and liabilities taken over.
2. ***Net Assets Method:*** Under this method, the purchase consideration is calculated by taking the difference between the assets and liabilities to be taken over at agreed value by the purchasing company. In other words, it is the net amount of the difference between the assets and liabilities.

Particulars	Amount (₹)
Total value of assets to be taken over at agreed value	xxx
Less: **Total value of liabilities to be taken over at agreed value**	xxx
Purchase consideration as per Net Asset Method	**xxx**

3. ***Net Payment Method:*** As per this method, the amount of actual payment made by the purchasing company to the vendor firm for the transfer of assets and liabilities by the vendor firm to the purchasing company is settled and this payment may be in cash, shares or debentures or the combination of all.

Particulars	Amount (₹)
Equity shares of ₹… each	xxx
Preference shares of ₹… each	xxx
Debentures of ₹… each	xxx
Cash	xxx
Purchase consideration as per Net Payment Method	**xxx**

5.7 MODES OF DISCHARGE OF PURCHASE CONSIDERATION

Discharge of purchase consideration mainly deals with the form in which the purchase consideration mentioned earlier is discharged. In other words, this step deals with the mode of settlement of purchase consideration adopted by the purchasing company. The mode of settlement may take any of the following forms:

1. By way of equity shares
2. By way of preference shares
3. By way of debentures
4. By way of cash
5. By way of partly in cash and equity shares
6. By way of partly in cash and preference shares
7. By way of partly in cash and debentures
8. By way of combination of shares, debentures and cash

5.8 PREPARATION OF JOURNAL ENTRIES AND LEDGER ACCOUNTS IN THE BOOKS OF VENDOR

5.8.1 Closing Books of Accounts of Vendor Firm by Drafting Journal Entries and Ledger Accounts

The vendor firms' books of accounts have to be closed by passing the following journal entries and Ledger Accounts.

S. No.	Circumstance	Journal entry	
1.	Transfer of asset to Realisation A/c at book value	Realisation A/c	Dr.
		To respective Assets A/c	
2.	Transfer of liabilities to Realisation A/c at book value	Respective Liabilities A/c	Dr.
		To Realisation A/c	
3.	Purchase consideration due	Purchasing Company A/c	Dr.
		To Realisation A/c	
4.	Purchase consideration received	Cash/Bank A/c	Dr.
		Shares in Purchasing Co. A/c	Dr.
		Debentures in Purchasing Co. A/c	Dr.
		To Purchasing Co. A/c	

(Contd.)

5

S. No.	Circumstance	Journal entry	
5.	Payment of realisation expenses	Realisation A/c To Cash/Bank A/c	Dr.
6.	Sale of assets not taken over by the purchasing company	Cash/Bank A/c To Realisation A/c	Dr.
7.	Settlement of liabilities not taken over by the purchasing company	Realisation A/c To Cash/Bank A/c	Dr.
8.	Assets taken over by partners/vendor firm	Partner's Capital A/c To Realisation A/c	Dr.
9.	Liabilities taken over by partners/vendor firm	Realisation A/c To Partner's Capital A/c	Dr.
10.	Profit on realisation	Realisation A/c To Partner's Capital A/c	Dr.
11.	Loss on realisation	Partner's Capital A/c To Realisation A/c	Dr.
12.	Transfer of reserve	Reserve A/c To Partner's Capital A/c	Dr.
13.	Transfer of undistributed profit	Profit and Loss A/c To Partner's Capital A/c	Dr.
14.	Transfer of undistributed loss	Partner's Capital A/c To Profit/Loss A/c	Dr.
15.	Settlement of partner's loan	Partner's Loan A/c To Cash/Bank A/c	Dr.

Ledger Accounts in the books of vendor firm

1. ***Realisation Account:*** Realisation Account is prepared by the vendor firm at the time of closing books of accounts. This account is debited with all the assets including Cash and Bank Balance and credited with all liabilities at their respective book values; but if there is any partner's loan, the same thing is not credited to Realisation Account. If the purchasing company has not taken over any asset of vendor firm, the same has to be either sold in the market to realise money or the partners may have to take over the asset, whereas, with regards to liability not taken over by the purchasing company, the partners may have to settle the liabilities before closing books of accounts. As a result of this, the loss or gain arising there from gets automatically adjusted in Realisation Account. This account also shows the amount expended towards realisation, and if the same is borne by the vendor firm, it will be debited to Profit and Loss Account.

Realisation Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Concerned Assets A/c (Assets taken over at book value)	xxx	By Concerned Liabilities A/c (Liabilities taken over at book value)	xxx
To Cash/Bank A/c (Realisation expenses paid)	xxx	By Purchasing Company A/c (Purchase consideration due)	xxx
To Partner's Capital A/c (Liabilities taken over by partners)	xxx	By Cash/Bank A/c (Sale of assets not taken over by purchasing company)	xxx
To Cash/Bank A/c (Settlement of liabilities not taken over by Purchasing company)	xxx	By Partner's Capital A/c (Assets taken over by partners)	xxx
To Partner's Capital A/c (Profit) (*Balancing figure*) X xxx Y xxx Z xxx	xxx	By Partner's Capital A/c (Loss) (*Balancing figure*) X xxx Y xxx Z xxx	xxx
	xxx		**xxx**

2. ***Purchasing Company Account:*** This account is prepared to show the amount of purchase consideration and the discharge of purchase consideration. This account is debited with the purchase price of the asset and credited with the mode of discharge of purchase consideration either by way of cash, equity shares, preference shares or debentures or a combination of all.

Purchasing Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Realisation A/c (Purchase consideration)	xxx	By Equity Shares in Purchasing Co. A/c By Preference Shares in Purchasing Co. A/c By Debentures in Purchasing Co. A/c By Cash/Bank A/c	xxx xxx xxx xxx
	xxx		**xxx**

3. ***Shares in Purchasing Company Account:*** This account is prepared to show the amount received as purchase consideration by a vendor firm in the form of equity or preference shares in purchasing company. This account is debited with the shares received from purchasing company and credited to the respective partners account in the Profit Sharing ratio or Final Claim ratio.

Shares (equity/preference) in Purchasing Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Purchasing Company A/c (Purchased consideration received by way of shares)	xxx	By Partner's Capital A/c X xxx Y xxx Z xxx	xxx
	xxx		**xxx**

4. ***Debentures in Purchasing Company Account:*** This account is prepared to show the amount received as purchase consideration by a vendor firm in the form of debentures in purchasing company. This account is debited with the debentures received from purchasing company and credited to the respective Partners Account in the Profit Sharing ratio or Final Claim ratio.

Debentures in Purchasing Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Purchasing Company A/c (Purchased consideration received by way of debentures)	xxx	By Partner's Capital A/c X xxx Y xxx Z xxx	xxx
	xxx		**xxx**

5. ***Partner's Capital Account:*** In the event of sale/conversion of Partnership Firm into a joint-stock company, there is need to prepare Partners' Capital/Current Account to assess the amount due or payable to the partners. This account will be credited with their opening balances of capital, reserves and surplus, Realisation Profit (if any), liabilities taken over by the partners that are not taken over by the purchasing company. At the same time, this account will be debited with accumulated loss, Assets taken over by the partners that are not taken over by the purchasing company, loss on realisation.

Partner's Capital Account

Dr. **Cr.**

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Profit and Loss A/c (Balance of Loss)	xxx	xxx	xxx	By Balance b/d (Opening balance of capital)	xxx	xxx	xxx
To Realisation A/c (Assets not taken over by purchasing company is taken over by partners)	xxx	xxx	xxx	By Reserve Fund A/c (Balance of reserves if any)	xxx	xxx	xxx
				By Profit and Loss A/c (Balance of profit)	xxx	xxx	xxx
To Realisation A/c (Loss on realisation)	xxx	xxx	xxx	By Realisation A/c (Liabilities not taken over by purchasing company is taken over by partners)	xxx	xxx	xxx
To Shares in Purchasing Company A/c	xxx	xxx	xxx				
To Debentures in Purchasing Company A/c	xxx	xxx	xxx	To Realisation A/c (Profit on realisation)	xxx	xxx	xxx
To Cash/Bank A/c (Surplus amount) (*Balancing figure*)	xxx	xxx	xxx	By Cash/Bank A/c (Deficit Amount) (*Balancing figure*)	xxx	xxx	xxx
	xxx	**xxx**	**xxx**		**xxx**	**xxx**	**xxx**

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6. ***Partner's Loan Account:*** Any amount due to partner has to be paid-off, prior to settling partner's capital. For this purpose, the account treatment will be to debit Partner's Loan Account (if any) and Crediting Cash or Bank Account.

Partner's Loan Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Cash/Bank A/c (Settlement of loan)	xxx	By Balance b/d (Opening balance of loan)	xxx
*To Shares in Purchasing Company A/c**	xxx		
*To Debentures in Purchasing Company A/c**	xxx		
	xxx		**xxx**

**Note:* The amount of loan due to partner by way of loan may either be settled in cash or by way of shares or debentures in the purchasing company.

7. ***Cash/Bank Account:*** This account is prepared to record all payment and receipts by way of cash. The opening balance of cash with the vendor firm is recorded on the debit side along with sale proceeds of assets sold not taken over by the purchasing company, and any amount of purchase consideration received by way of cash. The closing balance of cash is credited along with any payment towards realisation expenses, settlement of liabilities not taken over by the purchasing company, settlement of partner's loan (if any). The resulting amount will be either cash balance surplus or deficit as the case may be.

Cash/Bank Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d (Opening balance)	xxx	By Realisation A/c (Cash balance transferred to Realisation A/c)	xxx
To Realisation A/c (Sale proceeds of Assets sold not taken over by purchasing company)	xxx	By Realisation A/c (Payment of realisation expenses)	xxx
To Purchasing Company (Purchase consideration paid in cash)	xxx	By Realisation A/c (Settlement of liabilities not taken over by purchasing company)	xxx
To Concerned Partner's A/c (Deficit capital)	xxx	By Partner's Loan A/c (Settlement by partners)	xxx
		By Concerned Partner's A/c (Surplus capital)	xxx
	xxx		**xxx**

5.9 PREPARATION OF INCORPORATION ENTRIES AND BALANCE SHEET IN THE BOOKS OF PURCHASING COMPANY

1. Passing of incorporating entries and preparation of Balance Sheet in the books of purchasing company

After the closure of books of accounts of vendor firm, the next step is to transfer all the assets and liabilities and the business itself to the purchasing company. The purchasing company will have to pass incorporating entries in its books to show the takeover of assets and liabilities, amount paid towards the purchase consideration and the mode of discharge of purchase consideration. The purchasing company is also required to prepare the Balance Sheet to accommodate the assets and liabilities taken over from vendor firm into its business.

S. No.	Circumstance	Journal entry	
1.	Purchase consideration due	Business Purchase A/c To Vendor Firm A/c	Dr.
2.	Assets and Liabilities taken over at agreed value and purchase consideration payable (Note: If the assets are more than the total of liabilities and business purchase, then the difference is treated as goodwill, and if the assets are less than the total of liabilities and business purchase, the difference is treated as Capital Reserve)	Respective Assets A/c Goodwill A/c (*Balancing figure*) To Respective Liabilities A/c To Capital Reserve A/c (*Balancing figure*) To Business Purchase A/c	Dr. Dr.
3.	Discharge of purchase consideration	Vendor Firm A/c To Cash/Bank A/c To Equity Shares A/c To Share Premium A/c To Preference Shares A/c To Debentures A/c	Dr.
4.	Dissolution expenses of vendor firm paid by the purchasing company	Goodwill A/c To Cash/Bank A/c	Dr.

2. Preparation of Balance Sheet

After passing the incorporating entries in the books of purchasing company, the next step is to prepare the Balance Sheet. This is to accommodate all the assets, liabilities taken over of vendor company and the amount of consideration paid to vendor company in the Balance

Sheet of purchasing company. By preparing the Balance Sheet, the sale or conversion of Partnership Firm into a joint-stock company is pursued.

In the Books of Purchasing Company
Proforma of Balance Sheet as on …………………..

Particulars	Amount (₹)	Amount (₹)
A. CAPITAL AND LIABILITIES		
SHAREHOLDERS FUND		
Equity share capital	xxx	
Preference share capital	xxx	
Reserves and surplus	xxx	xxx
NON-CURRENT LIABILITIES		
Secured loans	xxx	
Unsecured loans	xxx	xxx
CURRENT LIABILITIES AND PROVISIONS		
Trade payables	xxx	
Other Current Liabilities	xxx	
Short-term provisions	xxx	xxx
TOTAL CAPITAL AND LIABILITIES		xxx
B. ASSETS		
NON-CURRENT ASSETS		
FIXED ASSETS		
Tangible Assets	xxx	
Intangible Assets	xxx	xxx
NON-CURRENT INVESTMENTS		xxx
CURRENT ASSETS		
Current investments	xxx	
Inventories	xxx	
Trade receivables	xxx	
Cash and Cash equivalents	xxx	
Short-term loans and advances	xxx	xxx
TOTAL ASSETS		**xxx**

5.10 ILLUSTRATIONS

Illustration 1: Ascertainment of value of stock at the beginning

Ascertain the value of stock at the beginning:

Particulars	(₹)
Purchases	1,20,000
Direct Wages	80,000
Sales	5,00,000
Stock at the end	45,000

Rate of gross profit is 25% on cost. **[B.U., B.Com., Nov/Dec 2015, Section B]**

Solution:

Particulars	₹	Particulars	₹
Opening stock (*Balancing figure*)	2,45,000	Sales	5,00,000
Purchases	1,20,000	Closing Stock	45,000
Direct wages	80,000		
Gross profit	1,00,000		
	5,45,000		**5,45,000**

Illustration 2: Purchase consideration—Net Payment Method

Calculate the amount of purchase consideration from the following details:

The purchasing company agreed to issue 10,000 equity shares of ₹10 each at 25 per share,

1,000 9% Preference shares of ₹100 at par

1,000 10% Debentures of ₹100 each at a discount of 10% and to pay cash equal to 20% of total purchase consideration. **[B.U., B.Com., Nov/Dec 2015, Section B]**

Solution:

Calculation of purchase consideration

Particulars	Amount (₹)
10,000 Equity shares of ₹10 each at a premium of ₹25 per share (10,000 × 25)	2,50,000
1,000 9% Preference shares of ₹100 each (1,000 × ₹100)	1,00,000
1,000 10% Debentures of ₹100 each at a discount of 10%; 10% discount on ₹100 (1,000 debentures × 100 – 10) (1,000 × 90)	90,000
Total purchase consideration excluding cash	**4,40,000**
Add: Cash equal to 20% of the total purchase consideration $4,40,000 \times \frac{20}{80}$	1,10,000
Total Purchase Consideration	**5,50,000**

Illustration 3: Purchase consideration—Net Payment Method

Calculate the amount of purchase consideration from the following details:

5

The purchasing company agreed to issue 30,000 equity shares of ₹10 each at a premium of 10%

1,000 8% Preference shares of ₹100 at par

1,000 6% Debentures of ₹100 each at a discount of 10% and to pay cash equal to 25% of total purchase consideration. **[B.U., B.Com., Nov/Dec 2016, Section B]**

Solution:

Calculation of purchase consideration

Particulars	Amount (₹)
30,000 Equity shares of ₹10 each at a premium of 10% (30,000 × 11)	3,30,000
1,000 8% Preference shares of ₹100 each (1,000 × ₹100)	1,00,000
1,000 10% Debentures of ₹100 each at a discount of 10%; 10% discount on ₹100 (1,000 debentures × 100 − 10) (1,000 × 90)	90,000
Total purchase consideration excluding cash	**5,20,000**
Cash equal to 20% of the total purchase consideration $5{,}20{,}000 \times \frac{25}{75}$	1,73,333
Total Purchase Consideration	**6,93,333**

Illustration 4: **Purchase consideration—Net Assets Method**

A company takes over the following assets and liabilities from a particular firm.

Land and building – ₹45,000; Plant and machinery – ₹20,000; Stock – ₹20,000; Debtors – ₹23,200; Bills receivable – ₹16,000; Current liabilities – ₹28,800.

The value of goodwill is fixed at ₹28,800; calculate purchase consideration payable 10,000 equity shares of ₹10 each and the balance in cash.

[B.U., B.Com., Nov/Dec 2009, Section B]

Solution:

Calculation of purchase consideration

Particulars	Amount (₹)
Goodwill (given)	28,800
Land and building	45,000
Plant and machinery	20,000
Stock	20,000
Debtors	23,200
Bills receivable	16,000
Total Assets	**1,53,000**
Less: Current Liabilities	28,800
Net Assets	**1,24,200**
Amount of purchase consideration payable by way of equity shares (10,000 shares of ₹10 each)	1,00,000
Balance Amount payable in cash	24,200
Total Purchase Consideration	**1,24,200**

Illustration 5: Purchase consideration and passing of incorporating entries in the books of purchasing company

Sandeep Ltd. has agreed to take over the following assets and liabilities from ABC, a Partnership Firm. Land and building ₹58,000; Plant and machinery ₹33,000; Stock ₹11,000; Debtors ₹28,200; Bills receivable ₹18,500; Current liabilities ₹17,400. The company has decided the value of goodwill to be ₹32,000. Calculate purchase consideration payable – 10,000 equity shares of ₹10 each and the balance in cash. Also pass the necessary journal entries in the books of the purchasing company.

Solution:

Particulars	Amount (₹)
Goodwill (given)	32,000
Land and Building	58,000
Plant and Machinery	33,000
Stock	11,000
Debtors	28,200
Bills Receivable	18,500
Total Assets	**1,80,700**
Less: Current Liabilities	17,400
Net Assets	**1,63,300**
Amount of purchase consideration payable by way of equity shares (10,000 shares of ₹10 each)	1,00,000
Balance Amount payable in cash	63,300
Total Purchase Consideration	**1,63,300**

Date	Particulars		L.F.	Dr.	Cr.
1.	Business Purchase A/c	Dr.		1,63,300	
	To Vendor's Firm A/c				1,63,300
	(*Being purchase consideration due*)				
2.	Land and Building A/c	Dr.		58,000	
	Plant and Machinery A/c	Dr.		33,000	
	Stock A/c	Dr.		11,000	
	Debtors A/c	Dr.		28,200	
	Bills Receivable A/c	Dr.		18,500	
	Goodwill (given) A/c	Dr.		32,000	
	To Current Liabilities A/c				17,400
	To Business Purchase A/c				1,63,300
	(*Being Assets and Liabilities taken over and purchase consideration payable*)				
3.	Vendor's Firm A/c	Dr.		1,63,300	
	To Equity Share Capital A/c				1,00,000
	To Cash A/c				63,300
	(*Being purchase consideration paid*)				

Illustration 6: Calculation of purchase consideration and passing of incorporating entries in the books of purchasing company

Sam and Co. takes over the following assets and liabilities from PQR, a Partnership Firm.

