Financial Accounting

Second Edition

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Preface to the Second Edition

Firstly, we would like to thank everyone for the overwhelming support given to the first edition of this book.

In the last two years there have been a lot of changes in various laws and regulations for the preparation and presentation of financial statements. The Companies Act, 2013 has been introduced from 1st April, 2013. The new Companies Act demands thorough knowledge of Accounting Standards.

In this book we have discussed all relevant Accounting Standards in details with proper examples. In the 'Branch Accounting' chapter, the treatment of foreign exchange loss/gain has been incorporated as per latest Accounting Standard.

In this edition, we have incorporated various suggestions provided by the students and the subject experts from all over the country.

After teaching financial accounting to various professional, undergraduate and postgraduate classes for the past three decades, we are convinced that there is a need for a book with balanced text and problems. Multiple-choice questions have been included at the end of each chapter to help students test conceptual clarity. In addition, scores of unsolved problems have been provided, with guide to answers.

Utmost care has been taken to make it an error free book. However, if you still find any error(s) please email us at ***pmhanif@gmail.com***. All suggestions are welcome.

We specially thank Mr. S. Rangarajan for typesetting and formatting this book, and bearing with us.

Our students have always been our source of inspiration and happiness. Curiously, they never cease to raise good points and we have tried to incorporate their points in this book.

AUTHORS

Publisher's Note

We value your views, comments and suggestion and hence look forward to your communication at *info.india@mheducation.com*. Please feel free to report piracy issues, if any.

Preface to the First Edition

In today's competitive world of real business, financial accounting has assumed critical importance. Financial accounting is not an end itself, but is intended to provide information that is useful in making business decisions. In Financial Accounting, we have attempted to provide comprehensive and balanced coverage of the various accounting concepts including framework for the preparation and presentation of Financial Statements, and Indian Accounting Standards issued by the Council of The Institute of Chartered Accountants of India. Since accounting standards are mandatory in nature, it is necessary that the topics in this title should be discussed with reference to the relevant Accounting Standards. In this title, we have implemented, where necessary, ***relevant accounting standards*** for non-corporate entities. We hope this will help accounting information become comparable, leading to better analysis and comparison of performances.

From our experience of teaching accountancy to undergraduate students of commerce, we found that it is extremely important to reinforce the theoretical principles with actual practice. For this purpose, we have included about 850 fully solved problems interspersed within the text. In addition, nearly 550 unsolved problems have been graded with different levels of difficulty. While selecting problems to be included in the book, we kept in mind two important factors: First, that the problems clearly illustrate the concepts and procedures discussed earlier. Second, they serve as practice exercises for preparation of various university and professional examinations in accountancy. For the latter case, a number of problems that we have chosen have actually appeared in different examinations in the recent past. We hope the addition of such a large number of problems would enable students acquire a clear and thorough understanding of the principles, procedures and practices of accountancy, and also acquaint them with the nature and type of problems they are likely to encounter in their examinations and later in their professional career.

In our endeavour to make the book more oriented towards students and fully meet their requirements, some important topics have been dealt in greater depth. Based on our teaching experience and interaction with students, we identified topics that students find difficult to understand and have given such topics more elaborate treatment. These topics have also been profusely illustrated with solved problems. Some of these topics include: Inventories, Depreciation, Partnership (seven full chapters have been devoted to this important topic). Specialised areas like Lease Accounting, Farm Accounting, Hire Purchase have also been discussed in sufficient detail.

We have taken sufficient care to ensure that the book meets the needs of a variety of students. Undergraduate students of commerce (both B Com (Pass) and B Com (Hons), those appearing for professional examinations of the Institute of Chartered Accountants of India (ICAI), Institute of Cost and Works Accountants of India (ICWAI), Institute of Company Secretaries (ICSI) and Institute of Chartered Financial Analysts of India (ICFAI), and M Com students would benefit equally.

A number of colleagues and friends in the profession helped us in the preparation of this book. We would like to express our gratitude to all of them. Mr. S. Rangarajan took special interest in the typesetting and formatting of the book. Much of the attractiveness of the presentation and layout of the book is due to his untiring efforts.

While we have taken all possible care to see that the book has no errors, we would be grateful if any mistakes or lacunae are pointed out. Suggestion for further improvement would be more than welcome from both fellow teachers and students.

AUTHORS

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1

Introduction to Accounting

Meaning of Accounting

Accounting is an *art* of recording, classifying, summarising and reporting of transactions with the aim of showing the financial health of an entity — a business unit, a club, a charitable organisation, etc., one which has its incomes and expenses. Accounting may be *defined* as a body of principles and conventions as well as an established general process for capturing financial information related to an entity's resources and their use in meeting the entity's goals. It is a field of specialisation critical to the functioning of all types of organisations.

In a popular sense, accounting has been referred to as "the language of business" because of its role in maintaining and processing all relevant financial information that an entity requires for its managing and reporting purposes. The terms '***book-keeping***' and '***accounting***' are often used synonymously. Book-keeping is an activity concerned with the recording of financial data related to the business operations in a significant and an orderly manner. Accounting is based on a careful and efficient book-keeping system. In fact, the process of accounting begins where that of book-keeping ends.

The *distinction* between the two is that whereas book-keeping is the systematic recording of financial and economic transactions, accounting is the analysis and interpretation of book-keeping records. Accounting, therefore, includes not only maintenance of accounting records but also of the preparation of financial and economic information which involves the measurement of transactions and other events pertaining to a business. To operate a business profitably and to stay solvent, the profitability and solvency of a business should be measured at regular intervals. For that, it is essential to know whether a business unit is earning sufficient profits or incurring losses as also whether it has sufficient money to pay-off debts. Accounting provides all these information which enable the management to guide the business on a profitable and solvent course. Since accounting is the art of measuring, describing and interpreting financial and economic activities of a business, it is necessary, for an accounting system, to record, classify and summarise each day's data concerning financial activities.

Accounting deals with numbers and measurable quantities. It accumulates, measures and communicates numbers and measurable quantities of economic information about an enterprise. Accumulation refers to recording and classifying data in journals and ledgers. Measurement refers to the quantification of business transactions that have occurred, or that may occur. Communication refers to relevant and reliable information to users of accounting information.

Distinction between Bookkeeping and Accounting

Bookkeeping should not be confused with accounting. Persons with little knowledge of accounting may fail to understand the difference between bookkeeping and accounting. Therefore, it is useful to make a distinction between the two. Accounting is a broad subject. It calls for a greater understanding of records obtained from bookkeeping and an ability to analyse and interpret the information provided by bookkeeping records. Bookkeeping is a small part of the field of accounting and probably the simplest part, just like arithmetic is a small part of the broad discipline of mathematics. The main distinction between the two is that where bookkeeping is the recording phase, accounting is concerned with the summarising phase of an accounting system. Therefore, the process of accounting begins where the bookkeeping process ends. Accounting includes not only the maintenance of accounting records, but also the preparation of the following two financial statements :

1. Trading, and Profit and Loss Account. (How well did the business do during an accounting period ?)
2. Balance Sheet. (How does the business stand on the last day of the accounting period ?)

The distinction between Bookkeeping and Accounting are as under :

	Bookkeeping		**Accounting**
1.	It is the recording phase of an accounting system.	1.	It is the summarising phase of an accounting system.
2.	It is the basis of accounting.	2.	It is the basis for business language.
3.	Persons responsible for bookkeeping are called book- keepers.	3.	Persons responsible for accounting are called accountants.
4.	It does not require any special skill.	4.	It requires special skill and knowledge.
5.	Personal judgement of the book-keeper is not required.	5.	Personal judgement of the accountant is essential.
6.	Financial statements are not prepared from bookkeeping records.	6.	Financial statements are prepared from accounting records.
7.	It does not give the complete picture of the financial condition of the business unit.	7.	It gives the complete picture of the financial condition of the business unit.
8.	It does not help in complying with legal formalities.	8.	Legal formalities can be complied with the help of accounting.
9.	It does not provide any information for taking managerial decisions.	9.	It provides information for taking managerial decisions.
10.	It has no branch.	10.	It has several branches, e.g., financial accounting, cost accounting, management accounting, etc.

Functions of Accounting

According to Moonitz, the functions of accounting are :

(i) to manage the resources held by specific entities;
(ii) to reflect the claims against and the interests in those entities;
(iii) to measure the changes in those resources, claims and interests;
(iv) to assign the changes to specifiable periods of time; and,
(v) to express the above in terms of money as a common denominator.

Characteristics of Accounting

Modern accounting possesses the following basic characteristics :

(i) Accounting involves recording of economic activities which accompany the complexity and uncertainty of business. Therefore, while preparing timely accounting statements, estimates and professional judgements must be made.
(ii) Accounting statements are prepared on :(a) *cash basis of accounting*, which recognises an event as a transaction only when cash is received or paid, or (b) *accrual basis of accounting*, which recognises revenues earned and expenses incurred as transactions.
(iii) Accounting is historical in nature — it is the recording of past happenings.

Objectives of Accounting

These include providing reliable information about :

(i) changes in financial position resulting from the income-producing efforts of an enterprise;
(ii) earnings of an enterprise, presented in a manner that emphasizes sources and trends of earnings;
(iii) economic resources and obligations of an enterprise;
(iv) changes in net financial resources which result from the financial and investment activities of an enterprise; and,
(v) any additional information, in the form of disclosures, which is relevant to statement users in assessing a particular enterprise's prospects.

Advantages of Accounting

(i) It provides information useful for making economic decisions.
(ii) It serves primarily those users who have limited authority, ability or resources to obtain information and who rely on financial statements as their principal sources of information about an enterprise's economic activities.
(iii) It provides information useful to investors and creditors for predicting, comparing and evaluating potential cash flows in terms of amount, timing and related uncertainty.
(iv) It supplies information useful in judging the management's ability to utilise enterprise resources effectively in acheiving primary enterprise goals.
(v) It provides factual and interpretative information about transactions and other events which are useful for predicting, comparing and evaluating the enterprise's earning power.

Limitations of Accounting

(i) Accounting is historical in nature, it does not reflect the current financial position or worth of a business.
(ii) The Profit and Loss Account tends to match current revenues with historical costs (expenses) rather than current costs.
(iii) Accounting statements do not show the impact of inflation.
(iv) The Profit and Loss Account does not reflect those increases in net asset values which are not considered to be realised.
(v) Accounting principles are not static or unchanging—alternative accounting procedures are often equally acceptable. Therefore, accounting statements do not always present comparable data.

Evolution of Accounting

No social study has ever been static—it has always evolved. Necessarily, the present-day shape and contents of accounting are a product of history.

The origin of accounting as a social study can be traced back to very ancient days. Indeed, it is as old as the beginning of the use of money itself. Even under the barter system, some primitive form of accounting existed. For, otherwise, how could loss and gain have been calculated? The object of gain has always been the driving force of any exchange and this gave birth to the need for accounting.

But, till the 13th century, the mode of keeping accounts was primitive. Books of business were no more than mere note book transactions. A French merchant wrote in his book: 'Lent 10 gold coins to a man last year, I forgot his name'. In Europe, calculations were made largely in Roman numerals, and sums were very often wrong. Long divisions were regarded as something of a mystery, and the use of zero was not clearly comprehended.

Is it surprising, therefore, that a system of accounting, as we know, could not have been developed? However, it did develop in the fifteenth century and its genesis can be traced to Double Entry Bookkeeping which is said to have been fashioned by ***Fra Luca Pacioli*** (about 1445 – 1520), the multi-talented mathematician and philosopher of Venice. His treatise ***Summa De Arithmatica, Geometrica, Preportioni at Preportionalita*** was published in 1494. (However, ***Pacioli*** is not regarded as the inventor of the system; he is said to have just collated the different aspects of it in a comprehensive tract).

Of course, for a considerable time, the Double Entry System remained ignored in Europe; the people thereof continued following what is called *Stewardship Accounting*, the method of keeping accounts of household expenses followed by stewards. (In our country, it may be called the *munim* system of accounting. For it was the *munims* who kept accounts of big households).

When, with the advent of joint stock companies, ownership was separated from the management, the idea of financial accounting based on the Double Entry Principle came to be recognised and was valued as a principle of action. The shareholders' and others' interests were to be safeguarded; they were to be acquainted with the performance of the companies. The need was statutorily recognised, and there emerged as an information system for the investors and others such statements as Balance Sheet, Profit and Loss Account, etc. By and by, the dimension of this financial information system expanded and it came to be all-pervasive.

Since business and other concerns operate in the social setting, evolution of accounting could not come to a halt just at providing information to the investors and managers alone. Social cost as well as social benefit had to be assessed. This brought into being social accounting, an important adjunct to the system of measuring and assessing. *Economic activities*, which in economic parlance, are described as 'activities performed for making a living', and which again, in money-economy are nothing other than money-earning and money-spending activities.

Subfields of Accounting

1. Financial Accounting

Financial accounting is that part of accounting which is mainly concerned with the historical, custodial and stewardship aspects of external reporting to shareholders, government and other users of accounting information outside the business entity.

Financial accounting emphasizes the stewardship aspects of accounting rather than the control or decision-making aspects of accounting. It is the recording and processing of financial data affecting the business unit, which relates to the past and is generally for one year. The end-product of financial accounting is the Profit and Loss Account for the period ended (which shows the profit earned or losses incurred) and the Balance Sheet as on the last day of the accounting period (which shows the financial position). The preparation of the financial accounting is based on generally accepted accounting principles enunciated by the accounting profession and is heavily constrained by legal regulations and accounting standards.

2. Cost Accounting

Cost Accounting is primarily concerned with the cost to produce goods and services. Cost accounting applies the principles of accounting in such a manner that it is possible to have a detailed recording and analysis of expenditures incurred in connection with the operation of any business, e.g., manufacturing, administration or selling, or the production of an article so that it is able to measure performance and control activities.

Cost accounting is made up of the following :

(1) Mechanics of cost keeping, i.e., routines followed in reducing and classifying expenditures.
(2) Analysis of costs to measure managerial efficiency.
(3) Installation and supervision of cost systems.

3. Management Accounting

Any form of accounting which enables a business unit to be conducted more efficiently can be regarded as management accounting. Management accounting is that part of accounting which is concerned, mainly with internal reporting to the managers of a business unit. It relates to planning, control and decision-making which is useful to the management in the discharge of its functions. Thus, it emphasizes the control of decision-making aspects of accounting, which is tailor-made to suit the needs of the management of a specific enterprise, rather than stewardship aspects of accounting. Management accounting is 'forward-looking' and generally includes cost accounting and budgeting. The preparation of management accounting is not based on generally accepted accounting principles and is relatively free of constraints imposed by legal regulations and accounting standards. Therefore, management accounting is the presentation of accounting information in such a way as to assist management in the creation of policy and the day-to-day operation of an undertaking. The technique of accounting is of extensive importance as it works in the most nearly universal medium available for the expression of facts so that facts of great diversity can be presented in the same picture. It is not the presentation of these pictures that is the function of management but the use of them.

4. Social Accounting

Social accounting is a branch of accounting which attempts to measure the social benefits that an organisation provides and the social costs that an organisation imposes. Social accounting is not a new method of keeping books of account, but a concept based on evaluating the costs and benefits relating to socially responsible actions by business enterprises. Both social cost and social benefit arise from externalities. Externalities are the benefits or costs which are not received or borne by the business unit responsible for them. Social costs as well as social benefits are a function of social perception of what is bad or good about business activity.

5. Human Resource Accounting

Human resource accounting is the accounting for the human resource of an enterprise. It is the process of identifying and measuring data about human resources and communicating this information to interested parties. Human resource accounting is, therefore, accounting for people as organisational resource. It is an act of identifying, measuring and evaluating the worth of human resources of an enterprise in a systematic manner to the organisation and to society as a whole, and recording these in a significant manner in the financial statement for presenting the information to the various users and to communicate their worth with changes over the period as also results obtained from their utilisation to those users.

6. National Accounting

National accounting is the accounting of the transactions of a national economy, as distinct from those of entities in sectors of the economy, i.e., business enterprises and public authorities. National accounting is not based on generally accepted accounting principles. It has been developed by economists and statisticians and, therefore, data for national accounting must be collected from non-accounting sources.

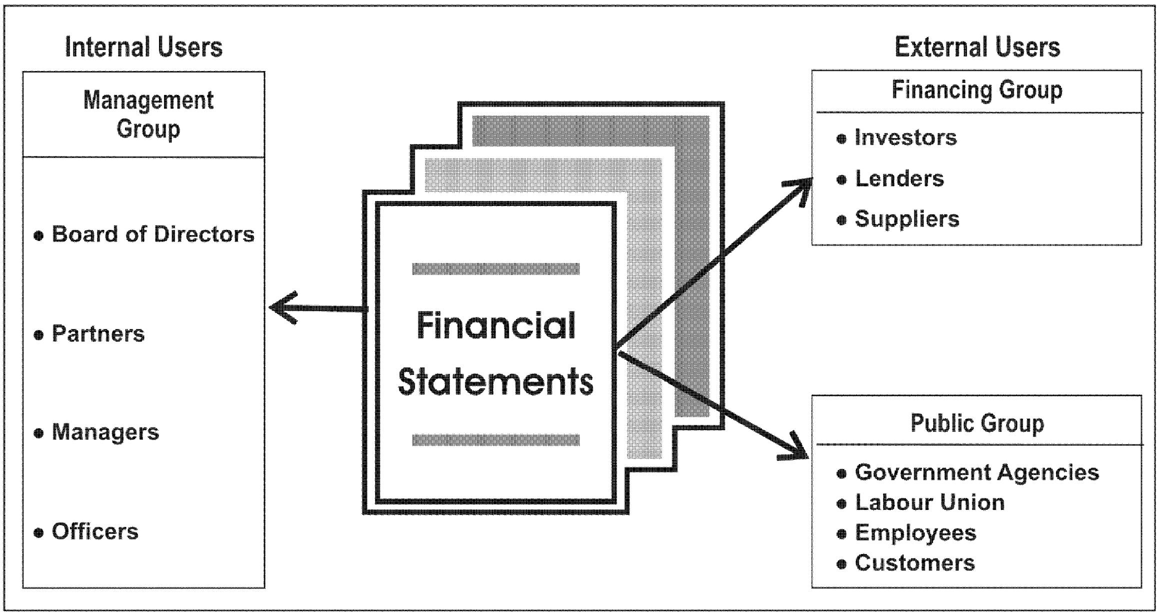
Distinction between Financial Accounting and Management Accounting

	Financial Accounting		Management Accounting
1.	It is primarily for external purposes.	1.	It is primarily for internal purposes.
2.	It records what has happened based on past transactions in a true and fair manner.	2.	It provides information which is used to take decisions about the future.
3.	It is heavily constrained by legal regulation and accounting standard.	3.	It is relatively free of constraints imposed by legal regulation and accounting standards.
4.	It must comply with statute and generally accepted accounting principles.	4.	It is tailored to suit the needs of the users.
5.	It emphasizes on the type of expenses.	5.	It emphasizes on the products, processes and departments.
6.	It emphasizes the stewardship aspect of accounting.	6.	It emphasizes the control or decision-making aspects of accounting.
7.	It provides an overall view of the business enterprise.	7.	It gives a detailed analysis of all aspects of the business unit.

Users of Accounting Information

Accounting information is needed by two sets of people—internal and external. Internal users are associated with management of the concern for which information is sought to be gathered and surveyed. For example, the directors or the partners, managers and officers.

The external users consist of several explicit groups : (1) investors; (2) lenders; (3) suppliers; (4) customers; (5) government agencies; (6) the public; and, (7) employees.



Investors : They supply the risk capital to the business unit. Ownership is separated from management in joint stock companies, hence, investors need to know how their money is being spent by the managers.

Financial information helps them to decide about (a) making investments, (b) quantum of investment, and (c) holding on to the equities they own.

Lenders : Accounting information provides them with reasonable assurance as to the payment of interest and repayment of the principal.

Suppliers : They normally sell on credit and they must have reasonable assurance that their credit will be honoured. Financial information helps them to decide about the credibility of the firm, and whether they should continue supplying on credit.

Customers : They are a composite group, consisting of (a) producers at every stage of processing, (b) wholesalers and retailers and (c) the final consumers. Producer at the next stage of processing must be assured of the input which they obtain from the concern in question. The wholesalers and retailers must also be sure about the uninterrupted supply of materials. Otherwise, they will be hesitant to stock it. The ultimate consumer is interested in the continuous availability of the product. Should he come to think that the availability may be disrupted or stopped, he will shift his preference for another variety or brand. In all these kindred decisions, accounting information has a significant role to play.

Government agencies : Any economy of the day is, in a way, controlled and regulated by the political authorities, i.e., the government. Consequently, government agencies rely on the financial information for permitting expansion or contraction of business, for import and export of products and/or materials, for allocation of essential resources for regulating labour or taxation, etc.

Public : For members of the public the financial information is of the nature of a health examination report — it tells them about employment opportunities and general growth in the individual concern and the economy as a whole.

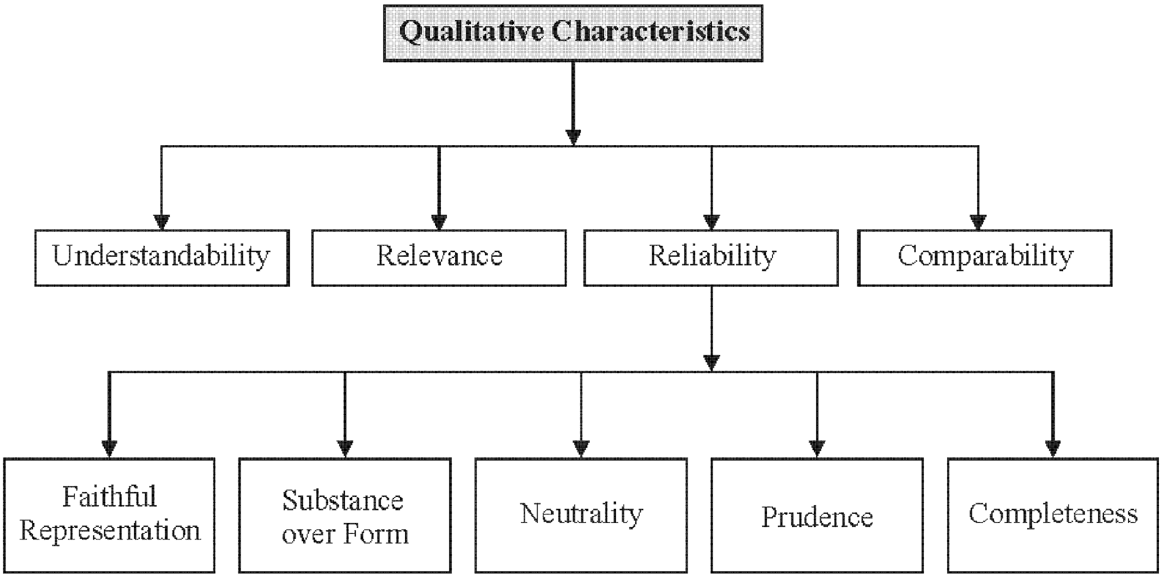
Employees : The employees of the concern are interested in the financial information because both, their present and future are tied up with the company's fortunes.

Thus, financial information serves diverse interests. Hence, the information should be gathered and disseminated in a way that benefits each interest. Information should not be biased and should not supress facts or suggest anything false.

Qualitative Characteristics of Financial Statements

Accounting information must possess some qualitative characteristics. These are the attributes that make the information provided in the financial statements useful to users. The ***four*** main qualitative characteristics are:

(1) Understandability;
(2) Relevance;
(3) Reliability; and
(4) Comparability.



Understandability

Understandability is the quality of accounting information that enables users to perceive its significance, i.e., to understand the content and significance of accounting statements and reports. If a user cannot understand the accounting information given to him, it is not useful, even though it may be relevant to whatever decision he wants to make. To have the characteristics of understandability, accounting information must be presented in a manner that users can understand, i.e., it must be expressed in terminology that is understandable to theusers. Now-a-days, business activities and transactions have become increasingly complex. It may not always be possible to describe complex transactions in simple terms. It is, therefore, necessary that the users of the accounting information must attain a minimum level of competence in understanding the terminology used in accounting statements. It is assumed that the users have a basic knowledge of business accounting, and they will spend some time and effort in studying the accounting statements. However, the accountant has a basic responsibility to describe business transactions clearly and concisely.

Relevance

Accounting information must be relevant to the user. Information is relevant if it meets the needs of the user in decision-making. Relevance is *defined* in terms of the ability to affect a decision-maker's course of action, because whether a particular set of accounting information is relevant or not depends on the specific decision-maker's objectives. Thus, for information to be relevant, it must have some bearing on the decision being made. Relevant accounting information should be capable of making a *difference* in a decision by helping users of accounting information to form predictions about the outcomes of past, present and future events. The decision *not* to modify or correct previous actions is a very important one. Financial information which does not have relevance to users is worse than no information at all, i.e., any information does not connote utility if it is not relevant to the purpose. To be relevant, it should be capable of monetary computation.

Reliability

Accounting information should be reliable. Reliability is the characteristic of accounting information which gives the user confidence and trust that the reported information is a reasonable representation of the actual items or events that have occurred. To be reliable, the accounting information should be error-free and neutral — an accountant's bias must not colour his information. The other subsidiary qualities which make information reliable are as follows :

Faithful representation : Information must faithfully represent the effects of transactions and other events. If the information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form.

For example, X Ltd has purchased a building for their sales office. The rights and beneficial interest in the property have been transferred but the documentation and legal formalities are pending. It is to be shown in the financial statement as own property though legally it has not been transferred in the name of X Ltd.

Substance over Form : The accounting treatment and presentation in financial statements of transactions and events should be governed by their substance and not merely by the legal form. In accounting, substance should normally take *precedence* over form in deciding how a particular transaction should be recorded. The legal form of a transaction is frequently descriptive of its economic substance. However, the form occasionally misrepresents the characteristics that are relevant to users. If the substance can be reliably determined, the accountant should describe the transaction in terms of the substance rather than the form. Accounting for hire-purchase transactions, for example, is based on the above concept, i.e., it looks at the substance of the transaction rather than its legal form. The hire-purchaser can record the asset at its cash down price, while paying for it by instalments over an agreed period of time.

Neutrality : Judgement is required in arriving at many items in the financial statements. Judgement is involved in valuing stock, determining the amount of doubtful debts, etc. Neutrality means that these judgements are made without any bias.

Prudence : Caution must be exercised while preparing financial statements and estimating the outcome of uncertain events. For example, collectability of receivable, the warranty claims that may occur etc. However, this does not mean, that the approach should be over cautious. The aim should be to report most likely outcome, with a reasonable element of caution. The financial statements must not be prepared on the most optimistic basis.

Completeness : The information in the financial statements must be complete within the bounds of materiality and cost.

Comparability

Usefulness is enhanced if accounting information can be compared with similar information for the ***same organisation*** at different times, and for ***different organisations*** at the same time. Comparability enhances the value of accounting information by enabling the users to discern and detect similarities and the dissimilarities among different concerns as also in respect of the same concern over time. Absoluteness of the information is not of much use — it is the comparability that lends itself to proper decision-making. Whether one is doing well or not is not the enquiry; the enquiry should be whether one is doing better or more (or worse) than others or than in other periods. To achieve comparability, consistency and disclosure of accounting policies are necessary.

Key Points

- Accounting is a service activity. Its function is to provide quantitative information primarily financial in nature, about economic entities that is intended to be useful in making economic decisions in making reasoned choices among alternative courses of action. Accounting includes several branches, e.g., financial accounting, managerial accounting and government accounting.
- The **objectives of accounting** are :
  (i) To keep a systematic record of financial transactions that affect the business enterprise.
  (ii) To ascertain the profits earned or losses incurred by a business unit during a particular accounting period.
  (iii) To ascertain the financial position of the business unit at the end of the accounting period.
  (iv) To exercise control over business assets and properties.
  (v) To facilitate business decision-making.
- Book-keeping is an activity concerned with the recording of financial data related to business operations in a significant and orderly manner. Book-keeping is the record-making phase of accounting. Accounting is based on a careful and efficient book-keeping system.
- Accounting information is a *statement* which provides quantitative information about the effect of transactions and other events on an accounting entity. Accounting information is used for predicting, comparing and evaluating the earning power and financial position of a business enterprise. It also serves the needs of the users who rely on accounting statements as their principal source of information for decision-making.
- Accounting information is required by two sets of people—internal and external. Internal users are associated with management of the concern for which information is sought to be gathered and surveyed. For example, the directors or the partners, managers and officers.The external users consist of several explicit groups : (1) investors; (2) lenders; (3) suppliers; (4) customers; (5) government agencies; (6) the public; and, (7) employees.
- Accounting information must possess some qualitative characteristics. These are the attributes that make the information provided in financial statements useful to users. The four main qualitative characteristics are : (i) Reliability; (ii) Relevance; (iii) Understandability; and (iv) Comparability.

THEORETICAL QUESTIONS

1. Define accounting and discuss its functions.
2. What are the characteristics of modern accounting ?
   State the advantages and limitations of accounting ?
3. What are the objectives of accounting ?
4. Who are the users of accounting information ?
   Why do they need information ?
5. What are the qualitative characteristics of accounting information ?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below.

1. Which of the following is / are a sub-field(s) of accounting ?
   A financial accounting
   B cost accounting
   C management accounting
   D all the above
2. Which of the following is not an internal user of financial statement ?
   A board of directors
   B managers
   C officers
   D lenders

3. Accounting information must possess some qualitative characteristics. For example,
   (i) reliability
   (ii) relevance
   (iii) understandability
   Which of the above is / are correct ?
   A (i) and (ii) only
   B (i) only
   C (ii) and (iii) only
   D all the above
4. Which of the following is not an external user ?
   A investor
   B government agencies
   C partners
   D labour union
5. Which of the following is true ?
   A Accounting is the recording phase of past happening
   B Accounting reflects the current financial position or worth of a business
   C Accounting statements always present comparable data
   D Accounting statements show the impact of data
6. Which of the following is true ?
   A Human resources accounting is the accounting for the human resources of an enterprise that are included in the financial statements
   B Social responsibility accounting is the reporting of cost and benefits relating to socially responsible actions by business enterprises
   C Cost accounting is a division of financial accounting
   D Financial accounting is not concerned with external reporting

7. Which of the following is an advantage of accounting ?
   A accounting provides information useful for making economic decisions
   B accounting provides comparable data for comparison
   C accounting proivides information useful for predicting uncertainty
   D accounting information is useful in judging managements' ability
8. Which of the following is not a limitation of accounting ?
   A accounting information is historical in nature
   B accounting information does not show the impact of inflation
   C accounting reflects those increases in net assets that are realised
   D accounting information must possess some qualitative characteristics
9. Which of the following is not true ?
   A Financial accounting is primarily for external user
   B Management accounting is primarily for internal user
   C Financial accounting provides an overall view of the business enterprise
   D Cost accounting does not give a detailed analysis of all aspects of the business unit
10. Which of the following is not true ?
   A Financial accounting emphasises on the type of expenses and revenues
   B Cost accounting emphasises on the products, processes and department
   C Management accounting emphasises on the stewardship aspect of accounting
   D Management accounting is tailored to suit the needs of the users

Guide to Answers

Multiple Choice

1. D 2. D 3. D 4. C 5. A 6. B 7. B 8. D 9. D 10. C.

2

Double Entry System

Introduction

Double entry is an almost universally used system of business record keeping. It is a system of recording business transactions which recognises that each transaction has a dual aspect. It is so named because the principles of double entry book-keeping are based upon every transaction having two aspects or two parts, i.e., two accounts are always affected by each transaction. Under this system, each transaction is seen as a flow of value from one account to another. The receiving account is debited with the amount and the giving account is credited. Therefore, every debit has an equal and offsetting credit.

If only two accounts are affected (as in the purchase of building for cash), one account, Building is debited and the other account, Cash is credited for the same amount. If more than two accounts are affected by a transaction, the sum of the debit entries must be equal to the sum of the credit entries.

Features of Double Entry System

(1) This method records both aspects of each transaction.
(2) Under this system, equal debit and credit entries are made for every transaction in two different accounts.
(3) Under this system, all transactions are recorded fully.
(4) Under this system, it is possible to prepare a Trial Balance and check the arithmetical accuracy of the books of account because it records all transactions in full.
(5) Under this system, profit / loss can be found out by showing in detail the expenses and incomes.
(6) Under this system, Balance Sheet can be prepared in detail.

Advantages of the Double Entry System

(1) A complete record of all the transactions relating to a business unit are maintained systematically.
(2) The financial position of the firm can be ascertained.
(3) The arithmetical accuracy of the books of account can be ensured.
(4) Location and rectification of errors are possible.
(5) The system can be applied to any form of organisation.
(6) Consistency can be maintained in the books of account, which help make a comparative study of current year's figures with those of the previous year(s).

(7) The profits earned or losses suffered for an accounting period can be ascertained.
(8) Amount due to suppliers and due from customers can be easily ascertained.
(9) The amount of cash balance available at any point of time can be ascertained.
(10) It helps take managerial decisions.
(11) Greater control over the affairs of the business can be exercised and, thereby, frauds and misappropriations can be minimised.
(12) The business transactions do not get mixed up with private transactions of the owner(s).

Disadvantages of the Double Entry System

(1) This system adopts money as its basic unit of measurement. But money is an inelastic yardstick for measurement.
(2) Many important events cannot be recorded in the books of account simply because they cannot be expressed in monetary terms.
(3) Transactions are all historical records and not future probabilities.
(4) If any transaction is not recorded at all in the books of account, it may remain undiscovered.
(5) If the amount of a transaction is wrongly recorded in the books of original entry, it is difficult to detect the error.
(6) A compensating error may also remain undetected.
(7) This system requires personal judgement of the accountant.
(8) This system is not suitable for small businesses where the owner(s) can directly control the affairs of the business.

Accounting Equation

The accounting equation is the basis for double entry system of accounting. Total assts of the business unit are provided by the creditors/lenders and the owners. Therefore, at any point of time, the total assets of the business are equal to total liabilities. Liabilities to the outsiders are known as liabilities but liability to the owners, in accounting, is referred to as 'capital'.

The relationship that exists among assets, liabilities and the capital can be expressed in the form of an accounting equation which is as follows :

$$\text{Total Assets} = \text{Total Liabilities}$$
OR
$$\text{Total Assets} = \text{Liabilities} + \text{Capital}$$
OR
$$\text{Total Assets} - \text{Liabilities} = \text{Capital}$$

Assets and liabilities are two independent variables and capital is the dependent variable, for it is the difference between assets and liabilities. A transaction may affect either both sides of the equation by the same amount or on one side of the equation only, by both increasing or decreasing it by equal amounts and thus netting to zero. An increase in an asset, without a corresponding increase in liability or a corresponding decrease in another asset, must represent an increase in capital. Conversely, an increase in liability without a corresponding increase in asset, or a corresponding decrease in another liability, will indicate a decrease in capital.

Concept of Debit, Credit and Duality

The rules of Debit and Credit are as follows :

1. **Debit** : Any ***increase*** on the ***left hand side*** of the equation
2. **Credit** : Any ***decrease*** on the ***left hand side*** of the equation.
3. **Debit** : Any ***decrease*** on the ***right hand side*** of the equation
4. **Credit** : Any ***increase*** on the ***right hand side*** of the equation.

Illustration 1

(a) If the liabilities of a business is ₹ 75,000 and the capital is ₹ 85,000. Find out the total assets.
(b) A business has assets of ₹ 54,321 and owner's equity is ₹ 34,215. What is the amount of liability?
(c) Cash ₹ 10,000; Stock ₹ 15,000; Building ₹ 10,000; Machinery ₹ 1,80,000; Debtors of ₹ 45,000 and Creditors ₹ 27,500. Ascertain the capital.

Solution

(a) Total Assets – Liabilities = Capital
or, Total Asset = Capital + Liabilities
∴ Total Assets = ₹ (85,000 + 75,000) = ₹ **1,60,000**.

(b) Assets – Liabilities = Capital (Owner's equity)
or Assets – Capital = Liabilities
Therefore, liabilities = ₹ (54,321 – 34,215) = ₹ **20,106**.

(c) Assets – Liabilities = Capital
or Capital = (Cash + Stock + Building + Machinery + Debtors) – Creditors
(₹ 10,000 + ₹ 15,000 + ₹ 10,000 + ₹ 1,80,000 + ₹ 45,000) – ₹ 27,500
= ₹ 2,60,000 – ₹ 27,500 = ₹ **2,32,500**.

Illustration 2

Calculate as directed using accounting equation :

(a) If the total assets of a business are ₹ 1,50,000 and capital is ₹ 75,000, calculate creditors.
(b) If the capital of a business is ₹ 80,000 and the liabilities are ₹ 60,000, calculate the total assets of the business.
(c) Calculate total assets if (i) Capital is ₹ 50,000; (ii) Creditors ₹ 30,000; (iii) Revenue during the period ₹ 52,000; and (iv) Expenses during the same period are ₹ 38,000.

Solution

(a) Total Assets – Liabilities = Capital
or Liabilities = Total Assets – Capital
or Creditors = Total Assets – Capital
= ₹ 1,50,000 – ₹ 75,000
= ₹ **75,000**.

(b) Total Assets – Liabilities = Capital
or Total Assets = Capital + Liabilities
= ₹ 80,000 + ₹ 60,000
= ₹ **1,40,000**.

(c) Total Assets – Liabilities = Capital + Profit
or Total Assets = Capital + Profit + Liabilities
= ₹ 50,000 + ₹ (52,000 – 38,000) + ₹ 30,000 = ₹ 50,000 + ₹ 14,000 + ₹ 30,0000 = ₹ **94,000**.

Illustration 3

From the following information calculate total assets of the business : Capital ₹ 40,000; Creditors ₹ 30,000; Revenue earned during the period ₹ 75,000; Expenses incurred during the period ₹ 20,000. Value of stocks unsold ₹ 20,000.

Solution

Total Assets – Liabilities = Capital + Profit
or Total Assets = Capital + Liabilities + Profit
or Total Assets = Capital + Creditors + Profit
= ₹ 40,000 + ₹ 30,000 + ₹ 55,000 (₹ 75,000 – ₹ 20,000)
= ₹ 1,25,000 (includes ₹ 20,000 closing stock).

Illustration 4

Prabhas Senapati has the following assets and liabilities as on 31st December, 2009. Ascertain his capital.

Cash ₹ 2,500; Bank ₹ 4,750; Debtors ₹ 1,800; Creditors ₹ 2,200; Plant and Machinery ₹ 8,000; Building ₹ 20,000; Furniture ₹ 2,400; Bills Receivable ₹ 5,650; Bills Payable ₹ 2,350.

Solution

Assets – Liabilities = Capital
or Capital = Assets – Liabilities
or Capital = (Cash + Bank + Debtors + Plant and Machinery + Building + Furniture + Bills Receivable)
– (Creditors + Bills Payable)
= ₹ (2,500 + 4,750 + 1,800 + 8,000 + 20,000 + 2,400 + 5,650) – ₹ (2,200 + 2,350)
= ₹ (45,100 – 4,550) = ₹ 40,550.

Illustration 5

Show the accounting equations on the basis of the following transactions.

(i) Raghunath commenced business with cash ₹ 80,000.
(ii) Purchased goods on credit ₹ 20,000.
(iii) Withdrew cash for private use ₹ 2,000.
(iv) Sold goods on credit (cost-price ₹ 15,000) ₹ 20,000.
(v) Purchased furniture ₹ 1,500.

Solution

Accounting Equation : Total Assets – Liabilities = Capital

(i) Raghunath commenced business with cash ₹ 80,000

Here business is getting ₹ 80,000 in the form of cash and owes Raghunath ₹ 80,000. Therefore, in the form of accounting equation it can be shown as follows :

	Assets	–	Liabilities	=	Capital
Cash	80,000	–	0	=	80,000

(ii) Purchased goods on credit ₹ 20,000

Here stock of the business will be increased by ₹ 20,000 and liabilities in the form of creditor will be increased by the same amount. Therefore, the new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	80,000	–	0	=	80,000
Stock	20,000	–	Creditors 20,000	=	0
	1,00,000	–	20,000	=	80,000

(iii) Withdrew cash for private use ₹ 2,000

Here cash will be reduced by ₹ 2,000 and capital will also be reduced by ₹ 2,000. Therefore, the new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	78,000	–	0	=	78,000
Stock	20,000	–	Creditors 20,000	=	0
	98,000	–	20,000	=	78,000

(iv) Sold goods on credit ₹ 20,000 (cost price ₹ 15,000)

Here stock will be reduced by ₹ 15,000 and asset in the form of debtors will be increased by ₹ 20,000. Capital will be increased by ₹ 5,000 profit (₹ 20,000 – ₹ 15,000). The new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	78,000		0	=	*83,000
Stock	5,000		Creditors 20,000		
Debtors	20,000				
	1,03,000	–	20,000	=	83,000

* It includes profit of ₹ 5,000 (₹ 20,000 – ₹ 15,000).

(v) Purchased furniture ₹ 1,500

Here cash will be reduced by ₹ 1,500 and furniture will appear in the equation as an asset. The new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	76,500		0	=	83,000
Stock	5,000		Creditors 20,000		
Debtors	20,000				
Furniture	1,500				
	1,03,000	–	20,000	=	83,000

Illustration 6

Show the accounting equations on the basis of the following transactions.

(i) D. Mahapatra commenced business with cash ₹ 50,000.
(ii) Purchased goods for cash ₹ 8,000.
(iii) Sold goods costing ₹ 6,000 for ₹ 9,000.
(iv) Purchased furniture ₹ 20,000.
(v) Took a loan of ₹ 10,000 from bank.
(vi) Paid salary ₹ 4,000 and insurance ₹ 2,000.
(vii) Received rent ₹ 3,000 and interest ₹ 1,500.

(viii) Paid ₹ 800 as premium of life insurance policy.
(ix) Purchased a bicycle for the owners' son ₹ 1,200.
(x) Depreciate furniture by ₹ 300.

Solution

Accounting Equation : Total Assets = Total Liabilities OR Total Assets = Capital + Liabilities OR Total Assets – Liabilities = Capital

(i) D. Mahapatra commenced business with cash ₹ 50,000

Here business is getting ₹ 50,000 in the form of cash and owes Mahapatra ₹ 50,000. Therefore, in the form of accounting equation it can be shown as follows :

	Assets	–	Liabilities	=	Capital
Cash	50,000	–	0	=	50,000

(ii) Purchased goods for cash ₹ 8,000

Here stock of the business will be increased by ₹ 8,000 and cash will be reduced by ₹ 8,000. Therefore, the new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	42,000	–	0	=	42,000
Stock	8,000	–	0	=	8,000
	50,000	–	0	=	50,000

(iii) Sold goods costing ₹ 6,000 for ₹ 9,000

Here stock will be reduced by ₹ 6,000 and cash will be increased by ₹ 9,000. Capital will be increased by ₹ 3,000 profit (₹ 9,000 – ₹ 6,000). The new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	51,000	–	0	=	51,000
Stock	2,000	–	0	=	2,000
	53,000	–	0	=	53,000

(iv) Purchased furniture ₹ 20,000

Here cash will be reduced by ₹ 20,000 and furniture will appear in the equation as an asset. The new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	31,000	–	0	=	31,000
Stock	2,000	–	0	=	2,000
Furniture	20,000	–	0	=	20,000
	53,000	–	0	=	53,000

(v) Took a loan of ₹ 10,000 from bank

Here cash will be increased by ₹ 10,000 and liabilities in the form of loan will be increased by the same amount. Therefore, the new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	41,000	–	Loan 10,000	=	31,000
Stock	2,000	–	0	=	2,000
Furniture	20,000	–	0	=	20,000
	63,000	–	10,000	=	53,000

(vi) Paid salary ₹ 4,000 and insurance ₹ 2,000

Here cash will be reduced by ₹ 6,000 and profit will be reduced by ₹ 6,000, i.e., capital will be reduced by ₹ 6,000. The new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	35,000	–	Loan 10,000	=	25,000
Stock	2,000	–	0	=	2,000
Furniture	20,000	–	0	=	20,000
	57,000	–	10,000	=	47,000

(vii) Received rent ₹ 3,000 and interest ₹ 1,500

Here cash will be increased by ₹ 4,500 and capital will be increased by the same amount in the form of profit. Therefore, the new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	39,500	–	Loan 10,000	=	29,500
Stock	2,000	–	0	=	2,000
Furniture	20,000	–	0	=	20,000
	61,500	–	10,000	=	51,500

(viii) Paid ₹ 800 as premium of life insurance policy

Here cash will be reduced by ₹ 800 and capital will be reduced by ₹ 800 by way of drawing. Therefore, the new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	38,700	–	Loan 10,000	=	28,700
Stock	2,000	–	0	=	2,000
Furniture	20,000	–	0	=	20,000
	60,700	–	10,000	=	50,700

(ix) Purchased a bicycle for the owner's son ₹ 1,200

Here cash will be reduced by ₹ 1,200 and capital will be reduced by ₹ 1,200 by way of drawing. Therefore, the new equation will be :

	Assets	–	Liabilities	=	Capital
Cash	37,500	–	Loan 10,000	=	27,500
Stock	2,000	–	0	=	2,000
Furniture	20,000	–	0	=	20,000
	59,500	–	10,000	=	49,500

(x) Depreciate furniture by ₹ 300

Here furniture will be reduced by ₹ 300 and capital will be reduced by ₹ 300 by way of loss due to depreciation. Therefore, the new equation will be:

	Assets	–	Liabilities	=	Capital
Cash	37,500	–	Loan 10,000	=	27,500
Stock	2,000	–	0	=	2,000
Furniture	19,700	–	0	=	19,700
	59,200	–	10,000	=	49,200

Elements of Financial Statements

The elements directly related to the measurement of financial position in the Balance Sheet are : ***assets***, ***liabilities*** and ***equity***.

The elements directly related to the measurement of performance in the Statement of Profit and Loss are : ***income*** and ***expenses***.

These definitions applied together with the recognition criteria, helps to understand how and when the financial effect of transactions should be recognised in the financial statements.

Definitions

(a) An ***asset*** is a resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise.

(b) A ***liability*** is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

(c) ***Equity*** is the residual interest in the assets of the enterprise after deducting all its liabilities.

(d) ***Income*** is increase in economic benefits during the accounting period in the form of inflows or enhancements of assets or decrease in liabilities, that in turn increases the equity other than those relating to contribution from equity participants.

(e) ***Expenses*** are decrease in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

Assets

Assets are those resources that the business owns. They refer to some property or legal right owned by a business enterprise which can be measured in terms of money.

An asset has the following ***three*** essential characteristics :

(1) It has the potential to provide future economic benefits to the enterprise.
(2) It is a result of past transactions or events.
(3) The enterprise has the control over it.

Liability

Liability is a present obligation expressed in terms of money, which arises from transactions or other events that have already occurred. It involves an enterprise in a probable future transfer of cash, goods or services or the foregoing of a future cash receipt.

Obligations may arise from normal business practice, custom and a desire to maintain good business relations.

Recognition of the Elements of Financial Statements

An item that meets the definition of an element (given above) should be recognised if :

(a) it is possible that any future economic benefit associated with the item will flow to or from the enterprise; and
(b) the item has a cost or value that can be measured with reliability.

In the ***first criterion***, the concept of probability is used to refer to the degree of uncertainty. Assessments of the degree of uncertainty attaching to the flow of future economic benefits are made on the basis of the evidence available when the financial statements are prepared.

The ***second criterion*** for the recognition of an item is that it possesses a cost or value that can be measured with reliability. When, however, a reasonable estimate cannot be made, the item is not recognised in the Balance Sheet or Statement of Profit and Loss.

Recognition of Assets

An asset is recognised in the Balance Sheet when it is probable that the future economic benefits associated with it will flow to the enterprise and the asset has a cost or value that can be measured reliably.

If there is any doubt about the flow of benefits to the enterprise beyond current accounting period, the expenditure incurred will not be recognised as an asset.

Recognition of Liabilities

A liability is recognised in the Balance Sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably.

Recognition of Income

Income is recognised in the Statement of Profit and Loss when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably.

Recognition of Expenses

Expenses are recognised in the Statement of Profit and Loss when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably.

An expense is recognised immediately in the Statement of Profit and Loss when an expenditure produced no future economic benefits. An expense is also recognised to the extent that future economic benefits from an expenditure do not qualify, or cease to qualify, for recognition in the Balance Sheet as an asset.

Measurement of Elements of Financial Statements

After deciding that an item is to be recognised in the financial statements, the next step is to decide the basis for its measurement.

The framework refers to ***four*** measurement bases that are frequently used in reporting. These are :

1. Historical Cost
2. Current Cost
3. Realisable (Settlement) Value
4. Present Value

In measuring assets and liabilities, the historical cost is most commonly used. This is usually combined with other measurement bases. For example, inventories are usually carried at lower of cost and net realisable value (NRV) and pension liabilities are carried at their present value.

Concept of Capital and Capital Maintenance

Concept of Capital

The framework refers to two concepts of capital :

(a) Financial concept of Capital

(b) Physical concept of Capital

Under financial concept of capital, capital is synonymous with the net assets or equity of the enterprise.

Under physical concept of capital, capital is regarded as the productive capacity of the enterprise.

Determination of Profit

Under the financial concept of capital a profit is earned if financial amount of the net assets at the end of the period is greater than at the beginning of the period after deducting any distributions to and contributions from owners.

Under physical concept of capital, a profit is earned if physical productive capacity of the enterprise at the end of the period exceeds the physical productive capacity at the beginning of the period, after deducting any distributions to and contributions from owners.

Capital Maintenance

It is assumed that, an enterprise has maintained its capital if it has more capital at the end of the accounting year than that at the beginning of the year. The main point in capital maintenance is to decide which concept to be adopted.

Financial capital maintenance is measured either in nominal monetary units or units of constant purchasing power.

Physical capital maintenance concept requires the adoption of the current cost basis of measurement — an appreciation of what it would cost to ***replace assets at current prices***.

The main difference between two concepts of capital maintenance is the treatment of the effects of changes in the prices of assets and liabilities of the enterprises.

Key Points

- Double entry is an almost universally used system of business record keeping. It is a system of recording business transactions which recognises that each transaction has a dual aspect. It is so named because the principles of double entry book-keeping are based upon every transaction having two aspects or two parts, i.e., two accounts are always affected by each transaction.
- The relationship that exists among assets, liabilities and the capital can be expressed in the form of an accounting equation which is as follows :

Total Assets = Total Liabilities OR Total Assets = Liabilities + Capital OR Total Assets – Liabilities = Capital

Key Points (Contd.)

- Liability is a present obligation expressed in terms of money, which arises from transactions or other events that have already occurred. It involves an enterprise in a probable future transfer of cash, goods or services or the foregoing of a future cash receipt.

THEORETICAL QUESTIONS

1. What do you mean by double entry system ?
2. What are the features of double entry system ?
3. What are the advantages and disadvantages of double entry system ?
4. What is accounting equation ?
5. What are the elements of financial statements ?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below.

1. Which of the following equations is correct ?
   A total assets – liabilities = capital – profit
   B total assets – liabilities = capital + profit
   C total assets + profit = capital + liabilities
   D total assets + liabilities = capital – profit
2. Robin introduces his car into his business. Which parts of the business accounting equation will change?
   A capital and liability
   B liabilities and assets
   C capital and profit
   D assets and capital
3. Which of the following equation is wrong ?
   A net assets = proprietor's fund
   B net assets = capital + profit + drawings
   C net assets = capital + profit – drawings
   D fixed assets + net current assets = capital + profit – drawings
4. Which of the following is a correct version of the 'fundamental accounting equation' ?
   A assets = capital less liability
   B assets = liabilities
   C assets plus liabilities = capital
   D assets = capital + liabilities
5. Consider the following statements :
   (i) 'Double entry book-keeping' means that two sets of records are maintained.
   (ii) In double entry book-keeping we have a basic check on the accuracy of the entries as the total value of the debit entries and total value of the credit entries should be equal.
   Are the statements true or false ?

	Statement (i)	Statement (ii)
A	True	True
B	True	False
C	False	True
D	False	False

6. A business borrowed ₹ 60,000 from its bank, and used the cash to buy a new computer. How is accounting equation Affected by these transactions ?

	Assets	Liabilities
A	unchanged	decreased
B	unchange	dincreased
C	increased	increased
D	increased	decreased

PRACTICAL QUESTIONS

1. (a) If the capital of the firm is ₹ 1,50,000 and creditor is ₹ 50,000. Find out the total assets.
   (b) A business has total assets of ₹ 85,000 and capital is ₹ 35,000. What is the amount of liability ?
   (c) Plant and machinery ₹ 1,00,000; Land and Building ₹ 2,00,000; Stock ₹ 50,000; Cash in hand ₹ 10,000; Cash at Bank ₹ 40,000; Sundry Debtors ₹ 50,000 and Sundry Creditors ₹ 1,00,000. Ascertain the capital.
2. Show accounting equations on the basis of the following transactions.
   (a) Ganguly commenced business with ₹ 1,00,000.
   (b) Purchased machinery for ₹ 30,000.
   (c) Purchased goods for ₹ 40,000.
   (d) Sold all goods for cash ₹ 60,000.
3. Show the accounting equations on the basis of the following transactions.
   (a) Commenced business with cash ₹ 40,000.
   (b) Deposited ₹ 10,000 in SBI.
   (c) Purchased machine from Amar & Sons ₹ 30,000.
   (d) Purchased goods from Bijoy Bros. ₹ 30,000.
   (e) Purchased goods for cash ₹ 18,000.
   (f) Half of the goods purchased from Bijoy Bros are sold at a profit of 40% on cost price for cash. The remaining half were sold on credit to Chitra Suppliers at a profit of 50% on selling price.
   (g) Paid ₹ 15,000 cash and ₹ 7,000 by cheque to Amar & Sons.
   (h) Owner withdraw ₹ 1,000 for personal expenses.
4. Dinesh starts business with cash ₹ 50,000 and furniture ₹ 20,000. The details of his transactions are given below:
   (i) Purchased goods on credit from Eknath ₹ 60,000 at 10% discount.
   (ii) Goods costing ₹ 20,000 are sold for ₹ 35,000.
   (iii) Goods costing ₹ 10,000 are sold to Fakir & Co. for ₹ 18,000.
   (iv) Fakir returned 1/5th of the goods.
   (v) Received commission ₹ 6,000.
   (vi) Paid ₹ 14,000 to Eknath and accepted a Bills Payable of 3 months for the balance amount.
   (vii) Paid salary ₹ 3,000 to Gumasta.
   (viii) Depreciate furniture by 10%.

   You are required to prepare accounting equations for Dinesh.
5. Gopinath started business with cash ₹ 30,000 and goods ₹ 10,000. His other transactions are given below. You are required to show the accounting equations.
   (i) Purchased goods from Hanuman Bhai ₹ 30,000.
   (ii) Paid ₹ 10,000 to Hanuman Bhai.
   (iii) Sold goods costing ₹ 12,000 for ₹ 19,000 to Inderjeet & Co.
   (iv) Goods costing ₹ 3,000 are destroyed during cyclone and could be sold for ₹ 1,000 only.
   (v) Paid wages ₹ 1,000.
   (vi) Goods costing ₹ 1,000 are distributed as relief during the cyclone.
   (vii) Goods costing ₹ 400 (market price ₹ 500) are taken for household use.
   (viii) Goods costing ₹ 3,000 are used for construction of a room.
   (ix) Goods costing ₹ 5,000 are sold for ₹ 20,000.
   (x) Goods worth ₹ 2,000 are destroyed in fire.

Guide to Answers

Multiple Choice

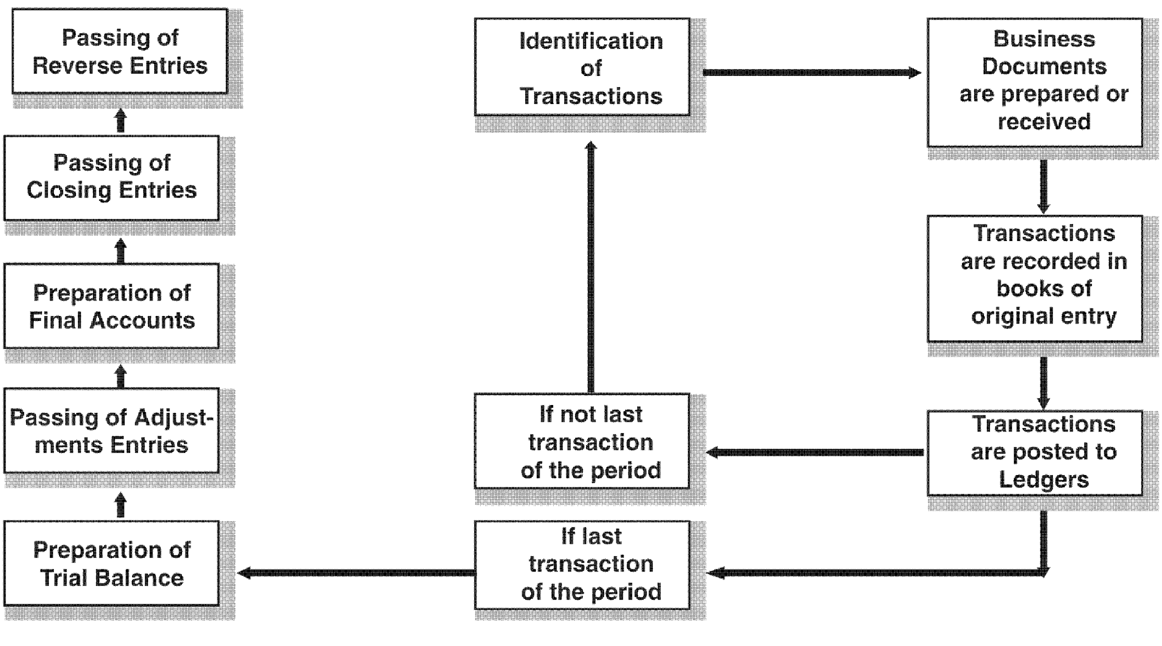
1. B 2. D; 3. B; 4. D; 5. C; 6. C.

3

Accounting Cycle

Accounting Cycle

Accounting Cycle refers to the sequence of accounting procedures used to record, classify and summarise the business transactions. It begins with the identification of business transactions and ends with the reverse entries for prepaid and outstanding expenses. A business enterprise has numerous transactions every day during an accounting period. Unless the transactions are analysed and recorded individually, it is not possible to determine the impact of each transaction in the financial statements. The purpose of accounting is to ascertain the cumulative effect of the transactions. For accounting, the following steps are followed.



Source Documents

Source documents are basically external documents or documents relating to external activities, which are the first input to the accounting system. These source documents come into the company through a variety of departments, in particular, and most obviously the sales and purchasing departments, and they head towards the accounting department for processing.