Particulars	Amount (₹)
Land and Building	1,20,000
Plant and Machinery	95,000
Furniture	80,000
Inventory	25,000
Debtors	45,000
Bills receivable	18,500
Current Liabilities:	
Creditors	35,000
Bills payable	11,500

Calculate purchase consideration on the basis of Net Assets Method – payable in 1,000 equity shares of ₹100 each; 1,000 8% preference shares of ₹100 each; 1,000 10% debentures of ₹100 each and the remaining balance in the form of cash.

Solution:

Particulars	Amount (₹)
Land and Building	1,20,000
Plant and Machinery	95,000
Furniture	80,000
Inventory	25,000
Debtors	45,000
Bills Receivable	18,500
Total Assets	**3,83,500**
Less: Current Liabilities: Creditors	35,000
Bills Payable	11,500
Net Assets	**3,37,000**
1,000 Equity shares of ₹100 each	1,00,000
1,000 8% Preference shares of ₹100 each	1,00,000
1,000 10% Debentures of ₹100 each	1,00,000
Balance in cash	37,000
Total Purchase Consideration	**3,37,000**

5

Date	Particulars		L.F.	Dr.	Cr.
1.	Business Purchase A/c	Dr.		3,37,000	
	To PQR Firm A/c				3,37,000
	(*Being purchase consideration due*)				
2.	Land and Building A/c	Dr.		1,20,000	
	Plant and Machinery A/c	Dr.		95,000	
	Stock A/c	Dr.		80,000	
	Furniture A/c	Dr.		25,000	
	Debtors A/c	Dr.		45,000	
	Bills Receivable A/c	Dr.		18,500	
	To Creditors A/c				35,000
	To Bills Payable A/c				11,500
	To Business Purchase A/c				3,37,000
	(*Being Assets and Liabilities taken over and purchase consideration payable*)				
3.	PQR Firm A/c	Dr.		3,37,000	
	To Equity Share Capital A/c				1,00,000
	To 8% Preference Share Capital A/c				1,00,000
	To 10% Debentures A/c				1,00,000
	To Cash A/c				37,000
	(*Being purchase consideration paid*)				

Illustration 7: Purchase consideration and passing of incorporating entries in the books of purchasing company

From the following details, calculate purchase consideration and show the journal entries in the books of purchasing company.

The purchasing company has agreed to issue 8,000 equity shares of ₹10 each at par. 500 8% preference shares of ₹100 each at 10% premium, 1,000 debentures of ₹50 each at 10% discount and pay cash equal to 10% of total purchase consideration. **[B.U., B.Com., Nov/Dec 2014, Section B]**

Solution:

Calculation of purchase consideration

Particulars	Amount (₹)
8,000 Equity shares of ₹10 each at par (8,000 × 10)	80,000
500 8% Preference shares of ₹100 each at a premium of 10% (500 × 110)	55,000
1,000 Debentures of ₹50 each at a discount of 10%; 10% discount on ₹50 (1,000 debentures × 50-5) (1,000 × 45)	45,000
Total purchase consideration excluding cash	**1,80,000**
Cash equal to 20% of the total purchase consideration $1{,}80{,}000 \times \frac{10}{90}$	20,000
Total Purchase Consideration	**2,00,000**

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Journal entries in the books of purchasing company

Date	Particulars		L.F.	Dr.	Cr.
1.	Purchasing Company A/c	Dr.		2,00,000	
	To Vendor A/c				2,00,000
	(*Being purchase consideration due*)				
2.	Vendor Company A/c	Dr.		2,00,000	
	To Equity Share Capital A/c				80,000
	To 8% Preference Share Capital A/c				55,000
	To Debentures A/c				45,000
	To Cash A/c				20,000
	(*Being purchase consideration paid*)				

Illustration 8: **Purchase consideration and passing of incorporating entries in the books of purchasing company**

Pass opening entries in the books of a purchasing company from the following details:

1. Sundry assets taken over ₹13,50,000
2. Current Liabilities taken over ₹1,35,000
3. Purchase consideration ₹11,25,000

Purchase consideration is payable as to 60% in equity shares of ₹10 each at par and the balance in 8% debentures of ₹100 each at par and cash in equal proportions.

[B.U., B.Com., Nov/Dec 2007/2013, Section B]

Solution:

Calculation of purchase consideration

Particulars	Amount (₹)
67,500 Equity shares of ₹10 each at par (11,25,000 × 60% = 6,75,000)	6,75,000
2,250, 8% Debentures of ₹100 each at par (being 50% of balance = 11,25,000 – 6,75,000 = 4,50,000 × 50% = 2,25,000)	2,25,000
Cash (being remaining 50% balance 11,25,000 – 6,75,000 = 4,50,000 × 50% = 2,25,000)	2,25,000
Total Purchase Consideration (given)	**11,25,000**

5

Journal entries in the books of purchasing company

Date	Particulars		L.F.	Dr.	Cr.
1.	Business Purchase A/c	Dr.		11,25,000	
	To Vendor's Firm A/c				11,25,000
	(*Being purchase consideration due*)				
2.	Sundry Assets A/c	Dr.		13,50,000	
	To Current Liabilities A/c				1,35,000
	To Business Purchase A/c				11,25,000
	To Capital Reserves A/c (*Balancing figure*)				90,000
	(*Being Assets and Liabilities taken over and purchase consideration payable*)				
3.	Vendor's Firm A/c	Dr.		11,25,000	
	To Equity Share Capital A/c				6,75,000
	To 8% Debentures A/c				2,25,000
	To Cash A/c				2,25,000
	(*Being purchase consideration paid*)				

Illustration 9: **Purchase consideration and passing of incorporating entries in the books of purchasing company**

Calculate the purchase consideration from the following and pass journal entries in the books of purchasing company.

1. 1,000 Equity shares of ₹100 each, issued at a premium of 20%
2. 1,000 Preference shares of ₹100 each
3. 1,000 10% Debentures of ₹100 each at 2% discount
4. Cash at ₹2,50,000

[B.U., B.Com., Nov/Dec 2012, Section A]

Solution:

Calculation of purchase consideration

Particulars	Amount (₹)
1,000 Equity shares of ₹100 each at a premium of 20% (1,000 × 120)	1,20,000
1,000 Preference shares of ₹100 each	1,00,000
1,000 Debentures of ₹100 each at a discount of 2% (1,000 debentures × ₹100-2)	98,000
Cash	2,50,000
Total Purchase Consideration	**5,68,000**

Journal entries in the books of purchasing company

Date	Particulars		L.F.	Dr.	Cr.
1.	Business Purchase A/c	Dr.		5,68,000	
	To Vendor's Firm A/c				5,68,000
	(*Being purchase consideration due*)				
2.	Vendor's Firm A/c	Dr.		5,68,000	
	To Equity Share Capital A/c				1,20,000
	To Preference Share A/c				1,00,000
	To 8% Debentures A/c				98,000
	To Cash A/c				2,50,000
	(*Being purchase consideration paid*)				

Illustration 10: Problem on Lump Sum Method, passing of journal entries and preparation of Ledger Accounts

Gita, Sita and Rita were partners sharing profits in the ratio of 3:2:1, respectively, and they took a call on converting their partnership into a company. The Balance Sheet on that date is as follows:

Liabilities	₹	Assets	₹
Creditors	12,000	Land and Building	20,000
Bills payable	10,000	Plant and Machinery	20,000
Capitals:		Furniture	10,000
Gita	28,000	Inventory	8,000
Sita	19,000	Debtors	10,000
Rita	9,000	Cash	1,000
		Profit and Loss A/c	9,000
	78,000		**78,000**

The new company was formed to take over the assets and liabilities for consideration of ₹75,000, by way of 5,000 equity shares of ₹10 each and the balance in cash. The shares were agreed to be shared among the partners in their respective Profit Sharing ratio. Pass the necessary journal entries in the books of a vendor firm to close the books along with the necessary Ledger Accounts.

Solution:

Step 1: **Calculation of purchase consideration**

Purchase price agreed = ₹75,000 (**Lump Sum Method**)

Step 2: **Discharge of purchase consideration**	₹
5,000 Equity shares of ₹10 each	50,000
Cash	25,000
Total Purchase Consideration	$\boxed{75,000}$

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Step 3: Closing books of accounts in the books of vendor firm (journal entries and Ledger Accounts)

Date	Particulars		L.F.	Dr.	Cr.
1.	Realisation A/c	Dr.		69,000	
	To Land and Building A/c				20,000
	To Plant and Machinery A/c				20,000
	To Furniture A/c				10,000
	To Inventory A/c				8,000
	To Debtors A/c				10,000
	To Cash A/c				1,000
	(*Being transfer of assets at their book values*)				
2.	Creditors A/c	Dr.		12,000	
	Bills Payable A/c	Dr.		10,000	
	To Realisation A/c				22,000
	(*Being transfer of liabilities at their book values*)				
3.	Purchasing Company A/c	Dr.		75,000	
	To Realisation A/c				75,000
	(*Being purchase consideration due*)				
4.	Shares in Purchasing Company A/c	Dr.		50,000	
	Cash A/c	Dr.		25,000	
	To Purchasing Company A/c				75,000
	(*Being purchase consideration received*)				
5.	Realisation A/c (75,000 + 22,000 – 69,000)	Dr.		28,000	
	To Gita's Capital A/c $\left(28,000 \times \frac{3}{6}\right)$				14,000
	To Sita's Capital A/c $\left(28,000 \times \frac{2}{6}\right)$				9,333
	To Rita's Capital A/c $\left(28,000 \times \frac{1}{6}\right)$				4,667
	(*Being profit on realisation transferred to Capital Accounts in their Profit Sharing ratio*)				
6.	Gita's Capital A/c (9,000 × 3/6)	Dr.		4,500	
	Sita's Capital A/c (9,000 × 2/6)	Dr.		3,000	
	Rita's Capital A/c (9,000 × 1/6)	Dr.		1,500	
	To Profit and Loss A/c				9,000
	(*Being loss appearing on the asset side of the Balance Sheet transferred to Capital Accounts in their Profit Sharing ratio of 3:2:1*)				
7.	Gita's Capital A/c (75,000 × 3/6)	Dr.		37,500	
	Sita's Capital A/c (75,000 × 2/6)	Dr.		25,000	
	Rita's Capital A/c (75,000 × 1/6)	Dr.		12,500	
	To Equity Shares in Purchasing Company A/c				50,000
	To Cash A/c				25,000
	(*Being final payment to partners in their Profit Sharing ratio of 3:2:1*)				

Ledger Accounts

Realisation Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Land and Building A/c	20,000	By Creditors	12,000
To Plant and Machinery A/c	20,000	By Bill Payable	10,000
To Furniture A/c	10,000	By Purchasing Company A/c (P.C.)	75,000
To Inventory A/c	8,000		
To Debtors A/c	10,000		
To Cash A/c	1,000		
To Partner's Capital A/c (3:2:1)			
Gita's Capital A/c 14,000			
Sita's Capital A/c 9,333			
Rita's Capital A/c 4,667	28,000		
	97,000		**97,000**

Purchasing Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Realisation A/c (P.C.)	75,000	By Equity Shares in Purchasing Co. A/c	50,000
		By Cash A/c	25,000
	75,000		**75,000**

Equity shares in Purchasing Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Purchasing Company A/c	50,000	By Gita's Capital A/c – 25,000	
		By Sita's Capital A/c – 16,667	
		By Rita's Capital A/c – 8,333	50,000
	50,000		**50,000**

Partner's Capital Account

Dr. **Cr.**

Particulars	Gita (₹)	Sita (₹)	Rita (₹)	Particulars	Gita (₹)	Sita (₹)	Rita (₹)
To Profit and Loss A/c	4,500	3,000	1,500	By Balance b/d	28,000	19,000	9,000
To Equity Shares in Purchasing Company A/c	25,000	16,667	8,333	By Realisation A/c (Profit)	14,000	9,333	4,667
To Cash (*Balancing figure*)	12,500	8,666	3,834				
	42,000	28,333	13,667		42,000	28,333	13,667

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Cash/Bank Account

Dr. **Cr.**

Particulars	₹	Particulars		₹
To Balance b/d	1,000	By Realisation A/c		1,000
To Purchasing Company (Purchase consideration paid in cash)	25,000	By Gita's Capital A/c*	(25,000 × 3/6)	12,500
		By Sita's Capital A/c*	(25,000 × 2/6)	8,666
		By Rita's Capital A/c*	(25,000 × 1/6)	3,834
	26,000			**26,000**

***Debit side − Credit side = 26,000 − 1,000 = 25,000 is apportioned among the partners in the ratio of 3:2:1**

Illustration 11: Purchase consideration as per Lump Sum Method and preparation of Ledger Accounts and Balance Sheet

XY Co. Ltd. was registered on 1 January 2012 with an authorised capital of ₹10,00,000 divided into 10,000 ordinary shares of ₹100 each. The company was formed to take over the firm of X and Y as a going concern on the basis of the following Balance Sheet as on 31 December 2011.

Liabilities	₹	Assets	₹
Sundry creditors	20,000	Plant and Machinery	50,000
Capital Accounts		Stock	40,000
X – ₹60,000		Sundry Debtors	25,000
Y – ₹40,000	1,00,000	Cash in Hand	5,000
	1,20,000		**1,20,000**

The purchase consideration was ₹1,40,000 payable ₹1,00,000 by the issue of 1,000 fully paid up shares and balance in 9% debentures of ₹100 each. You are asked to close the books of the firm by means of preparing necessary Ledger Accounts and prepare opening Balance Sheet of the company.

[B.U., B.Com., Nov/Dec 2013, Section C]

Solution:

Step 1: Calculation of purchase consideration

Purchase price agreed = ₹1,40,000 (**Lump Sum Method**)

Step 2: Discharge of purchase consideration	₹
1,000 Equity shares of ₹100 each	1,00,000
400, 9% Debentures of ₹100 each	40,000
Total Purchase Consideration	**1,40,000**

Step 3: Closing books of accounts in the books of X and Y (Ledger Accounts)

Ledger Accounts
Realisation Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Cash A/c	5,000	By Sundry Creditors	20,000
To Sundry Debtors A/c	25,000	By XY Company Ltd. (P.C.)	1,40,000
To Stock A/c	40,000		
To Plant and Machinery A/c	50,000		
To Partner's Capital A/c (1:1)			
X – 20,000			
Y – 20,000	40,000		
	1,60,000		**1,60,000**

Note: In the absence of information, Profit Sharing ratio is assumed to be equal. Students may also assume 3:2 Capital ratio as Profit Sharing ratio.

XY Co. Ltd. Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Realisation A/c (P.C.)	1,40,000	By Shares in XY Co. Ltd. A/c	1,00,000
		By 9% Debentures in XY Co. Ltd. A/c	40,000
	1,40,000		**1,40,000**

Adjusted Capital ratio/Final Claim ratio

Particulars	X	Y
Capital	60,000	40,000
Add: Realisation profit	20,000	20,000
	80,000	60,000
	8	6
Final Claim Ratio	4:3	

Note: The shares and debentures received from the purchasing company by the vendor firm are to be distributed among the partners in the Adjusted Capital ratio or Final Claim ratio or Final Capital Balance ratio. In the absence of information, either Final Claim ratio or Profit Sharing ratio can be followed.

Shares in XY Co. Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To X Y Co. A/c	1,00,000	By X's Capital A/c 1,00,000 × $\frac{4}{7}$	57,143
		By Y's Capital A/c 1,00,000 × $\frac{3}{7}$	42,857
	1,00,000		**1,00,000**

9% Debentures in XY Co. Account

Dr. Cr.

Particulars	₹	Particulars	₹
To X Y Co. A/c	40,000	By X's Capital A/c 40,000 × $\frac{4}{7}$	22,857
		By Y's Capital A/c 40,000 × $\frac{3}{7}$	17,143
	40,000		**40,000**

Partner's Capital Account

Dr. Cr.

Particulars	X (₹)	Y (₹)	Particulars	X (₹)	Y (₹)
To Shares in Purchasing Company A/c	57,143	42,857	By Balance b/d	60,000	40,000
To Cash (*Balancing figure*)	22,857	17,143	By Realisation A/c (Profit)	20,000	20,000
	80,000	**60,000**		**80,000**	**60,000**

Balance Sheet in the books of XY Co. Ltd.
As on 1 January 2012

Particulars	Amount (₹)	Amount (₹)
A. CAPITAL AND LIABILITIES		
SHAREHOLDERS FUND		
Equity share capital		1,00,000
Preference share capital	–	–
Reserves and surplus	–	
NON-CURRENT LIABILITIES		
Secured Loans – 9% debentures	–	40,000
Unsecured loans_	–	–
CURRENT LIABILITIES AND PROVISIONS		
Trade payables – Creditors	20,000	
Other Current Liabilities	–	
Short-term provisions	–	20,000
TOTAL CAPITAL AND LIABILITIES		**1,60,000**
B. ASSETS		
NON-CURRENT ASSETS		
FIXED ASSETS		
Tangible Assets – Plant and Machinery	50,000	
Intangible Assets – Goodwill (*Balancing figure*)	40,000	90,000
NON-CURRENT INVESTMENTS		–
CURRENT ASSETS		
Current investments	–	
Inventories	40,000	
Trade Receivables – debtors	25,000	
Cash and Cash Equivalents	5,000	
Short-term Loans and Advances	–	70,000
TOTAL ASSETS		**1,60,000**

Illustration 12: Purchase consideration as per Lump Sum Method and preparation of Ledger Accounts and Balance Sheet

A, B and C are partners sharing profits in the ratio of 3:2:1, respectively. They decided to convert their partnership into a company on which date their Balance Sheet was as follows:

Liabilities	₹	Assets		₹
Creditors	8,000	Building		11,440
Capitals:		Stock		10,000
A	17,440	Debtors	10,000	
B	8,000	*Less:* Reserve	1,000	9,000
C	6,000	Cash		6,000
		Profit and Loss A/c		3,000
	39,440			**39,440**

The new company took over the assets and liabilities and agreed to pay the purchase price of ₹32,900 payable by the allotment of 1,800 equity shares of ₹10 each and the balance in cash.

The partners agreed to share the shares issued by the new company in their Profit Sharing ratio. Pass journal entries to close the books of the firm. Prepare all the necessary Ledger Accounts.