Source documents include the following :

1. Sales order : A customer place order in writing or signs an order for goods and services he wishes to buy.

2. Purchase order : A business makes an order from another business for the purchase of goods or services.

3. Invoices and credit notes : These are discussed further below.

4. Petty cash voucher : It is prepared for petty cash expenses.

5. Credit card sales voucher : When goods are sold against credit card, a credit card sales voucher is prepared by the seller and signed by the customer. Credit card sales are entered in the cash book as cash sales.

Invoices

An invoice relates to a sales order or a purchase order. When a business sells goods or services on credit to a customer, it sends out an invoice. It shows the goods sold, with descriptions, quantities, prices and trade discounts. The details in the invoice should match with the details on the sales order. It may include additional charges — for insurance, carriage and container. It also shows the total amount due from the customer.

When a business buys goods or services on credit it receives an invoice from the supplier. The details in the invoice should match with the details on the purchase order. An invoice is often prepared on multi-part stationery or carbon copied. The top copy is sent to customer and other copies are used by the different departments within the business.

A specimen of an invoice is given below :

INVOICE

No- 786/2015 Date : 19th Feb, 2015

Sony India Ltd.
40, Jawaharlal Nehru Road
Kolkata 700016

Customer's Name
Capital Electronics
42, Gariahat Road, Kolkata 700019

Qty.	Description	Rate	Amount	Total (₹)	Remarks
10 Pcs.	Colour T V	25,000	2,50,000		
	Less : Trade Discount 20%		50,000	2,00,000	
E & O E					

Credit Note

In all businesses goods are returned for different reasons. They may have been damaged in transit, the wrong size or make may have been supplied; or the goods were found to be faulty. When goods are returned by the customers, a document is prepared called "credit note" and sent it to customer to intimate him that his account has been credited.

Credit notes are similar in style and layout to invoices, but they are usually smaller and printed in red.

A credit note is also sent to the customer in the following cases :

1. When allowances is granted for defective goods.
2. When containers are returned by the customers.
3. When excessive charge was made by mistake.

A specimen of credit note is given below :

CREDIT NOTE No. 99

Kirloskar Electric Co. Ltd.
Bombay-Pune Highway
Pune
Maharashtra

Date : 19th November, 2015

To
Shyam Trading Corporation
10, Asaf Ali Road
New Delhi 110 011

We have credited your account as follows :

Goods Returned	₹
1 piece Electric Motor 15 HP	25,000
1 piece Pump	10,000
	35,000

For Kirloskar Electric Co. Ltd.

Voucher

The ***voucher*** is a document which provides the authorisation to pay and specifies the accounts to be debited and credited. It is prepared for each expenditure, regardless of whether the expenditure covers services, merchandise for resale or assets for use in the business. A voucher, as illustrated on page 3.3, is attached to each incoming invoice and given an identification number.

The voucher has space for listing the data from the invoice. Space is also provided for approval of signatures for each step in the verification and approval of the liability. It contains written evidence that :

1. All expenditures have been incurred on the basis of proper authorisation, for example, against purchase order.
2. The goods and services have been received in full.
3. The payment has been made only for the goods and services received.

Features of a Voucher

The form of a voucher will vary from organisation to organisation. Regardless of the specific form of the vouchers, the following features are usually present :

1. A separate voucher for every incoming invoice.
2. Consecutive numbering of vouchers.
3. Name and address of creditor listed on voucher.
4. Description of liability.
5. Amount due and terms of payment.
6. Approval of signature for : (a) verification of invoice; (b) recording in accounts; (c) payment of liability.
7. Cheque number and date of cheque listed on voucher.

Preparing a Voucher

A clerk prepares a voucher by filling in the appropriate blanks with data taken from the invoice, such as the invoice date, invoice number and amount, and creditor's name and address.

The voucher with invoice attached is then sent to the employees responsible for verifying and comparing prices, quantities and terms with those specified in the purchase order. After verification, the voucher and supporting documents are sent to an employee of the accounting department, who indicates on the voucher the accounts to be debited and credited. The voucher is now ready to be recorded. But before recording, it is submitted to accounts officer for final approval. After receiving this executive approval, the voucher is entered in the books of original entry.

The specimen of a voucher is given below :

Capital Electronics
Kolkata - 700 019

Pay to ______________________	Voucher No. ____________
______________________	Date ____________
______________________	Date due ____________

Date of Invoice	____________	Gross Amount	____________
Invoice Number	____________	*Less* : Cash Discount	____________
Credit Terms	____________	Net Amount	____________

Approval

	Approved by	Date
Prices in agreement with purchase order	____________	____________
Quantities in agreement with receiving report	____________	
Credit terms in agreement with purchase order	____________	
Account distribution and recording approved	____________	
Approved for payment	____________	
		Accounts Officer

Reverse Side

Account Head	Amount		
		Voucher No.	____________
		Date	____________
Purchases	____________		
Transportation	____________	Date due	
Repairs	____________		
Heat, light and power	____________	Payee	
Misc. general expenses	____________	Amount of Invoice	
Telephone and telegraph	____________	Less : Cash discount	
Sales salaries	____________	Net amount	
Office salaries	____________	Paid by cheque no.	
____________		Date of cheque	____________
____________		Amount of cheque	____________
Credit vouchers payable (total)	____________		
Account distribution by	____________	Entered in voucher register by	

Illustrative Example 1

The following is a typical business transaction :

(a) The purchase of goods on credit.
(b) Allowance to credit customers upon the return of faulty goods.
(c) Refund from petty cash to an employee of an amount spent on entertaining a client.
(d) Credit card sales

For each transaction, identify clearly the original document(s) for the data.:

Solution

(a) The supplier's invoice would be the original document.
(b) The usual documentation is a credit note. Occasionally, however, a customer may himself issue a debit note.
(c) The original documents for the data would be receipts and a petty cash voucher.
(d) The original document would be the credit card sales voucher.

Meaning of Transaction

A transaction is a particular type of external event, which can be expressed in terms of money and brings change in the financial position of a business unit. A transaction involves transfer of something of value between two or more entities. A transaction may be an exchange in which each party receives as well as sacrifices value. In other words, in every transaction, there is a movement of value from one source to another. For example, when goods are purchased for cash, there is a movement of goods from the seller to the buyer and a movement of cash from the buyer to the seller.

A transaction can also be a non-reciprocal transfer in which a business unit incurs a liability (penalty imposed by a local authority) or transfer an asset to another entity (payment of income tax) or receives an asset (subsidy received from Government) or cancellation of a liability (provision for workmen's compensation) without directly receiving (or giving) value in exchange.

Transactions may be external (between a business entity and a second party, for example, goods sold on credit to X) or internal (not involving second party, for instance, depreciation charged on the machinery).

Meaning of Event

Event is an occurrence, happening, change or incident, which may or may not bring any change in the financial position of a business unit. It may be an internal event that occurs within a business unit, such as using new materials in production, death of the general manager or threat by a labour union to call a strike. It may be an external event that involves interaction between a business unit and its environment, for example, a change in the price of a product that the business unit buys or sells, or an improvement in technology by a competitor.

Illustration 1

State with reasons whether the following events are transactions or not to Mr. X (Proprietor) :

(i) Mr. X started business with capital (brought in cash) ₹ 40,000.
(ii) Paid salaries to staff ₹ 5,000.
(iii) Purchased machinery for ₹ 20,000 in cash.
(iv) Placed an order with Sen & Co. for goods for ₹ 5,000.
(v) Opened a bank account by depositing ₹ 4,000.
(vi) Received pass book from bank.
(vii) Appointed Mr. B. Sen as manager on a salary of ₹ 4,000 per month.
(viii) Received interest from bank ₹ 500.
(ix) Received a price list from B.
(x) Received free samples ₹ 1,000.
(xi) Gave lift to a supplier in the business car.
(xii) Sent peon to post office to bring the V.P.P. of ₹ 600.

Solution

Here, each event is to be considered from the view point of Mr. X's business. Those events which can be measured in terms of money and will change the financial position of the business of Mr. X, should be regarded as transaction.

(i) It is a transaction, because it changes the financial position of Mr. X's business. Cash will increase by ₹ 40,000 and Capital will increase by ₹ 40,000.
(ii) It is a transaction, because it changes the financial position of Mr. X's business. Cash will decrease by ₹ 5,000 and Salaries (expenses) will increase by ₹ 5,000.
(iii) It is a transaction, because it changes the financial position of Mr. X's business. Machinery comes in and cash goes out.
(iv) It is not a transaction, because it does not change the financial position of the business.
(v) It is a transaction, because it changes the financial position of the business. Bank balance will increase by ₹ 4,000 and cash will decrease by ₹ 4,000.
(vi) It is not a transaction, because it does not change the financial position of the business of Mr. X.
(vii) It is also not a transaction, because it does not change the financial position of the business of Mr. X.
(viii) It is a transaction, because it changes the financial position of Mr. X's business. Bank interest will increase by ₹ 500 and cash will increase by the same amount.
(ix) It is not a transaction, because it does not change the financial position of the business of Mr. X.
(x) It is not a transaction.
(xi) It is not a transaction because it does not change the financial position of the business of Mr. X.
(xii) It is not a transaction because it does not change the financial position of the business of Mr. X.

Classification of Transaction

Cash transaction: A transaction which involves immediate cash/cheque receipt or payment is called a Cash Transaction. For example, goods sold to X for cash ₹ 5,000. In a cash transaction, the name of the party to whom goods are sold or from whom goods are purchased, is not recorded. This is because, it serves no purpose.

Credit transaction: An external transaction not involving immediate cash receipt or payment is called a Credit Transaction. For example, Purchase of goods on credit from Y. In a credit transaction, delivery of goods and receipt/payment of money takes place on two different dates.

In a credit transaction, the name of the party is recorded to ascertain how much is owed to or from him.

External transaction: A transaction which involves the business entity and a second party is called an External Transaction. For example, goods sold to Ram for ₹ 2,000 on credit.

Internal transaction: A transcation which does not involve a second party is called Internal Transaction. For example, depreciation charged on machinery.

Rules for Determining Cash or Credit Transaction

Students sometimes experience a little difficulty deciding whether a transaction is for cash or on credit. The following rules will help :

(1) Cash purchases, cash sales and all transactions where the word 'paid'is mentioned are to be treated as cash transactions. For example, salary paid, goods sold for cash and so on.

(2) When a personal name or the name of a firm is mentioned in the transaction, it will be treated as credit transaction. For example, goods sold to X for ₹ 500.

(3) When both cash and personal name are mentioned in the transaction, it will be treated as a cash transaction. For example, goods sold to Y for cash ₹ 1,000.

Illustration 2

State whether the following are cash transactions or credit transactions :

1. Sachin commenced business with ₹ 1,00,000.
2. Paid rent in advance ₹ 5,000.
3. Purchased a typewriter for ₹ 7,000 from Sen & Co.
4. Bought furniture from M/s. Modern Furniture for cash ₹ 3,000.
5. Purchased goods from Sohan Brothers for cash ₹ 30,000.
6. Sold goods to Shyam for ₹ 25,000.
7. Bought goods from Ramesh ₹ 20,000.
8. Paid rent ₹ 1,000.
9. Paid salary to staff ₹ 4,000.
10. Received cash from Shyam ₹ 20,000.
11. Paid Romesh ₹ 19,000.

Solution

1. It is a cash transaction.
2. It is a cash transaction.
3. It is a credit transaction.
4. It is a cash transaction.
5. It is a cash transaction.
6. It is a credit transaction.
7. It is a credit transaction.
8. It is a cash transaction.
9. It is a cash transaction.
10. It is a cash transaction.
11. It is a cash transaction.

Illustration 3

State whether the following are external transactions or internal transactions:

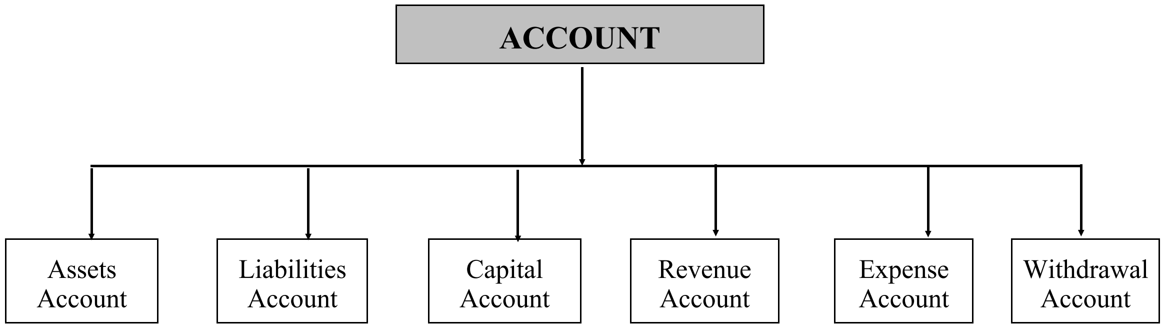
1. Purchased a computer from HCL on credit for ₹ 60,000.
2. Goods destroyed by fire ₹ 1,000 (not insured).
3. Purchased an electronic typewriter for cash ₹ 20,000.
4. Charged depreciation on furniture ₹ 400 and ₹ 200 on typewriter.

Solution

1. It is an external transaction.
2. It is an internal transaction.
3. It is an external transaction.
4. It is an internal transaction.

Classification of Accounts

Modern Classification of Accounts



According to modern approach, accounts are classified into six categories : (1) Assets Account; (2) Liabilities Account; (3) Capital Account; (4) Revenue Account; (5) Expense Account; and (6) Withdrawal Account.

Assets Account : These accounts are accounts of assets and properties such as land, building, plant, machinery, patents, cash investments, inventory, etc.

Liabilities Account : These accounts are accounts of lenders, creditors for goods, creditors for expenses, etc.

Capital Account : It is the account of the proprietor / partner who invested money in the business.

Revenue Account : These are accounts of incomes and gains. Examples are : sales, discount received, interest received, etc. These accounts accumulate data required for preparation of Trading, Profit and Loss Account.

Expense Account : These are accounts of expenses and losses. Examples are : purchases, wages paid, depreciation, rent, rates and taxes, etc. Like Revenue Account, these accounts accumulate data required for preparation of Trading, Profit and Loss Account.

Withdrawal Account : It is the account related to drawings by the proprietor / partners.

Rules for Debit and Credit

Sl. No.	Types of Account	Account to be debited	Account to be credited
1.	Assets Account	Increase ↑	Decrease ↓
2.	Liabilities Account	Decrease ↓	Increase ↑
3.	Capital Account	Decrease ↓	Increase ↑
4.	Revenue Account	Decrease ↓	Increase ↑
5.	Expense Account	Increase ↑	Decrease ↓
6.	Withdrawal Account	Increase ↑	Decrease ↓

Illustration 4

Analyse the following transactions, state the nature of accounts and state which account will be debited and which account will be credited.

(1) Kabir started his business with a cash of ₹ 50,000.
(2) Borrowed from Naresh ₹ 30,000.
(3) Purchased furniture for ₹ 20,000 in cash from Modern Furniture House.
(4) Purchased furniture from Bombay Safe for ₹ 40,000.
(5) Purchased goods for cash ₹ 15,000.
(6) Purchased goods from Romen ₹ 30,000.
(7) Sold goods for Cash to Karim ₹ 25,000.
(8) Sold goods to Shyam on Credit ₹ 30,000.

(9) Received cash from Shyam ₹ 20,000.
(10) Paid cash to Romen ₹ 20,000.
(11) Deposited cash into bank ₹ 15,000 for opening an account.
(12) Withdrew cash for personal use ₹ 1,000.
(13) Withdrew from bank for office use ₹ 5,000.
(14) Withdrew from bank for personal use ₹ 2,000.
(15) Received a cheque from Shyam ₹ 5,000.
(16) Deposited Shyam's cheque next day.
(17) Paid Romen by cheque ₹ 5,000.
(18) Paid salary to staff ₹ 10,000.
(19) Paid rent by cheque ₹ 5,000.
(20) Paid interest on loan ₹ 4,000.

Solution **Analysis of Transactions**

Transactions	Accounts involved	Nature of Account	Debit (₹)	Credit (₹)	Reason
1. Kabir started his business with a cash of ₹ 50,000.	Cash Capital	Asset Capital	50,000	 50,000	Increased Increased
2. Borrowed from Naresh ₹ 30,000.	Cash Loan from Naresh	Asset Liability	30,000	 30,000	Increased Increased
3. Purchased furniture for ₹ 20,000 in cash from Modern Furniture House.	Furniture Cash	Asset Asset	20,000	 20,000	Increased Decreased
4. Purchased furniture from Bombay Safe for ₹ 40,000.	Furniture Bombay Safe	Asset Liability	40,000	 40,000	Increased Increased
5. Purchased goods for cash ₹ 15,000.	Purchases Cash	Expense Asset	15,000	 15,000	Increased Decreased
6. Purchased goods from Romen ₹ 30,000.	Purchases Romen	Expense Liability	30,000	 30,000	Increased Increased
7. Sold goods for Cash to Karim ₹ 25,000.	Cash Sales	Asset Revenue	25,000	 25,000	Increased Increased
8. Sold goods to Shyam on Credit ₹ 30,000.	Shyam Sales	Asset Revenue	30,000	 30,000	Increased Increased
9. Received cash from Shyam ₹ 20,000.	Cash Shyam	Asset Asset	20,000	 20,000	Increased Decreased
10. Paid cash to Romen ₹ 20,000.	Romen Cash	Liability Asset	20,000	 20,000	Decreased Decreased
11. Deposited cash into bank ₹ 15,000 for opening an account.	Bank Cash	Asset Asset	15,000	 15,000	Increased Decreased
12. Withdrew cash for personal use ₹ 1,000.	Drawings Cash	Withdrawal Asset	1,000	 1,000	Increased Decreased
13. Withdrew from bank for office use ₹ 5,000.	Cash Bank	Asset Asset	5,000	 5,000	Increased Decreased
14. Withdrew from bank for personal use ₹ 2,000.	Drawings Bank	Withdrawal Asset	2,000	 2,000	Increased Decreased
15. Received a cheque from Shyam ₹ 5,000.	Cash Shyam	Asset Asset	5,000	 5,000	Increased Decreased
16. Deposited Shyam's cheque next day.	Bank Cash	Asset Asset	5,000	 5,000	Increased Decreased
17. Paid Romen by cheque ₹ 5,000.	Romen Bank	Liability Asset	5,000	 5,000	Decreased Decreased
18. Paid salary to staff ₹ 10,000.	Salary Cash	Expense Asset	10,000	 10,000	Increased Decreased
19. Paid rent by cheque ₹ 5,000.	Rent Bank	Expense Asset	5,000	 5,000	Increased Decreased
20. Paid interest on loan ₹ 4,000.	Interest Cash	Expense Asset	4,000	 4,000	Increased Decreased

Traditional Classification of Accounts

This is a very old system of classifying accounts. Nowadays, in advanced countries this system of classification of accounts is hardly used. Under this system, accounts are classified into four types.

1. Personal Accounts : These accounts show the transactions with the customers, suppliers, money lenders, the bank and the owner. A business may have many credit transactions with the above persons or organisations. A separate account is to be prepared for each of them. Persons or organisations with whom the business has credit transactions are either debtors or creditors. If they have to give some money to the firm, they are called debtors. Conversely, if the firm is to pay them some money they are known as creditors. The main purpose of preparing personal accounts is to ascertain the balances due to or due from persons or organisations.

2. Real Accounts : These accounts are accounts of assets and properties such as land, building, plant, machinery, patent, cash, investment, inventory, etc. When a machinery is purchased for cash, the two accounts involved are machinery and cash — both are Real Accounts. But if the same machine is purchased from Z & Co. on credit, the two accounts involved will be those of Machinery and Z & Co., the former being a Real Account and the latter being a Personal Account.

3. Nominal Accounts : These are the accounts of incomes, expenses, gains and losses. Examples are : Wages paid, discount allowed or received, purchases, sales, etc. These accounts generally accumulate the data required for the preparation of income statement, i.e., the Trading and Profit and Loss Account.

4. Valuation Accounts : Value is a measure, in terms of money, of the usefulness or desirability of an asset. Valuation is the process of attaching a monetary value to some asset (or liability). It is an adjustment usually made to an asset account, in order to allow for, or provide for, a fall in value as a result of, e.g., depreciation or doubtful debts. Where fixed assets are maintained in the books of accounts at original cost, to reflect the actual book value of the assets, a provision for depreciation account on the credit is maintained. In the Balance Sheet, it is shown as a deduction from the original cost of the asset.

Similarly, if the Debtors' personal accounts are retained at total amount due, a valuation account on the credit — provision for doubtful debts is required. In the Balance Sheet, it is shown as a deduction from Sundry Debtors Account to reflect estimated realisable value.

Illustration 5

Following accounts are being maintained in the books of Sri Pratap Sathpathy & Co. Classify them under Personal, Real and Nominal headings.

(i) Cash; (ii) Bank; (iii) Commission; (iv) Salaries; (v) Discount; (vi) Bills Receivable; (vii) Sohan Lal; (viii) Behera Brothers; (ix) Depreciation; (x) Bad Debt.

Solution

(i) Cash — **Real Account**; (ii) Bank — **Personal Account**; (iii) Commission — **Nominal Account**; (iv) Salaries — **Nominal Account**; (v) Discount — **Nominal Account**; (vi) Bills Receivable — **Real Account**; (vii) Sohan Lal — **Personal Account**; (viii) Behera Brothers — **Personal Account**; (ix) Depreciation — **Nominal Account**; (x) Bad Debt — **Nominal Account**.

Illustration 6

The following accounts are maintained in the books of Ghanashyam. Classify these under : Personal, Real and Nominal headings : (i) Interest; (ii) Cash; (iii) Bank; (iv) Mohan Lal; (v) Saraswati Pustak Bhandar; (vi) Vidyapuri; (vii) Motor Vehicles; (viii) Goodwill; (ix) Depreciation; (x) Commission.

Solution

(i) Interest — **Nominal Account**; (ii) Cash — **Real Account**; (iii) Bank — **Personal Account**; (iv) Mohan Lal — **Personal Account**; (v) Saraswati Pustak Bhandar — **Personal Account**; (vi) Vidyapuri — **Personal Account**; (vii) Motor Vehicles — **Real Account**; (viii) Goodwill — **Real Account**; (ix) Depreciation — **Nominal Account**; (x) Commission — **Nominal Account**.

Illustration 7

Classify the following into Real, Nominal, Personal and Valuation Accounts :

(i) Plant and Machinery; (ii) Purchases ; (iii) Investment; (iv) Bank; (v) Provision for Bad and Doubtful Debt; (vi) Tata Iron and Steel Co. Ltd.; (vii) Rent; (viii) Land and Building; (ix) Carriage Outwards; (x) Capital; (xi) Leasehold property; (xii) Trademark; (xiii) Returns outwards; (xiv) Import duty; (xv) Provision for depreciation.

Solution

(i) Plant and Machinery — **Real Account**; (ii) Purchases — **Nominal Account**; (iii) Investment — **Real Account;** (iv) Bank **— Personal Account**; (v) Provision for Bad and Doubtful Debt — **Valuation Account**; (vi) Tata Iron and Steel Co. Ltd **— Personal Account**; (vii) Rent — **Nominal Account**; (viii) Land and Building — **Real Account**; (ix) Carriage Outwards — **Nominal Account**; (x) Capital — **Personal Account**; (xi) Leasehold Property — **Real Account**; (xii) Trade Mark — **Real Account**; (xiii) Returns Outwards — **Nominal Account**; (xiv) Import Duty — **Nominal Account**; (xv) Provision for Depreciation — **Valuation Account**.

It has already been stated that each transaction involves two or more accounts. After ascertaining the accounts involved, our next problem is to decide which account should be debited and which account should be credited.

Rules for Debit and Credit (Traditional)

Debit and credit are simply additions to or subtraction from an account. In accounting, debit refers to the left hand side of any account and credit refers to the right side. Asset, expenses and losses accounts normally have debit balances; liability, income and capital accounts normally have credit balances.

The term debit is derived from the latin base *debere* (to owe) which contracts to the form 'Dr.' used in journal entries to refer to debits. Credit comes from the word *credere* (that which one believes in, including persons, like a creditor), which contracts to the form 'Cr.' used in journal entries for a credit.

1. Personal Accounts : Debit the account of the person who receives something and credit the account of the person who gives something.

2. Real Accounts : Debit the account of the asset/property which comes into the business or addition to an asset, and credit the account which goes out of the business. When furniture is purchased for cash, furniture account is debited (which comes into the business) and cash account is credited (which goes out of the business).

3. Nominal Accounts : Debit the accounts of expenses and losses, and credit the accounts of incomes and gains. When wages are paid, wages account is debited (expenses) and cash account is credited (asset goes out).

4. Valuation Account : Debit the account when the account is to be reduced and credit the account when the account is to be increased.

Rules for Debit and Credit at a Glance

Types of Account	Account to be debited	Account to be credited
1. Personal Account	Receiver	Giver
2. Real Account	What comes in	What goes out
3. Nominal Account	Expense and Loss	Income and Gain
4. Valuation Account	When account to be decreased	When account to be increased

Illustration 8

From the following transactions, state the nature of accounts and state which account will be debited and which account will be credited :

1. Mr. A started business with ₹ 50,000 in cash.
2. Purchased goods for cash ₹ 10,000.
3. Sold goods for cash ₹ 15,000.
4. Purchased goods from X for cash ₹ 5,000.
5. Sold goods to B for ₹ 6,000.
6. Purchased furniture for ₹ 4,000.
7. Purchased plant for ₹ 10,000.
8. Paid wages ₹ 400.

Solution

1. Mr. A started business with ₹ 50,000 — Here, accounts involved are (i) Cash Account and (ii) Capital Account.

(i) Cash Account ⟶ Real ⟶ Debit (Incomings)
(ii) Capital Account ⟶ Personal ⟶ Credit (Giver)

2. Purchased goods for cash ₹ 10,000 — Here, accounts involved are (i) Purchases Account and (ii) Cash Account

(i) Purchases Account ⟶ Nominal ⟶ Debit (Expenses)
(ii) Cash Account ⟶ Real ⟶ Credit (Outgoings)

3. Sold goods for cash ₹ 15,000 — Here, accounts involved are (i) Cash Account and (ii) Sales Account

(i) Cash Account ⟶ Real ⟶ Debit (Incomings)
(ii) Sales Account ⟶ Nominal ⟶ Credit (Income)

4. Purchased goods from X for cash ₹ 5,000 — Here, accounts involved are (i) Purchases Account and (ii) Cash Account
(i) Purchases Account → Nominal → Debit (Expenses)
(ii) Cash Account → Real → Credit (Outgoings)

5. Sold goods to B for ₹ 6,000 — Here, accounts involved are (i) B Account and (ii) Sales Account
(i) B Account → Personal → Debit (Receiver)
(ii) Sales Account → Nominal → Credit (Income)

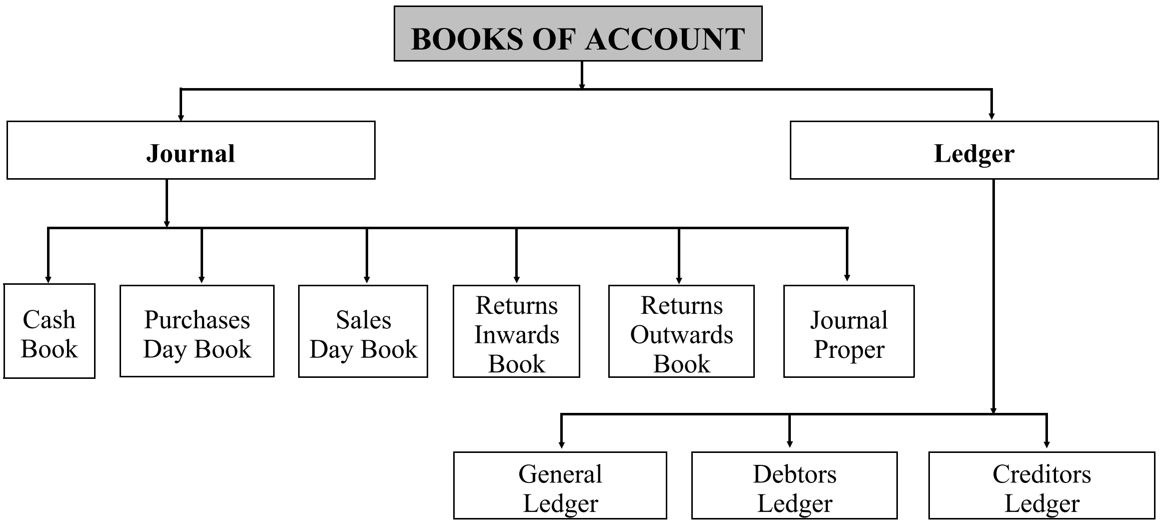
6. Purchased furniture for ₹ 4,000 — Here, accounts involved are (i) Furniture Account and (ii) Cash Account
(i) Furniture Account → Real → Debit (Incomings)
(ii) Cash Account → Real → Credit (Outgoings)

7. Purchased plant for ₹ 10,000 — Here, accounts involved are (i) Plant Account and (ii) Cash Account
(i) Plant Account → Real → Debit (Incomings)
(ii) Cash Account → Real → Credit (Outgoings)

8. Paid wages ₹ 400 — Here, accounts involved are (i) Wages Account and (ii) Cash Account
(i) Wages Account → Nominal → Debit (Expenses)
(ii) Cash Account → Real → Credit (Outgoings)

Journal and Ledger

Nowadays, many businesses use computers for maintaining accounting records and data may be stored on floppy disks rather than in journals and ledgers. However, an understanding of accounting concepts is most easily acquired by the study of manual accounting system. For this reason, we shall use standard written accounting forms, such as journal and ledger, as the model for a study of basic accounting concepts.