Solution:

Step 1: **Calculation of purchase consideration**

Agreed purchase price ₹32,900

Step 2: **Discharge of purchase consideration**

Particulars	₹
1,800 shares of ₹10 each	18,000
Cash (Balance ₹32,900 − 18,000)	14,900
Total Purchase Consideration	**32,900**

Step 3: **Closing books of accounts in the books of vendor firm (journal entries and Ledger Accounts)**

Date	Particulars		L.F.	Dr.	Cr.
1.	Realisation A/c	Dr.		37,440	
	To Building A/c				11,440
	To Stock A/c				10,000
	To Debtors A/c (excl. reserve for bad debt)				10,000
	To Cash A/c				6,000
	(Being transfer of Assets at their book values)				
2.	Creditors A/c	Dr.		8,000	
	Reserve for Bad Debts A/c	Dr.		1,000	
	To Realisation A/c				9,000
	(Being transfer of Liabilities at their book values)				

(Contd.)

Date	Particulars		L.F.	Dr.	Cr.
3.	Purchasing Company A/c	Dr.		32,900	
	To Realisation A/c				32,900
	(Being purchase consideration due)				
4.	Shares in Purchasing Company A/c	Dr.		18,000	
	Cash A/c	Dr.		14,900	
	To Purchasing Company A/c				32,900
	(Being purchase consideration received)				
5.	Realisation A/c (32,900 + 9,000 – 37,440)	Dr.		4,460	
	To A's Capital A/c $\left(4{,}460 \times \frac{3}{6}\right)$				2,230
	To B's Capital A/c $\left(4{,}460 \times \frac{2}{6}\right)$				1,487
	To C's Capital A/c $\left(4{,}460 \times \frac{1}{6}\right)$				743
	(Being profit on realisation transferred to Capital Accounts in their Profit Sharing ratio)				
6.	A's Capital A/c 3,000 × 3/6	Dr.		1,500	
	B's Capital A/c 3,000 × 2/6	Dr.		1,000	
	C's Capital A/c 3,000 × 1/6	Dr.		500	
	To Profit and Loss A/c				3,000
	(Being loss appearing on the asset side of the Balance Sheet transferred to Capital Accounts in their Profit Sharing ratio of 3:2:1)				
7.	A's Capital A/c 32,900 × 3/6	Dr.		16,450	
	B's Capital A/c 32,900 × 2/6	Dr.		10,967	
	C's Capital A/c 32,900 × 1/6	Dr.		5,483	
	To Equity Shares in Purchasing Company A/c				18,000
	To Cash A/c				14,900
	(Being final payment to partners in their Profit Sharing ratio of 3:2:1)				

Ledger Accounts

Realisation Account

Dr. **Cr.**

Particulars		₹	Particulars	₹
To Building		11,440	By Reserve for Bad Debts	1,000
To Stock		10,000	By Creditors	8,000
To Debtors		10,000	By Purchasing Company A/c	32,900
To Bank		6,000		
To Partner's Capital A/c (3:2:1)				
A's Capital A/c	2,230			
B's Capital A/c	1,487			
C's Capital A/c	743	4,460		
		41,900		**41,900**

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Purchasing Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Realisation A/c (P.C.)	32,900	By Equity Shares in Purchasing Co. A/c By Cash A/c	18,000 14,900
	32,900		**32,900**

Note: Adjusted Capital ratio/Final Claim ratio is not calculated as the partners have agreed to share the shares issued by the new company in their Profit Sharing ratio (3:2:1)

Shares in Purchasing Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Purchasing Company A/c	18,000	By A's Capital A/c $18,000 \times \frac{3}{6}$	9,000
		By B's Capital A/c $18,000 \times \frac{2}{6}$	6,000
		By C's Capital A/c $18,000 \times \frac{1}{6}$	3,000
	18,000		**18,000**

Partner's Capital Account

Dr. **Cr.**

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Profit and Loss A/c	1,500	1,000	500	By Balance b/d	17,440	8,000	6,000
To Shares in Purchasing Company A/c	9,000	6,000	3,000	By Realisation A/c (Profit)	2,230	1,487	743
To Cash (*Balancing figure*)	9,170	2,487	3,243				
	19,670	**9,487**	**6,743**		**19,670**	**9,487**	**6,743**

Cash/Bank Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	6,000	By Realisation A/c	6,000
To Purchasing Company A/c	14,900	By Partners' Capital A/c	
(P.C. received in cash)		A	9,170
		B	2,487
		C	3,243
	20,900		**20,900**

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Illustration 13: **Purchase consideration as per Net Asset Method and preparation of Ledger Accounts**

Girish, Dinesh and Yatish carry on partnership business sharing profits/losses in the ratio of 4:3:1. On 31 December 2001, they sold their business to limited company on which date their Balance Sheet was as follows:

Liabilities		₹	Assets	₹
Capital:		4,80,000	Plant	1,20,000
Girish	2,00,000		Land	1,80,000
Dinesh	1,50,000		Debtors	1,50,000
Yatish	1,30,000		Stock	1,30,000
Loan		40,000	Cash	20,000
Creditors		80,000		
		6,00,000		**6,00,000**

Company took over the following assets at values:

Land ₹2,20,000; Plant ₹1,10,000; Stock ₹1,20,000; Debtors ₹1,40,000; Goodwill ₹40,000. Company also agreed to take creditors at ₹77,000.

Company paid ₹3,36,000 in fully paid shares of ₹10 each and remaining balance in cash, realisation expenses were ₹5,000.

Prepare necessary Ledger Accounts.

[B.U., B.Com., Nov/Dec 2014, Section C]

Solution:

Step 1: Calculation of purchase consideration

Particulars	Amount (₹)	Amount (₹)
Land	2,20,000	
Plant	1,10,000	
Debtors	1,40,000	
Stock	1,20,000	
Goodwill	40,000	
Total Assets taken over at agreed values		6,30,000
***Less:* Agreed values of liabilities taken over**		
Creditors		77,000
Total Purchase Consideration		**5,53,000**

Step 2: Discharge of purchase consideration

Particulars	₹
33,600 shares of ₹ 10 each	3,36,000
Cash (Balance ₹ 5,53,000 − 3,36,000)	2,17,000
Total Purchase Consideration	**5,53,000**

Step 3: **Closing books of accounts in the books of vendor firm (Ledger Accounts)**

Ledger Accounts
Realisation Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Land A/c	1,80,000	By Creditors	80,000
To Plant A/c	1,20,000	By Loan A/c	40,000
To Debtors A/c	1,50,000	By Purchasing Company A/c	5,53,000
To Stock A/c	1,30,000		
To Cash A/c (Settlement of loan)	40,000		
To Cash A/c (Realisation expenses)	5,000		
To Partner's Capital A/c (4:3:1)			
Girish's Capital A/c 24,000			
Dinesh's Capital A/c 18,000			
Yatish's Capital A/c 6,000	48,000		
	6,73,000		**6,73,000**

Purchasing Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Realisation A/c (P.C.)	5,53,000	By Equity Shares in Purchasing Co. A/c	3,36,000
		By Cash A/c	2,17,000
	5,53,000		**5,53,000**

Adjusted Capital ratio/Final Claim ratio

Particulars	Girish	Dinesh	Yatish
Capital	2,00,000	1,50,000	1,30,000
Add: Realisation Profit	24,000	18,000	6,000
	2,24,000	1,68,000	1,36,000
	224	168	136
Final Claim Ratio	28:21:17		

Shares in Purchasing Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Purchasing Company A/c	3,36,000	By Girish's Capital A/c $3{,}36{,}000 \times \frac{28}{66}$	1,42,545
		By Dinesh's Capital A/c $3{,}36{,}000 \times \frac{21}{66}$	1,06,910
		By Yatish's Capital A/c $3{,}36{,}000 \times \frac{17}{66}$	86,545
	3,36,000		**3,36,000**

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Partner's Capital Account

Dr. **Cr.**

Particulars	Girish (₹)	Dinesh (₹)	Yatish (₹)	Particulars	Girish (₹)	Dinesh (₹)	Yatish (₹)
To Shares in Purchasing Company A/c	1,42,545	1,06,910	86,545	By Balance b/d	2,00,000	1,50,000	1,30,000
To Cash (*Balancing figure*)	81,455	61,090	49,455	By Realisation A/c (Profit)	24,000	18,000	6,000
	2,24,000	**1,68,000**	**1,36,000**		**2,24,000**	**1,68,000**	**1,36,000**

Cash/Bank Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	20,000	By Realisation A/c (Settlement of loan)	40,000
To Purchasing Company A/c (P.C. received in cash)	2,17,000	By Realisation A/c (Realisation expenses)	5,000
		By Partners' Capital A/c	
		Girish	81,455
		Dinesh	61,090
		Yatish	49,455
	2,37,000		**2,37,000**

Illustration 14: **Purchase consideration as per Net Asset Method and preparation of Ledger Accounts**

A, B and C carrying on business in partnership sharing profits and losses in the ratio of 4:3:1, respectively.

On 31 March 2016, they agreed to sell their business to a limited company; their position on that date was as follows:

Liabilities	₹	Assets	₹
Sundry creditors	40,000	Freehold property	90,000
Loan	20,000	Machinery	60,000
Capitals:		Debtors	75,000
A	1,00,000	Stock	65,000
B	75,000	Cash	10,000
C	65,000		
	3,00,000		**3,00,000**

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The company took over the following assets except cash:

Freehold property ₹1,10,000; machinery ₹55,000; debtors ₹70,000; stock ₹60,000; goodwill ₹20,000.

The company also agreed to pay the creditors which were agreed at ₹38,500. The company paid ₹1,68,000 in fully paid shares of ₹10 each and the balance in cash. The expenses amounted to ₹2,500.

Prepare necessary Ledger Accounts in the books of the firm.

[B.U., B.Com., Nov/Dec 2016, Section C]

Solution:

Step 1: Calculation of purchase consideration

Particulars	Amount (₹)	Amount (₹)
Freehold property	1,10,000	
Machinery	55,000	
Debtors	70,000	
Stock	60,000	
Goodwill	20,000	
Total assets taken over at agreed values		3,15,000
Less: **Agreed values of liabilities taken over**		
Creditors		38,500
Total Purchase Consideration		**2,76,500**

Step 2: Discharge of purchase consideration

Particulars	₹
16,800 Equity shares of ₹10 each	1,68,000
Cash (Balance ₹2,76,500 – 1,68,000)	1,08,500
Total Purchase Consideration	**2,76,500**

Step 3: Closing books of accounts in the books of vendor firm (Ledger Accounts)

Ledger Accounts

Realisation Account

Dr. **Cr.**

Particulars		₹	Particulars	₹
To Freehold Property		90,000	By Creditors	40,000
To Machinery A/c		60,000	By Loan A/c (loan from bank)	20,000
To Stock A/c		65,000	By Purchasing Company A/c	2,76,500
To Debtors A/c		75,000		
To Cash A/c (Settlement of loan)		20,000		
To Cash A/c (Realisation expenses)		2,500		
To Partner's Capital A/c (4:3:1)				
A's Capital A/c	12,000			
B's Capital A/c	9,000			
C's Capital A/c	3,000	24,000		
		3,36,500		**3,36,500**

Purchasing Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Realisation A/c (P.C.)	2,76,500	By Equity Shares in Purchasing Co. A/c	1,68,000
		By Cash A/c	1,08,500
	2,76,500		**2,76,500**

Adjusted Capital ratio/Final Claim ratio

Particulars	A	B	C
Capital	1,00,000	75,000	65,000
Add: Realisation Profit	12,000	9,000	3,000
	1,12,000	84,000	68,000
	112	84	68
Final Claim Ratio		28:21:17	

Equity shares in Purchasing Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Purchasing Company A/c	1,68,000	By A's Capital A/c $1,68,000 \times \frac{28}{66}$	71,273
		By B's Capital A/c $1,68,000 \times \frac{21}{66}$	53,455
		By C's Capital A/c $1,68,000 \times \frac{17}{66}$	43,273
	1,68,000		**1,68,000**

Partner's Capital Account

Dr. Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Shares in Purchasing Company A/c	71,273	53,455	43,273	By Balance b/d	1,00,000	75,000	65,000
To Cash (*Balancing figure*)	40,727	30,545	24,727	By Realisation A/c (Profit)	12,000	9,000	3,000
	1,12,000	**84,000**	**68,000**		**1,12,000**	**84,000**	**68,000**

Cash/Bank Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Balance b/d	10,000	By Realisation A/c (Settlement of loan)	20,000
To Purchasing Company A/c (P.C. received in cash)	1,08,500	By Realisation A/c (Realisation expenses)	2,500
		By Partners' Capital A/c	
		A	40,727
		B	30,545
		C	24,727
	1,18,500		**1,18,500**

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Illustration 15: **Purchase consideration as per Net Asset Method and preparation of Ledger Accounts**

A, B and C were in partnership sharing profits and losses in the ratio of 4:3:1, respectively. On 31 March 2014, they agreed to sell their business to a limited company. Their position on that date was as follows:

Liabilities	₹	Assets	₹
Creditors	16,000	Land and Building	36,000
Loan from bank	8,000	Furniture	24,000
Capital A/c		Debtors	30,000
A	40,000	Stock	26,000
B	30,000	Cash	4,000
C	26,000		
	1,20,000		**1,20,000**

The company took assets at the valuation shown as follows:

Land and building ₹44,000; Furniture ₹22,000; Debtors ₹28,000; Stock ₹24,000; Goodwill ₹8,000.

The company also agreed to pay the creditors which were agreed at ₹15,400. The company paid 3,300 shares of ₹10 each and the balance in cash. The expenses amounted to ₹1,000.

Prepare necessary Ledger Accounts in the books of the firm.

[B.U., B.Com., Nov/Dec 2015, Section C]

Solution:

Step 1: Calculation of purchase consideration

Particulars	Amount (₹)	Amount (₹)
Land and Building	44,000	
Furniture	22,000	
Debtors	28,000	
Stock	24,000	
Goodwill	8,000	
Total assets taken over at agreed values		1,26,000
Less: **Agreed values of liabilities taken over**		
Creditors		15,400
Total Purchase Consideration		**1,10,600**

Step 2: Discharge of purchase consideration

Particulars	₹
3,300 Shares of ₹10 each	33,000
Cash (Balance ₹1,10,600 – 33,000)	77,600
Total Purchase Consideration	**1,10,600**

Step 3: Closing books of accounts in the books of vendor firm (Ledger Accounts)

Ledger Accounts

Realisation Account

Dr. **Cr.**

Particulars		₹	Particulars	₹
To Land and Building		36,000	By Creditors	16,000
To Furniture		24,000	By Purchasing Company A/c	1,10,600
To Debtors		30,000		
To Stock		26,000		
To Bank (Realisation expenses)		1,000		
To Partner's Capital A/c (4:3:1)				
A's Capital A/c	4,800			
B's Capital A/c	3,600			
C's Capital A/c	1,200	9,600		
		1,26,600		**1,26,600**

Purchasing Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Realisation A/c (P.C.)	1,10,600	By Equity Shares in Purchasing Co. A/c	33,000
		By Cash A/c	77,600
	1,10,600		**1,10,600**

Shares in Purchasing Account

Dr. **Cr.**

Particulars	₹	Particulars		₹
To Purchasing Company A/c	33,000	By A's Capital A/c	$\frac{4}{8} \times 33,000$	16,500
		By B's Capital A/c	$\frac{3}{8} \times 33,000$	12,375
		By C's Capital A/c	$\frac{1}{8} \times 33,000$	4,125
	33,000			**33,000**

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Partner's Capital Account

Dr. **Cr.**

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Shares in Purchasing Company A/c	16,500	12,375	4,125	By Balance b/d	40,000	30,000	26,000
To Cash (*Balancing figure*)	28,300	21,225	23,075	By Realisation A/c (Profit)	4,800	3,600	1,200
	44,800	**33,600**	**27,200**		**44,800**	**33,600**	**27,200**

Cash/Bank Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	4,000	By Realisation A/c (Settlement of loan)	8,000
To Purchasing Company A/c (P.C. received in cash)	77,600	By Realisation A/c (Realisation expenses)	1,000
		By Partners' Capital A/c	
		A	28,300
		B	21,225
		C	23,075
	81,600		**81,600**

Illustration 16: **Purchase consideration as per Net Payment Method, drafting of incorporating entries and Balance Sheet.**

X Ltd. was formed to take over the assets and liabilities of A and B. The Balance Sheet of A and B on 31 March 2006 was as follows:

Liabilities	₹	Assets	₹
Creditors	8,000	Cash in Hand	2,000
Capital:		Cash at Bank	12,000
A	80,000	Book debts	18,000
B	80,000	Stock	78,000
		Furniture	10,000
		Land and Buildings	48,000
	1,68,000		**1,68,000**

The purchase consideration was agreed at ₹2,00,000 and was to be paid as follows:

1. 5,600 Equity shares of ₹20 each fully paid
2. 6,800 in 6% Preference shares of ₹100 each issued at par
3. 20,000 In cash

All the assets and liabilities were valued as per Balance Sheet except the book debts which were subject to a bad debt provision of 5%. The company raised further capital by issue of 15,000 equity shares of ₹20 each.

The adjoining premises were purchased for ₹1,00,000 and additional stock ₹1,40,000 was obtained from open market. Record the transactions mentioned before in the books of X Ltd. through journal entries and draft its opening Balance Sheet.

[B.U., B.Com., Nov/Dec 2005, Section C]

Solution:

Step 1: **Calculation and discharge of purchase consideration**

Particulars	₹
5,600 Equity shares of ₹20 each	1,12,000
6,800 6% Preference shares of ₹100 each	68,000
Cash (Balance ₹2,00,000 − 1,12,000 – 68,000)	20,000
Total Purchase Consideration	**2,00,000**

Step 2: **Incorporating entries in the books of X Company (purchasing company)**

Journal entries

Date	Particulars		L.F.	Dr.	Cr.
1.	Business Purchase A/c	Dr.		2,00,000	
	To Vendor's Firm A/c				2,00,000
	(Being purchase consideration due)				
2.	Cash in Hand A/c	Dr.		2,000	
	Cash at Bank A/c	Dr.		12,000	
	Book Debts A/c	Dr.		18,000	
	Stock A/c	Dr.		78,000	
	Furniture A/c	Dr.		10,000	
	Land and Building A/c	Dr.		48,000	
	Goodwill A/c (*Balancing figure*)	Dr.		40,900	
	To Trade Creditors A/c				8,000
	To Provision for Bad Debts A/c (18,000 × 5%)				900
	To Business Purchase A/c				2,00,000
	(Being Assets and Liabilities taken over and purchase consideration payable)				
3.	Bank A/c	Dr.		3,00,000	
	To Equity Share Capital A/c (15,000 shares @ 20 each)				3,00,000
	(Being additional capital raised by fresh issue of equity shares)				
4.	Vendor's Firm A/c	Dr.		2,00,000	
	To Equity Share Capital A/c				1,12,000
	To 6% Preference Share Capital A/c				68,000
	To Cash A/c				20,000
	(Being purchase consideration paid)				
5.	Premises A/c	Dr.		1,00,000	
	Stock A/c	Dr.		1,40,000	
	To Cash/Bank A/c				2,40,000
	(Being additional assets purchased recorded)				

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Balance Sheet in the purchasing company
As on 31 October 2006

Particulars	Amount (₹)	Amount (₹)
A. CAPITAL AND LIABILITIES		
SHAREHOLDERS FUND		
Equity share capital (5,600 + 15,000 × 20 per share)	4,12,000	
6% Preference share capital (6,800 × 10)	68,000	
Reserves and Surplus		4,80,000
NON-CURRENT LIABILITIES		
Secured loans		—
Unsecured loans		—
CURRENT LIABILITIES AND PROVISIONS		
Trade payables – Creditors	8,000	
Other Current Liabilities		
Short-term provisions – Provision for debts	900	8,900
TOTAL CAPITAL AND LIABILITIES		4,88,900
B. ASSETS		
NON-CURRENT ASSETS		
FIXED ASSETS		
Tangible Assets – Land and Building (48,000 + 1,00,000) Furniture (10,000)	1,58,000	
Intangible Assets – Goodwill	40,900	1,98,900
NON-CURRENT INVESTMENTS		—
CURRENT ASSETS		
Current Investments	—	
Inventories (1,40,000 + 78,000)	2,18,000	
Trade receivables – debtors	18,000	
Cash and Cash equivalents (52,000 + 2,000)	54,000	
Short-term Loans and Advances	—	2,90,000
TOTAL ASSETS		**4,88,900**

Illustration 17: **Purchase consideration as per Net Asset Method, preparation of Ledger Accounts**

Sumit and Amit were in partnership sharing profits and losses in the ratio of 2:1. The summarised partnership Balance Sheet as on 31 March 2016 was as follows:

The summarised partnership Balance Sheet as on 31 March 2016 is given in the following table:

Liabilities		₹	Assets	₹
Fixed Capital Accounts:			Fixed Assets	35,000
Sumit		25,000	Current Assets:	
Amit		20,000	Stock	17,500
Current Accounts			Debtors	32,500
Sumit	10,000		Bank	7,500
Less: Amit	5,000	5,000		
Amit's loan		15,000		
Creditors		27,500		
		92,500		**92,500**

The Fixed Assets included two motor cars having book values of ₹4,000 and ₹3,000, respectively.

The partners desiring to retire from business accepted the offer of Western India Limited to acquire stock and Fixed Assets, other than motor cars at an agreed purchase price of ₹80,000.

The purchase consideration was to be satisfied by a cash payment of ₹28,000, the allotment by the company to the partners of 200, 5% preference shares of ₹100 each and the balance by the allotment by the company to the partners of 450 equity shares of ₹100 each.

The debtors realised ₹30,500 and the creditors settled for ₹25,500.

The partners agreed that the following should be the basis of distribution on dissolution of the partnership:

1. Sumit to take over one car at a valuation of ₹6,000 and Amit the other car at ₹4,000.
2. Amit to be allotted preference shares to the value of his loan, the remainder to be allotted to Sumit.
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 balance to be settled in cash.

You are required to prepare Ledger Accounts.

Solution:

Step 1: **Calculation of purchase consideration**

Agreed purchase price = ₹80,000

Step 2: **Discharge of purchase consideration**

Particulars	₹
450 Equity shares of ₹80 each	36,000
200 Preference shares of ₹80 each	16,000
Cash	28,000
Total Purchase Consideration	**80,000**

Step 3: Closing books of accounts in the books of vendor firm (Ledger Accounts)

Ledger Accounts
Realisation Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Fixed Assets A/c	35,000	By Creditor's A/c	27,500
To Stock A/c	17,500	By Purchasing Co. A/c	80,000
To Debtors A/c	32,500	By Bank A/c (Amount received from debtors)	30,500
To Bank A/c (Creditors paid)	25,500	By Sumit's Current A/c (Motor car taken over)	6,000
To Partner's Current A/c (2:1)		By Amit's Current A/c (Motor car taken over)	4,000
Sumit's Current A/c $37{,}500 \times \frac{2}{3}$	25,000		
Amit's Current A/c $37{,}500 \times \frac{1}{3}$	12,500		
	1,48,000		**1,48,000**

Purchasing Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Realisation A/c (P.C.)	80,000	By Equity Shares in Purchasing Co. A/c	36,000
		By Preference Shares in Purchasing Co. A/c	16,000
		By Cash A/c	28,000
	80,000		**80,000**

Shares in Purchasing Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Purchasing Company A/c	36,000	By A's Capital A/c $36{,}000 \times \frac{5}{9}$	20,000
		By B's Capital A/c $36{,}000 \times \frac{4}{9}$	16,000
	36,000		**36,000**

The equity shares have been distributed between the partners in the proportion of fixed capital of 25,000:20,000 = 5:4

Partner's Current Account

Dr. **Cr.**

Particulars	Sumit (₹)	Amit (₹)	Particulars	Sumit (₹)	Amit (₹)
To Balance c/d	–	5,000	By Balance b/d	10,000	–
To Realisation A/c (Motor car)	6,000	4,000	By Realisation A/c (Profit)	25,000	12,500
To Capital A/c (Balance transferred)	29,000	3,500			
	35,000	**12,500**		**35,000**	**12,500**

Partner's Capital Account

Dr. **Cr.**

Particulars	Sumit (₹)	Amit (₹)	Particulars	Sumit (₹)	Amit (₹)
To Preference Shares*	1,000	-	By Balance b/d	25,000	20,000
To Equity Shares in Purchasing Co. A/c	20,000	16,000	By Current A/c	29,000	3,500
To Bank A/c (*Balancing figure*)	33,000	7,500			
	54,000	**23,500**		**54,000**	**23,500**

***The preference shares allotted to Mr. Sumit towards the settlement of his capital is calculated as follows:**

Total preference shares received by the partners	16,000
Less: Preference shares issued to Amit towards the settlement of his Loan Account	15,000
Balance or preference shares issued to Sumit towards the settlement of his Capital Account	**1,000**

Cash/Bank Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	7,500	By Realisation A/c (Settlement of creditors)	25,500
To Realisation A/c (Debtors realised)	30,500	By Partners' Capital A/c	
To Purchasing Company A/c (P.C. received in cash)	28,000	Sumit	33,000
		Amit	7,500
	66,000		**66,000**

Illustration 18: Purchase consideration as per Lump Sum Method, preparation of Ledger Accounts and Balance Sheet

Z Ltd. was formed to take over the business of M/s X and Y who are carrying on business in partnership. The Balance Sheet of the firm as on 31 December 2016 was as follows:

Liabilities	₹	Assets	₹
Sundry creditors	65,000	Plant and Machinery	2,60,000
Bills payable	22,000	Land and Building	69,000
Profit and Loss A/c	43,000	Stock	1,30,000
Partner's capital		Investment	52,000
X	2,00,000	Sundry debtors	1,38,000
Y	3,19,000		
	6,49,000		**6,49,000**

The company took over all the assets and liabilities except the investments at their book values, and the purchase consideration of ₹5,50,000 was satisfied by the issue of ₹2,00,000. 7% debentures of X Ltd. and the balance in fully paid shares of ₹100 each; in X Ltd., the investments were taken over by the Y at book value. The shares in Z Ltd. have been taken over by the partners in the ratio of 3:2 and the final settlement being made in the form of debentures.

1. Prepare necessary Ledger Accounts to close the books of the firm.
2. Pass the entries in the books of X Ltd. and draft its Balance Sheet.

Solution:

Step 1: **Calculation of purchase consideration**

Agreed purchase price = ₹5,50,000

Step 2: **Discharge of purchase consideration**

Particulars	₹
3,500 Equity shares of ₹100 each (5,50,000 – 2,00,000) 7% Debentures	3,50,000 2,00,000
Total Purchase Consideration	**5,50,000**

Step 3: **Closing books of accounts in the books of vendor firm (Ledger Accounts)**

Ledger Accounts

Realisation Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Plant and Machinery A/c	2,60,000	By Sundry Creditors A/c	65,000
To Land and Building A/c	69,000	By Bills Payable A/c	22,000
To Stock A/c	1,30,000	By Z Ltd. A/c (P.C.)	5,50,000
To Investment A/c	52,000	ByY'sCapitalA/c(Investmenttakenover)	52,000
To Sundry Debtors A/c	1,38,000		
To Partner's Capital A/c (2:1)			
X's Capital A/c 40,000 × $\frac{3}{5}$ = 24,000			
Y's Capital A/c 40,000 × $\frac{2}{5}$ = 16,000	40,000		
	6,89,000		**6,89,000**

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Purchasing Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Realisation A/c (P.C.)	5,50,000	By Equity Shares in Purchasing Co. A/c By 7% Debentures A/c	3,50,000 2,20,000
	5,50,000		**5,50,000**

Shares in Purchasing Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Purchasing Company A/c	3,50,000	By A's Capital A/c $3{,}50{,}0000 \times \frac{3}{5}$	2,10,000
		By B's Capital A/c $3{,}50{,}000 \times \frac{2}{5}$	1,40,000
	3,50,000		**3,50,000**

Partner's Capital Account

Dr. **Cr.**

Particulars	X (₹)	Y (₹)	Particulars	X (₹)	Y (₹)
To Realisation A/c (Investment taken over)	–	52,000	By Balance b/d	2,00,000	3,19,000
To Equity Shares in Z Ltd.	2,10,000	1,40,000	By Realisation A/c (Profit)	24,000	16,000
To Debenture in Z Ltd. (*Balancing figure*)	39,800	1,60,200	By Profit and Loss A/c (Cr.) (43,000 in 3:2 ratio)	25,800	17,200
	2,49,800	**3,52,200**		**2,49,800**	**3,52,200**

Incorporating entries in the books of Z Company (purchasing company)
Journal entries

Date	Particulars		L.F.	Dr.	Cr.
1.	Business Purchase A/c	Dr.		5,50,0000	
	To M/s X and Y Co. A/c				5,50,000
	(Being purchase consideration due)				
2.	Plant and Machinery A/c	Dr.		2,60,000	
	Land and Building A/c	Dr.		69,000	
	Stock A/c	Dr.		1,30,000	
	Debtors A/c	Dr.		1,38,000	
	Goodwill A/c (*Balancing figure*)	Dr.		40,000	
	To Sundry Creditors A/c				65,000
	To Bills Payable A/c				22,000
	To Business Purchase A/c				5,50,000
	(Being Assets and Liabilities taken over and purchase consideration payable)				

(Contd.)

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Date	Particulars		L.F.	Dr.	Cr.
3.	M/s X and Y Co. A/c	Dr.		5,50,000	
	To 7% Debentures A/c				2,00,000
	To Equity Share Capital A/c				3,50,000
	(Being purchase consideration paid)				

Balance Sheet of Z Ltd.

As on 31 October 2016

Particulars	Amount (₹)	Amount (₹)
A. CAPITAL AND LIABILITIES		
SHAREHOLDERS FUND		
Equity share capital (3,500 × 100 per share)		3,50,000
Reserves and surplus		–
NON-CURRENT LIABILITIES		
Secured loans		–
Unsecured loans_– 7% debentures		2,00,000
CURRENT LIABILITIES AND PROVISIONS		
Trade payables – 65,000 + 22,000 (Creditors and bills payable)		87,000
Other Current Liabilities		
Short-term provisions		
TOTAL CAPITAL AND LIABILITIES		**6,37,000**
B. ASSETS		
NON-CURRENT ASSETS		
FIXED ASSETS		
Tangible Assets – Land and Building (69,000) Plant and Machinery (2,60,000)	3,29,000	
Intangible Assets – Goodwill	40,000	3,69,000
NON-CURRENT INVESTMENTS		–
CURRENT ASSETS		
Current Investments		–
Inventories	1,30,000	
Trade receivables – debtors	1,38,000	
Cash and Cash equivalents (52,000 + 2,000)	–	
Short-term Loans and Advances	–	2,68,000
TOTAL ASSETS		**6,37,000**

Illustration 19: **Ledger Accounts in the books of vendor firm**

X and Y were in partnership sharing profits and losses in the ratio of 3:2. The following was the Balance Sheet of the firm as on 31st March 2014.

Liabilities	₹	Assets	₹
Creditors	26,000	Cash	12,000
X's loan	4,000	Debtors	30,000
Capitals:		Stock	38,000
X	60,000	Fixed Assets	40,000
Y	30,000		
	1,20,000		**1,20,000**

Z Company Ltd. agreed to take over Fixed Assets and stock for a consideration of ₹80,000 which is to be satisfied.

1. By payment of cash ₹16,000
2. By allotment of 240, 8% preference shares of ₹100 each and
3. By allotment of 3,200 equity shares of ₹10 each valued at ₹12.50 per share

The debtors realised ₹28,000 and the creditors were paid ₹24,000 in full settlement. It was agreed between the partners as follows:

1. Equity shares are to be allotted in their Profit Sharing ratio.
2. Preference shares are to be allotted to X to the value of his/her Loan Account and the remaining preference shares are to be allotted to the partners equally.

Prepare the necessary Ledger Accounts in the books of X and Y.

[B.U., B.Com., Nov/Dec 2008, Section C]

Solution:

Step 1: **Calculation of purchase consideration**

Agreed purchase price = ₹80,000

Step 2: **Discharge of purchase consideration**

Particulars	₹
3,200 Equity shares of ₹12.50 each	40,000
8% Preference shares (240 shares × ₹100 each)	24,000
Cash	16,000
Total Purchase Consideration	**80,000**

Step 3: **Closing books of accounts in the books of vendor firm (Ledger Accounts)**

Ledger Accounts

Realisation Account

Particulars	₹	Particulars	₹
To Debtors A/c	30,000	By Sundry Creditors A/c	26,000
To Stock A/c	38,000	By Cash A/c (Collection from debtors)	28,000
To Fixed Assets A/c	40,000	By Z Ltd. A/c (P.C.)	80,000
To Cash A/c (Settlement to creditors)	24,000		
To Partner's Capital A/c (Profit on realisation) (3:2)	2,000		
X's Capital A/c $2{,}000 \times \frac{3}{5} = 1{,}200$			
Y's Capital A/c $2{,}000 \times \frac{2}{5} = 800$			
	1,34,000		**1,34,000**

Z Co. Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Realisation A/c (P.C.)	80,000	By Equity Shares in Z Co. A/c	40,000
		By 8% Preference Shares in Z Co. A/c	24,000
		By Cash A/c	16,000
	80,000		**80,000**

Equity shares in Z Co. Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Z Co. A/c	40,000	By X's Capital A/c $3{,}200 \times \frac{3}{5} \times ₹12.50$	24,000
		By Y's Capital A/c $3{,}200 \times \frac{2}{5} \times ₹12.50$	16,000
	40,000		**40,000**

8% Preference shares in Z Co. Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Z Co. A/c	24,000	By X's Loan A/c (settlement of loan)	4,000
		By X's Capital A/c $\left(24{,}000 - 4{,}000 = 20{,}000 \times \frac{1}{2}\right)$	10,000
		By Y's Capital A/c $\left(24{,}000 - 4{,}000 = 20{,}000 \times \frac{1}{2}\right)$	10,000
	24,000		**24,000**

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X's Loan Account

Dr. Cr.

Particulars	₹	Particulars	₹
To 8% Preference Shares in Z Co. A/c (Settlement of loan)	4,000	By Balance b/d (Balance of loan)	4,000
	4,000		**4,000**

Partner's Capital Account

Dr. Cr.

Particulars	X (₹)	Y (₹)	Particulars	X (₹)	Y (₹)
To 8% Preference Shares in Z Co. A/c	10,000	10,000	By Balance b/d	60,000	30,000
To Equity Shares in Z Co. A/c	24,000	16,000	By Realisation A/c (Profit)	1,200	800
To Cash A/c (*Balancing figure*)	27,200	4,800			
	61,200	**30,800**		**61,200**	**30,800**

Cash/Bank Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Balance b/d	12,000	By Realisation A/c (Settlement of creditors)	24,000
To Realisation A/c (Collection from debtors)	28,000	By Partner's Capital A/c	
		X's Capital	27,200
To Z Co. A/c (Purchase consideration in cash)	16,000	Y's Capital	4,800
	56,000		**56,000**

Illustration 20: **Ledger Accounts in the books of the vendor firm**

P and Q are partners sharing profits in the ratio of 3:2. Their Balance Sheet as on 31 December 2013 was as follows:

Liabilities	₹	Assets	₹
Bills payable	40,000	Machinery	80,000
Creditors	80,000	Building	1,68,000
P's capital	2,40,000	Goodwill	60,000
Q's capital	1,60,000	Bank	8,000
Mrs. P's loan	16,000	Debtors	1,12,000
		Investments	20,000
		Stock	88,000
	5,36,000		**5,36,000**

5

They agreed to sell the business to a limited company. The purchasing company agreed to take over the assets and liabilities as follows:

Machinery ₹60,000; Goodwill ₹80,000; Building ₹2,40,000; Debtors ₹1,00,000 and Stock ₹80,000. The company agreed to take over the Creditors and Bills payable at book values.

The firm retained investments and sold them for ₹24,000 and paid Mrs. P's loan.

The purchase consideration was settled by the issue of 40,000 equity shares of ₹10 each and the balance in cash, shares being distributed in Profit Sharing ratio.

Prepare necessary Ledger Accounts in the books of the firm.

[B.U., B.Com., Nov/Dec 2006, Section C]

Solution:

Step 1: **Calculation of purchase consideration**

Particulars	Amount (₹)	Amount (₹)
Machinery	60,000	
Goodwill	80,000	
Buildings	2,40,000	
Debtors	1,00,000	
Stock	80,000	
Total assets taken over at agreed values		5,60,000
Less: **Agreed values of liabilities taken over**		
Creditors	80,000	
Bills payable	40,000	1,20,000
Total Purchase Consideration		**4,40,000**

Note: Bank Balance appearing in the Balance Sheet is excluded from the calculation of purchase consideration, as the problem does not state about takeover of Bank Balance by the purchasing company.