The Journal and its Nature

The first book in which the transactions of a business unit are recorded is called a Journal. Here, business transactions are recorded in chronological order, i.e. in the order in which they occur. Each record in a journal is called an entry. As a journal is the first book in which entries are recorded, a journal is also known as a book of original entry.

A journal entry is an analysis of the effects of a transaction on the accounts, usually accompanied by an explanation (properly called as a narration). Therefore, a journal is a tool for analysing and describing the impact of various transactions upon a business unit. Before a journal entry is passed, it is necessary to decide for each transaction, what are the accounts involved. It is also necessary that the accounts to be debited or credited are identified.

Ruling of a Journal

In its usual form, a Journal is divided by vertical lines into five columns in which to enter, in respect of each transactions : (a) Date; (b) Particulars; (c) Ledger folio; (d) Amount (debit); (e) Amount (credit).

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

Date	Particulars	L.F.	Amount	Amount
(a)	(b)	(c)	(d)	(e)

(a) The date : The year is written at the top of the date column of each page of the journal. Thereafter, on the next line of the date column, the month and day of the first entry are written. Unless the month or year changes or until a new page is begun, neither the month nor the year is repeated on the page.

(b) Particulars : The particulars column is the column for account titles and description. The name of the account to be debited is entered at the extreme left of the particulars column next to the date column. The symbol 'Dr.' is written at the right end of the particulars column on the same line of the account debited. The amount of the account debited is entered in the left hand money column. The name of the account to be credited is entered on the next line with a prefix 'To' and is indented to the right of the date column. The amount of the account credited is entered in the right hand money column. A short explanation of the transaction known as narration begins on the line immediately below the account credited. The narration should be adequate to explain the transaction and may include any data needed to identify the transaction. It should be noted that the narration is particularly important for non-routine transactions where their nature is, otherwise, not apparent. The narration always appears within parentheses and is begun with the word "Being" — which means what it is. Finally, a thin line is drawn all through the particulars column to indicate that the entry of a transaction has been completed.

(c) Ledger folio (L.F.) : The ledger folio column to the right of the particulars columns is not filled in when transactions are recorded in the journal. When the debits and credits are posted in the ledger accounts, the page number of the ledger in which these accounts are appearing are listed in this column.

(d) Amount (Debit) : The debit amount is recorded in the amount (Dr.) column opposite the title of the account debited. The unit of measurement, i.e. ₹ is recorded at the top of this column on each page and this is not repeated.

(e) Amount (Credit) : The credit amount is recorded in the amount (Cr.) column opposite the title of the account credited. Like the amount (Dr.) column, ₹ is recorded at the top of this column on each page.

Example of a Journal Entry :

This can be illustrated by means of an example. We suppose, on 1.1.2015, a trader sells goods for cash ₹ 1,000. Here, the accounts involved are—Cash Account and Sales Account. Cash Account is to be debited and the Sales Account is to be credited.

Again, we suppose that on 2.1.2015 goods worth ₹ 500 were purchased for cash. Here, Purchases Account is to be debited and Cash Account is to be credited. The entries in the Journal will be as under :

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

	Date	Particulars		L.F.	Amount	Amount
	2015					
Debit Account	Jan, 1	Cash Account	Dr.		1,000	
Credit Account		To Sales Account				1,000
Narration		(Being goods sold for cash)				
Month and year not repeated	2	Purchases Account	Dr.		500	
		To Cash Account				500
		(Being goods purchased for cash)				

In connection with the journal, the following points are to be remembered :

1. ***For each transaction, the exact accounts should be debited and credited. For that, the two accounts involved must be identified to pass a proper journal entry.***
2. ***Sometimes, a journal entry may have more than one debit or more than one credit. This type of journal entry is called compound journal entry. Regardless of how many debits or credits are contained in a compound journal entry, all the debits are entered before any credits are entered. The aggregate amount of debits should be equal to the aggregate amount of credits.***

> ***3. For a business, journal entries generally extend to several pages. Therefore, the total are cast at the end of each page, against the debit and credit columns, the following words are written in the particular column, which indicates carried forward (of the amount on the next page) 'Total c/f'.***
>
> ***The debits and credits totals of the page are then written on the next page in the amount columns; and opposite to that on the left, the following words are written in the particulars column to indicate brought forward (of the amount of the previous page) 'Total b/f'. This process is repeated on every page and on the last page, 'Grand Total' is cast.***

Simple and Compound Journal Entries

A journal entry which contains only one debit entry and one credit entry is called a ***Simple Journal Entry***.

Example of a simple journal entry is given below :

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

Date	Particulars		L.F.	Amount	Amount
2015 May 5	Cash A/c To Capital A/c (Being cash brought in as capital ₹ 50,000)	Dr.		50,000	 50,000

A journal entry which contains more than one debit entry or more than one credit entry or both is called a ***Compound Journal Entry***. It should be noted that total amount debited must be equal to total amount credited. In fact, a compound journal entry is nothing but a combination of two or more simple journal entries.

Example of a compound journal entry is given below :

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

Date	Particulars		L.F.	Amount	Amount
2015 May 5	Building A/c Furniture A/c Cash A/c To Capital A/c (Being different assets brought in as capital)	Dr. Dr. Dr.		1,00,000 80,000 20,000	 2,00,000

> **Key Points to Remember**
>
> ***1. Unless instructed to the contrary, assume that all transactions for the purchase or the sale of goods are on credit when a personal name or the name of a firm is mentioned in the question.***
> ***2. No need to mention the name of buyer or seller in the case of cash purchase or a cash sale, as money is simply exchanged for goods handed over.***
> ***3. Cash purchases, cash sales and all transactions where the word 'paid' is mentioned are obviously cash transactions.***
> ***4. When goods are purchased or sold for cash, the name of the supplier or customer is immaterial. Therefore, it is to be ignored at the time of recording transaction.***
> ***5. Return of goods by customer (sales returns) is recorded in the Returns Inwards Account or Sales Returns Account.***
> ***6. Return of goods to supplier (purchase returns) is recorded in the Returns Outwards Account or Purchase Returns Account.***

Illustration 9

2015

January 1 Mr. Peter commences business as a computer merchant, trading under the name of 'Computer Point' with a capital of ₹ 4,00,000 brought in cash.

3 He buys on credit from Hindusthan Computers Ltd., 10 computers @ ₹ 30,000 each.

15 He receives an invoice from Janata Transport Corporation for ₹ 5,000 in respect of carriage of computers from Bangalore.

20 He opens a bank account by depositing ₹ 3,50,000.

25 He sells 6 computers on credit to ABC Computers @ ₹ 35,000 each.

29 He pays by cheque the amount for carriage.
31 He receives cash ₹ 2,00,000 from ABC Computers.
31 He issues a cheque to Hindusthan Computers Ltd. for ₹ 3,00,000.

You are required to pass necessary Journal entries in the books of Computer Point.

Explanation: In this illustration, there are eight distinct transactions to be recorded:

1. The commencement of business : At the very beginning, it must be clearly understood that we are concerned only with the transactions of Computer Point. From the accounting point of view, the business and its proprietor are two distinct entities. If Mr. Peter takes any computer for his personal use, his account will be debited with the cost (represented by Drawings Account). Similarly, if he introduces capital in the business, his account will be credited (being giver) with the amount of capital.

Here, Mr. Peter introduces ₹ 4,00,000 as capital (in effect lending this sum to the business). In the books of Computer Point, Cash Account will be debited because Cash (Real Account)—***comes in*** and Peter's Capital Account will be credited because Peter's Capital Account (Personal Account)—***giver***.

2. Purchase of computers on credit : Mr. Peter's business is the purchase and sale of computers. Therefore, for recording this transaction, Purchases Account will be debited (Nominal Account—***expenses***) and Hindusthan Computers Ltd. will be credited (Personal Account—***giver***).

In this respect, we must mention that if the computer is used for the purpose of maintaining accounts of the business, Office Equipment Account will be debited in place of Purchases Account.

3. Carriage of the computers : Janata Transport Corporation performs the service of transporting computers from Bangalore. To record this transaction, Carriage Inward Account will be debited and Personal Account of Janata Transport Corporation will be credited. Here, students should note that carriage paid for bringing the purchased goods to the business godown is treated as 'Carriage Inward', whereas carriage paid to deliver the sold goods is treated as 'Carriage Outward'.

4. Opening of Bank Account : Here, Bank is receiving money from the business. Bank Account will be debited (Personal Account—***receiver***) and Cash Account will be credited (Real Account—***goes out***).

5. Sale of computers on credit : ABC Computers Account will be debited (Personal Account—***receiver***) and Sales Account will be credited (Nominal Account—***income***).

6. Payment to Janata Transport Corporation : Janata Transport Corporation receives cheque in settlement of its account for carriage. So, Janata Transport Corporation Account will be debited (Personal Account—***receiver***) and Bank Account will be credited (Personal Account—***giver***).

(Note that this transaction will not affect Carriage Inward Account).

7. Cash received from ABC Computers : To record this transaction, Cash Account will be debited (Real Account—***comes in***) and ABC Computer Account will be credited (Personal Account—***giver***).

8. Payment to Hindusthan Computers : This transaction is similar to above (6). Therefore Hindusthan Computer Ltd. will be debited (Personal Account—***receiver***) and Bank Account will be credited (Personal Account—***giver***).

Solution

In the books of Computer Point
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 Jan. 1	Cash A/c	Dr.		4,00,000	
	To Capital A/c				4,00,000
	(Being business started with capital brought in cash)				
3	Purchases A/c	Dr.		3,00,000	
	To Hindusthan Computers Ltd. A/c				3,00,000
	(Being the purchase of 10 computers @ ₹ 30,000 each on credit)				
15	Carriage Inward A/c	Dr.		5,000	
	To Janata Transport Corporation A/c				5,000
	(Being carriage charges payable)				
20	Bank A/c	Dr.		3,50,000	
	To Cash A/c				3,50,000
	(Being the opening of a Bank Account)				
25	ABC Computers A/c	Dr.		2,10,000	
	To Sales A/c				2,10,000
	(Being the sale of 6 computers @ ₹ 35,000 each on credit)				

29	Janata Transport Corporation A/c To Bank A/c (Being paid by cheque)	Dr.		5,000	5,000
31	Cash A/c To ABC Computers A/c (Being cash received from ABC Computers)	Dr.		2,00,000	2,00,000
31	Hindusthan Computers A/c To Bank A/c (Being paid by cheque)	Dr.		3,00,000	3,00,000
	Grand Total			17,70,000	17,70,000

Subdivision of Journal

The journal is inadequate as the sole book of the original entry when the transactions are numerous. The nature of operations and the volume of transactions in the particular business determine the number and type of journals needed. A medium size business generally maintains the following types of journals :

1. Cash Book — to record cash transactions;
2. Sales Day Book — to record credit sales;
3. Purchases Day Book — to record credit purchases;
4. Sales Return Day Book — to record sales returns;
5. Purchases Return Day Book — to record purchases returns;
6. Bills Receivable Book — to record bills receivable;
7. Bills Payable Book — to record bills payable;
8. Petty Cash Book — to record petty cash payments; and,
9. Journal Proper — to record residuary transactions. It is also used for rectifying errors.

The Ledger

The ledger is the principal book of accounts where similar transactions relating to a particular person or thing are recorded. The journal is used to record the transactions in the chronological order. The owner of a business is not interested to know the effect of individual transaction on the financial statements, what he wants is the accumulated effect of each 'Chart of Accounts'. Chart of accounts is an index to all accounts contained in a double entry system. It allocates to each account a number and arranges accounts in logical subdivisions. For example, if he wants to know the total purchases for an accounting period, he will only see the ''Purchase Account''.

It is not possible to ascertain from the journal the total amount of purchases made. In the journal, record of purchases made at different dates can also be against cash or credit. Therefore, similar transactions should be sorted out and consolidated at one place to ascertain their net effect. This kind of processing is possible where different accounts are prepared in the ledger. Again, for example, to ascertain the cash position of a business, one is to look at the Cash Account; one can not know cash position with the help of a journal. Likewise, to ascertain net sales for the account period, one is to look at the Sales Account, which incorporates all information with regard to cash sales, credit sales, and the like.

Therefore, an account represents a detailed record of changes that have occured in a particular asset, liability, expense, loss, gain or capital during an accounting period.

Can Ledger suffice without a Journal ?

The owner of a business is not interested to know the effects of individual transactions on the financial statements (Trading, Profit and Loss Account and Balance Sheet), what he wants is the accumulated effect of each "Account". For example, if he wants to know the total purchases for an accounting period, he will only see the "Purchases Account". It is not possible to ascertain from the journal the total amount of purchases made. In the journal, record of purchases are made at different dates, which can also be against cash or credit. Therefore, similar transactions should be sorted out and consolidated at one place to ascertain their net effect. This kind of processing is possible where different accounts are prepared in the ledger.

The ledger is regarded as a principal book of account for the following reasons :

1. The ledger helps us preparing the trial balance to ensure the arithmatical accuracy of the books of account.
2. The ledger assists us in preparing the Trading, Profit and Loss Account and the Balance Sheet.
3. Amounts due to creditors or due from debtors can be ascertained through ledger.
4. Ledger reduces the possibility of errors, improves the probability of locating errors that do occur.

From the above, it is clear that ledger is the principal book of account but journal entry cannot be avoided for the following reasons :

1. It is a first or primary record in which transactions are analysed before they are posted to ledger.
2. A journal is the record which shows the complete story of a transaction in one entry.
3. It shows all necessary information regarding a transaction. The Ledger Account cannot provide detailed information of a transaction.
4. It provides an explanation of the transaction.
5. It provides a date-wise record of all the transactions.
6. It provides an individual source of quick reference in the future in response to queries.

Subdivisions of Ledger

While the number of transactions relating to a business is small, all the accounts may be maintained in one single ledger. However, after a business has reached a certain size, the number of transactions which require recording will become so large that the operation of one ledger will become both cumbersome and difficult to implement. As a business expands the volume of transactions will require the employment of more than one person to maintain the accounts, and some kind of division of the ledger is needed if both are to be able to work at the same time.

There are no hard and fast rules, but the generally accepted division of ledger is as follows :

1. Sales Ledger / Debtors' Ledger : It contains the personal accounts of all those to whom goods have been sold on credit. The total of the balances on this ledger will give "Sundry Debtors" for the Trial Balance and the Balance Sheet. The accounts concerned are arranged in alphabetical order and the number of accounts involved may require more than one "Sales Ledger" to contain the surnames within 'A — D'; 'E — J'; 'K — P'; and so on.

2. Bought Ledger / Creditors' Ledger : It contains the personal accounts of all those who supplied goods on credit. The total of the balances on this ledger will give "Sundry Creditors" for the Trial Balance and the Balance Sheet. Again, the accounts are arranged in alphabetical order and subdivision 'A — H'; 'I — Z' may be necessary.

3. General Ledger : It contains all the real accounts such as Building, Plant and Machinery, Office Equipments, Furniture and Fixtures and so on.

4. Nominal Ledger : It contains all those accounts which are normally looked upon as expenses (e.g., wages, salaries, rent, rates and taxes, insurance, carriage, discount allowed and so on). Accounts dealing with income (such as commission received, rent received and discount received) are also maintained in this ledger. In the category of nominal accounts we also include purchases, sales, return inwards, return outwards, depreciation, provision for bad debts, etc.

5. Private Ledger : In some cases, accounts of a confidential nature, such as capital or drawings or salaries of senior staff, may be kept in a separate private ledger.

6. Cash Book : It contains two ledger accounts — cash and bank.

It should be noted that some organisations are not maintaining nominal ledger, general ledger and private ledger separately. They are combined in a single 'general ledger'.

Standard Form of Ledger Account

'T' accounts are simplified representation of ledger accounts and is widely used. A 'T' account is divided into two sides, the left hand side represents the debit side and the right hand side represents the credit side. Each side of the ledger has columns of varying sizes for the following :

(a) Date; (b) Particulars; (c) Folio; and (d) Amount.

A specimen 'T' form account is as under :

Dr. **Title of Account** **(Account No ...)** **Cr.**

Date	Particulars	Folio	₹	Date	Particulars	Folio	₹

Running Balance form of Ledger Account

An alternative ruling of a ledger, which is generally adopted by commercial banks and some other business houses, is that the entire ledger is divided into six columns as under :

(a) Date; (b) Particulars; (c) Folio; (d); Dr. Amount; (e) Cr. Amount; and (f) Balance.

The specimen of such ruling is as under :

Bank Account **(Account No ...)**

Date	Particulars	Folio	Dr. Amount	Cr. Amount	Balance
2015			₹	₹	₹
June 1	To Balance b/d		—	—	5,000 (Dr.)
	To Sales		10,000	—	15,000 (Dr.)
5	By Salary		—	4,000	11,000 (Dr.)

The *Date* column shows the date of the transaction, which is not necessarily the same as the date on which entry is made in the account.

The *Particulars* column is used for writing the name of the accounts debited or credited.

The *Folio* column is used to list the page number of the journal in which the transaction is recorded, thus making it possible to trace ledger entries back to their source (a journal).

The *Dr. Amount* column is used for writing the amount of the account debited. Similarly *Cr. Amount* column is used for writing the amount of the account credited.

The *Balance* column is used for writing the new balance each time the account is debited or credited. Thus, the current balance of the account can always be observed at a glance.

Sequence and Numbering of Ledger Accounts

Ledger accounts are generally arranged in some logical manner, such as assets first, followed by liabilities, owner's equity, revenues and expenses. Again among assets, fixed assets are first followed by current assets and so on. The number of accounts required by a business will depend upon its size, the nature of its operations, and the policy of the management. An identification number is assigned to each account in the ledger to facilitate their location. A Chart of Accounts is a list of account titles and account numbers being used by a given business. Its main purpose is to guide those who are engaged in accounting and recording work.

Account Title	Account Number
Fixed Assets (1 — 15)	
Goodwill	01
Land	02
Building	03
Current Assets (16 — 25)	
Stock in trade	16
Sundry Debtors	17
Bills Receivable	18
Cash at bank	19
Liabilities (26 — 50)	
Bills Payable	26

Posting

The process of transferring of the debits and credits from the journal to the ledger accounts is called posting. Each amount entered in the debit column of the journal is posted by entering it on the debit side/column of an account in the ledger, and each amount entered in the credit column of the journal is posted by entering it on the credit side/column of an account in the ledger. Posting from journal to the ledger accounts are necessary in order to know how transactions have changed the account balances.

The Mechanics of Posting

The following procedures are followed for posting :

1. Locate in the ledger the 1st account named in the journal.
2. Enter on the debit side of the ledger in particulars column, the name of the account credited with a prefix ‘To’.
3. Enter the date of the transaction in the date column.
4. Enter in the debit column of the ledger account, the amount of debit as shown in the journal.
5. Enter in the folio column of the ledger, the number of the journal page from which the entry is being posted.
6. Enter in the folio column of the journal, the number of the ledger page in which the posting has been done.
7. Locate in the ledger the second account named in the journal.
8. Enter in the credit side of the ledger in particulars column, the name of the account debited with a prefix ‘By’.
9. Enter the date of the transaction in the date column.
10. Enter in the credit column of the ledger account the amount of credit as shown in the journal.
11. Enter in the folio column of the ledger, the number of the journal page from which the entry is being posted.
12. Enter in the folio column of the journal, the number of the ledger page in which posting has been done.

Illustration of posting process

Journal (Page 5)

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 July 9	Cash A/c	Dr.	9	10,000	
	To Capital A/c		20		10,000
	(Being new capital introduced)				

Ledger

Cash Account (Page 9)

Dr. Date	Particulars	J.F.	₹	Cr. Date	Particulars	J.F.	₹
2015 July 9	To Capital A/c	5	10,000				

Capital Account (Page 20)

Dr. Date	Particulars	J.F.	₹	Cr. Date	Particulars	J.F.	₹
				2015 July 9	By Cash A/c	5	10,000

Balancing Ledger Accounts

Balance is the sum necessary to equalise the debit and credit totals of an account. Periodically, all the accounts in a ledger are balanced to ascertain the cumulative effect of entries on the accounts. The *balance* is an accounting term which means the difference between the two sides of an account, or the total of an account containing only debits and credits. A computerised system will usually print the balance of the account after each transaction, but in a manual system we must calculate the balance.

Where the total of the debit side exceeds the total of the credit side, the account is said to have a *debit balance*.

Where the total of the credit side exceeds the total of the debit side, the account is said to have a *credit balance*. Therefore, balancing is the process of bringing two sets of related figures into agreement.

The following steps are followed for balancing the accounts :

1. On a rough sheet of paper take the total of the two sides of the account concerned.
2. Compute the difference of the total of two sides.
3. If the debit side total is more, put the difference on the credit side amount column, by writing the words in particulars column 'By Balance c/d'. If the credit side total is more, put the difference on the debit side amount column by writing the words in particulars column 'To Balance c/d'.
4. After putting the difference in the appropriate side of the account, add both the sides of the account. Draw a thin line above and below the total.
5. Bring down the debit balance on the debit side by writing the words in particulars column 'To Balance b/d'. Similarly bring down the credit balance on the credit side by writing the words in the particulars column 'By Balance b/d'.

Dr. **Bank Account** **(Account No ...)** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
1.6.2015	To Capital A/c		30,000	5.6.2015	By Purchases A/c		10,000
10.1.2015	To Sales A/c		15,000	20.6.2015	By Wages A/c		5,000
				25.6.2015	By Freight A/c		2,000
				30.6.2015	By Balance c/d		28,000
			45,000				45,000
1.7.2015	To Balance b/d		28,000				

Illustration 10

Pass necessary journal entries and post them in the appropriate Ledger Accounts of P. Basak for the month of January 2015:

1 Started business with ₹ 2,00,000 in the bank and ₹ 40,000 cash;
1 Bought shop fittings ₹ 40,000 and a van ₹ 60,000 both paid by cheque;
2 Paid rent by cheque ₹ 5,000;
3 Bought goods for resale on credit from Zakir & Co ₹ 50,000;
5 Cash sales ₹ 5,000;
8 Paid wages of assistant in cash ₹ 1,000;
10 Paid insurance by cheque ₹ 500;
12 Cash sales ₹ 8,000;
15 Paid wages of assistant in cash ₹ 1,000; Goods returned to Zakir & Co ₹ 6,000;
17 Paid Zakir & Co ₹ 30,000 by cheque;
19 Bought goods for resale on credit from Rao & Co ₹ 25,000;
19 Cash sales ₹ 7,000;
22 Paid wages of assistant in cash ₹ 1,000;
24 Bought stationery, paid in cash ₹ 500;
25 Cash sales ₹ 15,000;
27 Paid Rao & Co ₹ 14,000 by cheque;
29 Paid wages of assistant in cash ₹ 1,000;
31 Paid ₹ 20,000 into the bank.

Solution **In the books of P. Basak**

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

Date	Particulars		L.F.	₹	₹
2015 Jan 1	Bank A/c	Dr.		2,00,000	
	Cash A/c	Dr.		40,000	
	To Capital A/c				2,40,000
	(Being capital invested)				
1	Furniture & Fittings A/c	Dr.		40,000	
	Van A/c	Dr.		60,000	
	To Bank A/c				1,00,000
	(Being the purchase of furniture and fittings and van for the business)				

2	Rent A/c Dr. To Bank A/c (Being rent paid by cheque)			5,000	5,000
3	Purchases A/c Dr. To Zakir & Co. A/c (Being goods purchased on credit)			50,000	50,000
5	Cash A/c Dr. To Sales A/c (Being goods sold for cash)			5,000	5,000
8	Wages A/c Dr. To Cash A/c (Being wages paid to assistant)			1,000	1,000
10	Insurance A/c Dr. To Bank A/c (Being insurance paid by cheque)			500	500
12	Cash A/c Dr. To Sales A/c (Being goods sold for cash)			8,000	8,000
15	Wages A/c Dr. To Cash A/c (Being wages paid in cash)			1,000	1,000
15	Zakir & Co A/c Dr. To Returns Outwards A/c (Being goods returned to Zakir & Co.)			6,000	6,000
17	Zakir & Co A/c Dr. To Bank A/c (Being paid by cheque)			30,000	30,000
19	Purchases A/c Dr. To Rao & Co A/c (Being goods purchased on credit)			25,000	25,000
19	Cash A/c Dr. To Sales A/c (Being goods sold for cash)			7,000	7,000
22	Wages A/c Dr. To Cash A/c (Being wages paid to assistant)			1,000	1,000
24	Stationery A/c Dr. To Cash A/c (Being purchase of stationery)			500	500
25	Cash A/c Dr. To Sales A/c (Being goods sold for cash)			15,000	15,000
27	Rao & Co A/c Dr. To Bank A/c (Being paid by cheque)			14,000	14,000
29	Wages A/c Dr. To Cash A/c (Being wages to assistant paid in cash)			1,000	1,000
31	Bank A/c Dr. To Cash A/c (Being cash paid into bank)			20,000	20,000
	GRAND TOTAL			5,30,000	5,30,000

Dr. **Bank Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
1.1.2015	To Capital A/c		2,00,000	1.1.2015	By Furniture & Fittings A/c		40,000
31.1.2015	To Cash A/c		20,000		By Van A/c		60,000
				2.1.2015	By Rent A/c		5,000
				10.1.2015	By Insurance A/c		500
				17.1.2015	By Zakir & Co A/c		30,000
				27.1.2015	By Rao & Co A/c		14,000
				31.1.2015	By Balance c/d		70,500
			2,20,000				2,20,000
1.2.2015	To Balance b/d		70,500				

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

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
1.1.2015	To Capital A/c		40,000	8.1.2015	By Wages A/c		1,000
5.1.2015	To Sales A/c		5,000	15.1.2015	By Wages A/c		1,000
12.1.2015	To Sales A/c		8,000	22.1.2015	By Wages A/c		1,000
19.1.2015	To Sales A/c		7,000	24.1.2015	By Stationery A/c		500
25.1.2015	To Sales A/c		15,000	29.1.2015	By Wages A/c		1,000
				31.1.2015	By Bank A/c		20,000
				31.1.2015	By Balance c/d		50,500
			75,000				75,000
1.2.2015	To Balance b/d		50,500				

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

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
31.1.2015	To Balance c/d		2,40,000	1.1.2015	By Bank A/c		2,00,000
				1.1.2015	By Cash A/c		40,000
			2,40,000				2,40,000
				1.2.2015	By Balance b/d		2,40,000

Dr. **Furniture & Fittings Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
1.1.2015	To Bank A/c		40,000	31.1.2015	By Balance c/d		40,000
1.2.2015	To Balance b/d		40,000				

Dr. **Van Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
1.1.2015	To Bank A/c		60,000	31.1.2015	By Balance c/d		60,000
1.2.2015	To Balance b/d		60,000				

Dr. **Rent Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2.1.2015	To Bank A/c		5,000	31.1.2015	By Balance c/d		5,000
1.2.2015	To Balance b/d		5,000				

Dr. **Purchases Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
3.1.2015	To Zakir & Co A/c		50,000	31.1.2015	By Balance c/d		75,000
19.1.2015	To Rao & Co A/c		25,000				
			75,000				75,000
1.2.2015	To Balance b/d		75,000				

Dr. **Zakir & Co Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
15.1.2015	To Returns Outwards A/c		6,000	31.1.2015	By Purchases A/c		50,000
17.1.2015	To Bank A/c		30,000				
31.1.2015	To Balance c/d		14,000				
			50,000				50,000
				1.2.2015	By Balance c/d		14,000

Dr. **Sales Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
31.1.2015	To Balance c/d		35,000	5.1.2015	By Cash A/c		5,000
				12.1.2015	By Cash A/c		8,000
				19.1.2015	By Cash A/c		7,000
				25.1.2015	By Cash A/c		15,000
			35,000				35,000
				1.2.2015	By Balance b/d		35,000

Dr. **Wages Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
8.1.2015	To Cash A/c		1,000	31.1.2015	By Balance c/d		4,000
15.1.2015	To Cash A/c		1,000				
22.1.2015	To Cash A/c		1,000				
29.1.2015	To Cash A/c		1,000				
			4,000				4,000
1.2.2015	To Balance b/d		4,000				

Dr. **Insurance Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
10.1.2015	To Bank A/c		500	31.1.2015	By Balance c/d		500
1.2.2015	To Balance b/d		500				

Dr. **Returns Outwards Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
31.1.2015	To Balance c/d		6,000	15.1.2015	By Zakir & Co A/c		6,000
				1.2.2015	By Balance b/d		6,000

Dr. **Rao & Co Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
27.1.2015	To Bank A/c		14,000	19.1.2015	By Purchases A/c		25,000
31.1.2015	To Balance c/d		11,000				
			25,000				25,000
				1.2.2015	By Balance b/d		11,000

Dr. **Stationery Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
24.1.2015	To Cash A/c		500	31.1.2015	By Balance c/d		500
1.2.2015	To Balance b/d		500				

Illustration 11

Complete in every details, the posting of the following Journal Entry in the ledger of Mr. X.