Step 2: **Discharge of purchase consideration**

Particulars	₹
40,000 Shares of ₹10 each	4,00,000
Cash (Balance ₹4,40,000 − 4,00,000)	40,000
Total Purchase Consideration	**4,40,000**

Step 3: **Closing books of accounts in the books of vendor firm (Ledger Accounts)**

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Ledger Accounts

Realisation Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Machinery A/c	80,000	By Bills Payable A/c	40,000
To Buildings A/c	1,68,000	By Creditor's A/c	80,000
To Goodwill A/c	60,000	By Mrs. P's Loan	16,000
To Debtors A/c	1,12,000	By Bank A/c (Investment sold)	24,000
To Investment A/c	20,000	By Purchasing Company A/c (P.C.)	4,40,000
To Stock A/c	88,000		
To Bank A/c (Settlement of loan)	16,000		
To Partner's Capital A/c (Realisation Profit)			
P's Capital A/c $\left(56,000 \times \frac{3}{5}\right)$	33,600		
Q's Capital A/c $\left(56,000 \times \frac{2}{5}\right)$	22,400		
	6,00,000		**6,00,000**

Purchasing Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Realisation A/c (P.C.)	4,40,000	By Equity Shares in Purchasing Co. A/c By Cash A/c	4,00,000 40,000
	4,40,000		**4,40,000**

Equity shares in Purchasing Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Purchasing Company A/c	4,00,000	By P's Capital A/c $4,00,000 \times \frac{3}{5}$	2,40,000
		By Q's Capital A/c $4,00,000 \times \frac{2}{5}$	1,60,000
	4,00,000		**4,00,000**

Partner's Capital Account

Dr. Cr.

Particulars	P (₹)	Q (₹)	Particulars	P (₹)	Q (₹)
To Shares in Purchasing Company A/c	2,40,000	1,60,000	By Balance b/d	2,40,000	1,60,000
To Bank A/c (*Balancing figure*)	33,600	22,400	By Realisation A/c (Profit)	33,600	22,400
	2,73,600	**1,82,400**		**2,73,600**	**1,82,400**

Cash/Bank Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	8,000	By Realisation A/c (Settlement of P's loan)	16,000
To Realisation A/c (Investments sold)	24,000	By Partner's Capital A/c	
To Purchasing Company A/c (P.C. received in cash)	40,000	P's Capital A/c	33,600
		Q's Capital A/c	22,400
	72,000		**72,000**

Illustration 21: **Ledger Accounts in the books of vendor firm**

The following is the summarised Balance Sheet of A and B who were sharing profits and losses in the ratio of 2:1, respectively.

Balance Sheet as on 31 December 2013

Liabilities	₹	Assets	₹
Capitals:		Fixed Assets	1,40,000
A	1,40,000	Stock	70,000
B	1,00,000	Debtors	1,30,000
B's loan	60,000	Cash at Bank	50,000
Creditors	90,000		
	3,90,000		**3,90,000**

The Fixed Assets included two motor cars having book values of ₹16,000 and ₹12,000 which were taken over by A and B at agreed values of ₹24,000 and 16,000, respectively. They sold the Fixed Assets (other than the motor cars) and stock to Sundar Ltd. at an agreed price of ₹3, 20,000. The company agreed to pay cash of ₹1,12,000 and issue 800 preference shares of ₹80 each and 1,800 equity shares of ₹100 each at a market value of ₹80 each.

The debtors realised ₹1,22,000 and the creditors were paid ₹85,000 in full settlement. Preference shares were used to pay B towards his/her loan and the balance of preference shares was given to A in part payment of the amount due to him/her. Equity shares were allotted between A and B in the ratio of 5:4.

Show the necessary Ledger Accounts in the books of Partnership Firm.

[B.U., B.Com., Nov/Dec 2005, Section C]

Solution:

Step 1: **Calculation of purchase consideration**

Agreed Purchase Price = ₹3,20,000

Step 2: **Discharge of purchase consideration**

Particulars	₹
1,800 Equity shares of ₹100 each at a market value of ₹80 each	1,44,000
800 Preference shares of ₹80 each	64,000
Cash	1,12,000
Total Purchase Consideration	**3,20,000**

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Step 3: Closing books of accounts in the books of vendor firm (Ledger Accounts)

Ledger Accounts
Realisation Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Fixed Assets A/c	1,40,000	By Creditors A/c	90,000
To Stock A/c	70,000	By A's Capital A/c (Motor car taken over)	24,000
To Debtors A/c	1,30,000	By B's Capital A/c (Motor car taken over)	16,000
To Bank A/c (Settlement of creditors)	85,000	By Bank A/c (Collection from debtors)	1,22,000
To Partner's Capital A/c (Realisation Profit)		By Sundar Ltd. A/c (P.C.)	3,20,000
A's Capital A/c 1,47,000 × $\frac{2}{3}$ = 98,000			
B's Capital A/c 1,47,000 × $\frac{1}{3}$ = 49,000	1,47,000		
	5,72,000		**5,72,000**

Sundar Ltd. Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Realisation A/c (P.C.)	3,20,000	By Equity Shares in Sundar Ltd. A/c	1,44,000
		By Preference Shares in Sundar Ltd. A/c	64,000
		By Cash A/c	1,12,000
	3,20,000		**3,20,000**

Equity shares in Sundar Ltd. Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Sundar Ltd. A/c	1,44,000	By A's Capital A/c 1,44,000 × $\frac{5}{9}$	80,000
		By B's Capital A/c 1,44,000 × $\frac{4}{9}$	64,000
	1,44,000		**1,44,000**

B's Loan Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Preference Shares in Sundar Ltd. A/c (Settlement of loan)	60,000	By Balance b/d (Balance of loan)	60,000
	60,000		**60,000**

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Partner's Capital Account

Dr. **Cr.**

Particulars	A (₹)	B (₹)	Particulars	A (₹)	B (₹)
To Realisation A/c (Motor car)	24,000	16,000	By Balance b/d	1,40,000	1,00,000
To Equity Shares in Sundar Co. A/c	80,000	64,000	By Realisation A/c (Profit)	98,000	49,000
To Preference Shares in Sundar Ltd. A/c (Preference shares issued – loan balance) (64,000 − 60,000)	4,000	–			
To Cash A/c (*Balancing figure*)	1,30,000	69,000			
	2,38,000	**1,49,000**		**2,38,000**	**1,49,000**

Cash/Bank Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	50,000	By Realisation A/c (Settlement of creditors)	85,000
To Realisation A/c (Collection from debtors)	1,22,000	By Partner's Capital A/c	
To Sundar Ltd. A/c (Purchase consideration in cash)	1,12,000	A's Capital B's Capital	1,30,000 69,000
	2,84,000		**2,84,000**

Summary

- Sale or Conversion of existing Partnership Firm into a Joint Stock Company refers to taking over of or transforming a Partnership Firm into a Joint Stock Company as the benefits accruing to a joint stock company form of business organisation are better than the Partnership Firm in many different ways.
- Objectives of sale or conversion of Partnership Firm into Joint Stock Company are to increase capital, enjoy the benefit of limited liability, enhance the scale of operations, attain perpetual succession, enjoy the status of legal entity, increase the managerial skills, etc.
- The accounting treatment of conversion of Partnership Firm into Joint Stock Company involves the following steps:

(Contd.)

1. Calculation of purchase consideration
2. Discharge of purchase consideration
3. Passing journal entries and preparation of ledger accounts to close the books of vendor firm
4. Drafting incorporating entries in the books of purchasing firm

- Purchase consideration can be calculated on the basis of the below mentioned methods:
  1. Lumpsum Method
  2. Net Assets Method
  3. Net Payment Method
- Purchase consideration can be discharged by way of equity shares, preference shares, debentures, and cash or by a combination of all or a few.
- Realisation account is prepared by the vendor firm at the time of closing books of accounts. This account is debited with all the assets including cash and bank balance and credited with all liabilities at their respective book values.
- Purchasing company account is prepared to show the amount of purchase consideration and the discharge of purchase consideration.
- Shares in purchasing company account is prepared to show the amount received as purchase consideration by vendor firm in the form of equity or preference shares in purchasing company.
- Debentures in purchasing company account are prepared to show the amount received as purchase consideration by vendor firm in the form of debentures in purchasing company.
- Partner's capital account will be credited with their opening balances of capital, reserves and surplus, realisation profit (if any), liabilities taken over by the partners that are not taken over by the purchasing company.
- Cash or bank account is prepared to record all payment and receipts by way of cash. The opening balance of cash with the vendor firm is recorded on the debit side along with sale proceeds of assets sold not taken over by the purchasing company, and any amount of purchase consideration received by way of cash.
- The purchasing company will have to pass incorporating entries in its books to show the takeover of assets and liabilities, amount paid towards the purchase consideration and the mode of discharge of purchase consideration.
- After passing the incorporating entries in the books of purchasing company the next step is to prepare the balance sheet. This is to accommodate all the assets, liabilities taken over of vendor company and the amount of consideration paid to vendor company in the balance sheet of purchasing company. By preparing the balance sheet the sale or conversion of Partnership Firm into a Joint Stock Company is pursued.

Review Questions

Section A (2 Marks)

1. What do you mean by sale of a firm to a company? **[B.U., B.Com., Nov/Dec 2010]**
2. What do you mean by Purchase Consideration? **[B.U., B.Com., Nov/Dec 2005/2006/2012]**
3. Mention the method of calculating purchase consideration. **[B.U., B.Com., Nov/Dec 2007/2008/2015]**
4. Mention four objectives of conversion of a firm into a limited company. **[B.U., B.Com., Nov/Dec 2006/2007/2008/2011/2012/2014]**
5. State the ratio in which debentures received from the purchasing company is to be distributed among the partners. **[B.U., B.Com., Nov/Dec 2005]**
6. Explain Goodwill in the context of sale of a firm to a company. **[B.U., B.Com., Nov/Dec 2005]**
7. Give the meaning of Preference shares **[B.U., B.Com., Nov/Dec 2006]**
8. State the treatment of assets not taken over by the purchasing company with the help of journal entries. **[B.U., B.Com., Nov/Dec 2013]**
9. What is Realisation Account? Explain the purpose of opening a Realisation Account. **[B.U., B.Com., April 1998/1999/Nov/Dec 2001/2002/2003/2014]**
10. Write an entry to close Realisation Account. **[B.U., B.Com., Nov/Dec 2006]**
11. Explain the treatment of contingent liabilities at conversion of a firm. **[B.U., B.Com., Nov/Dec 2013]**
12. Write a note on Net Asset Method. **[B.U., B.Com., Nov/Dec 2010]**
13. Explain the meaning of incorporating entries. **[B.U., B.Com., Nov/Dec 2009]**
14. Pass the journal entry for the assets and liabilities taken over by the purchasing company in the books of purchasing company.
15. Write on the modes of discharge of purchase consideration.
16. What is Final Claim Ratio?

Section B (8 Marks)

1. What is the procedure involved in the sale of a firm to a limited company? **[B.U., B.Com., Nov/Dec 2005/2007/2011]**
2. Calculate the amount of purchase consideration from the following details:

   The purchasing company agreed to issue 15,000 equity shares of ₹10 each valued at ₹12 each, 6,000, 6% debentures of ₹10 each at a discount of 5% pay cash equal to 10% of face value of shares and debentures issued. The company also agreed to meet dissolution expenses of ₹2,500.

   [B.U., B.Com., Nov/Dec 2015, Section A]

   (Ans: ₹1,80,000 – Equity shares; ₹57,000 debentures and ₹21,000 by way of cash; total purchase consideration ₹2,58,000)
3. Calculate purchase consideration from the following details:

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The purchasing company has agreed to issue 8,000 equity shares of ₹10 each at par, 500 8% preference shares of ₹100 each at 10% premium, 1,000 debentures of ₹50 each at 10% discount and pay cash equal to 10% of total purchase consideration. **[B.U., B.Com., Nov/Dec 2005/2011, Section A]**

(Ans: ₹80,000 – Equity shares; ₹55,000 by way of preference shares; ₹45,000 debentures and ₹20,000 by way of cash; total purchase consideration ₹2,00,000)

4. Calculate the amount of purchase consideration from the following:

   The purchasing company has agreed to issue 30,000 equity shares of ₹10 each at a premium of 10%; 1,000, 8% preference shares of ₹100 each; 1,000, 6% debentures of ₹100 each at a discount of 10% and pay cash equal to 25% of the total purchase consideration.

   [B.U., B.Com., Nov/Dec 2006, Section A]

   (Ans: ₹3,30,000 – Equity shares; ₹1,00,000 by way of preference shares; ₹90,000 debentures and ₹1,73,333 by way of cash; total purchase consideration ₹6,93,333)

5. Calculate the amount of purchase consideration from the following:

   Purchasing company agreed to issue 60,000 equity shares of ₹10 each valued at ₹12 each. 24,000, 8% debentures of ₹10 each at a discount of 5%, pay cash equal to 10% of the face value of shares and debentures issued.

   The company also agreed to meet the dissolved expenses of ₹10,000.

   [B.U., B.Com., Nov/Dec 2007, Section A]

   (Ans: ₹7,20,000 – Equity shares; ₹2,28,000 debentures and ₹84,000 by way of cash; total purchase consideration ₹10,32,000)

6. Calculate the amount of purchase consideration from the following details:

   The Purchasing Company agreed to issue 20,000 equity shares of ₹12.50 per shares. 1,000, 9% preference shares of ₹100 each at par, 1,000, 6% debentures of ₹100 each at a discount of 10% and pay cash equal to 20% of the total purchase consideration. **[B.U., B.Com., Nov/Dec 2008, Section A]**

   (Ans: ₹80,000 – Equity shares; ₹55,000 by way of preference shares; ₹45,000 debentures and ₹1,10,000 by way of cash; total purchase consideration ₹5,50,000)

7. Calculate the amount of purchase consideration from the following:

   Purchasing company agreed to issue 1,00,000 equity shares of ₹10 each valued at ₹12 each; 50,000, 8% debentures of ₹10 each @ a discount of 5%; pay cash equal to 10% of face value of shares and debentures issued. The company has also agreed to meet the dissolution expenses of ₹5,000.

   [B.U., B.Com., Nov/Dec 2010, Section A]

   (Ans: ₹12,00,000 – Equity shares; ₹4,75,000 debentures and ₹1,50,000 by way of cash; total purchase consideration ₹18,25,000)

8. Pass incorporation entries in the books of the company from the following particulars.

   Purchase consideration ₹9,00,000; value of sundry assets taken over ₹10,50,000; Current Liabilities taken over ₹75,000; settlement of purchase consideration – 75% in equity shares of ₹10 each; 1,000, 8% debentures of ₹100 each and the balance in cash. **[B.U., B.Com., Nov/Dec 2009, Section B]**

   (Ans: ₹6,75,000 – Equity shares; ₹1,00,000 debentures; cash ₹1,25,000 and Capital Reserve ₹75,000; total purchase consideration ₹9,00,000)

9. Pass incorporation entries in the books of the company form the following particulars:

   Purchase consideration ₹6,00,000; value of sundry assets taken over ₹7,00,000; Current Liabilities taken over ₹50,000; settlement of purchase consideration: 80% in equity shares of ₹10 each and the balance in 8% debentures of ₹100 each. **[B.U., B.Com., Nov/Dec 2008, Section B]**

(Ans: ₹4,80,000 – Equity shares; ₹1,20,000 debentures and Capital Reserve ₹50,000; total purchase consideration ₹6,00,000)

10. Pass incorporation entries in the books of the company from the following particulars. Purchase consideration ₹2,50,000; value of sundry assets taken over ₹3,00,000; Current Liabilities taken over ₹30,000. Settlement of purchase consideration 60% in equity shares of ₹10 each @ face value and the balance in 6% debentures of ₹100 each at face value. **[B.U., B.Com., Nov/Dec 2004, Section B]**

(Ans: ₹1,50,000 – Equity shares; ₹1,00,000 debentures and Capital Reserve ₹20,000; total purchase consideration ₹2,50,000)

11. Following is the Balance Sheet of A, B and C who share profits and losses in the ratio of 2:2:1.

Liabilities	₹	Assets	₹
Trade Creditors	1,00,000	Land and Building	10,00,000
Reserve Fund	1,00,000	Plant and Machinery	5,00,000
Capitals:		Investments	5,10,000
A	10,00,000	Trade debtors	6,00,000
B	10,00,000	Cash	90,000
C	5,00,000		
	27,00,000		**27,00,000**

The firm was sold to a private limited company for ₹17,50,000. The company took all the assets (except debtors and investments) and assumed liabilities. A took over 60% of debtors at 70% and B is to take over the balance of debtors at 75%. Investments were taken over by B at 2% less than its book value. Realisation expenses amounted to ₹10,000 and it was borne by A and C equally. The purchase consideration was settled by issuing equity shares at face value.

Prepare Ledger Accounts to close the books of the firm. **[B.U., B.Com., Nov/Dec 2004, Section C]**

(Ans: ₹17,50,000 – Equity shares; total purchase consideration ₹17,50,000; Realisation Profit ₹71,800 – share of A's Realisation Profit = ₹28,720; share of B's Realisation Profit ₹28,720; share of C's Realisation Profit ₹14,360; partner's capital balance A = ₹1,21,720 (Dr.); B = ₹1,89,360 (Dr.) and C = ₹3,11,080 (Cr.))

12. Ram and Company Ltd. was formed to take over the running business of M/s Ram and Shyam who shared the profits in the ratio of 3:2.

Their Balance Sheet as on 31 December 2013 was as follows:

Liabilities	₹	Assets	₹
Bills payable	10,000	Buildings	42,000
Creditors	20,000	Machinery	20,000
Ram's Capital	60,000	Stock	22,000
Shyam's Capital	40,000	Debtors	28,000
Mr. Ram's Loan	4,000	Investments	5,000
		Goodwill	15,000
		Bank	2,000
	1,34,000		**1,34,000**

The company agreed to take over the assets as follows: machinery ₹15,000; building ₹60,000; stock ₹20,000; debtors ₹25,000; goodwill ₹20,000.

The company also agreed to take over the creditors and bills payable at book values. The firm retained investments and sold them for ₹6,000 and paid Mr. Ram's loan.

The purchase consideration was settled by the issue of 10,000 equity shares of ₹10 each and balance in cash, shares being distributed in Profit ratio.

Pass the journal entries to close the books of the firm. **[B.U., B.Com., Nov/Dec 2003, Section C]**

(Ans: ₹1,00,000 – Equity shares; ₹10,000 by way of cash; total purchase consideration ₹1,10,000; Realisation Profit ₹14,000 - share of Ram's Realisation Profit = ₹8,400; share of Shyam's Realisation Profit ₹5,600; partner's capital balance Ram = ₹8,400 and Shyam = ₹5,600)

13. P and Q were partners sharing profits in a ratio of 2:1, respectively. Their Balance Sheet on 31 December 2013 on which date they converted their business into a company was as follows:

Liabilities	₹	Assets	₹
Creditors	60,000	Cash	14,000
Mortgage on freehold premises	20,000	Debtors	52,000
Capitals:		Stock	32,000
P	40,000	Machinery	10,000
Q	20,000	Freehold Premises	32,000
	1,40,000		**1,40,000**

The company took over all the assets and liabilities except mortgage on freehold premises for a purchase price of ₹1,20,000 payable as to ₹24,000 in cash, ₹48,000 in debentures and the balance in equity shares of ₹100 each. Close the books of the firm after the transactions mentioned before have been carried out. Mortgage has been paid and partners agree to share debentures and shares in proportion to their capital. Prepare the Ledger Accounts in the books of the firm.