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

Date	Particulars		L.F.	₹	₹
2015 April 1	Cash A/c	Dr.		10,000	
	Bank A/c	Dr.		30,000	
	To Capital A/c				40,000
	(Being money invested by the owner in his new business)				

Solution

Ledger of X

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

Date	Particulars	₹	Date	Particulars	₹
1.4.2015	To Capital A/c	10,000			

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2015	To Capital A/c	30,000			

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

Date	Particulars	₹	Date	Particulars	₹
			1.4.2015	By Cash A/c	10,000
			1.4.2015	By Bank A/c	30,000

Illustration 12

Prepare the Stationery Account of a firm for the year ended 31.12.2015 duly balanced off, from the following details: ₹

Jan.	1	Stock in hand	480
Apr.	5	Purchase of stationery by cheque	800
Nov.	15	Purchase of stationery on credit from Five Star Stationery Mart	1,280
Dec.	20	Purchase of stationery from petty cash	80
Dec.	31	Stock in hand	240

Solution

Dr. **Stationery Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/d	480	31.12.2015	By Profit & Loss A/c (Balancing figure)	2,400
5.4.2015	To Bank A/c	800	31.12.2015	By Balance c/d	240
15.11.2015	To Five Star Stationery Mart A/c	1,280			
20.12.2015	To Petty Cash A/c	80			
		2,640			2,640

Illustration 13

The following data is given by Mr. Singh, the owner, with a request to compile only the two personal accounts of Mr. Herbert and Mr. Robert, in his ledger, for the month of April 2015.

1	Mr. Singh owes Mr. Robert ₹ 15,000; Mr. Herbert owes Mr. Singh ₹ 20,000.
4	Mr. Robert sold goods worth ₹ 60,000 @ 10% trade discount to Mr. Singh.
5	Mr. Singh sold to Mr. Herbert goods prices at ₹ 30,000.
17	Record a purchase of ₹ 25,000 net from Robert, which were sold to Herbert at a profit of ₹ 15,000.
18	Mr. Singh rejected 10% of Mr. Robert's goods of 4th April.
19	Mr. Singh issued a cash memo for ₹ 10,000 to Mr. Herbert who came personally for this consignment of goods, urgently needed by him.
22	Mr. Herbert cleared half his total dues to Mr. Singh, enjoying a $^1/_2$% cash discount (of the payment received ₹ 20,000 was by cheque).
26	Robert's total dues (less ₹ 10,000 held back) were cleared by cheque, enjoying a cash discount of ₹ 1,000 on the payment made.
29	Close Herbert's Account to record the fact that all but ₹ 5,000 was cleared by him, by a cheque, because he was declared bankrupt.
30	Balance Robert's Account.

Solution

In the books of Mr. Singh

Dr. **Mr. Herbert Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2015	To Balance b/d	20,000	22.4.2015	By Bank A/c	20,000
5.4.2015	To Sales A/c	30,000	22.4.2015	By Cash A/c (Note 2)	24,775
17.4.2015	To Sales A/c	40,000	29.4.2015	By Discount Allowed A/c	225
			29.4.2015	By Bank A/c	40,000
			29.4.2015	By Bad Debts A/c	5,000
		90,000			90,000

Dr. **Mr. Robert Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
18.4.2015	To Purchase Returns A/c	5,400	1.4.2015	By Balance b/d	15,000
26.4.2015	To Bank A/c	77,600	4.4.2015	By Purchases A/c	54,000
26.4.2015	To Discount Received A/c	1,000	17.4.2015	By Purchases A/c	25,000
30.4.2015	To Balance c/d	10,000			
		94,000			94,000
			1.5.2015	By Balance b/d	10,000

Working Notes:

(1) Sale of ₹ 10,000 on 19th April is a cash sales, therefore, it will not be recorded in the Personal Account of Mr. Herbert; and

(2) On 22nd April, Mr. Herbert owes Mr. Singh ₹ 90,000, amount paid by Mr. Herbert $^1/_2$ of ₹ 90,000 less $^1/_2$% discount, i.e. ₹ 45,000 – ₹ 225 = ₹ 44,775. Out of this amount, ₹ 20,000 paid by cheque and the balance of ₹ 24,775 in cash.

Illustration 14

The following balances appeared in the books of Jane Seymour on 1st March, 2015 :

		₹
Cash Book (Bank Balance, Debit)		8,500
General Ledger :		
	Sales Account	89,000
	Purchases Account	42,000
	Returns Inward Account	5,000
Sales Ledger :		
	D Jones	4,000
	N Cross	3,000
	P White Limited	2,500

Purchases Ledger :

J Freemen	18,000
Value Supplies Limited	14,000

During the month of March 2015, the following transactions took place :

			₹
1. *Purchases of goods on credit for resale :*			
March	4	Value Supplies Limited	26,000
	20	J Freemen	6,000
2. *Sales on Credit :*			
March	9	D Jones	5,000
	21	N Cross	8,000
3. *Returns Inward :*			
March	15	D Jones	600
4. *Payment received by cheque :*			
March	8	N Cross in full settlement of account at 1st March less 10% discount	2,700
5. *Payment made by cheque :*			
March	3	Value Supplies Limited	14,000

From the above information open the accounts which would appear in Jane's Ledger, and show the Cash Book (Bank Column).

Record the above transactions for the month of March, 2015 (entries in subsidiary books are not required). Balance the accounts as at 31st March, 2015.

Solution

Dr. **Cash Book (Bank Column)** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2015				2015			
March 1	To Balance b/d		8,500	March 3	By Value Supplies Ltd. A/c		14,000
8	To N Cross A/c		2,700		(Being paid by cheque)		
	(Being a cheque received from N. Cross)						
31	To Balance c/d		2,800				
			14,000				14,000

In the General Ledger

Dr. **Sales Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2015				2015			
March 31	To Balance c/d		1,02,000	March 1	By Balance b/d		89,000
				9	By D Jones A/c		5,000
				21	By N Cross A/c		8,000
			1,02,000				1,02,000

Dr. **Purchases Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2015				2015			
March 1	To Balance b/d		42,000	March 31	By Balance c/d		74,000
4	To Value Supplies Ltd. A/c		26,000				
20	To J Freeman		6,000				
			74,000				74,000

Dr. **Returns Inward Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2015				2015			
March 1	To Balance b/d		5,000	March 31	By Balance c/d		5,600
15	To D Jones A/c		600				
			5,600				5,600

Dr. **Discount Allowed Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2015				2015			
March 8	To N Cross A/c		300	March 31	By Balance c/d		300

In the Sales Ledger

Dr. **D Jones Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2015				2015			
March 1	To Balance b/d		4,000	March 15	By Returns Inward A/c		600
9	To Sales A/c		5,000	31	By Balance c/d		8,400
			9,000				9,000

Dr. **N Cross Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2015				2015			
March 1	To Balance b/d		3,000	March 8	By Bank A/c		2,700
21	To Sales A/c		8,000	"	By Discount Allowed A/c		300
				31	By Balance c/d		8,000
			11,000				11,000

Dr. **P White Limited Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2015				2015			
March 1	To Balance b/d		2,500	March 31	By Balance c/d		2,500

In the Purchases Ledger

Dr. **J Freeman Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2015				2015			
March 31	To Balance c/d		24,000	March 1	By Balance b/d		18,000
				20	By Purchases A/c		6,000
			24,000				24,000

Dr. **Value Supplied Account** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2015				2015			
March 3	To Bank A/c		14,000	March 1	By Balance b/d		14,000
31	To Balance c/d		26,000	4	By Purchases A/c		26,000
			40,000				40,000

Purchases Day Book

All credit purchases of goods are primarily recorded in this book. On receiving the goods and the invoice, the receiving department compare both with the copy of the order placed by the purchase department. If everything is found in order, the goods are sent to the stores. On the basis of the invoice received from the supplier, necessary record is made in the Purchases Day Book.

Specimen of an Inward Invoice:

INVOICE

No- 786/2015
Date : 19th Feb, 2015

M.K. & Co Ltd.
40, Jawaharlal Nehru Road
Calcutta 700016

Customer's Name P.C. Chandra & Sons
P/16 C.I.T. Road
Calcutta 700017

Qty.	Description	Rate	Amount	Total (₹)	Remarks

E. & O. E.

It is clear from the specimen that an invoice contains the following details:

1. Names and addresses of both the parties to the contract of sale.

2. An exact description of the goods, including the quantity, rate and total value of the goods.
3. The terms and conditions of sale (on the overleaf).

E.&O.E. means Errors and Omissions Excepted. The supplier reserves the right to correct any errors in the invoice.

The ruling of the Purchases Day Book is given below :

Purchases Day Book

Date	Particulars	Inward Invoice No.	L.F.	Details ₹	Total ₹

(i) In the 'Date' column, the date on which the invoice is received is entered.
(ii) In the 'Particulars' column, the names of the suppliers are recorded. A brief description of each type of article purchased are also written in this column.
(iii) In the 'Invoice No.' column, the serial number of the Inward Invoice is written.
(iv) In the 'L.F.' column, the page number of creditors' account in the Creditors' Ledger is written.
(v) In the 'Details' column, the value of the goods purchased and amount of trade discount received are written.
(vi) In the 'Total' column, the actual amount payable to the creditors is written.

Illustration 15

From the following particulars given below, write up the Purchases Day Book of M/s Universal Electric Co, which deals in electric goods:

Jan. 5 Purchased on Credit from Bajaj Electric Co.—10 Electric Iron @ ₹ 70 each; 5 Electric Stoves @ ₹ 60 each;
Jan. 19 Purchased on Credit from Capital Electric Co.—30 Electric Heaters @ ₹ 100 each; 20 Electric Kettles @ ₹ 60 each;
Jan. 25 Purchased from Paul Electric Co. on Credit—10 Toasters @ 120 each; 5 Electric Heaters @ ₹ 60 each;
Jan. 30 Purchased from Bombay Electric Stores on Credit—20 Electric Shavers @ ₹ 200 each; 5 Electric Fans @ ₹ 400 each.

Solution

Purchases Day Book

Date	Particulars	Inward Invoice No.	L.F.	Details ₹	Total ₹
Jan. 5	**Bajaj Electric Co.**				
	10 Electric Iron @ ₹ 70 each			700	
	5 Electric Stoves @ ₹ 60 each			300	1,000
Jan. 19	**Capital Electric Co.**				
	30 Electric Heaters @ ₹ 100 each			3,000	
	20 Electric Kettles @ ₹ 60 each			1,200	4,200
Jan. 25	**Pal Electric Co.**				
	10 Toasters @ ₹ 120 each			1,200	
	5 Electric Heaters @ ₹ 60 each			300	1,500
Jan. 30	**Bombay Electric Stores**				
	20 Electric Shavers @ ₹ 200 each			4,000	
	5 Electric Fans @ ₹ 400 each			2,000	6,000
					12,700

These figures are credited to Supplier's Individual Account..

This total of the book is posted periodically to the Debit of Purchases Account.

Trade Discount

Trade Discount is a reduction made in the catalogue price of an article to enable the retailer to earn a profit. Generally, it is recorded in the Purchases Book and Sales Book but it does not enter in the ledger accounts. In the ledger, only net amount of purchase and sale are entered. Observe the following illustration :

Illustration 16

Draw up a properly ruled Purchases Day Book from the following particulars:

Jan. 1 Purchased from Electronic Corporation Ltd. on credit: 50 Black & White T.V. @ ₹ 3,000 each, less 10 % Trade Discount. 10 Colour T.V. @ ₹ 6,000 each, less 10% Trade Discount.

9 Purchased from Pico Electronics Co. Ltd. on credit: 10 Pieces of Taperecorder @ ₹ 1,000 each, less 10% Trade Discount. 10 Pieces of Two-in-one @ ₹ 1,500 each, less 10% Trade Discount.

19 Purchased from Calcutta Gramophone Mart on credit: 100 pieces of Gramophone records @ ₹ 30 each, less Trade Discount @ 5%.

29 Purchased from Bharat Stationers on credit for office use —10 dozen of carbon papers @ ₹ 35 per dozen; 10 dozen of ball pens @ ₹ 25 per dozen.

Solution **Purchases Day Book**

Date	Particulars	Inward Invoice No.	L.F.	Details ₹	Total ₹
Jan. 1	**Electronic Corporation Ltd.**				
	50 Black & White T.V. @ ₹ 3,000 each			1,50,000	
	10 Colour T.V. @ ₹ 6,000 each			60,000	
				2,10,000	
	Less: Trade Discount @ 10%			21,000	1,89,000
Jan. 9	**Pico Electronics Co. Ltd.**				
	10 pieces of Taperecorder @ ₹ 1,000 each			10,000	
	10 pieces of Two-in-one @ ₹ 1,500 each			15,000	
				25,000	
	Less: Trade Discount @ 10%			2,500	22,500
Jan. 19	**Calcutta Gramophone Mart**				
	100 pieces of gramophone records @ ₹ 30 each			3,000	
	Less: Trade Discount @ 5%			150	2,850
					2,14,350

Tutorial Note : It should be noted that credit purchase of stationery will not be recorded in the Purchases Day Book. It is to be recorded in the Journal Proper.

Illustration 17

Record the following transactions in a suitably ruled Purchases Day Book.

Mar. 1 Purchased goods from M/s A. & Co., 20 bales of cotton @ ₹ 1,000 per bale, less trade discount @ 5% and cash discount @ 6%.

Mar. 12 Purchased from Madura Coats 1,500 mtrs of fabrics @ ₹ 2 per mtr, less trade discount @ 10%.

Mar. 25 Purchased from Silk House, 20 bales of silk pcs @ ₹ 3,000 per bale, less trade discount @ 5%.

Mar. 30 Purchased furniture from Bombay Safe for ₹ 5,000.

Solution **Purchases Day Book**

Date	Particulars	Inward Invoice No.	L.F.	Details ₹	Total ₹
March 1	**M/s A & Co.**				
	20 bales of cotton @ ₹ 1,000 per bale			20,000	
	Less: Trade Discount @ 5%			1,000	19,000
March 12	**Madura Coats**				
	1,500 metres of cotton fabrics @ ₹ 2 per metre			3,000	
	Less: Trade Discount @ 10%			300	2,700
March 25	**Silk House**				
	20 bales of silk pieces @ ₹ 3,000 per bale			60,000	
	Less: Trade Discount @ 5%			3,000	57,000
					78,700

Tutorial Note : Purchase of furniture from Bombay Safe will be recorded in the Journal Proper. Similarly, cash discount will be recorded in Cash Book when payment will be made within a specified time.

Posting the Purchases Day Book into the Ledger

After the transactions are entered in the Purchases Day Book, posting those into the ledger involves the following steps:

Step 1 At the end of the day, each entry is posted to the credit side of the appropriate individual account in the Creditors' Ledger, to keep the accounts upto date.

Step 2 At the end of the month, the aggregate of the 'total column' is posted to the General Ledger by passing the following entry :

Purchases Account Dr.
To Sundry Creditors Account (Control Account)

Illustration 18

From the information of illustration 3, show ledger posting.

Solution

General Ledger

Dr. Purchases Account Cr.

Date	Particulars	₹	Date	Particulars	₹
March 31	To Sundry Creditors A/c	78,700			

Dr. Sundry Creditors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
			March 31	By Purchases A/c	78,700

Creditors' Ledger

Dr. M/s A & Co. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
			March 1	By Purchases A/c	19,000

Dr. Madura Coats Account Cr.

Date	Particulars	₹	Date	Particulars	₹
			March 12	By Purchases A/c	2,700

Dr. Murshidabad Silk House Account Cr.

Date	Particulars	₹	Date	Particulars	₹
			March 25	By Purchases A/c	57,000

Sales Day Book

In this book, all credit sales are recorded. It should be remembered that Sales Day Book records only those goods which are sold on credit and the goods in question must be those, which the firm generally deals in.

Procedure for Writing up the Sales Day Book

When goods are sold on credit, an outward invoice is prepared for every credit sale and are checked as to quality, quantity and price of the goods before they are despatched to the customers. The duplicate copy of the invoice remains with the firm and the original copy is sent to the customer. Sales Day Book is written up on the basis of duplicate outward invoice.

Specimen of an Outward Invoice is given below:

INVOICE

No- P-29
Date : 9th June, 2015

F.G. Cable Co. Ltd.
31, Jawaharlal Nehru Road
Calcutta 700016

Customer's Name West Bengal State Electricity Board
Block- CG, Sale Lake
Calcutta - 700091

Qty.	Description	Rate	Amount	Total (₹)	Remarks

E. & O. E.

The invoice contains the following details:

1. The names and addresses of both the parties to the contract.
2. An exact description of the goods, including the quantity, rate and total value of the goods sold.
3. The terms and conditions of sales (on the overleaf).

E. &.O. E. means Errors and Omissions Excepted. The maker reserves the right to correct any error in the invoice.

The ruling of the Sales Day Book is given below :

Sales Day Book

Date	Particulars	Outward Invoice No.	L.F.	Details ₹	Total ₹

1. In the 'Date' column, the date on which the invoice is prepared is entered.
2. In the 'Particulars' column, the names of the customers are recorded. A brief description of each type of article sold is also written in this column.
3. In the 'Outward Invoice No.' column, the serial number of Outward Invoice is written.
4. In the 'L.F.' column, the page number of the Debtors' Account in the Debtors' Ledger is written.
5. In the 'Details' column, the value of the goods sold and amount of trade discount is written.
6. In the 'Total' column, the actual amount receivable from debtors is written.

Illustration 19

From the following transactions write up the Sales Day Book of M/s X & Co. :

Jan. 1 Sold to Premier Traders 100 bags of sugar @ ₹ 650 per bag, less trade discount @ 5%.
Jan. 10 Sold to R & Co. 10 bags of milk powder @ ₹ 500 per bag, less trade discount @ 10%.
Jan. 20 Sold to Tea King (P) Ltd. 10 chests C.T.C. Tea @ ₹ 2,000 per chest, less trade discount @ 10%.
Jan. 29 Sold old office furniture on credit to Modern Furniture for ₹ 2,500.

Solution

Sales Day Book

Date	Particulars	Outward Invoice No.	L.F.	Details ₹	Total ₹
Jan. 1	**Premier Traders**				
	100 bags of sugar @ 650 per bag			65,000	
	Less: Trade Discount @ 5%			3,250	61,750
Jan. 10	**R. & Co.**				
	10 bags of milk powder @ ₹ 500 per bag			5,000	
	Less: Trade Discount @ 10%			500	4,500
Jan. 20	**Tea King (P) Ltd**				
	10 chests of CTC tea @ ₹ 2,000 per chest			20,000	
	Less: Trade Discount @ 10%			2,000	18,000
					84,250

These figures are debited to Customer's Individual Account..

This total of the book is posted periodically to the Credit of Salees Account.

Tutorial Note : Sale of old furniture to be passed through Journal Proper.

Sales Book With Sales Tax Column

Sales Tax is a tax levied at the point of sale. It is based on the selling price of goods or services. It is the duty of the seller to realise sales tax from customers and deposit it to the Government. Sales tax is calculated at a fixed percentage on the net price of the goods, i.e, after trade discount. Generally a separate column is provided in the Sales Day Book for sales tax. Periodically, the total of sales tax column is credited to Sales Tax Account. When actual payment is made to the Government, the Sales Tax Account is debited and Cash/Bank Account is credited and any balance of Sales Tax Account at the end of the year is shown in the Balance Sheet as a liability.

Illustration 20

Enter the following transactions in Sales Day Book :

Apr. 1 Sold to Indian Coffee House 50 chests of coffee @ ₹ 600 per chest, less Trade Discount 5%, Excise Duty to be charged @ 10%.

Apr. 5 Sold to Subodh Bros. 100 kg. of Tea @ ₹ 30 per kg. less 5% Trade Discount. Excise Duty 5% extra.

Apr. 15 Sold to Dhar Bros. 20 bags of milk powder @ ₹ 1,000 per bag, less 2% Trade Discount. Excise Duty @10%.

Apr. 28 Sold to Robin & Co. 10 chests of tea @ ₹ 600 per chest, less 10% Trade Discount. Excise Duty 5% extra.

Sales Tax is charged @ 8% on all sales.

Solution

Sales Day Book

Date	Particulars	Gross Amount	Trade Discount	Excise Duty	Net Price	S.T. 8%	Total Amount
		₹	₹	₹	₹	₹	₹
April 1	**Indian Coffee House** 50 chests of coffee @ ₹ 600 per chest — 5% T.D.; 10% E.D.	30,000	1,500	3,000	31,500	2,520	34,020
April 5	**Subodh Bros.** 100 kg.. of Tea @ ₹ 30 per kg. — 5% T.D.; 5% E.D.	3,000	150	150	3,000	240	3,240
April 15	**Dhar Bros.** 20 bags of milk power @ ₹ 1,000 per bag — 2% T.D.; 10% E.D.	20,000	400	2,000	21,600	1,728	23,328
April 28	**Robin & Co.** 10 chests of Tea @ ₹ 600 per chest — 10% T.D.; 5% E.D.	6,000	600	300	5,700	456	6,156
		59,000	2,650	5,450	61,800	4,944	66,744

Tutorial Note: (1) Excise duty is calculated on list price. (2) Sales Tax is calculated on net price.

Posting the Sales Day Book into the Ledger

After the transactions are entered in the Sales Day Book, posting those into the ledger involves the following steps:

Step 1 At the end of the day, each entry is posted to the debit side of the appropriate individual account in the Debtors' Ledger, to keep the accounts upto date.

Step 2 At the end of the month, the total is posted to the General Ledger by passing the following entry:

Sundry Debtors Account (Control Account) Dr.
To Sales Account
To Sales Tax Payable Account

Illustration 21

Enter the following transactions in Sales Day Book and post them into ledger:

May 1 Sold to Allied Radio Stores 5 pieces of Radio @ ₹ 1,000 each, less Trade Discount 5%.

May 8 Sold to J.D. Electronics Co. 5 pieces of Colour T.V. @ 6,000 each, less 5% Trade Discount.

May 20 Sold to Anandamela Stores, 10 pieces of Car-stereo @ ₹ 900 each, less 5% Trade Discount.

All sales are subject to 10% Sales Tax.

Solution

Sales Day Book

Date	Particulars	Gross Amount	Trade Discount	Excise Duty	Net Price	S.T. 10%	Total Amount
		₹	₹	₹	₹	₹	₹
May 1	**Allied Radio Stores** 5 pcs. of radio @ ₹ 1,000 each less 5% T.D.	5,000	250	—	4,750	475	5,225
May 8	**J.D. Electronics Co.** 5 pcs. of colour T.V. @ ₹ 6,000 each less 5% T.D.	30,000	1,500	—	28,500	2,850	31,350
May 20	**Anandamela Stores** 10 pcs. of car-stereo @ ₹ 900 each less 5% T.D.	9,000	450	—	8,550	855	9,405
		44,000	2,200	—	41,800	4,180	45,980

General Ledger

Dr. Sundry Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
May 31	To Sales A/c To Sales Tax Payable A/c	41,800 4,180			

Dr. Sales Account Cr.

Date	Particulars	₹	Date	Particulars	₹
			May 31	By Sundry Debtors A/c	41,800

Dr. Sales Tax Payable Account Cr.

Date	Particulars	₹	Date	Particulars	₹
			May 31	By Sundry Debtors A/c	4,180

Debtors' Ledger

Dr. Allied Radio Stores Account Cr.

Date	Particulars	₹	Date	Particulars	₹
May 1	To Sales A/c To Sales Tax Payable A/c	4,750 475			

Dr. J.D. Electronics Co. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
May 8	To Sales A/c To Sales Tax Payable A/c	28,500 2,850			

Dr. Anandamela Stores Account Cr.

Date	Particulars	₹	Date	Particulars	₹
May 20	To Sales A/c To Sales Tax Payable A/c	8,550 855			

Purchases Returns Book

It may be necessary to return some goods that the firm has bought on credit for a variety of reasons such as defective or excess quantity of goods supplied, etc. All returns of goods are recorded primarily in the Purchases Returns Book.

When a firm returns some goods to its supplier, it prepares a 'Debit Note' and sends it along with the goods returned. The supplier, in turn, will prepare a 'Credit Note'. The original copy of the credit note will be sent to the firm. Entries in the Purchases Returns Book are made on the basis of original 'Credit Note' received from the supplier. On receipt, all credit notes should be numbered consecutively and should be filed properly for future reference. Purchases Returns Book is prepared in the same way as Purchases Day Book, except that it should, in addition, include a brief description of the reason for the return in the remarks column.

The specimen of the Purchases Returns Book is given below :

Purchases Returns Book

Date	Particulars	Credit Note No.	L.F.	₹	Remarks

Posting the Purchases Returns into the Ledger

After transactions are entered in the Purchases Returns Book, Posting to the ledger involves the following steps:

Step 1 At the end of the day, each entry is posted to the debit side of the appropriate individual account in the Creditors' Ledger, to keep the accounts upto date.

Step 2 At the end of the month, the total of the amount column is posted to the General Ledger passing the following entry:

Sundry Creditors Account (Control Account) Dr.
To Purchases Returns Account

Debit Note

It is a commercial document notifying a person that a debit has been made to his accounts. For example, if the goods are sold on credit and a part of that is returned, a debit note might be issued for the value of the goods returned.

Credit Note

It is a document evidencing that a credit entry has been made to a debtors' account. For example, if a customer returns a part of the goods previously sold on credit, or credit rate may be issued.

Illustration 22

From the following information, write up a Purchases Returns Book of M/s. Agarwal & Sons and post them into Ledger:

May 1 Returned to Uptron Television Co. Ltd. 4 colour T.V. @ ₹ 6,000 each.
May 15 Returned to Philips (India) Ltd. 2 pieces of Two-in-one @ ₹ 2,500 each.
May 19 Returned to Bajaj Electricals Ltd. 2 pieces of Electric heater @ ₹100 each.
May 29 Returned to BPL-India Ltd. 3 pieces of VCR @ ₹ 10,000 each.

Solution

Purchases Returns Book

Date	Particulars	Credit Note No.	L.F.	₹	Remarks
May 1	**Uptron Television Co. Ltd.** 4 colour T.V. @ ₹ 6,000 each			24,000	
May 15	**Philips (India) Ltd.** 2 pcs. of Two-in-one @ ₹ 2,500 each			5,000	
May 19	**Bajaj Electricals Ltd.** 2 pcs. of Electric heater @ ₹ 100 each			200	
May 29	**BPL India Ltd.** 3 pcs. of VCR @ ₹ 10,000 each			30,000	
				59,200	

General Ledger

Dr. **Purchases Returns Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
			May 31	By Sundry Creditors A/c	59,200

Dr. **Sundry Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
May 31	To Purchases Returns A/c	59,200			

Creditors' Ledger

Dr. **Uptron Television Co. Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
May 1	To Purchases Returns A/c	24,000			

Dr. **Philips (India) Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
May 15	To Purchases Returns A/c	5,000			

Dr. **Bajaj Electricals Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
May 19	To Purchases Returns A/c	200			

Dr. **BPL India Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
May 29	To Purchases Returns A/c	30,000			

Sales Returns Book

Goods may be returned by the customers for a variety of reasons such as wrong quantity and/or quality. All goods returned by the customers are primaily recorded in this book.

When goods are returned by the customer, a 'Credit Note' is made out in his name. A Credit Note is prepared in duplicate. The original being sent to the customer for his information and record. The duplicate is preserved in the file for future reference. Duplicate credit note provides information for recording in the Sales Returns Book.

The specimen ruling of the Sales Returns Book is given below :

Sales Returns Book

Date	Particulars	Credit Note No.	L.F.	₹	Remarks

Like Purchases Returns Book, Sales Returns Book is also prepared in the same way as Sales Day Book except that it should, in addition, include a brief description of the reasons for the retum in the remarks column.

Posting the Sales Returns into the Ledger

After transactions are entered in the Sales Returns Book, posting to the ledger involves the following steps:

Step 1 At the end of the day, each entry is posted to the credit side of the appropriate individual account in the Debtors' Ledger, to keep the accounts upto date.

Step 2 At the end of the month, the total of the amount column is posted into the General Ledger, by passing the following entry:

Sales Return Account (Control Account) Dr.
To Sundry Debtors Account

Illustration 23

From the following information, write-up a Sales Returns Book of Allied Electronics Co. Ltd. and post them into ledger:

Apr 1 Returned by Sur-O-Bani 4 pieces of Philips radio costing ₹ 1,500 each.
Apr 9 Returned by Capital Electronics 3 pieces of VCP costing ₹ 9,000 each.
Apr 29 Returned by K.B. & Co. 2 pieces of Two-in-one costing ₹ 2,000 each.

Solution

Sales Returns Book

Date	Particulars	Credit Note No.	L.F.	₹	Remarks
April 1	**Sur-O-Bani** 4 pcs. of Philips radio @ ₹ 1,500 each			6,000	
April 9	**Capital Electronics** 3 pcs. of VCP @ ₹ 9,000 each			27,000	
April 29	**K.B. & Co.** 2 pcs. of Two-in-one @ ₹ 2,000 each			4,000	
				37,000	

General Ledger

Dr. Sales Returns Account Cr.

Date	Particulars	₹	Date	Particulars	₹
April 30	To Sundry Debtors A/c	37,000			

Dr. Sundry Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
			April 30	By Sales Returns A/c	37,000

Debtors' Ledger

Dr. Sur–O–Bani Account Cr.

Date	Particulars	₹	Date	Particulars	₹
			April 1	By Sales Returns A/c	6,000

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

Date	Particulars	₹	Date	Particulars	₹
			April 9	By Sales Returns A/c	27,000

Dr. **K.B. & Co. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
			April 29	By Sales Returns A/c	4,000

Journal Proper or General Journal

Journal Proper is used for making the original record of those transactions, because of their importance or rareness of occurrence which do not find a place in any of the aforesaid books of original entry.

Entries recorded in the Journal Proper may be classified as follows:

(1) Opening entries; (2) Closing entries; (3) Transfer entries; (4) Rectification of Errors entries; (5) Adjusting entries; (6) Credit purchase of assets; (7) Credit sale of worn-out or obsolete assets; (8) Credit purchase of stationery. The specimen ruling of the Journal Proper is given below :

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

Date	Particulars	L.F.	₹	₹
(1)	(2)	(3)	(4)	(5)

(1) Date—This column records the date of transaction.
(2) Particulars—This column records the name of the accounts debited or credited. The account debited is written first, adjacent to the line of date and the account credited is written below with the prefix 'To'. In this column, the narration is also recorded.
(3) L.F.—This column records the page number of ledger in which this account has been posted.
(4) Dr. column—It records the debit amount.
(5) Cr. column—It records the credit amount.