[B.U., B.Com., Nov/Dec 2012, Section C]

(Ans: ₹1,00,000 – Equity shares; ₹10,000 by way of cash; total purchase consideration ₹1,20,000; Realisation Profit ₹40,000 − share of P's Realisation Profit = ₹26,667; share of Q's Realisation Profit ₹13,333; partner's capital balance P = ₹2,667 and Q = ₹1,333)

14. P and Q are partners sharing profits in the ratio of 3:2. Their Balance Sheet as on 31 December 2013 was as follows:

Liabilities	₹	Assets	₹
Bills payable	40,000	Machinery	80,000
Creditors	80,000	Building	1,68,000
P's capital	2,40,000	Goodwill	60,000
Q's capital	1,60,000	Bank	8,000
Mrs. P's loan	16,000	Debtors	1,12,000
		Investments	20,000
		Stock	88,000
	5,36,000		**5,36,000**

They agreed to sell the business to a limited company. The purchasing company agreed to take over the assets and liabilities as follows:

Machinery ₹60,000; goodwill ₹80,000; building ₹2,40,000; debtors ₹1,00,000 and stock ₹80,000. The company agreed to take over the creditors and bills payable at book values.

The firm retained investments and sold them for ₹24,000 and paid Mrs. P's loan.

The purchase consideration was settled by the issue of 40,000 equity shares of ₹10 each and the balance in cash, shares being distributed in Profit Sharing ratio.

Prepare necessary Ledger Accounts in eth books of the firm.

[B.U., B.Com., Nov/Dec 2004, Section C]

(Ans: ₹4,00,000 – Equity shares; ₹40,000 by way of cash; total purchase consideration ₹4,40,000; Realisation Profit ₹56,000 – share of P's Realisation Profit = ₹33,600; share of Q's Realisation Profit ₹22,400; partner's capital balance P = ₹33,600 and Q = ₹22,400)

15. A and B were in partnership sharing profits and losses in the ratio of 3:2. The following was the Balance Sheet of the firm as on 31 March 2014.

Liabilities	₹	Assets	₹
Creditors	52,000		24,000
A's loan	8,000		60,000
Capitals:			76,000
A	1,20,000		80,000
B	60,000		
	2,40,000		**2,40,000**

C Co. Ltd. agreed to take over Fixed Assets and stock for a consideration of ₹1,60,000 which is to be satisfied.

a. By payment of cash ₹32,000
b. By allotment of 480, 8% preference shares of ₹100 each
c. By allotment of 6,400 equity shares of ₹10 each valued at ₹12.50 per share

The debtors realised ₹56,000 and the creditors were paid ₹48,000 in full settlement. It was agreed between the partners as follows:

1. Equity shares are to be allotted in their Profit Sharing ratio.
2. Preference shares are to be allotted to A to the value of his/her Loan Account and the remaining preference shares to be allotted to partners equally.

Prepare necessary Ledger Accounts in the books of A and B.

[B.U., B.Com., Nov/Dec 2012, Section C]

(Ans: ₹80,000 – Equity shares; ₹32,000 by way of cash; preference shares ₹48,000; total purchase consideration ₹1,60,000; Realisation Profit ₹4,000 - share of A's Realisation Profit = ₹2,400; share of B's Realisation Profit ₹1,600; partner's capital balance A = ₹54,400 and B = ₹9,600)

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16. A and B are partners sharing profits in the ratio of 2:1 and their Balance Sheet as on 31 March 2014 was as follows:

Liabilities	₹	Assets		₹
Creditors	1,20,000	Cash		1,000
Bills payable	30,000	Debtors	1,80,000	
Reserve fund	18,000	*Less:* Reserve	9,000	1,71,000
A's loan	60,000	Bills receivable		15,000
Capital:		Stock		1,31,000
A	90,000	Machinery		60,000
B	60,000			
	3,78,000			**3,78,000**

They agreed to sell the business to a limited company which decided to take over the assets and liabilities as follows:

Machinery at ₹48,000; stock ₹1,05,000; debtors at ₹1,52,000; bills receivables at ₹15,000 and goodwill at ₹18,000. The company agreed to take over creditors at ₹1,14,000 and bills payable at ₹30,000. The firm received ₹1,20,000 of the purchase price in ₹10 fully paid equity shares and the balance in cash. Distribute the shares as per the original Capital ratio. Prepare the necessary Ledger Accounts in the books of the firm. **[B.U., B.Com., Nov/Dec 2007, Section C]**

(Ans: ₹1,20,000 – Equity shares; ₹74,000 by way of cash; total purchase consideration ₹1,94,000; Realisation Loss ₹33,000 - share of A's Realisation Loss = ₹1,29,333; share of B's Realisation Loss ₹64,667)

17. Ram Kumar and Prem Kumar were partners sharing profits and losses in the ratio of 2:1 and their Balance Sheet as on 31 December 2013 was as follows:

Liabilities	₹	Assets		₹
Creditors	40,000	Cash in Hand		300
Bills payable	10,000	Bills receivable		5,000
Ram Kumar's loan	20,000	Debtors 60,000		
Ram Kumar's capital	30,000	*Less:* Reserve	3,000	57,000
Prem Kumar's capital	20,000	Stock		43,700
Reserve fund	6,000	Machinery		20,000
	1,26,000			**1,26,000**

They agreed to sell the business to a Ltd. Co. and the company to take over the assets and liabilities as follows:

Machinery at ₹16,000; stock at ₹35,000; debtors at ₹50,700; bills receivable at ₹5,000 and goodwill at ₹6,000. The company agreed to take over creditors at ₹38,000 and bills payable at ₹10,000. The expenses of realisation amounted to ₹300. The firm received ₹40,000 of the purchase price in ₹10 fully paid equity shares and the balance in cash. Distribute the shares as per original Capital ratio. Prepare the necessary Ledger Accounts in the books of the firm.

[B.U., B.Com., Nov/Dec 2006, Section C]

(Ans: ₹40,000 – Equity shares; ₹24,700 by way of cash; total purchase consideration ₹64,700; Realisation Loss ₹11,300 - Share of Ram Kumar's Realisation Loss = ₹7,533; share of Prem Kumar's Realisation Loss ₹3,767; partner's capital balance Ram Kumar's = ₹2,467 and Prem Kumar's = ₹2,233)

18. Alpha and Beta were in partnership sharing profits and losses in the ratio of 3:1. The following is the Balance Sheet as on 31 December 2014.

Liabilities	₹	Assets	₹
Creditors	14,320	Fixed Assets	21,000
Beta's loan	3,000	Stock	11,200
Capitals:		Debtors	19,600
Alpha	28,200	Cast at Bank	3,720
Beta	10,000		
	55,520		**55,520**

Mega Ltd. agreed to take over stock and Fixed Assets excluding the value of motor car ₹4,100 (included in Fixed Assets), 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 debt 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 their Profit and Loss Sharing ratio.
b. The preference shares to be allotted to Beta to the value of his/her loan and the balance to be allotted between the partners.
c. Balance remaining to be settled in cash, prepare Realisation Account, partner's Capital Account and Bank Account in the books of Alpha and Beta.

[B.U., B.Com., Nov/Dec 2009, Section C]

(Ans: ₹16,000 – Equity shares; preference shares ₹12,000; ₹20,000 by way of cash; total purchase consideration ₹48,000; Realisation Profit ₹19,920 − Share of Alpha's Realisation Profit = ₹14,940; Share of Beta's Realisation Profit ₹4,980; Partner's Capital Balance Alpha = ₹22,440 and Beta = ₹6,480)

19. Disha and Nisha are equal partners and desire to convert their partnership into a limited company. Their Balance Sheet as on 31 December 2016 is as follows:

Liabilities	₹	Assets	₹
Capital:		Building	20,000
Disha	20,000	Machinery	47,000
Nisha	20,000	Stock	15,000
General reserves	15,000	Debtors	35,000
Creditors	25,000		
Loan	37,000		
	1,17,000		**1,17,000**

The following terms were agreed upon:

a. The loan creditor has agreed to take preference shares in the new company.
b. The creditors were to be paid in cash.
c. Machinery and building were to be taken at the agreed values of ₹20,000 and ₹55,000, respectively.

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d. 9% Debentures to be issued for cash to the extent of ₹1,00,000.
e. The goodwill of the firm is to be valued at ₹20,000.
f. The company is to allot equity shares to the vendor for the purchase consideration.
   Prepare Ledger Accounts and Balance Sheet.

(Ans: ₹1,00,000 – Equity shares; preference shares ₹25,000; debentures ₹1,00,000 total purchase consideration ₹1,62,000; Realisation Profit ₹45,000 - Share of A's Realisation Profit = ₹22,500; Share of B's Realisation Profit ₹22,500; Partner's Capital Balance A = ₹50,000 and B = ₹50,000)

Moderate Level

Model Test Paper-1

B.COM. SEMESTER-I

FINANCIAL ACCOUNTING

[Time: 3 Hours] **[Max Marks: 70]**

Section A

Answer any five sub-questions. Each question carries 2 marks: **($5 \times 2 = 10$)**

1. (a) How do you close Realisation Account?
(b) What is recoupment of shortworking?
(c) Give any two reasons for conversion of a firm into a limited company.
(d) Give the meaning of Hire-Purchase system.
(e) Write any two differences between single-and double-entry system.
(f) What are the objectives of Accounting Standard?
(g) Mention the different accounting conventions.

Section B

Answer any three questions. Each question carries 6 marks: **($3 \times 6 = 18$)**

1. What are the objectives of financial accounting?

2. Calculate the value of each installment from following details:
Cash price ₹6,000
Down payment – 20% of cash price
Balance of cash price is payable in three equal installments together with interest at 10% on the outstanding cash price.

Ans: 1st Installment – ₹2,080; 2nd Installment – ₹1,920; 3rd Installment – ₹1,770

3. Pass incorporation entries in the books of the company from the following particulars:
Purchase consideration ₹3,00,000; value of sundry assets taken over ₹3,50,000; current liabilities taken over ₹25,000; settlement of purchase consideration: 80% in equity shares of ₹10 each and the balance in 8% debentures of ₹100 each.

Ans: ₹2,40,000 – equity shares; ₹60,000 debentures and Capital Reserve ₹25,000; total purchase consideration ₹3,00,000

4. Calculate the amount of purchase consideration from the following details:
The purchasing company agreed to issue 15,000 equity shares of ₹10 each valued at ₹12 each, 6,000, 6% debentures of ₹10 each at a discount of 5% pay cash equal to 10% of face value of shares and debentures issued. The company also agreed to meet dissolution expenses of ₹2,500.

Ans: ₹90,000 – equity shares; ₹28,500 debentures and ₹10,500 by way of cash; total purchase consideration ₹1,29,000

5. Calculate the missing figure.

Capital at the beginning of the year	₹1,00,000
Further capital introduced	₹30,000
Drawings	₹15,000
Net Loss	₹10,000
Closing stock	?

Ans: Closing stock ₹45,000

Section C

Answer any three questions. Each question carries 14 marks: **(3 × 14 = 42)**

1. On 1 January 2013, Dharti Mining Company entered into an agreement with the owner of the coal mine on the following terms:
(a) A royalty of ₹15 per ton of coal raised
(b) A minimum rent of ₹45,000 per annum
(c) The recovery of shortworkings within a period of first 4 years
(d) The output during the first 5 years was:

Year	2013	2014	2015	2016	2017
Output in tons	1900	2050	2800	3600	4600

Journalise the transactions and prepare the following accounts in the books of Dharti Mining Company.
(i) Royalty A/c (ii) Lessor A/c (iii) Shortworkings A/c

Ans: Surplus: ₹33,000; shortworking ₹33,750; shortworking recovered ₹9,000 and shortworking irrecovered ₹24,750

2. Mr. Suresh purchased a motor car on Hire Purchase system. The total cash price of the car is ₹15,98,000 payable ₹4,00,000 as down payment and three installments of ₹6,00,000, ₹5,00,000 and ₹2,00,000 payable at the end of 1st, 2nd and 3rd year, respectively. Interest is charged at 5% p.a. Rate of depreciation is 25% p.a. on diminishing balance method. Prepare necessary accounts in the books of Mr. Suresh.

Ans: HPP: ₹17,00,000; Interest ₹1,02,000; CP: ₹15,98,000

3. A and B are partners sharing profits in the ratio of 3:2. Their Balance Sheet as on 31 December 2013 was as follows:

Liabilities	₹	Assets	₹
Bills payable	20,000	Machinery	40,000
Creditors	40,000	Building	84,000
A's Capital	1,20,000	Goodwill	30,000
B's Capital	80,000	Bank	4,000
Mrs. A's Loan	8,000	Debtors	56,000
		Investments	10,000
		Stock	44,000
	2,68,000		**2,68,000**

They agreed to sell the business to a limited company. The purchasing company agreed to take over the assets and liabilities as follows:

Machinery ₹30,000; Goodwill ₹40,000; Building ₹1,20,000; Debtors ₹50,000 and Stock ₹40,000. The company agreed to take over the creditors and bills payable at book values.

The firm retained investments and sold them for ₹12,000 and paid Mrs. A's Loan.

The purchase consideration was settled by the issue of 20,000 equity shares of ₹10 each and the balance in cash, shares being distributed in Profit Sharing ratio.

Ans: ₹2,00,000 – equity shares; ₹20,000 by way of cash; total purchase consideration ₹2,20,000; Realisation Profit ₹28,000; share of A's Realisation Profit = ₹16,800; share of B's Realisation Profit ₹11,200; partner's capital balance A = ₹16,800 and B = ₹11,200

4. From the following information calculate total purchases and total sales.

Particulars	₹
Opening debtors	14,000
Closing debtors	10,000
Opening creditors	8,000
Closing creditors	9,500
Cash received from debtors	6,400
Cash paid to creditors	2,000
Discount earned	200
Discount allowed	400
Bills receivable from debtors	2,500
Bills payable issued to creditors	5,800
Bad debts written off	300

Ans: Credit Sales ₹5,600; Credit Purchases ₹9,500

5. (a) Moonshine Ltd. patented punching machine and gave the same to Sunshine Ltd. to manufacture and sell under a license for 5 years. The other details are mentioned as follows:

1. Royalty of ₹10 paid for each machine sold
2. A minimum rent of ₹40,000 is payable p.a.
3. Right to recoup shortworkings of any year in the following 2 years
4. The machines sold are mentioned as follows:

Year	2014	2015	2016	2017
No. of machines sold	3500	4000	4500	6000

Prepare table of analysis and Minimum Rent Account.

(b) Mr. Rajesh maintains his records under single-entry system of bookkeeping; he commenced his business on 1 January 2017 with an initial capital of ₹37,500. Following was his position as on 31 December 2017.

Land ₹27,500; Machinery ₹12,500; Furniture ₹6,500; Debtors ₹10,000; Stock ₹7,500; Bills receivable ₹3,500; Cash in Hand ₹950; Cash at Bank ₹3,550; Creditors ₹9,000 and Bills payable ₹3,750. Determine the closing capital of Mr. Rajesh.

Ans: (a) Surplus ₹25,000; shortworking ₹15,000; shortworking recovered ₹10,000; shortworking irrecovered ₹5, 000

(b) Capital balance ₹49,250

Difficult Level

Model Test Paper-2

B.COM. SEMESTER-I

FINANCIAL ACCOUNTING

[TIME: 3 HOURS] **[MAX MARKS: 70]**

Section A

Answer any five sub-questions. Each question carries 2 marks: **($5 \times 2=10$)**

1. (a) What is Final Claim ratio?

(b) Mention the different methods of purchase consideration?

(c) What is the meaning of Royalty?

(d) Distinguish between Hire Purchase and sale.

(e) Explain the term minimum rent.

(f) Mention any four objectives of conversion of a firm into a limited company.

(g) Give opening entries in the books of purchasing company.

Section B

Answer any three questions. Each question carries 6 marks: **($3 \times 6 = 18$)**

1. Briefly explain the different accounting principles?

2. Calculate the cash price of an asset from the following:

₹1,500 paid at the time of agreement

₹10,800 paid at the time of 1st year

₹10,350 paid at the time of 2nd year
₹9,900 paid at the time of 3rd year
₹9,450 paid at the time of 4th year
Rate of interest is 5% p.a.
Rate of depreciation is 25% p.a.

Ans: Cash price of the Asset ₹37,500

3. A company takes over the following assets and liabilities from a particular firm.
Land and building – ₹22,500; Plant and machinery – ₹10,000; Stock – ₹10,000; Debtors – ₹11,600; Bills receivable – ₹8,000; Current Liabilities – ₹14,400
The value of goodwill is fixed at ₹14,400; calculate purchase consideration payable 5,000 equity shares of ₹10 each and the balance in cash.

Ans: Purchase consideration ₹62,100

4. The following balances appear in the books of Mr. Rishab that are kept under single-entry system:

Particulars	1/04/2016	31/03/2017
Machinery	47,500	50,000
Furniture	17,500	17,500
Creditors	8,000	9,500
Debtors	12,500	15,000
Stock	6,000	5,000
Cash in Hand and at Bank	3,500	4,750
Outstanding income	1,000	1,750
Income received in advance	1,250	1,800

Ascertain the opening and closing capital of Mr. Rishab.

Ans: Opening capital: ₹78,750; Closing capital ₹82,700

5. On 1 January 2013, Superior Limited, patentees of new type of electric motors, issued a licence to Super Limited for the manufacture and sale of motors for 5 years on the following terms and conditions:

1. Super Limited to pay a Royalty of ₹200 for every motor manufactured
2. Minimum rent is ₹1,00,000 per year
3. Shortworking if any is allowed to recouped in the next year only
4. Sales and closing stock of motors of Excellent Limited for 5 years is as follows:

Year	2013	2014	2015	2016	2017
Sales (Units)	400	800	1200	1100	460
Closing Stock (Units)	100	200	140	300	40

Prepare analytical table.

Ans: Surplus ₹3,60,000; shortworking ₹60,000

Section C

Answer any three questions. Each question carries 14 marks: **($3 \times 14 = 42$)**

1. Sugam Collieries Ltd. leased a mine from Mr. Bharath at royalty payable at ₹1 per ton. Each year's excess of minimum rent over royalties is recoverable out of the royalties of the next 2 years. In the event of strike, minimum rent would stand reduced proportionate to the time actually worked.