1. Opening Entries

Opening entries are used at the beginning of the financial year to open the books by recording the assets, liabilities and capital, appearing in the Balance Sheet of the previous year. The rule to be applied is :

Assets Account Dr.
  To Liabilities Account
  To Capital Account

Illustration 24

Balance Sheet of A. B. & Co. as at 31st December, 2014

Liabilities	₹	Assets	₹
Capital	1,50,000	Land and Building	80,000
Sundry Creditors	30,000	Plant and Machinery	30,000
Outstanding Salaries	20,000	Furniture	20,000
		Stock-in-trade	20,000
		Cash in hand	20,000
		Cash at bank	30,000
	2,00,000		2,00,000

You are required to pass Opening entry.

Solution **Journal Proper** **Dr.** **Cr.**

Date	Particulars		L.F.	₹	₹
2015 Jan.1	Land and Building A/c	Dr.		80,000	
	Plant and Machinery A/c	Dr.		30,000	
	Furniture A/c	Dr.		20,000	
	Stock-in-trade A/c	Dr.		20,000	
	Cash at bank A/c	Dr.		30,000	

	Cash in hand A/c Dr. To Sundry Creditors A/c To Outstanding Salaries A/c To Capital A/c (Being last year's balances brought forward)		20,000	 30,000 20,000 1,50,000

(It may, however, be mentioned that some accountants do not pass this opening entry but bring forward balances from preceding year directly to the ledger of the new financial year.)

2. Closing Entries

Closing entries are used at the end of accounting year for closing off accounts relating to expenses and revenues. These accounts are closed off by transferring their balances to the Trading and Profit and Loss Accounts. Since records must not be made in the ledger without journal entries, closing entries are passed in the Journal Proper first and then posted to the ledger. For example: let there be a debit balance in the purchase account of ₹ 75,000 at the end of the accounting year 2014. Now at the time of preparation of Final Accounts we will have to close off the Purchases Account as follows:

Journal Proper (Closing Entry) **Dr.** **Cr.**

Date	Particulars	L.F.	₹	₹
2014 Dec.31	Trading A/c Dr. To Purchases A/c (Being transfer of Purchases Account to Trading Account for determining gross profit)		75,000	 75,000

Dr. **Purchases Account (After Closure)** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
Jan. to Dec.	To Sundry Creditors A/c	75,000	Dec. 31, 2014	By Trading A/c	75,000

Dr. **Trading Account for the year ended 31st December, 2014** **Cr.**

To Purchases	75,000		

Illustration 25

At the end of his financial year, December 31, 2014, a trader's books show the following balances in the Nominal Accounts:

Purchases ₹ 10,050; Sales ₹ 15,668; Selling expenses ₹ 1,644; Returns Outwards ₹ 233; Returns Inwards ₹ 355; Establishment expenses ₹ 878; Discounts (Cr) ₹ 109; Discounts (Dr) ₹ 87; Office Expenses ₹ 1,448.

Besides, the Closing Stock Account in the Stock Ledger shows a balance of ₹ 644; but the actual year-end stock on counting was valued at ₹ 499. Draft the closing Journal entries relating to the compilation of Trading and Profit and Loss Accounts.

Solution **Journal Proper** **Dr.** **Cr.**

Date	Particulars	L.F.	₹	₹
2014 Dec. 31	Trading A/c Dr. To Purchases A/c To Returns Inwards A/c (Being transferred to Trading Account to determine gross profit)		10,405	 10,050 355
	Sales A/c Dr. Returns Outwards A/c Dr. Closing Stock A/c Dr. To Trading A/c (Being transferred to Trading Account to determine gross profit)		15,668 233 499	 16,400
	Trading A/c Dr. To Profit & Loss A/c (Being gross profit transferred to Profit and Loss Account)		5,995	 5,995
	Profit & Loss A/c Dr. To Selling Expenses A/c To Establishment Expenses A/c To Discount Allowed A/c To Office Expenses A/c (Being transferred to Profit and Loss Account for determining net profit)		4,057	 1,644 878 87 1,448
	Discount Received A/c Dr. To Profit & Loss A/c (Being transferred to Profit and Loss Account for determining net profit)		109	 109
	Profit & Loss A/c Dr. To Capital A/c (Being net profit transferred to Capital Account)		2,047	 2,047

3. Transfer Entries

Transfer entries are passed in the Journal Proper for transferring an item, entered in one account, to another account. For example, let ₹ 20,000 to be transferred to general reserve out of profit for the year ended on 31st December 2014; the entry should be passed through Journal Proper.

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

Date	Particulars	L.F.	₹	₹
2014 Dec.31	Profit & Loss A/c Dr. To General Reserve A/c (Being the amount transferred to General Reserve)		20,000	20,000

4. Rectification Entries

Mistake which has been made in passing an entry should be corrected by passing another entry in the Journal Proper and the practice of erasures should not be tolerated. *[For details see Chapter, 'Rectification of Errors'.]*

5. Adjustment Entries

Adjustment entry is an amendment to an accounting figure which is basically correct but which needs to allow for some circumstances not recorded in the bookkeeping system. Adjustment in accounts are very common. In an accrual system of accounting, adjustment entries are made to the Trial Balance at Balance Sheet date in provisions and reserves, prepaid and outstanding expenses; and, income received in advance and accrued income. Adjustment entries are passed before they are transferred to the Trading and Profit and Loss Account and Balance Sheet. This is because, adjustment entries always have a dual effect. They affect either the Trading Account or the Profit and Loss Account but definitely the Balance Sheet.

Illustration 26

For each of the following transactions, show Adjustment Entries for the purpose of preparing Final Accounts:

(i) Outstanding rent ₹ 4,500
(ii) Salary due to an employee but not received by him ₹ 1,500
(iii) Insurance premium paid in advance ₹ 1,200
(iv) Rent paid to landlord in advance ₹ 1,200
(v) Closing stock valued at ₹ 3,900
(vi) Interest due on loan but not paid. Loan of ₹ 15,000 was taken at 9% p.a., 9 months before the end of the year.

Solution **Journal Proper** **Dr.** **Cr.**

Date	Particulars	L F	₹	₹
(i)	Rent A/c Dr. To Outstanding Rent A/c (Being the adjustment of outstanding rent)		4,500	4,500
(ii)	Salaries A/c Dr. To Outstanding Salaries A/c (Being the adjustment for salaries due but not paid)		1,500	1,500
(iii)	Prepaid Insurance A/c Dr. To Insurance Premium A/c (Being the adjustment of insurance premium paid in advance)		1,200	1,200
(iv)	Rent Paid in Advance A/c Dr. To Rent A/c (Being the adjustment of rent paid in advance)		1,200	1,200
(v)	Closing Stock A/c (Note 1) Dr. To Purchases A/c (Being the adjustment of closing stock)		3,900	3,900
	Alternatively, Closing Stock A/c Dr. To Trading A/c (Being the adjustment of closing stock)		3,900	3,900
(vI)	Interest on Loan A/c (Note 2) Dr. To Outstanding Interest A/c (Being the adjustment of outstanding interest for 9 months @ 9% p.a. on ₹ 15,000)		1,013	1,013

Working Notes :

(1) Closing stock represents a part of purchased goods not yet sold. Therefore, for adjustment, Purchases Account will be credited and closing stock Account will be debited.
Alternatively, closing stock can be debited and Trading Account can be credited.

(2) Interest on loan = ₹ 15,000 x 9/100 x 9 / 12 = ₹ 1,012.50 or ₹ 1,013 (rounded off).

Illustration 27

How would you deal with the following in accounting of a going concern ?

(i) Rent amounting to ₹ 5,000 paid in advance for the next financial year and the total rent paid ₹ 20,000.

(ii) Outstanding wages for the current year amounted to ₹ 15,000.

(iii) ₹ 2,000 is due from Sri Basu, a debtor, is unrealisable from him.

Pass Journal Entries and show Profit and Loss Account relating to the entries stated above.

Solution **Journal Proper** **Dr.** **Cr.**

Date	Particulars	L F	₹	₹
(i)	Rent Paid in Advance A/c Dr.		5,000	
	To Rent A/c			5,000
	(Being the adjustment of rent paid in advance)			
(ii)	Wages A/c Dr.		15,000	
	To Outstanding Wages A/c			15,000
	(Being the adjustment of wages due but not paid)			
(iii)	Bad Debts A/c Dr.		2,000	
	To Debtors A/c			2,000
	(Being the amount unrealisable from Sri Basu written off as bad debt)			

Dr. **Profit and Loss Account (includes . . .)** **Cr.**

Particulars	₹	Particulars	₹
To Rent A/c (Note 1)	15,000		
To Bad Debts A/c	2,000		

Working Note :

(1) Total rent paid ₹ 20,000, out of which ₹ 5,000 paid as advance rent.
Therefore, only ₹ 15,000 (₹ 20,000 – ₹ 5,000) will be debited to Profit and Loss Account.

Illustration 28

Before you prepare Final Accounts for the year ended 31st March 2015 pass necessary Journal entries in respect of the following: (i) Commission earned but not received ₹ 1,200; (ii) Closing stock as at 31st March, 2015 ₹ 20,000; (iii) To carry forward one-fifth of an Insurance Premium paid at ₹ 2,780; (iv) Unpaid salary for ₹ 340 is to be provided for in the accounts; (v) Commission due to manager @ 6% on net profit after charging such commission. The profit before charging such Commission was ₹ 26,500.

Solution **Journal Proper** **Dr.** **Cr.**

Date	Particulars	L.F.	₹	₹
2015	Accrued Commission A/c Dr.		1,200	
March 31	To Commission Received A/c			1,200
	(Being commission earned but not yet received, now adjusted)			
	Closing Stock A/c Dr.		20,000	
	To Trading A/c			20,000
	(Being closing stock transferred to Trading A/c)			
	Prepaid Insurance Premium A/c Dr.		556	
	To Insurance Premium A/c			556
	(Being 1/5th of insurance premium c/f to next period)			
	Salary A/c Dr.		340	
	To Outstanding Salary A/c			340
	(Being outstanding salary provided)			
	Commission A/c Dr.		1,500	
	To Commission Payable to Manager A/c			1,500
	(Being commission payable to manager @ 6% on net profit after charging such commission)			

6. Purchases of Assets on Credit

When assets are purchased on credit, these are originally recorded in Journal Proper by passing the following entry:

Assets Account Dr.

To Creditors for Assets Account

7. Sale of Worn-out or Obsolete Assets (on Credit)

When obsolete assets are sold on credit, these are originally recorded in Journal Proper. The entries will depend upon the Book Value of the old assets and the actual price realised at the time of sale of such assets.

Example : On 29th May, 2015 B. Ltd. sold a machine valued on the book at ₹ 20,000 to Ideal Machinery Co. Pass necessary journal entry when the machine was sold for ₹ 15,000.

Journal Proper of B. Limited **Dr.** **Cr.**

Date	Particulars		L.F.	₹	₹
20010 May 29	Ideal Machinery Co. A/c	Dr.		15,000	
	Loss on Sale of Machinery A/c	Dr.		5,000	
	To Machinery A/c				20,000
	(Being obsolete machine was sold for ₹ 15,000)				

8. Purchase of Stationery (Credit)

When stationeries are purchased on credit, these are originally recorded in Journal Proper by passing the following entry :

Stationery Account Dr.

To Creditors for Stationery Account

Key Points

- Accounting Cycle refers to the sequence of accounting procedures used to record, classify and summarise the business transactions. It begins with the identification of business transactions and ends with the reverse entries for prepaid and outstanding expenses.
- Source documents are basically external documents or documents relating to external activities, which are the first input to the accounting system.
- An invoice relates to a sales order or a purchase order. When a business sells goods or services on credit to a customer, it sends out an invoice. It shows the goods sold, with descriptions, quantities, prices and trade discounts. The details in the invoice should match with the details on the sales order. It may include additional charges — for insurance, carriage and container. It also shows the total amount due from the customer.
- When goods are returned by the customers, a document is prepared called "credit note" and sent it to customer to intimate him that his account has been credited.
- The voucher is a document which provides the authorisation to pay and specifies the accounts to be debited and credited.
- A transaction is a particular type of external event, which can be expressed in terms of money and brings change in the financial position of a business unit. A transaction involves transfer of something of value between two or more entities.
- Event is an occurrence, happening, change or incident, which may or may not bring any change in the financial position of a business unit.
- A journal entry is an analysis of the effects of a transaction on the accounts, usually accompanied by an explanation (properly called as a narration).
- The ledger is the principal book of accounts where similar transactions relating to a particular person or thing are recorded.

THEORETICAL QUESTIONS

1. What do you mean by accounting cycle ?
2. What is a voucher ? What are the features of a voucher ? How a voucher is prepared ?
3. What do you mean by source document ? Give examples.
4. What do you understand by an account? Explain the nature of different kinds of accounts.
5. Explain the rules for debit and credit. Give a suitable example for each type of account.

6. Define the term Journal and explain its present day use.
7. Define ledger. Give its ruling and explain its utility in accountancy.
8. Distinguish between Journal and Ledger.
9. 'Ledger is the principal book of accounts in a business'. Do you agree with this statement ? Give reasons.
10. How are Ledger Accounts balanced ? Explain clearly.
11. What are the books of original entry? Explain their utilities.
12. Explain the nature of use of the following books of original entry:
    (i) Purchases Day Book;
    (ii) Sales Day Book;
    (iii) Journal Proper; and
    (iv) Sales Returns Book.
13. In which Book of Original Entry, will you record each of the following transactions ?
    (i) An allowance of ₹ 50 was offered for an early payment of cash of ₹ 1,050.
    (ii) A second hand motor car was purchased on credit, from Ross Bros. for ₹ 10,000.
    (iii) Goods, the payment of which is due after 2 months, were sold to M/s Bell & Co. for ₹ 1,000.
    (iv) Accounting for the partial recovery from Mr C, of an amount of ₹ 2,000 earlier written off as bad debt.
    (v) Credit purchase of stationery worth ₹ 5,000, by a stationery dealer from Mr Dubey.
    (vi) Rectifying the error of a credit purchase of goods worth ₹ 10,000 recorded as a credit sale to Mr Lily, discovered two months later.
    (vii) A cheque of ₹ 1,000, which was received from a debtor in full settlement for a claim of ₹ 1,100, is dishonoured.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below.

1. The first book in which the transactions of a business unit are recorded is called
   A a journal
   B a ledger
   C a trial balance
   D none of the above
2. Journal records all transactions in
   A alphabetical order
   B random manner
   C chronological order
   D none of the above
3. Journal is a
   A memorandum record
   B primary record
   C secondary record
   D none of the above
4. A journal records
   A only debit part of a transaction
   B only credit part of a transaction
   C both debit part and credit part of a transaction without narration
   D both debit part and credit part of a transaction with narration
5. In its usual form, a journal is divided by vertical lines into five columns in the following order
   A (i) Date; (ii) Ledger Folio; (iii) Particulars; (iv) Debit Amount; (v) Credit Amount
   B (i) Date; (ii) Particulars; (iii) Journal Folio; (iv) Debit Amount; (v) Credit Amount.
   C (i) Date; (ii) Particulars; (iii) Ledger Folio; (iv) Credit Amount; (v) Debit Amount
   D (i) Date; (ii) Particulars; (iii) Ledger Folio; (iv) Debit Amount; (v) Credit Amount
6. Compound journal entry contains
   A more than one debit entry only
   B more than one credit entry only
   C more than one debit entry or more than one credit entry or both
   D no narration

7. How is the distribution of goods as free samples recorded in the journal ?

	Debit	*Credit*
A	Trading Account	Sales Account
B	Advertisement Account	Profit and Loss Account
C	Advertisement Account	Purchases Account
D	Purchases Account	Advertisement Account

8. Cash sale of old asset (without profit or loss) is recorded in the journal by passing the following entry

	Debit	*Credit*
A	Cash Account	Sales Account
B	Buyer's Account	Asset Account
C	Assets Account	Cash Account
D	Cash Account	Asset Account

9. How is bad debt recovered recorded in the journal ?

	Debit	*Credit*
A	Bad Debt Account	Cash Account
B	Bad Debt Account	Bad Debt Recovery Account
C	Cash Account	Bad Debt Recovery Account
D	Bad Debt Recovery Account	Cash Account

10. A debit entry in the Purchases Account is matched by a credit entry in ITC Ltd Account. What do these entries record?
    A Purchase of goods for cash from ITC Ltd.
    B Purchase of goods on credit from ITC Ltd.
    C Purchase Return to ITC Ltd.

PRACTICAL QUESTION

Transaction

1. State which of the following events may be recorded as a transaction in the books of Sri Agarwal, a trader. Give reasons.
   (a) Agarwal sent a price list of his merchandise to Biswarup, a trader.
   (b) He received an order for supply of goods worth ₹ 1,000 from Biswarup.
   (c) He delivered on credit goods for ₹ 1,000 to Biswarup.
   (d) He despatched a letter of appointment to Chittarup appointing him as a book-keeper on a monthly salary of ₹ 2,000.
   (e) Out of goods supplied to Biswarup those for ₹ 100 were returned.
   (f) His book-keeper, Chittarup left the service after defalcating ₹ 500 from the cash box.
2. State whether the following are transactions :
   (a) Purchased machinery worth ₹ 70,000.
   (b) Appointed Sandeep as accountant.
   (c) Furniture has been depreciated by ₹ 1,000.
   (d) Paid rent ₹ 6,000.
   (e) Rent paid for the month of April ₹ 10,000.
   (f) Decided to purchase shares of ITC Ltd.
   (g) Sold old newspapers for ₹ 200.
   (h) Sold a machinery for ₹ 4,000 on credit to Sri Raja Roy.
   (i) Goods lost by fire ₹ 10,000.
   (j) Submitted a tender for a work of ₹ 10,000.
   (k) Received an order for supply of goods to Roy & Co. ₹ 25,000.
   (l) Took a loan from Swapan ₹ 10,000.
   (m) Deposited cash into bank ₹ 2,000.
   (n) Supplied goods to Dutta Bros. ₹ 5,000 as per their order.
   (o) Distributed free samples ₹ 4,000.
   (p) Received free samples ₹ 2,000.
   (q) Appointed Subhas as Manager in the scale of ₹ 5,000 – 200 – 8,000.
   (r) Sent a fax message to a supplier.
3. State whether the following are cash or credit transactions :
   (a) Paid salary ₹ 1,000.
   (b) Received from X ₹ 2,600.

(c) Paid rent ₹ 500.
(d) Paid electric bill ₹ 750.
(e) Sold goods to Y ₹ 4,000.
(f) Paid rent by cheque for ₹ 1,000.
(g) Dividend accrued ₹ 700.
(h) Purchased goods from Mukherjee Bros. for ₹ 1,000.
(i) Bought an almirah from Raj & Raj for ₹ 2,000.
(j) Purchased goods for ₹ 2,800 from Uma Sankar in cash.
(k) Paid Salary ₹ 18,000.
(l) Purchased a furniture for ₹ 3,000 from Furniture House in cash.
(m) Purchased books from Banerjee & Co. for ₹ 1,000.
(n) Sold goods to Ruma for ₹ 5,000.
(o) Received from Poddar a loan of ₹ 2,000.

4. State with reasons whether the following transactions are cash transactions or credit transactions:
(a) Started business with cash ₹ 20,000.
(b) Purchased goods from Bhuban for ₹ 3,000 in cash.
(c) Purchased goods from Rajat for ₹ 1,000.
(d) Sold goods to Arif for ₹ 6,000.
(e) Paid salaries ₹ 3,000.
(f) Purchased stationery for ₹ 100 from Tuhin.
(g) Purchased an almirah for ₹ 4,000 from Indra.
(h) Electric bill due ₹ 900.
(i) Purchased a machine from Raja for ₹ 20,000.
(j) Outstanding wages ₹ 1,000.
(k) Paid electric bill for ₹ 1,440.
(l) Received a cheque of ₹ 1,000 from Balrampur Chini Ltd. for dividend.
(m) Purchased goods worth ₹ 2,400 from Ghosh on credit.
(n) Received a cheque amounting to ₹ 5,000 from Robin.
(o) Cheque deposited into Bank on the following day.
(p) Sold old newspapers to Tuhin Kumar for ₹ 850.

5. State whether the following are cash or credit transactions :
(1) Sold goods for cash ₹ 10,000.
(2) Sold goods to Ram for cash ₹ 15,000.
(3) Sold goods to Shyam ₹ 2,000.
(4) Paid salary by cheque ₹ 12,000.
(5) Purchased office equipments from Raj & Raj ₹ 30,000.
(6) Purchased a plant from L&T Ltd. ₹ 1,00,000.
(7) Sold an old plant to GEC Ltd. ₹ 20,000.
(8) Paid for advertisement in cash ₹ 10,000.
(9) Sold shares of LML Ltd. to Rajan ₹ 6,000 for cash.
(10) Purchased shares of ITC Ltd. from Sajjan ₹ 14,000 in cash.

Classification of Accounts

6. Classify the following into Real, Nominal, Personal and Valuation Accounts:
(1) Land; (2) Investments; (3) Building; (4) Interest Received; (5) Salary; (6) Excise Duty; (7) Bank Overdraft; (8) Debtors; (9) Creditors; (10) Purchases Returns; (11) Provision for Doubtfu l Debts; (12) Discount allowed; (13) Bad debts; (14) Carriage inward; (15) Customs duty; (16) Return inward; (17) Return outward; (18) Postage; (19) Maintenance; (20) Insurance premium; (21) Repairs; (22) Commission; (23) Bad debts recovery; (24) Bills receivable; (25) Bills payable; (26) Drawings; (27) Capital; (28) Prepaid insurance; (29) Outstanding salary; (30) Leasehold premises; (31) Freehold premises; (32) Motor vehicles; (33) Horses and carts; (34) Commission received in advance; (35) Reserves; (36) Purchases; (37) Sales; (38) Stock; (39) Depreciation; (40) Freight; (41) Wages; (42) Goodwill; (43) Patents; (44) Technical knowhow; (45) Royalty; (46) Subscription; (47) Stock of stationery; (48) Stationery consumed; (49) 10% Govt. Bonds; (50) Miscellaneous expenses.

7. Classify the following into assets, liability, capital, withdrawal, revenue, expense.
(1) Plant and machinery; (2) Bank loan; (3) Sales; (4) Rent; (5) Discount received; (6) Carriage inwards; (7) Carriage outwards; (8) Purchases; (9) Interest paid on bank loan; (10) Capital; (11) Drawings; (12) Wages; (13) Cash in hand; (14) Goodwill; (15) Patents; (16) Vehicles; (17) Returns; (18) Furniture and fixture; (19) Freehold

premises; (20) Leasehold premises; (21) Investments; (22) Govt. security; (23) Stock of goods; (24) Outstanding expenses; (25) Prepaid expenses; (26) Advance incomes; (27) Accrued incomes; (28) Bills payable; (29) Bills receivable; (30) Commission paid.

8. From the following transactions find out the nature of account and also state which account should be debited and which account should be credited : (a) Rent paid; (b) Salaries paid; (c) Received from Suresh the proprietor; (d) Furniture purchased on credit from Gopal; (e) Purchased goods on credit from Ramesh.

9. For transactions given below one of the accounts involved is given. State the other account and state whether the account mentioned by you will be debited or credited.

(a)	Started business with a capital of ₹ 30,000.	Cash
(b)	Bought furniture from Modern Furniture Stores ₹ 1,000.	Furniture
(c)	Bought goods from Deepak & Sons ₹ 9,000.	Purchases
(d)	Sold goods to Dalip Singh ₹ 10,000.	Sales
(e)	Cash sales ₹ 5,000.	Sales
(f)	Sold to Bombay Stores for cash ₹ 3,000.	Sales
(g)	Returned goods to Deepak & Sons ₹ 2,000.	Deepak & Sons
(h)	Opened a bank account with ₹ 10,000.	Bank

JOURNAL AND LEDGER

10. Journalise the following transactions :

2015			₹
April	2	Cash deposited into bank	20,000
	5	Withdrawn from bank for personal use	6,000
	12	Cash paid to Rahim	2,000
	14	Cash received from Ranabir	6,000
	15	Purchased furniture on credit from Roy Traders	11,000
	25	Paid Salary to Jivan	2,000
	27	Received interest on bank deposit	500
	28	Loan arranged from Basak	12,000
	30	Paid for Carriage	1,000

11. Pass Journal entries for the following transactions in the books of A :

2015			₹
January	1	Started business with cash	5,000
	2	Purchased furniture in cash	500
	3	Opened a bank Account	1,000
	4	Goods purchased in cash	2,000
	5	Goods sold in cash	1,500
	8	Goods purchased on credit from Roy	3,000
	10	Paid Salary	800
	15	Paid rent by cheque	500
	18	Goods sold on Credit to Bose	1,800
	20	Cash paid to Roy	2,500
	21	Cash collected from Bose	1,500
	25	Cash deposited into Bank	1,600
	28	Cash drawn for household purposes	500
	30	Cheque drawn for office purposes	1,000

12. On 1st January, 2015, Prasanna started a business with a capital of ₹ 10,000 in cash and ₹ 5,000 in stock. His transactions during the month were as follows. Journalise the following transactions:

2015			₹
January	1	Bought goods from Raja	1,500
	2	Purchased furniture in cash from Billu	1,200
	4	Purchased office equipments	425
	9	Sold goods to Bikash	1,560
	12	Sold goods to Samir in cash	925
	15	Paid to Jolly as advance	90
	21	Sold goods to Suresh in cash	430
	22	Bought office furniture from Radha in cash	800

13. Write up the following transactions in the ledger of Mr J Reddy for the month of July, 2015.
    1. Started business with ₹ 80,000 in bank and ₹ 30,000 in cash.
    2. Paid rent by cheque ₹ 3,000; Bought goods on credit from : Barnali Sengupta & Co ₹ 15,000;
    3. Sold goods for cash ₹ 3,000 and on credit to P Sengupta & Co ₹ 5,000;
    4. Paid insurance by cheque ₹ 250 and bought stationery for ₹ 100 in cash;
    5. Paid wages in cash ₹ 500; sold goods for cash ₹ 700;
    8. Paid cash into bank ₹ 1,000 and returned goods to Barnali Sengupta & Co ₹ 3,000;
    9. Paid by cheque to Barnali Sengupta & Co. ₹ 10,000;
    11. Sold goods on credit to G Basu ₹ 8,000;
    12. Paid wages in cash ₹ 500 and sold goods for cash ₹ 2,000;
    15. Cash paid into bank ₹ 1,500; goods returned by P Sengupta & Co ₹ 1,000; bought shop furniture, paid by cheque ₹ 500;
    17. Cheque received from P Sengupta & Co ₹ 4,000;
    19. Paid wages in cash ₹ 500 and cash sales ₹ 2,000;
    21. Bought goods on credit from Barnali Sengupta & Co ₹ 6,000;
    22. Goods sold for cash ₹ 5,000 and on credit to P Sengupta & Co ₹ 10,000;
    26. Cash paid into bank ₹ 4,000 and bought postage stamps for ₹ 50;
    27. Paid telephone bill ₹ 500 and electricity ₹ 400 by cheque;
    30. Paid wages in cash ₹ 500.
14. On 1.1.2015, Sri Pranab Chatterjee commenced a business with a Capital of ₹ 30,000. His transactions for the month of January, 2015 were as under :

			₹
January	1	Bought goods for cash	1,000
	2	Purchased furniture for cash	300
		Purchased a small machine for cash	2,500
		Purchased goods from Naresh	1,800
	3	Goods sold for cash	6,000
	4	Sold goods on credit to Sohan	1,400
	5	Goods purchased from Mohan	700
	6	Goods sold to Krishna Kant	2,000
	7	Paid to Naresh on account	600
	8	Returned goods to Mohan	50
	9	Goods returned by Sohan	80
	10	Received from Krishna Kant	1,970
		and Discount allowed	30
	11	Paid to Naresh	1,175
		Discount allowed by him	25
	15	Sold goods to M.K.Mahajan	1,500
	18	Gave away as charity — in cash	210
		in goods	130
	25	Purchased a Plant	10,000
	27	Paid Sundry Expenses	125
	28	Received from M.K.Mahajan	1,460
		and Discount allowed	40
	29	Sohan paid on account	300
	31	Salaries paid	250
		Rent paid	100
		Withdrawn by the proprietor for personal use	400
		Received interest	310

Journalise the above transactions in the books of Sri Pranab Chatterjee.

15. Enter the following transactions in the four subsidiary books for the month of October, 2014 required for the proprietor Mr Raj. (Note – all the details are required in columnar form and narrations should not be written). Thereafter, complete the monthly totalling of the books.

1 Mr A sold goods worth ₹ 50,000 @ 10% discount.
3. Mr Otter bought of Mr Raj, four cases of goods, each valued at ₹ 7,000, less 3,000 trade discount.
6 Mr Sam supplied goods valued ₹ 25,000 as per invoice prepared.
18 Mr Raj bought from Mr Taj, four cases each costing ₹ 10,000, ₹ 5,000, ₹ 6,500 and ₹ 7,400 respectively.
24 One case sold earlier, was rejected by Mr Otter.
24 Twenty percent of the consignment of the 10th of October, was ejected for the wrong size.

8 Ten percent of the goods of Mr A were rejected.

10 Record invoice for ₹ 30,000 less ₹ 3,000, received from Mr Andrews.

15 Goods bought of Sam were despatched to Mr Amour at 50% above cost.

25 Recorded a Debit Note for ₹ 2,000 and a Credit Note for ₹ 4,000 issued to Mr Hardy and Mr Jack respectively.

30 Despatched a consignment worth ₹ 65,000 to Mr Sail and sent the invoice (clearly specifying the credit period of one month), by Registered Post.

30 Recorded a Sales Return for ₹ 1,400 from Ratan, against a sale order of ₹ 45,000 executed last month.

16. Mr J Hines is a wholesale grocer. Some of the transactions recorded in his book during May, 2015 :

May 1 Credit sales to N Brooks : 1 doz. cases of soup @ ₹ 100 per case; 1 doz. cases of baked beans @ ₹ 90 percase; 1 doz. cases of salad cream @ ₹ 25 per case;
May 5 N Brooks returned half doz. cases of soup @ ₹ 100 per case. A Credit Note was sent.
May 14 Credit sales to J Beagley : Half doz. cases of baked beans @ ₹ 90 per case.
May 21 Credit sales to G Boothroyd : 2 doz. cases of tomato ketchup @ ₹ 160 per case.
May 23 G Boothroyd returned 1 case of tomato ketchup as damaged. A Credit Note was sent.

During May, the customers of J Hines made to him the following payments by cheque :

May 14 N Brooks settled the balance owing on his account, less 2.5% cash discount.
May 31 G Boothroyd paid ₹ 1,000 on account.

You are required to : (i) Enter the above transactions in the books of prime entry of J Hines; (ii) Post the entries to appropriate Ledger Accounts and the cheque payments to the Cash Book and Ledger Accounts.

17 The Purchase Book of a firm is given below :

Date	Particulars	Inward Invoice No.	L.F.	Details ₹	Total ₹
2015 Mar. 5	M/s. Shah & Co., Madras	116		10,204	
Mar. 10	Mr. Kirtikumar, Delhi	117		7,985	
Mar. 18	M/s. Kamani Bros., Bombay	118		16,010	
Mar. 24	M/s. Kapoor & Sons, Nasik	119		4,050	
Mar. 28	M/s. Suresh & Co., Calcutta	120		5,000	43,249

(a) Explain briefly the advantages of maintaining the above record.
(b) Name the other three records, which could be maintained on similar lines.
(c) Show the posting necessary from the above record for March 2015.

18. Give the journal entries for :
(i) Cash withdrawal of interest on capital @ 8% earned by partner B on his capital investment of ₹ 50,000 for the year.
(ii) Transfer of the year's net profit shares of ₹ 5,000 and ₹ 3,000 appropriated to partners Karl and Steale respectively, who maintain their personal accounts on the fixed capital method.

19. Give journal entries for :
(a) An initial total investment of ₹ 80,000 by Mr. B in his business, in the form of ₹ 30,000 worth of machinery, ₹ 20,000 for vehicles and the balance equally distributed between the cash account and the bank account.
(b) Closing the Rent Account at the end of the year, which reflects a total sum of ₹ 10,000 to its debit, accounted during the year.
(c) Closing the Drawings Account at the end of the year, which showed a total withdrawal of ₹ 15,000 during the year, by the owner.
(d) Accounting the final equal distribution of remaining profits of ₹ 15,000 between partners C and D.

20. Enter the relevant transactions in the four day books for goods, for Mr. C. Kaul for the month of January, 2015.
1 Goods bought from Lata ₹ 12,000 @ 10% trade discount.
6 Sold 1/3 of the goods purchased on the 1st to Potter @ 5% on account of trade discount.
8 Purchased goods from Robert ₹ 16,000 @ 10% trade discount and 1% cash discount.
10 Received a debit note from Munira for ₹ 1,800 for goods rejected. Returned the goods to the original supplier, Donald, whose goods had been sold at a profit margin of 50%.
15 Sold an old machine to Lata, book value ₹ 20,000 at ₹ 18,000, the payment was promised in two equal instalments in February and March.
16 Reema sent goods worth ₹ 20,000 to Parikh on Mr. C. Kaul's instructions. The client was billed for the same at a margin of 75% profit for the proprietor, on the 20th, Reema's bill dated 18th, was received and recorded on 18th.
25 Record a debit note for ₹ 4,000 sent to Thomas and a debit note for ₹ 3,500 received from Bob.

Guide to Answers

Multiple Choice

1. A 2. C 3. B 4. D 5. D 6. C 7. C 8. D 9. C 10. B.

4

The Trial Balance

Meaning of Trial Balance

Before using the account balances to prepare Final Accounts, an attempt is made to prove that the total of accounts with debit balances is in fact equal to the total of accounts with credit balances. This proof of the equality of debit and credit balances is called a ***Trial Balance***.

A Trial balance is a five-column schedule listing the names and balances of all the accounts in the ledger and cash book, listed in the order in which they appear in the ledger. Last two columns are used for listing the balances of different accounts. The debit balances are listed in the left-hand column and the credit balances in the right-hand column. The total of two columns should agree. The different columns of the Trial Balance are:

(i) Serial number, (ii) Heads of Account, (iii) Ledger folio (L.F.), (iv) Debit balance, and (v) Credit balance.

A Trial Balance taken from the ledger balances of Sachin and Co is given below :

Trial Balance of Sachin and Co. as at 31st March, 2015

Serial Number	Heads of Account	L F	Debit Balance (₹)	Credit Balance (₹)
1.	Land and Building		6,00,000	
2.	Plant and Machinery		6,00,000	
3.	Furnitures and Fixtures		50,000	
4.	Purchases / Sales		5,00,000	8,00,000
5.	Wages and Salaries		1,50,000	
6.	Rent, Rates and Taxes		10,000	
7.	Cash in Hand		50,000	
8.	Creditors			60,000
9.	Loan from Bank			4,00,000
10.	Capital			7,00,000
	Total		19,60,000	19,60,000

Total of debit balances
and credit balances are equal

Key Points to Remember

1. ***The heading should show the date on which the Trial Balance is prepared.***
2. ***The heading should also contain the name of the organisation / person for whom the Trial Balance is prepared.***
3. ***The debit balances are listed in the left hand column and the credit balances are in the right hand column.***
4. ***The debit and credit columns of the Trial Balance should agree if all transactions are correctly recorded in the ledger accounts and if the balances of the accounts have also been struck correctly.***
5. ***A Trial Balance essentially proves the arithmatical accuracy of the books of account.***
6. ***A Trial Balance is prepared at regular intervals, for example on a monthly, half yearly or yearly basis, as desired.***
7. ***The Trial Balance is not part of the ledger, but is merely a statement of debit and credit balances in the ledger at a particular date.***
8. ***The order of accounts does not matter.***

Characteristics of a Trial Balance

1. It is a list of balances of all ledger accounts and cash book.
2. It is not a part of the double entry system of book-keeping. It is just a working paper.
3. It can be prepared any time during the accounting period.
4. It serves as an instrument for carrying out the job of checking and testing.
5. Arithmatical accuracy of posting of entries from journal to ledger can be ensured.
6. Some errors are not revealed by the Trial Balance, for example, errors of principle.

Objectives of Drawing up a Trial Balance

1. It ensures that all transactions have been recorded with identical debit and credit amounts and the balance of each account has been computed correctly.
2. It facilitates the preparation of the Trading, Profit and Loss Accounts and the Balance Sheet by making available the balances of all the accounts at one place.
3. It also ensures that the balance of each account, whether debit or credit, has been transferred properly to the respective columns of the trial balance and that the Trial Balance has been correctly added.
4. Some of the errors in the books of account can be detected by the Trial Balance and they can be rectified before the preparation of the final accounts.

Defects of a Trial Balance

A Trial Balance in which the credit and debit accounts match does not prove that :

1. All transactions have been correctly analysed and recorded in the proper accounts. If, for example, the wages paid for the installation of plant had been erroneously recorded by debiting the wages account in place of the plant account, the Trial Balance would still agree.
2. All transactions have been recorded in the books of original entry. If, for example, a sales invoice were to be completely omitted from being recorded in the sales day book, the error would not be disclosed in the Trial Balance.

We can say that a Trial Balance should not be regarded as conclusive proof of the correctness of the books of account.

Construction of a Trial Balance

The Trial Balance is generally prepared on a loose sheet that may have five columns :

(a) Serial Nos.; (b) Heads of Account; (c) Ledger Folio (L.F.); (d) Debit Balance; and (e) Credit Balance. For the preparation of a Trial Balance, the following steps are followed:

Step 1 Calculate the balances of the cash book and all ledger accounts.
Step 2 Write down the heading—'Trial Balance of ... as at ...' at the top of the loose sheet.
Step 3 Write down : (a) Serial numbers of the accounts in the 1st column; (b) Names of the accounts in the 2nd column; (c) L.F. number in the 3rd column; and (d) the balances in the respective columns.
Step 4 Add both the debit and credit columns to see whether they agree.

Illustration 1

Enter the following transactions in the ledger of Mr Alpha

2015			₹	2015			₹
Jan.	1	Started business with cash	6,000	Jan.	19	Sold goods for cash	350
	4	Bought goods for resale	500		20	Bought stationery	80
	7	Bought stationery	50		21	Paid wages	100
	10	Bought goods for resale	750		23	Bought goods for resale	200
	12	Paid wages	100		24	Sold goods for cash	600
	15	Sold goods for cash	350		25	Paid Postage	80
	16	Sold goods for cash	300		26	Paid for Advertisement	30
	17	Paid Electricity Bill	70		31	Sold goods for cash	700
					31	Paid wages	150

You are required to extract a Trial Balance as on 31st January 2015.

Solution

Ledger of Mr Alpha

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

Date	Particulars	₹	Date	Particulars	₹
2015 Jan. 1	To Capital A/c	6,000	2015 Jan. 4	By Purchases A/c	500
15	To Sales A/c	350	7	By Stationery A/c	50
16	To Sales A/c	300	10	By Purchases A/c	750
19	To Sales A/c	350	12	By Wages A/c	100
24	To Sales A/c	600	17	By Electricity Charges A/c	70
31	To Sales A/c	700	20	By Stationery A/c	80
			21	By Wages A/c	100
			23	By Purchases A/c	200
			25	By Postage A/c	80
			26	By Advertisement A/c	30
			31	By Wages A/c	150
			31	By Balance c/d	6,190
		8,300			8,300

Dr. **Purchases Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Jan. 4	To Cash A/c	500	2015 Jan. 31	By Balance c/d	1,450
10	To Cash A/c	750			
23	To Cash A/c	200			
		1,450			1,450

Dr. **Sales Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Jan. 31	To Balance c/d	2,300	2015 Jan. 15	By Cash A/c	350
			16	By Cash A/c	300
			19	By Cash A/c	350
			24	By Cash A/c	600
			31	By Cash A/c	700
		2,300			2,300

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

Date	Particulars	₹	Date	Particulars	₹
2015 Jan. 31	To Balance c/d	6,000	2015 Jan. 1	By Cash A/c	6,000

Dr. **Stationery Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Jan. 7	To Cash A/c	50	2015 Jan. 31	By Balance c/d	130
20	To Cash A/c	80			
		130			130

Dr. **Wages Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Jan. 12	To Cash A/c	100	2015 Jan. 31	By Balance c/d	350
Jan. 21	To Cash A/c	100			
Jan. 31	To Cash A/c	150			
		350			350

Dr. **Electricity Charges Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Jan. 17	To Cash A/c	70	2015 Jan. 31	By Balance c/d	70

Dr. **Postage Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Jan. 25	To Cash A/c	80	2015 Jan. 31	By Balance c/d	80

Dr. **Advertisement Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Jan. 26	To Cash A/c	30	2015 Jan. 31	By Balance c/d	30

Trial Balance of Mr Alpha as at 31st January, 2015

Sl. No.	Heads of Account	L.F.	Debit Balance (₹)	Credit Balance (₹)
1.	Cash Account		6,190	
2.	Purchases Account		1,450	
3.	Sales Account			2,300
4.	Capital Account			6,000
5.	Stationery Account		130	
6.	Wages Accounts		350	
7.	Electricity Charges Account		70	
8.	Postage Account		80	
9.	Advertisement		30	
	TOTAL		8,300	8,300

Illustration 2

The Balance Sheet of Rohit Furniture as on 31st March 2015 is given below :

Liabilities	₹	Assets	₹
Capital	1,00,000	Cash	42,000
General Reserve	19,000	Sundry Debtors	90,000
Sundry Creditors	25,000	Inventory	10,000
		Prepaid Rent	2,000
	1,44,000		1,44,000

Following is the summary of transactions that occurred during April, 2015 :	₹
(a) Collections from debtors	88,000
(b) Payments to creditors	24,000
(c) Acquisition of inventory on credit	80,000
(d) Inventory costing ₹ 70,000 was sold on credit for	85,000
(e) Recognition of rent expense in April	1,000
(f) Wages paid in cash in April	8,000

Required :

1. Prepare all ledger accounts after including the opening balances as on March 31, 2015. (Journal entries are not required).
2. Prepare the Trial Balance as on April 30, 2015 from the ledger accounts.

Solution **Ledger Accounts of Rohit Furniture**

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

Date	Particulars	₹	Date	Particulars	₹
1.4.2015	To Balance b/d	42,000	?	By Sundry Creditors A/c	24,000
?	To Sundry Debtors A/c	88,000	?	By Wages A/c	8,000
			30.4.2015	By Balance c/d	98,000
		1,30,000			1,30,000
1.5.2015	To Balance b/d	98,000			

Dr. Sundry Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2015	To Balance b/d	90,000	?	By Cash A/c	88,000
?	To Sales A/c	85,000	30.4.2015	By Balance c/d	87,000
		1,75,000			1,75,000
1.5.2015	To Balance b/d	87,000			

Dr. Sundry Creditors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Cash A/c	24,000	1.4.2015	By Balance b/d	25,000
30.4.2015	To Balance c/d	81,000	?	By Purchases A/c	80,000
		1,05,000			1,05,000
			1.5.2015	By Balance b/d	81,000

Dr. Purchases Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Sundry Creditors A/c	80,000	30.4.2015	By Balance c/d	80,000
1.5.2015	To Balance b/d	80,000			

Dr. Sales Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.4.2015	To Balance c/d	85,000	?	By Sundry Debtors A/c	85,000
			1.5.2015	By Balance b/d	85,000

Dr. Inventory Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2015	To Balance b/d	10,000	30.4.2015	By Balance c/d	10,000
1.5.2015	To Balance b/d	10,000			

Dr. Prepaid Rent Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2015	To Balance b/d	2,000	1.4.2015	By Rent Expenses A/c	1,000
			30.4.2015	By Balance c/d	1,000
		2,000			2,000
1.5.2015	To Balance b/d	1,000			

Dr. Rent Expenses Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.4.2015	To Prepaid Rent A/c	1,000	30.4.2015	By Balance c/d	1,000
1.5.2015	To Balance b/d	1,000			

Dr. Wages Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Cash A/c	8,000	30.4.2015	By Balance c/d	8,000
1.5.2015	To Balance b/d	8,000			

Dr. Capital Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.4.2015	To Balance c/d	1,00,000	1.4.2015	By Balance b/d	1,00,000
			1.5.2015	By Balance b/d	1,00,000

Dr. General Reserve Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.4.2015	To Balance c/d	19,000	1.4.2015	By Balance b/d	19,000
			1.5.2015	By Balance b/d	19,000

Trial Balance of Rohit Furniture as at 30th April, 2015

Sl. No.	Heads of Account	L.F.	Debit Balance (₹)	Credit Balance (₹)
1.	Cash Account		98,000	
2.	Sundry Debtors Account		87,000	
3.	Purchases Account		80,000	
4.	Prepaid Rent Account		1,000	
5.	Rent Expenses Account		1,000	

6.	Wages Account		8,000	
7.	Inventory Account		10,000	
8.	Sundry Creditors Account			81,000
9.	Sales Account			85,000
10.	Capital Account			1,00,000
11.	General Reserve Account			19,000
	TOTAL		2,85,000	2,85,000

Errors Disclosed by a Trial Balance

The disagreement of a Trial Balance indicates the presence of one or more of the following errors in the books of account.

1. Omission to Post an Amount in the Ledger The two sides of a Trial Balance will not agree, when a transaction has been correctly recorded in the books of original entry but has not been posted in the ledger. If a cash receipt of ₹ 500 from X has been properly recorded in the cash book, but has not been posted on the credit side of X Account, the credit side of the Trial Balance will fall short by ₹ 500.

2. Debit or Credit Entries are not Posted at all or Posted Twice If only one side of the transaction is recorded, the Trial Balance will not agree. If stationery purchased on credit from X for ₹ 300 has been properly recorded in the Stationery Account but not in the account of X, the Trial Balance will fail to agree. Similarly, if X Account is correctly credited but Stationery Account has been wrongly debited twice, the Trial Balance will not agree.

3. Debits are Wrongly Posted as Credits and Vice Versa A Trial Balance will be in disagreement when a transaction is recorded on the wrong side of an account. If a cash receipt of ₹ 1,000 as interest is properly debited in the cash book but has been recorded on the debit side of the interest account by mistake, the credit side of the Trial Balance will fall short by ₹ 2,000.

4. Wrong Totalling of Subsidiary Books If the total of any subsidiary books has been cast wrongly, it will cause a disagreement in the Trial Balance. If the sales day book is wrongly totalled as ₹ 1,800 (instead of ₹ 1,700), sales account will be credited by ₹ 1,800 but the debtor's account will be debited by ₹ 1,700, in which case the Trial Balance will fail to agree.

5. Difference in Amount between the Entries If different values of an item are posted in two different accounts, the Trial Balance will not agree. A cash receipt of ₹ 2,000 from X is correctly recorded in the cash book but the account of X is incorrectly credited by ₹ 200, the credit side of the Trial Balance would fall short by ₹ 1,800.

6. Error in the Computation of an Account Balance If the balance of an account is not correctly computed, the balance of the ledger will not show the true position and will cause disagreement of the Trial Balance.

7. Omission of Account Balance If the balance of an account is not listed in the Trial Balance at all, it will fail to agree.

8. Balance of an Account Wrongly Recorded in the Trial Balance If the balance of an account is wrongly recorded in the Trial Balance, it will not agree. For example, if the actual balance of purchase account is ₹ 1,000 but has been recorded in the Trial Balance as ₹ 100, the debit side of the Trial Balance will fall short by ₹ 900.

9. Errors in Extraction of the Trial Balance The Trial Balance will not tally if any or both the columns are wrongly totalled.

Errors Not Disclosed by a Trial Balance

1. Errors of Omission If a particular transaction is omitted altogether from the books of original entry, it will not disturb the agreement of the Trial Balance. If a sum of ₹ 100 paid to X, is not recorded either in the Cash Book or in the account of X, only the total of the Trial Balance will fall short by ₹ 100, but the debit and credit columns will show no difference.

2. Errors of Principle These errors arise because of an incorrect application of the principles of accounting, for instance, failure to differentiate between capital and revenue expenditure. The existence of this type of error is not disclosed by the Trial Balance. Examples are : (a) Wages paid for installation of machinery being debited to Wages Account; and, (b) Repairs of the building debited to Building Account and the like.

3. Compensating Errors These are a group of errors, the total effect of which is not reflected in the Trial Balance. These errors are of a neutralizing nature, i.e., one error is compensated by another error or by errors of an opposite nature. For example, an extra debit in Salary Account for ₹ 100 may be compensated by an extra credit of ₹ 100 in Sales Account.

4. Recording Wrong Amount in the Books of Original Entry If a transaction is wrongly recorded in the books of original entry and is subsequently carried through the ledgers, it will not cause disagreement in the Trial Balance. For example, if stationery purchased for cash ₹ 175 is recorded in the cash book as ₹ 751 and posted to Stationery Account in the ledger as ₹ 751, the Trial Balance will still agree.

5. Recording Both Aspects of a Transaction more than once in the Books of Account The Trial Balance will agree if both aspects of a transaction are recorded twice in the books of original entry. For example, if a credit purchase of ₹ 4,000 from Tata Chemicals Ltd. is entered in the purchase day book twice, the error will not cause a disagreement in the totals of the Trial Balance.

6. Errors in Recording a Transaction on the Correct Side of a Wrong Account If a transaction is recorded on the correct side of a wrong account, it will not cause a disagreement in the Trial Balance. For example, if ₹ 500 cash paid to Ram, is wrongly debited to Raman Account, it will not affect the agreement of the Trial Balance.

Steps to Detect Errors Through a Trial Balance

The following steps should be taken to locate the error or combination of errors that is causing a Trial Balance to disagree :

Step 1 Check whether the debit and credit columns have been added correctly by adding these columns in opposite directions, i.e. from bottom to top or from top to bottom.

Step 2 If the errors remain undetected, divide the exact difference between the totals of two columns by 9. If it is totally divisible by 9, this will mean that there is either a transposition error or a slide error. A ***transposition error*** is committed when a digit of an amount is placed wrongly, for example, if Plant Account has a balance of ₹ 5,760, but has been written as ₹ 5,670 in the Trial Balance, the resulting error is ₹ 90, which is divisible by 9. A ***slide error*** is committed when the decimal point is placed incorrectly, for example, ₹ 6,250 is copied as ₹, 62.50. The resulting error is ₹ 6,187.50 which is also divisible by 9.

Step 3 Divide the difference by 2, and scan the columns for an identical amount. If a debit balance has been entered in the credit column, or vice-versa, it will cause a difference which is twice this amount. If a debit balance of ₹ 250 in the Plant Account has been entered in the credit column of the Trial Balance, it will cause a difference of ₹ 500 in the Trial Balance total.

Step 4 Check from the ledger if any account shows a balance equal to the difference in the Trial Balance.

Step 5 Re-check the opening balances of all the accounts from the previous Balance Sheet.

Step 6 Cross check the amount in the Trial Balance with the balances in the ledger. Make sure that all the balances have been placed in the correct column of the Trial Balance.

Step 7 Re-compute the balances of each ledger account.

Step 8 If the errors remain undetected, check the postings from the journal and other books of original entry to the ledger accounts. Put tick marks with a coloured pencil in the journal and in the ledger after checking each figure. After completing the operation, look through the journal and the ledger for any unticked amount.

Step 9 If the errors still remain undetected, repeat the above steps with the help of other members of the staff, who are not in charge of maintaining the books of account.

Suspense Account

A Suspense Account is a Ledger Account in which entries are made on a temporary basis when the correct account cannot be immediately identified. This may be so because further information has to become available or while preparing the accounts, the accountant is unsure of how to proceed with it. It is opened in the following cases: (i) to balance a disagreed Trial Balance; (ii) to post doubtful items; and (iii) to record incomplete transactions.

(i) To Balance a Disagreed Trial Balance : Sometimes, a Trial Balance does not tally despite all efforts; but one cannot wait indefinitely as accounts must be closed at the end of a financial year. In such a case, the amount of difference is entered in the lighter column against Suspense Account. The point to note is that no double entry will be possible. Later, when the mistakes are detected, the rectifying entries are passed.

(ii) To Post Doubtful Items : Sometimes, an item cannot be posted to the correct account for one reason or another. For instance, you may receive a remittance of ₹ 1,500 but you may not know who has sent it. You then pass the following entry :

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

Date	Particulars	₹	₹
	Cash A/c Dr. To Suspense A/c (Being the remittance received from unknown sender)	1,500	 1,500

Later, you get the information that Ram, Shyam & Co has sent this amount. Then you should pass the following entry:

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

Date	Particulars	₹	₹
	Suspense A/c Dr. To Ram, Shyam & Co. A/c (Being credit given to the sender for a remittance which had been credited previously to Suspense Account)	1,500	 1,500

(iii) To Record Incomplete Transactions : Sometimes a Suspense Account is opened to record a balance that has not yet been finalised because a particular deal has not been concluded. For example, an advance of ₹ 10,000 received from X for the goods to be delivered in the future, subject to availability. A Suspense Account can include many transactions of this nature, without involving any error.

Preparation of The Trial Balance from Given Ledger Balances

For the purpose of preparing the Trial Balance from a given list of ledger balances, the following rules should be followed:

1. The balances of all accounts relating to:
   (a) Assets; (b) Expenses; (c) Losses; (d) Drawings; and (e) Debtors, should be placed in the ***Debit*** column of the Trial Balance.
2. The balances of all accounts relating to:
   (a) Liabilities; (b) Income and Revenue; (c) Gain; and (d) Creditors, should be placed in the ***Credit*** column of the Trial Balance.

Some Important Items

Closing Stock

Generally, closing stock does not appear in the Trial Balance because a separate account for this is not opened in the general ledger. It represents the balance of goods unsold out of opening stock and purchases. When goods are purchased, Purchases Account is debited and Cash/Creditors Account is credited (Closing Stock Account is not coming into picture). At the end of the year, if the following adjustment entry is passed, then closing stock will appear in the Trial Balance.

Closing Stock Account Dr.
To Purchases Account

Cost of Goods Sold

Cost of Goods Sold = Opening Stock + Purchases – Closing Stock.

Cost of Goods Sold will appear in the Trial Balance if the following entry is passed :

Cost of Goods Sold Account	Dr.		
Closing Stock Account	Dr.		
To Opening Stock Account			
To Purchases Account			

Illustrative Example

Opening Stock ₹ 5,000; Purchases ₹ 30,000; Closing Stock ₹ 10,000.

Cost of Goods Sold = ₹ 5,000 + 30,000 – 10,000 = ₹ 25,000.

Journal entry will be :

Cost of Goods Sold Account	Dr.	₹ 25,000	
Closing Stock Account	Dr.	₹ 10,000	
To Opening Stock Account			5,000
To Purchases Account			30,000

In the Trial Balance Cost of Goods Sold will be shown as a debit balance ₹ 25,000 and Closing Stock will be shown as debit balance ₹ 10,000.

Note : Cost of Goods Sold will be debited to Trading Account and Closing Stock will be shown in the Balance Sheet as a current asset.

Carriage Inwards and Carriage Outwards

Carriage paid for purchase of goods is called carriage inwards whereas carriage paid for sale of goods is called carriage outwards. Both are ***expenses***. Therefore, both carriage inward and carriage outward will be shown in the debit column of the Trial Balance.

Returns Inwards and Returns Outwards

Goods returned by customer is called the Returns Inwards. When goods are returned by the customer, Returns Inwards Account is debited and Customer Account is credited. Returns Inwards Account always will show a debit balance. Therefore, in the Trial Balance it will be shown in the debit column.

Goods returned to suppliers is called Returns Outwards. When goods are returned to supplier, Suppliers (Creditors) Account is debited and Returns Outwards Account is credited. Returns Outwards Account will always show a credit balance. Therefore, in the Trial Balance it will be shown in the credit column.

Illustration 3

From the following list of balances, prepare a Trial Balance as on 30.6.2015 :

		₹			₹
1.	Opening Stock	18,000	13.	Plant and Machinery	7,500
2.	Wages	10,000	14.	Loose Tools	1,800
3.	Sales	1,20,000	15.	Lighting	2,300
4.	Bank Loan	4,400	16.	Creditors	8,000
5.	Coal and Coke	3,000	17.	Capital	40,000
6.	Purchases	75,000	18.	Miscellaneous Receipts	600
7.	Repairs	2,000	19.	Office Salaries	2,500
8.	Carriage	1,500	20.	Office Furniture	600
9.	Income Tax	1,500	21.	Patents	1,000
10.	Debtors	20,000	22.	Goodwill	15,000
11.	Leasehold Premises	6,000	23.	Cash at Bank	5,100
12.	Cash in Hand	200	24.	Closing Stock	6,000

Solution **Trial Balance as at 30th June, 2015**

Sl. No.	Heads of Account	L.F.	Debit Balance (₹)	Credit Balance (₹)
1.	Opening Stock		18,000	
2.	Wages		10,000	
3.	Sales			1,20,000

4.	Bank Loan			4,400
5.	Coke and Coal		3,000	
6.	Purchases		75,000	
7.	Repairs		2,000	
8.	Carriage		1,500	
9.	Income Tax		1,500	
10.	Debtors		20,000	
11.	Leasehold Premises		6,000	
12.	Cash in hand		200	
13.	Plant and Machinery		7,500	
14.	Loose Tools		1,800	
15.	Lighting		2,300	
16.	Creditors			8,000
17.	Capital			40,000
18.	Miscellaneous Receipts			600
19.	Office Salaries		2,500	
20.	Office Furniture		600	
21.	Patents		1,000	
22.	Goodwill		15,000	
23.	Cash at Bank		5,100	
	TOTAL		1,73,000	1,73,000

Correction of Trial Balance

Illustration 4

The clerk of a businessman wrongly prepared the following Trial Balance. You are required to draw up a Trial Balance correctly stating reasons in brief:

Sl. No.	Heads of Account	L.F.	Debit Balance (₹)	Credit Balance (₹)
1.	Capital			60,000
2.	Stock at Commencement		5,000	
3.	Discount Allowed			500
4.	Commission Received			700
5.	Fixed Assets			60,000
6.	Sales		85,000	
7.	Purchases			45,000
8.	Return Outward			1,000
9.	Return Inward		2,000	
10.	Carriage Inward			600
11.	Carriage Outward			700
12.	Wages & Salary		25,000	
13.	Bills Receivable		7,000	
14.	Debtors		9,000	
15.	Bills Payable			7,000
16.	Rent		3,000	
17.	Interest Paid			2,000
18.	Cash		800	
19.	Creditors		6,900	
20.	Stock at the End		33,800	
	TOTAL		1,77,500	1,77,500

Solution **Trial Balance as at ...**

Sl. No.	Heads of Account	L.F.	Debit Balance (₹)	Credit Balance (₹)
1.	Capital			60,000
2.	Stock at Commencement		5,000	
3.	Discount Allowed		500	

4.	Commission Received			700
5.	Fixed Assets		60,000	
6.	Sales			85,000
7.	Purchases		45,000	
8.	Return Outward			1,000
9.	Return Inward		2,000	
10.	Carriage Inward		600	
11.	Carriage Outward		700	
12.	Wages & Salary		25,000	
13.	Bills Receivable		7,000	
14.	Debtors		9,000	
15.	Bills Payable			7,000
16.	Rent		3,000	
17.	Interest Paid		2,000	
18.	Cash		800	
19.	Creditors			6,900
	TOTAL		1,60,600	1,60,600

Reasons

1. Discount Allowed is an expense, so its balance will be a debit balance.
2. Fixed Assets always reflect debit balance because assets coming in are debited.
3. Sales are income, so its balance will be a credit balance.
4. Purchases are expenses, so its balance will be a debit balance.
5. Carriage Inwards is an expense, so its balance will be a debit balance.
6. Carriage Outwards is an expense, so its balance will be a debit balance.
7. Interest Paid is an expense, so its balance will be a debit balance.
8. Creditor is a liability, so its balance will be a credit balance.
9. Closing Stock is not an account, so it cannot have any balance and consequently, it cannot find a place in the Trial Balance. Only when closing stock is adjusted against purchases, it appears in the Trial Balance.