The annual output for the 5 years ending is

Year	2013	2014	2015	2016	2017
			(Strike for 3 months)		
Production in tons	1500	5000	16000	21000	32000
Minimum Rent (₹)	2,500	3,000	17,000	25,000	30,000

Ans: Surplus ₹6,250; shortworking ₹2,000; shortworking recovered ₹2,000 and shortworking irrecovered NIL; minimum rent in the period of strike ₹18,750

2. *Z* Ltd. purchased a machine costing ₹12,000 on 1 April 2011 from *Z* Ltd. agreeing to pay ₹2,000 as down payment and the balance in four installments of ₹2,500 with 5% interest payable at the end of each year. Z wishes to write off 10% depreciation on reducing balance method, prepare necessary ledger accounts in the books for 4 years.

Ans: Total HPP = ₹12,000; total interest chargeable 1,250

3. On 1 January 2014, Metro Engineering Works bought a drilling motor from Deepak Machine Tools Ltd. on Hire-Purchase basis. The cash price of the motor was ₹18,500 and the payment was to be made as follows: ₹3,500 on signing of the agreement and the balance in three half-yearly installments of ₹6,000 each at 20% p.a. interest to be charged by the Hire Vendor.

Prepare Ledger Accounts and pass the necessary journal entries in the books of JK Machine Tools Ltd.

Ans: HPP: ₹18,000; Interest ₹3,000; CP ₹15,000

4. Following are the incomplete records of a Partnership Firm as on 1 April 2017:

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	44,000	Cash in Hand	200
Bills payable	24,000	Bills receivable	34,000
Bank overdraft	7,000	Debtors	43,000
Capital:		Stock	49,000
Ajay	1,20,000	Machinery	72,500
Vijay	80,000	Building	76,300
	2,75,000		2,75,000

Cash Book

To Balance b/d (1/04/2017)	200	By Overdraft (1/04/2017)	7,000
To Cash Received from Debtors	3,00,000	By Salaries	18,000
To Bills Receivable	1,89,000	By Wages	19,200
		By Bills payable	1,65,000
		By Payment to creditors	1,56,000
		By Sundry expenses	10,000
		By Drawings:	
		Ajay	45,000
		Vijay	40,000
		By Balance on 31/03/2018	
		Cash in hand	2,750
		Cash at Bank	26,250
	4,89,200		**4,89,200**

Particulars	₹
Sales	4,95,000
Purchases	3,95,000
Discount to customers	6,000
Discount received from suppliers	4,000
Bills receivable received during the year	1,90,000
Bills payable issued during the year	1,95,000
Closing stock	77,000

Provide Depreciation on machinery and building at the rate of 5% and also provision for doubtful debt at 5%, also prepare Trading and Profit or Loss Account along with the Balance Sheet for the year ended 31 March 2018.

Ans: Opening stock ₹49,000; profit 24,030; Balance Sheet total ₹6,94,660

5. (a) On 1 January 2013, Mr. Sawan Kumar obtained a mining lease and from that date he sub-leased a part of the mine to Mr. Pawan Kumar. Show Ledger Accounts in the books of Mr. Sawan Kumar from the following data:

Year	Lease (tons)	Sub-lease (tons)
2013	1,500	1,000
2014	4,000	4,500
2015	18,000	10,000
2016	15,000	3,000 (strike)
2017	8,000	15,000
Royalty per ton	₹3.00	₹4.00
Minimum rent p.a.	₹35,000	₹25,000
S/W irrecoverable in the following	3 years	2 years

In the case of strike, royalty earned will discharge all rental obligations for the year only.

(b) Mr. Shivam commenced business as cloth merchant on 1 January 2017 with a capital of ₹2,000, on the same day; he purchased furniture for ₹600. The books are maintained by single-entry system. From the following particulars, prepare Trading and Profit and Loss Account for the year ending 31 December 2017 and a Balance Sheet as on that date:

	₹
Sales (including cash sales of ₹1,400)	3,400
Purchases (including cash purchases of ₹800)	3,000
Shivam's drawings	240
Salaries	400
Bad Debts written off	100
Business expenses	140
Closing stock	1,300
Closing debtors	1,040
Closing creditors	720

Mr. Shivam took cloth costing ₹100 from the shop for private use, paid ₹40 cash to his son, but omitted to record these transactions in his books. Provide Depreciation on furniture at 10% per annum.

Ans: (a) Surplus ₹1,02,000; shortworking ₹37,000; shortworking recovered ₹37,000; shortworking irrecovered NIL)

(b) Gross Profit ₹10,550; Net Loss ₹950; Balance Sheet ₹37,050)

Solved Bangalore University Question Paper 2015

BANGALORE UNIVERSITY
Semester-I, B.Com. Nov/Dec 2015

(CBCS SEMESTER SCHEME)

FINANCIAL ACCOUNTING

[TIME: 3 HOURS] **[MAX MARKS: 70]**

Section A

Answer any five sub-questions. Each question carries 2 marks: **($5 \times 2 = 10$)**

1. (a) Mention any two methods of calculating purchase consideration.

Sol. Refer to page no. 5.4.

(b) What is Royalty?

Sol. Refer to page no. 4.2.

(c) List out any two benefits of conversion of single- into double-entry system.

Sol. Refer to page no. 2.4.

(d) What do you mean by Accounting Standards?

Sol. Refer to page no. 1.26.

(e) Give the meaning of down payment.

Sol. Refer to page no. 3.2.

(f) What is recoupment of shortworking?

Sol. Refer to page no. 4.5.

(g) Who is a hirer?

Sol. Refer to page no. 3.2.

SECTION B

Answer any three questions. Each question carries 6 marks: **(3 × 6 = 18)**

2. What are the functions of financial accounting?

Sol. Refer to page no. 1.9.

3. Calculate the interest included in each installments, cash price ₹60,000; down payment ₹18,000; three annual installments of ₹24,000, ₹18,000 and ₹12,000, respectively, payable at the end of each year.

Sol. Refer to Illustration 6 on page no. 3.19.

4. Prepare an analytical table of Royalty from the following details:
Minimum Rent ₹25,000 p.a.
Royalty of ₹2 per ton of ore raised
Short workings are recoverable during the first three years of the lease only.
The output for the first four years is as follows:
I year – 3,000 tons; II year – 10,000 tons, III year – 30,000 tons and IV year – 35,000 tons.

Sol. Refer to Question 3 on page no. 4.63.

5. Calculate the amount of purchase consideration from the following details:
The purchasing company agreed to issue 10,000 equity shares of ₹10 each at 25 per share, 1,000 9% preference shares of ₹100 at par 1,000 10% debentures of ₹100 each at a discount of 10% and to pay cash equal to 20% of total purchase consideration.

Sol. Refer to Illustration 2 on page no. 5.12.

6. Ascertain the value of stock at the beginning:

Particulars	₹
Purchases	1,20,000
Direct wages	80,000
Sales	5,00,000
Stock at the end	45,000

Rate of gross profit is 25% on cost.

Sol. Refer to Illustration 1 on page no. 5.12.

Section C

Answer any three questions. Each question carries 14 marks: **(3 × 14 = 42)**

7. A mining company leased a property from X at a royalty of ₹10 per ton with a minimum rent over royalty is recoverable out of royalties of next 3 years. The results of the workings are as follows:

Year	I	II	III	IV	V
Output in tons	2,000	3,000	4,000	5,600	6,000

Prepare necessary Ledger Accounts in the books of the company for 5 years.

Sol. Refer to Question 1 on page no. 4.66.

8. On 1 January 2014, Miss Jayanthy purchased a washing machine from Royal Enterprises on Hire-Purchase basis. The cash price of the machine was ₹60,000 payable; ₹12,000 on signing the agreement and the balance in four annual installments of ₹12,000 plus interest at 15% p.a. payable on 31 December each year. Jayanthy writes off Depreciation at 10% p.a. on diminishing balance method. Show the necessary Ledger Accounts in the books of Jayanthy.

Sol. Refer to Illustration 27 on page no. 3.57.

9. A, B and C were in partnership sharing profits and losses in the ratio of 4:3:1, respectively. On 31 March 2014, they agreed to sell their business to a limited company. Their position on that date was as follows:

Balance Sheet
As on 31 March 2014

Liabilities	₹	Assets	₹
Creditors	16,000	Land and Building	36,000
Loan from bank	8,000	Furniture	24,000
Capital A/c		Debtors	30,000
A	40,000	Stock	26,000
B	30,000	Cash	4,000
C	26,000		
	1,20,000		**1,20,000**

The company took the following assets at the valuation shown below:

Land and building ₹44,000; furniture ₹22,000; debtors ₹28,000; stock ₹24,000; goodwill ₹8,000.

The company also agreed to pay the creditors which were agreed at ₹15,400. The company paid 3,300 shares of ₹10 each and the balance in cash. The expenses amounted to ₹1,000.

Prepare necessary Ledger Accounts in the books of the firm.

Sol. Refer to Illustration 15 on page no. 5.33.

10. (a) Sri Ram a trader maintains his books under single-entry system. He submits the following information:

Particulars	1.4.14	31.3.15
Cash	20,000	?
Debtors	72,500	80,000
Creditors	62,500	72,500
Furniture	20,000	20,000
Plant and Machinery	40,000	38,000
Stock	30,000	42,000

(b) Cash Transactions during the year 2014–15:

Particulars	₹
Cash from Debtors	6,20,000
Cash paid to creditors	4,80,000
Wages	24,000
Salaries	16,000
Rent	18,000
Drawing	16,500
Cash Purchase	24,000
Cash Sales	36,000
Carriage Outwards	10,000

(c) Other details

Bad Debts ₹3,200

Purchase Return ₹6,200

Stock worth ₹6,000 was utilised by Sri Ram for personal use

Prepare Final Accounts for the year ending 31 March 2015.

Sol. Refer to Illustration 22 on page no. 2.45.

11. (a) A Mining Co. took a lease from a land lord for a period of 20 years from 1 July 2010. On a royalty of ₹10 per ton of iron ore raised with a minimum rent of ₹20,000 and power to recoup shortworkings during the first 4 years of the lease. The annual output was as follows:

Year:	I	II	III	IV	V
Output in tonnes:	1,000	1,500	2,000	2,250	2,500

Prepare shortworkings account in the books of Mining Company.

(b) Ascertainment credit sales from the following:

Particulars	₹
Opening debtors	75,500
Cash Received from debtors	6,18,500
Bills receivable Received	24,000
Sales Return	8,600
Bad Debts	6,800
Bills receivable dishonoured	3,800
Discount allowed	2,000
Bills receivable discounted with bank	4,500

Sol. (a) Refer to Illustration 8 on page no. 4.19.

(b) Refer to Illustration 1 on page no. 2.13.

Solved Bangalore University Question Paper 2016

BANGALORE UNIVERSITY
Semester-I, B.Com. Nov/Dec 2016

(CBCS SEMESTER SCHEME)

FINANCIAL ACCOUNTING

[TIME: 3 HOURS] **[MAX MARKS: 70]**

Section A

Answer any five sub-questions. Each question carries 2 marks: **($5 \times 2 = 10$)**

1. (a) Mention any two objectives of accounting.

Sol. Refer to page no. 1.7.

(b) List any four Accounting Standards.

Sol. Refer to page no. 1.26.

(c) Mention any four disadvantages of single-entry system.

Sol. Refer to page no. 2.3.

(d) What is pure single-entry system?

Sol. Refer to page no. 2.2.

(e) Give the meaning of down payment.

Sol. Refer to page no. 3.2.

(f) What is Royalty?

Sol. Refer to page no. 4.2.

(g) What do you mean by purchase consideration?

Sol. Refer to page no. 5.3.

Section B

Answer any three questions. Each question carries 6 marks: **(3 × 6 = 18)**

1. Briefly discuss the users of accounting information.

Sol. Refer to page no. 1.12.

2. From the following information calculate opening stock:

Particulars	₹
Purchases during the year	55,000
Sales during the year	1,25,000
Closing stock	18,000
Manufacturing expenses	12,000
Carriage Inward	2,000

Rate of Gross Profit was 25% on cost.

Sol. Refer to Illustration 2 on page no. 2.13.

3. Calculate the amount of interest and principal included in each installment.

Cash price	₹2,00,000
Down payment	₹50,000

Balance in three installments of ₹60,000 each payable at the end of each year.

Sol. Refer to Illustration 1 on page no. 3.14.

4. Prepare a table of analysis from the following details: Royalty payable = 50 paise per ton of output; minimum rent ₹7,500 p.a.; Right of recoupment of shortworkings = up to 3 years; output during the first 3 years = 10,000; 14,000 and 18,000, respectively

Sol. Refer to Illustration 2 on page no. 4.13.

5. Calculate the amount of purchase consideration from the following details:

The purchasing company agreed to issue 30,000 equity shares of ₹10 each at a premium of 10%

1,000 8% preference shares of ₹100 at par

1,000 6% debentures of ₹100 each at a discount of 10% and to pay cash equal to 25% of total purchase consideration.

Sol. Refer to Illustration 3 on page no. 5.12.

Section C

Answer any three questions. Each question carries 14 marks: (3 × 14 = 42)

1. Mr. Tejas does not maintain proper books of accounts. From the following information, prepare Trading and Profit and Loss Account for the year ended 31 March 2016 and the Balance Sheet as on that date.

Assets and Liabilities	1.4.2015 (₹)	31.3.2016 (₹)
Debtors	18,000	25,000
Stock	9,800	13,200
Furniture	1,000	1,500
Creditors	6,000	4,500
Cash on Hand	5,000	?

Analyses of other transactions are as follows:

Particulars	₹
Cash collected from debtors	60,800
Cash paid to creditors	44,000
Salaries	12,000
Rent	1,500
Office expenses	1,800
Drawings	3,000
Foreign capital introduced	2,000
Cash Sales	1,500
Cash Purchases	5,000
Discount received	700
Discount allowed	300
Return Inward	1,000
Bad Debts	200

Sol. Refer to Illustration 21 on page no. 2.42.

2. Raman purchased a machine costing ₹2,40,000 on 1 April 2013 from Bangalore Machines Ltd. under Hire-Purchase system. The terms agreed were ₹60,000 as down payment and the balance in three equal annual installments along with interest at the rate of 20% p.a. on the outstanding cash price. Depreciation is to be charged at 15% p.a. diminishing balance method, prepare necessary Ledger Accounts in the books of Raman till 31 March 2016 under asset accrual method.

Sol. Refer to Illustration 24 on page no. 3.50.

3. X Co. Ltd. took a lease from a landlord for a period of 25 years from 1 January 2010 on a royalty of ₹2 per ton of coal raised with a minimum rent of ₹20,000 and power to recoup shortworkings during the first 4 years of the lease. The annual output was as follows:

Year	2010	2011	2012	2013	2014
Tonnes	5,000	8,000	10,000	15,000	20,000

Sol. Refer to Illustration 17 on page no. 4.39–4.41.

4. A, B and C carrying on business in partnership sharing profits and losses in the ratio of 4:3:1, respectively.

On 31 March 2016, they agreed to sell their business to a limited company; their position on that date was as follows:

Balance Sheet

As on 31 March 2014

Liabilities	₹	Assets	₹
Sundry creditors	40,000	Freehold property	90,000
Loan	20,000	Machinery	60,000
Capitals:		Debtors	75,000
A	1,00,000	Stock	65,000
B	75,000	Cash	10,000
C	65,000		
	3,00,000		**3,00,000**

The company took over the following assets except cash:

Freehold property ₹1, 10,000; machinery ₹55,000; debtors ₹70,000; stock ₹60,000; goodwill ₹20,000.

The company also agreed to pay the creditors which were agreed at ₹38,500. The company paid ₹1,68,000 in fully paid shares of ₹10 each and the balance in cash. The expenses amounted to ₹2,500.

Prepare necessary Ledger Accounts in the books of the firm.

Sol. Refer to Illustration 14 on page no. 5.30.

5. (a) Calculate the cash price of an asset from the following details: down payment ₹6,000 1st installment (payable at the end of 1st quarter of the year) ₹7,200, 2nd installment (payable at the end of 2nd quarter of the year) ₹6,900, 3rd installment (payable at the end of 3rd quarter of the year) ₹6,600, 4th installment (payable at the end of 4th quarter of the year) ₹6,300.

(b) Prepare an analysis table form the following details:

(a) Minimum rent ₹20,000 p.a.

(b) Royalty payable ₹5.00 per ton

(c) Shortworkings can be recoverable during the first 3 years of the lease only

(d) The product for the past 4 years were as follows:

2012 – 2000 tons

2013 – 3000 tons

2014 – 4000 tons

2015 – 4500 tons

Sol. (a) Refer to Illustration 4 on page no. 3.63.

(b) Refer to Illustration 1 on page no. 4.13.

Solved Bangalore University Question Paper 2017

BANGALORE UNIVERSITY
Semester-I, B.Com. Nov/Dec 2017
(CBCS SEMESTER SCHEME)
FINANCIAL ACCOUNTING

[TIME: 3 HOURS] **[MAX MARKS: 70]**

Section A

Answer any five sub-questions. Each question carries 2 marks: **($5 \times 2 = 10$)**

1. (a) What do you mean by Accounting Standards?
Sol. Refer to page no. 1.26.

(b) Mention any two objectives of financial accounting.
Sol. Refer to page no. 1.7.

(c) Bring out the meaning of short working with an example.
Sol. Refer to page no. 4.4.

(d) What is a single-entry system?
Sol. Refer to page no. 2.2.

(e) State two features of Hire-Purchase.
Sol. Refer to page no. 3.3.

(f) What is Realisation Account?

Sol. Refer to page no. 5.6.

(g) Mention the two methods of purchase consideration.

Sol. Refer to page no. 5.4.

Section B

Answer any three questions. Each question carries 6 marks: **(3 × 6 = 18)**

2. Describe any three advantages and three limitations of financial accounting.

Sol. Refer to page no. 1.14 and 1.15.

3. Prepare an analytical table of royalties from the following details:

(a) Minimum rent ₹20,000 p.a.

(b) Royalty ₹2 per ton of ore raised

(c) Short workings are recoverable during the first 3 years of the lease only

(d) The output for the first 4 years was

2013 – 2,000 tons,

2014 – 5,000 tons,

2015 – 15,000 tons,

2016 – 20,000 tons

Sol.

Analytical Table

Year	Output (tons)	Royalty (₹2 per ton)	Minimum rent	Surplus (Royalty-MR)	Short-working (MR-Royalty)	Short-working recovered	Short-working irrecovered	Payment made to lessor
2013	2,000	4,000	20,000	–	16,000	–	–	20,000
2014	5,000	10,000	20,000	–	10,000	–	–	20,000
2015	15,000	30,000	20,000	10,000	–	10,000	16,000	20,000
2016	20,000	40,000	20,000	20,000	–	–		40,000

4. Ms. Venya purchases a motor car on Hire-Purchase System. Calculate the cash price of the motor car from the following.

Down payment ₹20,000; 1st yearly installment ₹28,000; 2nd yearly installment ₹36,000; 3rd yearly installment ₹33,000; rate of interest 10% p.a.

Sol.

Calculation of Cash Price

No. of installments	Year-end balance	Yearly installment	Total amount	Interest (10/110)	Principal
3	–	33,000	33,000	3,000	30,000
2	30,000	36,000	66,000	6,000	60,000
1	60,000	28,000	88,000	8,000	80,000

Therefore, cash price = 80,000 + 20,000 (down payment)

Cash Price = 1,00,000

5. Calculate the total purchases from the following information:

Particulars	₹
Opening balance of creditors	3,000
Cash paid to creditors	90,000
Goods returned to creditors	15,000
Acceptances issued to creditors	90,000
Discount allowed to creditors	2,000
Closing balance of creditors	6,000
Cash purchases during the period amounted to	₹50,000

Sol. Calculation of Total purchases

Total Creditors Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Cash A/c (cash paid to creditors)	90,000	By Balance B/d	3,000
To Return Outwards (goods returned)	15,000	By credit purchases (Bal. fig.)	2,00.000
To Bills payable issued (acceptances)	90,000		
To Discount received from creditors	2,000		
To Balance c/d	6,000		
	2,03,000		**2,03,000**

Total purchases = Credit purchases + Cash purchases

2,50,000 = 2,00,000 + 50,000

6. Calculate the amount of purchase consideration from the following:

The Purchasing Co. has agreed to issue 30,000 equity shares of ₹10 each at a premium of 10%, 1,000, 8% preference shares of ₹100 each at par, 1,000, 6% debentures of ₹100 each at a discount of 10% and pay cash equal to ₹25,000.

Sol.

Calculation of amount of purchase consideration

Particulars	₹
Equity shares 30,000 × 11 (₹10 + 10 × 10%) (Premium)	3,30,000
8% Preference shares 1,000 × 100	1,00,000
6% Debentures 1,000 × 90 (₹100 – 100 × 10%)	90,000
Cash	25,000
Purchase Consideration	**5,45,000**

Section C

Answer any three questions. Each question carries 14 marks: **(3 × 14 = 42)**

7. On 1.1.2012 Deeksha and Company purchased machinery under Hire-Purchase System. The cash price was ₹17,000 payable as under ₹2,000 on signing the agreement and the balance in three installments of ₹5,000 each together with interest at 8% p.a. on 31 December each year the asset is depreciated at 10% p.a. on original cost method.

Prepare necessary ledger accounts in the books of Deeksha and Company, under asset accrual method.

Sol. **Calculation of Interest when HPP = CP (or when HPP is exclusive of Interest)**

Particulars	Amount (₹)
Cash Price	17,000
Less: Down Payment	2,000
Remaining Balance	15,000
Add: 1st year Installment Interest @ 8% on 15,000	1,200
	16,200
Less: 1st year Installment (5,000+1,200)	6,200
Remaining Balance	10,000
Add: 2nd year Installment Interest @ 8% on 10,000	800
	10,800
Less: 2nd year Installment (5,000+800)	5,800
Remaining Balance	5,000
Add: 3rd year Installment Interest @ 8% on 5,000	400
	5,400
Less: 3rd year Installment (5,000+400)	5,400
Remaining Balance	–

Calculation of Depreciation (Straight Line Method)

Particulars	Amount (₹)
Cash Price	17,000
Depreciation @ 10% p.a. every year on 17,000	1,700

Analysis Table

No. of installments	Installment amount (CP + Interest)	Interest (as calculated above)	Cash price (Installment money – Interest)	Depreciation (as calculated above)
Down payment	2,000	-	2,000	-
1st	5,000	1,200	3,800	1,700
2nd	5,000	800	4,200	1,700
3rd	5,000	400	4,600	1,700
	Total HPP = ₹17,000	**Total Interest = ₹2,400**	**Total CP = ₹14,600**	

Ledger Accounts in the Books of Deeksha and Co. (Hire Purchaser)

Machinery A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Bank A/c (DP)	2,000	31.12.2012	By Depreciation A/c	1,700
31.12.2012	To Hire Vendor A/c	3,800	31.12.2012	By Balance c/d	4,100
		5,800			**5,800**
1.1.2013	To Balance b/d	4,100	31.12.2013	By Depreciation A/c	1,700
31.12.2013	To Hire Vendor A/c	4,200	31.12.2013	By Balance c/d	6,600
		8,300			**8,300**
1.1.2014	To Balance b/d	6,600	31.12.2014	By Depreciation A/c	1,700
31.12.2014	To Hire Vendor A/c	4,600	31.12.2014	By Balance c/d	9,500
		11,200			**11,200**
1.1.2015	To Balance b/d	9,500			

Hire Vendor A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Bank A/c	6,200	31.12.2012	By Machinery A/c	5,000
				By Interest A/c	1,200
		6,200			**6,200**
31.12.2013	To Bank A/c	5,800	31.12.2013	By Machinery A/c	5,000
				By Interest A/c	800
		5,800			**5,800**
31.12.2014	To Bank A/c	5,400	31.12.2014	By Machinery A/c	5,000
				By Interest A/c	400
		5,400			**5,400**

Interest A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2012	To Hire Vendor A/c	1,200	31.3.2012	By P/L A/c	1,200
		1,200			**1,200**
31.3.2013	To Hire Vendor A/c	800	31.3.2013	By P/L A/c	800
		800			**800**
31.3.2014	To Hire Vendor A/c	400	31.3.2014	By P/L A/c	400
		400			**400**

Depreciation A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2012	To Machinery A/c	1,700	31.3.2012	By P/L A/c	1,700
		1,700			**1,700**
31.3.2013	To Machinery A/c	1,700	31.3.2013	By P/L A/c	1,700
		1,700			**1,700**
31.3.2014	To Machinery A/c	1,700	31.3.2014	By P/L A/c	1,700
		1,700			**1,700**

8. Ms. Monika patented an automatic door closer and granted the license to Mr. Suraksha to manufacture and sell the door closers for 10 years on the following conditions:

(a) Suraksha to pay a royalty of ₹5 for every door closer sold with a minimum rent of ₹2,500 p.a.

(b) Suraksha could set off the shortworkings arising in any year against surplus royalties payable in the next 2 years

(c) From the second year onwards the dead rent is agreed upon at ₹2,000 instead of ₹2,500 and all other terms being unchanged. The other details are as follows:

Year	Sales (units)
2013	100
2014	200
2015	300
2016	500

Show ledger accounts in the books of Suraksha and Co., including Minimum Rent Account.

Sol.

Table of Analysis

Year	Output in units	Royalty (₹5 per unit sold)	Minimum rent	Surplus (Royalty-MR)	Short-working (MR-Royalty)	Short-working recovered	Short-working irrecovered	Payment made to Lessor
2013	100	500	2,500	–	2,000	–	–	2,500
2014	200	1,000	2,000	–	1,000	–	–	2,000
2015	300	1,500	2,000	–	500	–	2,000	2,000
2016	500	2,500	2,000	500	–	500	500	2,000

Ledger Accounts in the books of Suraksha and Co.

Minimum Rent A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013	To Monika A/c	2,500	2013	By Royalties A/c	500
				By Shortworkings A/c	2,000
		2,500			**2,500**
2014	To Monika A/c	2,000	2014	By Royalties A/c	1,000
				By Shortworkings A/c	1,000
		2,000			**2,000**
2015	To Monika A/c	2,000	2015	By Royalties A/c	1,500
				By Shortworkings A/c	500
		2,000			**2,000**

Royalty A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013	To Minimum Rent A/c	500	2013	By Production A/c	500
		500			**500**
2014	To Minimum Rent A/c	1,000	2014	By Production A/c	1,000
		1,000			**1,000**
2015	To Landlord/Lessor A/c	1,500	2015	By Production A/c	1,500
		1,500			**1,500**
2016	To Landlord/Lessor A/c	2,000	2016	By Production A/c	2,500
	To Shortworkings A/c	500			
		2,500			**2,500**

Landlord/Lessor A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013	To Bank A/c	2,500	2013	By Minimum Rent A/c	2,500
		2,500			**2,500**
2014	To Bank A/c	2,000	2014	By Minimum Rent A/c	2,000
		2,000			**2,000**
2015	To Bank A/c	2,000	2015	By Minimum Rent A/c	2,000
		2,000			**2,000**
2016	To Bank A/c	2,000	2016	By Royalty A/c	2,000
		2,000			**2,000**

Shortworkings A/c

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2008	To Minimum Rent A/c	2,000	2008	By Balance c/d	2,000
		2,000			**2,000**
2009	To Balance b/d To Minimum Rent A/c	2,000 1,000	2009	By Balance c/d	3,000
		3,000			**3,000**
2010	To Balance b/d To Minimum Rent A/c	3,000 500	2010	By P/L A/c By Balance c/d	2,000 1,500
		3,500			**3,500**
2011	To Balance b/d	1,500	2011	By Royalty A/c By P/L A/c	500 1,000
		1,500			**1,500**

9. Mr. Ridhansh, a general goods merchant, does not maintain his books of accounts systematically. However, the following information could be ascertained from his books of accounts for the year ended 31.3.2016.

Assets and Liabilities	Balances	
	1.4.2015 (₹)	**31.3.2015 (₹)**
Plant and machinery	63,000	63,000
Stock of goods	28,000	24,500
Sundry debtors	7,000	10,500
Sundry creditors	17,500	16,310
Balances at bank	14,000	16,110

Cash transactions during the year ended 31.3.2016:

Particulars	₹
Wages paid	21,000
Sundry expenses	8,250
Advertisement expenses	3,920
Rent paid	8,750
Purchase expenses	8,610
Cash collected from debtors	2,88,750
Cash paid to creditors	2,25,190
Drawings	10,920

Mr. Ridhansh drew goods worth ₹2,730 from the business during the year for his household purposes. The purchase returns and sales returns during the year amounted to ₹7,000 and ₹3,500, respectively. The plant and machinery have to be depreciated at 5%.

Prepare Trading and Profit and Loss Account for the year ended 31.3.2016 and also balance sheet on the same date.

Sol.

Trading and Profit and Loss Account

For the year ended 31/03/2014

Dr. **Cr.**

Particulars		₹	Particulars		₹
To Opening Stock		28,000	By Sales (Credit)	2,95,750	
			Less: S/R	3,500	2,92,250
To Purchases (Credit)	2,31,000		By Closing Stock		24,500
Less: P/R	7,000	2,24,000	By Drawings – Goods		2,730
To Wages		21,000			
To Purchase expenses		8,610			
To Gross Profit c/d (*Balancing figure*)		37,870			
		3,19,480			**3,19,480**
To Sundry expenses		8,250	By Gross Profit b/d		37,870
To Advertisement expenses		3,920			
To Rent paid		8,750			
To Depreciation on Machinery		3,150			
To Net Profit		13,800			
		37,870			**37,870**

Balance Sheet

As on 31.3.2015

Liabilities		₹	Assets	₹
Creditors		16,310	Cash	16,110
Capital	94,500		Debtors	10,500
Add: Profit	13,800		Plant and Machinery (63,000 – 3,150)	59,850
	10,8,300			
Less: Drawings (10,920 + 2,730)	13,650	94,650		
			Closing stock	24,500
		1,10,960		**1,10,960**

Debtors Account

Particulars	₹	Particulars	₹
To balance b/d	7,000	By Cash (received from debtors)	2,88,750
To Credit Sales (*Balancing figure*)	2,95,750	By Sales return	3,500
		By balance c/d	10,500
	3,02,750		**3,02,750**

Creditors Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Cash (Paid to Creditors)	2,25,190	By balance b/d	17,500
To Purchase Returns	7,000	By Credit Purchases (*Balancing figure*)	2,31,000
To Balance c/d	16,310		
	2,48,500		2,48,500

Cash Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To balance b/d	14,000	By Creditors	2,25,190
To Debtors	2,88,750	By wages	21,000
		By Sundry expenses	8,250
		By Advertisement expenses	3,920
		By Rent	8,750
		By Purchase expenses	8,610
		By Drawings	10,920
		By Balance c/d	16,110
	3,02,750		3,02,750

Statement of Affairs
as on 1/04/2014

Liabilities	₹	Assets	₹
Creditors	17,500	Debtors	7,000
Capital (*Balancing figure*)	94,500	Stock	28,000
		Machinery	63,000
		Cash	14,000
	1,12,000		1,12,000

10. Ram and Prem are partners having a profit-sharing ratio of 2:1, and their balance sheet as on 31.3.2017 was as follows:

Balance Sheet

As on 31.3.2017

Liabilities	₹	Assets	₹
Creditors	40,000	Cash in hand	300
Bills Payable	10,000	Bills receivable	5,000
Ram's Loan	20,000	Debtors 60,000	
Ram's Capital	30,000	*Less:* Reserve 3,000	57,000
Prem's Capital	20,000	Stock	43,700
Reserve Fund	6,000	Machinery	20,000
	1,26,000		**1,26,000**

They agreed to sell the business to a limited company and the company to take over the assets and liabilities as follows:

Machinery at ₹16,000; Stock at ₹35,000; Debtors at ₹50,700; B/R at ₹5,000 and Goodwill at ₹6,000.

The company agreed to take over the creditors at ₹38,000 and B/P at ₹10,000. The expenses of realisation amounted to ₹300. The firm received ₹40,000 of the purchase price in ₹10 fully paid equity shares and the balance in cash. Distribute the shares as per original capital ratio.

Prepare the necessary ledger accounts in the books of the firm.

Sol. Step 1: Calculation of Purchase consideration

Particulars	Amount (₹)	Amount (₹)
Machinery	16,000	
Goodwill	6,000	
Bills receivable	5,000	
Debtors	50,700	
Stock	35,000	
Total assets taken over at agreed values		1,12,700
Less: **Agreed values of liabilities taken over**		
Creditors	38,000	
Bills payable	10,000	48,000
Total Purchase Consideration		**64,700**

Step 2: Discharge of Purchase consideration

Particulars	₹
Equity shares (4,000 × 10)	40,000
Cash (64,700 – 40,000)	24,700
	64,700

Step 3: Closing books of accounts in the books of vendor firm

Ledger Accounts
Realisation Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Bills Receivable A/c	5,000	By Reserve for doubtful debts	3,000
To Debtors A/c	60,000	By Creditors A/c	40,000
To Stock A/c	43,700	By Bills Payable A/c	10,000
To Machinery A/c	20,000	By Purchasing Co. A/c	64,700
To Cash A/c (Realisation expenses paid)	300	By Partner's Capital A/c	
		Ram (11,300 × 2/3)	7,533
		Prem (11,300 × 1/3)	3,767
	1,29,000		**1,29,000**

Purchasing Company A/c

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Realisation A/c (P.C.)	64,700	By Equity shares in Purchasing Co. A/c	40,000
		By Cash A/c	24,700
	64,700		**64,700**

Equity Shares in Purchasing Co. A/c

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Purchasing Co. A/c	40,000	By Ram's Capital A/c 4,000 × 3/5 × 10	24,000
		By Prem's Capital A/c 4,000 × 2/5 × 10	16,000
	40,000		**40,000**

Ram's Loan A/c

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Cash A/c (Loan repaid)	20,000	By Balance b/d (Balance of Loan)	20,000
	20,000		**20,000**

Partner's Capital Account A/c

Dr. **Cr.**

Particulars	Ram (₹)	Prem (₹)	Particulars	Ram (₹)	Prem (₹)
To Realisation A/c (loss)	7,533	3,767	By Balance b/d	30,000	20,000
To Equity shares in Purchasing Co. A/c	24,000	16,000	By Reserve Fund (2:1)	4,000	2,000
To Cash A/c (*Balancing figure*)	2,467	2,223			
	34,000	22,000		**34,000**	**22,000**

Cash/Bank A/c

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	300	By Realisation A/c (Realisation exps)	300
To Purchasing Co. A/c	24,700	By Ramkumar's loan	20,000
		By Ram's Capital A/c By Prem's Capital A/c	2,467 2,233
	25,000		25,000

11. (a) From the following details drawn from the books of Pradeeksha, you are required to ascertain the opening stock:

Particulars	₹
Purchases made during the year	22,000
Sales made during the year	33,000
Closing stock	2,000
Wages and freight	500
Indirect expenses	700
Rate of gross profit on cost	50%
Return Inwards	3,000
Return Outwards	2,000

(b) Calculate the amount of interest included in each installment of Hire-Purchase System. Cash price ₹1,50,000; down payment ₹45,000; three annual installments of ₹60,000, ₹45,000 and ₹30,000 respectively payable at the end of each year.

Sol. (a) Calculation of opening stock:

Trading A/c

Dr. **Cr.**

Particulars		₹	Particulars		₹
To Opening Stock (*Balancing figure*)		800	By Sales	33,000	
To Purchases	22,000		*Less:* Sales Return	3,000	30,000
Less: Purchases return	2,000	20,000	By Closing Stock		2,000
To Wages and Freight		500			
To Indirect expenses		700			
To Gross Profit (50% on cost or 33.33% on sales)		10,000			
		32,000			32,000

(b) **Calculation of Total Interest charged:**

Step 1: Calculation of Total Interest Charged

Total Interest Charged = Hire-Purchase Price* (Down Payment + Total Installments) - Cash Price

= 1,80,000 – 1,50,000

Total Interest Charged = 30,000

*Hire-Purchase Price = 45,000 (Down Payment) + 60,000 (1^{st} Installment) + 45,000 (2^{nd} Installment) + 30,000 (3^{rd} Installment) (Total Installments)

* HPP = 1,80,000

Step 2: Calculation of Amount due Ratio:

No. of Installments	**1**	**2**	**3**
Installment Money Due	HPP – Down Payment = 1,80,000 – 45,000 = 1,35,000	Balance – 1^{st} Installment = 1,35,000 – 60,000 = 75,000	Balance – 2^{nd} Installment = 75,000 – 45,000 = 30,000
Amount due Ratio	1,35,000	75,000	30,000
	135:75:30 or 9:5:2		
Calculation of Interest included in each Installment	30,000 × 9/16 **= 16,875**	30,000 × 5/16 **= 9,375**	30,000 × 2/16 **= 3,750**