Illustration 5

The total of the debit side of the Trial Balance of a large boot and shoe repairing company as at 31st December, 2014 is ₹ 1,66,590 and that of the credit side is ₹ 42,470.

After several checkings and re-checkings the following mistakes are discovered :

Name of Accounts	Correct Figure (as it should be)	Figure as it appears in the Trial Balance
Opening Stock	14,900	14,800
Repairs	61,780	61,780
		(But appear on the debit side)
Rent & Rates	2,160	2,400
Sundry Creditors	6,070	5,900
Sundry Debtors	8,060	8,310

Ascertain the correct total of the Trial Balance.

Solution Ascertainment of Correct Total of Trial Balance as at 31st December, 2014

Debit Side	₹	Credit Side	₹
Total as per Trial Balance	1,66,590	Total as per Trial Balance	42,470
Less: Wrong amount of Opening Stock	14,800	Add: Repairs (Note 1)	61,780
	1,51,790		1,04,250
Add: Correct amount of Opening Stock	14,900	Less: Wrong amount of Creditors	5,900
	1,66,690		98,350
Less: Repairs (Note 1)	61,780	Add: Correct amount of Creditors	6,070
	1,04,910		
Less: Wrong amount of Rent & Rates	2,400		

	1,02,510		
Add: Correct amount of Rent & Rates	2,160		
	1,04,670		
Less: Wrong amount of Sundry Debtors	8,310		
	96,360		
Add: Correct amount of Sundry Debtors	8,060		
	1,04,420		1,04,420

Note :

(1) Repairs is an income in the case of a shoe manufacturing, therefore it will appear on the credit side of the Trial Balance.

The Adjusted Trial Balance (Recasting of a Trial Balance)

When final accounts are to be prepared, the ledger balances need to be updated to include the effects of transactions that are either unrecorded or recorded improperly, for example, outstanding expenses, depreciation, closing stock, etc. Adjusting entries are necessary to bring the ledger balances to their proper levels. After all the necessary adjusting entries have been journalized and posted, a 2nd Trial Balance is prepared to prove that the ledger is still in balance and this 2nd Trial Balance is called ***the adjusted Trial Balance***. This Trial Balance provides a complete listing of the account balances to be used in preparing the Final Accounts. The following illustration will clear the matter.

Illustration 6

Mr Vijay Kumar has been carrying on wholesale trade in textiles from September 1, 2000. His Trial Balance as on December 31, 2014 is as follows :

Name of Account	Debit (₹)	Credit (₹)
Salary	3,200	
Rent	29,000	
Sundry Debtors	43,000	
Loan from Mrs Vijay Kumar		60,000
Cash	4,000	
Sundry Creditors		27,000
Interest paid in part on loan	1,200	
Mr Vijay Kumar's Capital		32,500
Sales		75,800
Purchases	92,500	
Furniture and Fixtures	20,000	
Insurance Premium	2,400	
	1,95,300	1,95,300

Mr Vijay Kumar furnishes the following additional information :

1. Salary due to his shop assistants on December 31, is ₹ 800.
2. Rent includes a deposit of ₹ 25,000, refundable by the landlord when the premises are vacated.
3. Sundry Debtors represent the amounts invoiced but not yet collected, except for a sum of ₹ 2,200 shown as due from Mr Harinarayan in respect of goods sent to him on approval basis. Mr Harinarayan has to exercise his option by January 5, 2015, cost of the goods is ₹ 1,800.
4. Loan from Mrs Vijay Kumar taken on October 1, 2014 carries simple interest at the rate of 12 percent per year. The first instalment of ₹ 15,000 including interest falls due for payment on February 1, 2015.
5. Inventory of mill goods in the shop on December 31, 2014 is ₹ 35,000 (cost).
6. All items of shop furniture were bought on October 1, 2014. They are expected to be useful for 20 years at the end of which they are to be scrapped.
7. Insurance premium for the period September 1, 2014 to August 31, 2015 has been paid.

Required :

(1) Post the entries to ledger accounts (date is not required); and,

(2) Prepare adjusted Trial Balance as on December 31, 2014.

Solution

Ledger of Mr Vijay Kumar

Dr. **Salary Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	3,200		By Balance c/d	4,000
	To Outstanding Salaries A/c	800			
		4,000			4,000

Dr. **Rent Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	29,000		By Rent Deposit A/c	25,000
				By Balance c/d	4,000
		29,000			29,000

Dr. **Sundry Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	43,000		By Sales A/c	2,200
				By Balance c/d	40,800
		43,000			43,000

Dr. **Loan Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance c/d	60,000		By Balance b/d	60,000

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

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	4,000		By Balance c/d	4,000

Dr. **Sundry Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance c/d	27,000		By Balance b/d	27,000

Dr. **Interest Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	1,200		By Balance c/d	1,800
	To Outstanding Interest A/c	600			
		1,800			1,800

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

Date	Particulars	₹	Date	Particulars	₹
	To Balance c/d	32,500		By Balance b/d	32,500

Dr. **Furniture & Fixtures Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	20,000		By Depreciation A/c	250
				By Balance c/d	19,750
		20,000			20,000

Dr. **Sales Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Sundry Debtors A/c	2,200		By Balance b/d	75,800
	To Balance c/d	73,600			
		75,800			75,800

Dr. **Insurance Premium Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	2,400		By Insurance Premium Adv A/c	1,600
				By Balance c/d	800
		2,400			2,400

Dr. **Purchases Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	92,500		By Closing Stock A/c	36,800
				By Balance c/d	55,700
		92,500			92,500

Dr. **Rent Deposit Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Rent A/c	25,000		By Balance c/d	25,000

Dr. **Outstanding Salary Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance c/d	800		By Salary A/c	800

Dr. **Outstanding Interest Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance c/d	600		By Interest A/c	600

Dr. **Depreciation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Furniture & Fixtures A/c	250		By Balance c/d	250

Dr. **Insurance Premium paid in Advance Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Insurance Premium A/c	1,600		By Balance c/d	1,600

Dr. **Closing Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Purchases A/c (Note 1)	36,800		By Balance c/d	36,800

Adjusted Trial Balance of Mr Vijay Kumar as at 31st December, 2014

Sl. No.	Heads of Account	L.F.	Debit Balance (₹)	Credit Balance (₹)
1.	Salary Account		4,000	
2.	Rent Account		4,000	
3.	Sundry Debtors Account / Sundry Creditors Account		40,800	27,000
4.	Loan Account			60,000
5.	Cash Account		4,000	
6.	Interest Account		1,800	
7.	Capital Account			32,500
8.	Furnitures & Fixtures Account		19,750	
9.	Purchases Account / Sales Account		55,700	73,600
10.	Insurance Premium Account		800	
11.	Rent Deposit Account		25,000	
12.	Outstanding Salary Account			800
13.	Outstanding Interest Account			600
14.	Depreciation Account		250	
15.	Insurance Premium paid in Advance Account		1,600	
16.	Closing Stock Account		36,800	
	TOTAL		1,94,500	1,94,500

Key Points

- A Trial balance is a five-column schedule listing the names and balances of all the accounts in the ledger and cash book, listed in the order in which they appear in the ledger.
- **Some of the objectives of Drawing up a Trial Balance are :**
  1. It ensures that all transactions have been recorded with identical debit and credit amounts and the balance of each account has been computed correctly.
  2. It facilitates the preparation of the Trading, Profit and Loss Accounts and the Balance Sheet by making available the balances of all the accounts at one place.
  3. It also ensures that the balance of each account, whether debit or credit, has been transferred properly to the respective columns of the trial balance and that the Trial Balance has been correctly added.
- A Suspense Account is a Ledger Account in which entries are made on a temporary basis when the correct account cannot be immediately identified.

THEORETICAL QUESTIONS

1. What do you mean by a Trial Balance?
   Discuss the main objectives and limitations of the Trial Balance.
2. A Trial Balance is merely a proof of arithmetical accuracy.
   Explain this statement and bring out clearly the various classes of errors which a Trial Balance fails to disclose.
3. Explain the errors which are disclosed by the Trial Balance.
4. Explain the steps for locating errors through the Trial Balance.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below.

1. Why does a business prepare a trial balance ?
   A to provide a list of all its assets and liabilities
   B to calculate its profit or loss
   C to check the accuracy of its ledger entries
   D to check its bank balance
2. The totals of a trial balance do not agree. Which type of error causes this ?
   A a compensating error
   B an error of casting
   C an error of omission
   D an error of principle
3. An error of principle would occur if
   A plant and machinery purchased was credited to a fixed assets account
   B plant and machinery purchased was debited to the purchases account
   C plant and machinery purchased was debited to the equipment account
   D plant and machinery purchased was debited to the correct account but with the wrong amount.
4. In a trial balance, which one of the following items would be correctly shown as a debit balance ?
   A returns outwards
   B discount received
   C returns inward
   D bank overdraft
5. In a trial balance, which one of the following items would be correctly shown as a credit balance ?
   A carriage inwards
   B carriage outwards
   C discount allowed
   D discount received
6. Which of the following is shown on the debit side of the trial balance ?
   A discount received
   B capital
   C sales returns
   D bank overdraft
7. If R. Singh were to post ₹ 1,000 to the debit of S. Ganguli's account instead of to the credit of S. Ganguli's account, this would be known as an error of
   A principle
   B commission
   C omission
   D compensation
8. Which one of the following is an error of principle ?
   A a gas bill credited to gas account and debited to the bank account
   B the purchase of a fixed asset credited to the asset account at cost and debited to the creditor's account
   C the purchase of a fixed asset debited to the purchases account and credited to the creditor's account
   D the payment of wages debited and credited to the correct accounts, but using the wrong amount.

9. Which of the following will cause a difference on a trial balance ?
   A an invoice omitted from the sales day book
   B an invoice for ₹ 415 entered in the sales day book as ₹ 451
   C an invoice for ₹ 600 entered in the sales day book not included in the monthly total
   D a credit note entered to the sales day book
10. After which error will a trial balance still balance ?
   A wages paid ₹ 1,500, was entered correctly in the bank account but debited to the wages account as ₹ 2,500
   B rent receivable of ₹ 200 was debited to the rent payable account
   C goods returned to supplier ₹ 150 were entered in purchases returns day book as ₹ 105
   D The sales day book was undercast by ₹ 200

PRACTICAL QUESTIONS

1. Enter the following transactions in the subsidiary books and post them into ledger and prepare a Trial Balance for the month of November 2014 and bring down the balances on 1st December, 2014. (all figures in ₹)

1	Mr X started a business with	60,000	11	Sold goods to Zakir Khan	10,000
4	Bought furniture from Modern Furniture	5,000	14	Goods returned by Zakir Khan	2,000
5	Purchased goods for cash	10,000	15	Payment to B.Sen & Co by cheque	5,000
8	Purchased from B.Sen & Co for ₹ 15,000. Trade discount 20%		20	Goods purchased on credit from Din Dayal & Co	10,000
9	Opened a bank account by depositing	14,000	25	Goods returned to Din Dayal & Co worth	1,000
10	Sold goods for cash	20,000	28	Paid electricity bill	100
10	Purchased stationery from Bharat Stationery Mart.	500	29	Cash sales	9,000
			30	Withdrew for private use from bank.	1,000

2. Correct the following Trial Balance : (all figures in ₹)

Dr.			Cr.
Return Outward	16,000	Debtors	15,000
Opening Stock	34,200	Carriage Outward	5,000
Salaries	12,000	Capital	55,200
Creditors	28,000	Machinery	18,000
Bank	45,000	Return Inward	3,000
Carriage Inward	6,000	Discount Received	4,000
Rent Received	3,000	Trade Expenses	6,000
Discount Allowed	2,000	Sales	1,40,000
Purchases	1,00,000	Building	20,000
Bills Payable	20,000		
	2,66,200		2,66,200

3. An inexperienced bookkeeper has drawn up a Trial Balance for the year ended 30th June, 2015 :

Dr.			Cr.
Provision for doubtful debts	200	Capital	4,591
Bank overdraft	1,654	Creditors	1,637
Debtors	2,983	Discount allowed	733
Discount received	252	General expenses	829
Drawings	1,200	Return Inwards	330
Office Furniture	2,155	Sales	16,882
Purchases	10,923		
Rent and Rates	314		
Salaries	2,520		
Stock	2,418		
Provision for depreciation on Furniture	364		
	24,983		25,002

Draw up a 'corrected' Trial Balance, debiting or crediting any residual errors to a Suspense Account.

4. The total of debit side of the Trial Balance of a daily newspaper firm at 31st December, 2014 is ₹ 1,80,590 and that of the credit side is ₹ 36,470. After several checkings and re-checkings the following mistakes are discovered :

Name of Accounts	Correct Figure (as it should be)	Figure as it appears in the Trial Balance
Opening Stock	12,700	12,600
Advertisement Income	71,780	71,780 (But appear on the debit side)
Rent & Rates	2,260	2,500
Sundry Creditors	6,170	6,000
Sundry Debtors	8,150	8,400

Ascertain the correct total of the Trial Balance.

5. The following Trial Balance of Sri A K Das was drafted by his son, Sri Provat Sundar Das, a Higher Secondary student. But due to his defective knowledge of the subject, it had been done incorrectly. You are now required to re-draft the Trial Balance correctly stating your reasons for correction.

Trial Balance as on 31.3.2015

Sl.No.	Heads of Account	Debit Balance (₹)	Credit Balance (₹)
1.	Capital	—	1,00,000
2.	Opening Stock	16,590	—
3.	Closing Stock	—	20,580
4.	Creditors	—	12,500
5.	Debtors	20,670	—
6.	Fixed Assets	79,000	—
7.	Gross Purchases	60,920	—
8.	Gross Sales	—	1,02,600
9.	Returns Inwards	2,400	—
10.	Returns Outwards	—	1,230
11.	Carriage Inwards	800	—
12.	Carriage Outwards	—	1,850
13.	Import Duty	1,200	—
14.	Export Duty	—	800
15.	Wages and Salaries	31,400	—
16.	Bills Receivable	15,000	—
17.	Bills Payable	—	8,000
18.	Rent Receivable	3,800	—
19.	Interest Paid	—	1,100
20.	Bank Overdraft	11,000	—
21.	Cash	380	—
22.	Commission Received	—	870
23.	Rates and Taxes	7,130	—
24.	Discount Allowed	—	760
	Total	2,50,290	2,50,290

6. The following Trial Balance of a sole trader, although it adds up to the same total on both sides, is incorrect :

Trial Balance as on 31st December, 2014

Sl. No.	Heads of Account	L F	Debit Balance (₹)	Credit Balance (₹)
1.	Capital, 1st January		4,47,500	—
2.	Drawings		—	52,500
3.	Stock, 1st January		1,86,250	—
4.	Purchases		11,55,000	—
5.	Sales		—	19,71,250
6.	Wages and Salaries		3,10,250	—
7.	Lighting and Heating		15,500	—
8.	Equipment		1,80,000	—
9.	Carriage Outwards		—	11,500
10.	Returns Inwards		5,250	—
11.	Returns Outwards		—	14,500
12.	Provision for Bad Debts		17,500	—
13.	Discount Allowed		14,250	—
14.	Discount Received		—	15,750
15.	Rent, Rates and Insurance		55,750	—

16.	Motor Vehicles		73,750	—
17.	Sundry Debtors		—	6,96,000
18.	Sundry Creditors		2,46,250	—
19.	Bank Overdraft		48,750	—
20.	Cash in hand		5,500	—
	Total		27,61,500	27,61,500

Stock in hand at 31st December ₹ 1,95,000. Draw up a corrected Trial Balance.

7. The following Trial Balance was prepared on 31.3.2015 without taking into consideration the information given below:

Debit Side	₹	Credit Side	₹
Salaries	75,000	Sales	2,75,000
Rent	15,000	Capital	2,50,000
Purchases	1,75,000	Creditors	50,000
Debtors	50,000	Bank Overdraft	27,500
Opening Stock	30,000	Bills Payable	25,000
Fixed Assets	2,30,000	Returns Outwards	2,500
Returns Inwards	5,000		
Bills Receivable	37,500		
Wages	5,000		
Insurance	7,500		
	6,30,000		6,30,000

Information :

(1) Credit purchases of ₹ 10,000 and credit sales of ₹ 20,000 have not been recorded in the books.

(2) Outstanding liabilities :

(i) Wages ₹ 5,000; (ii) Rent ₹ 2,000; (iii) Carriage inwards ₹ 1,000; (iv) prepaid insurance ₹ 500.

On the basis of the above information, (a) post entries to the ledger accounts (without date); (b) prepare adjusted Trial Balance as on 31st March, 2015.

Guide to Answers

Multiple Choice

1. C 2. B 3. B 4. C 5. D 6. C 7. B 8. C 9. C 10. C.

Practical Questions

1. **Trial Balance Total ₹ 1,21,500.**
2. **Trial Balance Total ₹ 2,66,200.**
3. **Trial Balance Total ₹ 25,550. Suspense Account (Dr.) ₹ 1,175.**
4. **Trial Balance Total ₹ 1,08,420.**
5. **Corrected Trial Balance ₹ 2,40,000.**
6. **Corrected Trial Balance ₹ 27,61,500.**
7. **Trial Balance Total ₹ 6,68,000.**

5

The Cash Book

Meaning and Nature of Cash

Cash is a current asset. Cash is indeed not different from any other asset. However, cash is of special significance for two reasons. First, it is the most readily available asset to meet the current obligation of the business unit and the one most universally accepted by creditors. Second, the economic activities of a business involve regular flow of cash to or from the business. Therefore, cash balance of a business unit is a very important element of its financial condition.

For accounting purposes, cash consists of items that we use in every day financial transactions as mediums of exchange, and which are available to meet current obligations. To an accountant, cash includes, paper currency, coins, money orders, demand deposits, cheque, bank drafts and the like.

However the following items should not be treated as cash:
(i) Postage stamp; (ii) Post-dated cheques; (ii) Securities; (iv) Investment in special funds;
(v) Trade advances to employees; and, (vi) Dishonoured cheques.

Cash Book

The Cash Book is a subdivision of the book of original entry, recording transactions involving receipts or payments of cash.

All cash transactions are first entered in the Cash Book and then posted from Cash Book into the ledger. Cash Book is maintained in the form of a ledger with narration. Practically, the Cash Book is a substitute for Cash Account in the ledger.

Kinds of Cash Book

There are different kinds of Cash Book, such as :

1. Single Column Cash Book—For recording cash transactions only.
2. Cash Book with Cash and Bank Column—For recording cash and bank transactions.

3. Cash Book with Cash, Bank and Discount Column—For recording cash and bank transactions involving loss or gain on account of discount.
4. Petty Cash Book—For recording petty expenses and receipts.

Single Column Cash Book

The Single Column Cash Book makes a record (with narration) of only cash transactions, and it is just like any other Account. In the Cash Book, all cash receipts are recorded on the left-hand (debit) side and all cash payments are recorded on the right-hand (credit) side.

The ruling of a Cash Book depends upon the specific needs of the organisation. However, a specimen ruling of a Single Column Cash Book is given below :

Dr. **Cash Book (Single Column)** **Cr.**

Date	Particulars	Vr. No.	L.F.	Amount	Date	Particulars	Vr. No.	L.F.	Amount
1	2	3	4	5	1	2	3	4	5

Date : The date column in the Cash Book ensures a chronological record of each transaction. In this column, year, month and actual date of transaction is recorded.

Particulars : The column for particulars is left for writing the heads of account to be credited and debited and also for providing the appropriate narration or explanation of the transaction recorded.

Voucher No. : The document in support of a transaction is called voucher. There are two types of vouchers: (1) Receipts voucher, and (2) Payment voucher. Generally, voucher has a serial number and this number is written in this column.

Ledger Folio (L.F.) : The column for ledger folio is for indexing. A folio is a page mark. The folio in which the accounts, named in the Cash Book, are maintained in the ledger, are marked in this column. This enables to locate the respective page or pages in the ledger easily.

Amount : The money value of the transaction is written in this column.

Single Column Cash Book—Some Observations

1. When an entry has been passed in the single column Cash Book, the corresponding entry is passed in the ledger. For instance, if Ram pays ₹ 500, the receipt (or debit) entry will be passed in a single column Cash Book and Ram Account will be credited in the ledger.
2. When a Cash Book is maintained, Cash Account is not opened in the ledger.
3. Cash Book is balanced just like any other account. This should be mentioned because normally a subsidiary book is just totalled, not balanced.
4. It makes no record of: (a) cheque given or received, and (b) cash discount allowed or received.

Balancing the Cash Book

In order to find out cash in hand at the end of the month, the Cash Book is balanced like an ordinary account. The following steps are followed in balancing a Cash Book. (See illustration 1)

Step 1 Add up the debit side of the Cash Book (Total cash received ₹ 85,750) with pencil.
Step 2 Add up the credit side of the Cash Book with pencil (Total cash paid ₹ 39,960).
Step 3 Since the debit side total (₹ 85,750) is greater than that of the credit side (₹ 39,960), the balance is ₹ 45,790.
Step 4 Enter this balance in the side with the smallest total as 'By Balance c/d'.
Step 5 Erase the pencil total.
Step 6 Draw a single line just below the balance amount on both sides.
Step 7 Now, re-add both sides including balance. Total of each side should be the same. Underline the totals with double lines.
Step 8 Carry down the balance to the opposite side as 'To Balance b/d'. Now, Cash Book is ready for making entries in the next month.

Illustration 1

Write up a trader's single column Cash Book for the month of April 2015, from the following (all figures in ₹) :

1 Cash in hand	1,650	17 Paid cleaner in cash	360
2 Cash sales	16,000	19 Cash sales	11,400
3 Paid cheque to Creditor ₹ 3,990 after deducting cash disc. of 210		21 Paid cash for window cleaning	180
4 Wages paid in cash	2,250	25 Paid wages in cash ₹ 2,400, paid cash for rates	3,600
4 Cash sales ₹ 18,000 of which ₹ 15,000 was banked on April 7.		26 Cash sales	19,200
9 Paid cash to TCI ₹ 420 against their bill no. 64.		29 Paid electricity bill in cash	900
11 Paid wages in cash	2,850	30 Cash collected from X (Debtor) ₹ 4,500 after allowing disc. of ₹ 200.	
15 Cash sales ₹ 15,000, of which ₹ 12,000 was banked on April 16.		Rule-off and balance the Cash Book at April 30, 2015.	

Solution

In the Books of . . .

Dr. Cash Book (Single Column) Cr.

Date	Particulars	V.N.	L.F.	₹	Date	Particulars	V.N.	L.F.	₹
2015					2015				
April 1	To Balance b/d			1,650	April 4	By Wages A/c			2,250
2	To Sales A/c			16,000		(Being wages paid)			
	(Being goods sold for cash)				7	By Bank A/c			15,000
4	To Sales A/c			18,000		(Being cash deposited into bank)			
	(Being goods sold for cash)				9	By TCI A/c			420
15	To Sales A/c			15,000		(Being cash paid against bill no. 64)			
	(Being goods sold for cash)				11	By Wages A/c			2,850
19	To Sales A/c			11,400		(Being wages paid)			
	(Being goods sold for cash)				16	By Bank A/c			12,000
26	To Sales A/c			19,200		(Being cash paid into bank)			
	(Being goods sold for cash)				17	By Office Expenses A/c			360
30	To X A/c			4,500		(Being cash paid to cleaner)			
	(Being cash collected after allowing discount of ₹ 200)				21	By Office Expenses A/c (Being cash paid for window cleaning)			180
					25	By Wages A/c			2,400
						(Being wages paid)			
					25	By Rates A/c			3,600
						(Being rates paid)			
					29	By Electricity A/c (Being electricity bill paid)			900
					30	By Balance c/d			45,790
				85,750					85,750
May 1	To Balance b/d			45,790					

Where the account is balanced at the end of the day, date the balance c/d on the next day.	The Cash Account has a debit balance of ₹ 45,790.	Double ruling on the same line	Re-added totals equal — Therefore balance is correct.

Note the following points

1. Always enter the date.
2. Entries should be made in strict ***date order***.
3. All receipts from cash sales, collection from debtors during the day are recorded on the debit side.
4. All payments during the day are recorded on the credit side.
5. The Cash Book is always balanced using the same layout as above.
6. The balance of ₹ 45,790 shows how much the receipts exceed the payments.
7. Payment to creditors by cheque will not be recorded in the Single Column Cash Book (3rd April)

Double Column Cash Book (Cash Book with Cash and Bank Column)

The Cash Book in which cash and transactions involving receipts and payments by cheques are recorded is called ***Double Column Cash Book***. A double column cash book is one, where both cash and bank transactions are shown in columnar fashion. Therefore, one book represents two separate accounts and the transactions are recorded accurately as being either cash or bank transactions. The Bank Account maintained by the enterprise is a ***Personal Account***. For recording transactions in the Bank Column of the Cash Book, the Golden Rule of Debit and Credit applicable to ***personal account*** should be followed, for instance, (Receiver—Debit; Giver—Credit). Thus, for cash deposited into bank—the bank would be receiver and would be debited in the Bank column of the Cash Book. Similarly, for cash withdrawn from bank—the bank would be giver and would be credited in the Bank column of the Cash Book.

Rather than keeping two accounts apart from each other, the ***Double Column Cash Book*** enables us to keep both the Cash and the Bank Account side by side. This is more convenient and we can quickly see how much cash and bank balance we have got altogether.

The main advantages of using this method arises from the fact that cash in hand and cash at bank are almost the same asset, and transactions will frequently occur which will affect both the accounts.

Cheques

Bank provides its depositors with cheque books containing 10, 25 or 50 or more cheques. These cheques are used for withdrawal of cash from bank or making payment to creditors. The use of cheques in business transactions, in particular, is becoming more and more prevalent. In advanced countries, the procedure has considerably eliminated the use of paper money, i.e., paper notes issued by the central banking authority. In India, too, the practice is spreading rapidly.

However, theoretically cheque is not money. It is at best a money substitute. It just enables the transfer of money from one account to another, and thus from one hand to another, eliminating the need of the bothersome cash transactions (withdrawing money, counting it, examining it in detail, arranging for small changes to the paise, and so on).

Definition of Cheque

A cheque is defined by Negotiable Instrument Act ..., as follows: ***A cheque is an unconditional order, drawn upon a specified banker, signed by the maker, directing the banker to pay on demand a certain sum of money only to the order of a person or to the bearer of the instrument.***

Therefore, the distinguishing features of a cheque are:

1. It must be an unconditional order to pay;
2. It must be drawn upon a specified banker;
3. It must be signed by the issuing person or authority, i.e. drawer or maker;
4. It must specify the amount to be paid;
5. It is made payable either to a person named therein, or as ordered.

Parties to a Cheque

There are three parties to a cheque:

(a) Drawer or Maker: The person who issues the cheque is called drawer or maker. Generally, cheques are issued by the depositor(s). In case of a limited company, cheques are issued by the authorised signatory(ies).

(b) Drawee: The bank on which the cheque is drawn is called the Drawee.

(c) Payee: The person who is named in the cheque for receiving the payment is called Payee.

Types of Cheques

Cheques may be drawn in two ways: (a) Payable to person named ‘or bearer’ and (b) ‘to order’.

(a) Bearer Cheques: A bearer cheque is payable to the person who presents it at the counter for encashment. Such a cheque can be transferred by mere delivery and need not be endorsed. Since it is a bearer cheque, the bank is under no obligation to ascertain that the payment is made to the right person. The language of a bearer cheque runs as follows:

Pay .... or bearer ₹ ....

(b) Order Cheques: An order cheque, on the other hand, is one which is payable to a certain person (named in the cheque) or as per order of that certain person. The language of an order cheque runs as follows:

Pay .... or order ₹ ....

An order cheque can be transferred only by endorsement and delivery. In the case of an order cheque, the bank is under obligation to ascertain that the payment is made to the right person and that all the endorsements are in proper order.

Bank Drafts

Bank drafts, which are also called ***banker's cheques***, are one of the very many services which the banks render to and for their customers. A bank draft is a written order of a bank to a certain sum of money to a person in whose favour the draft has been issued. Normally, bank drafts are issued for payment in another town. It is thus a remittance facility made available by banks to its customers. A charge is, of course, made by bank for the facility thus accorded. Since the charge is not very high, the remittance facility is not costly.

Bank Overdraft

Bank overdrafts are a very common form of borrowing. Overdraft is the drawing out from a bank account of more than what has been deposited in it. Therefore, an overdraft is a credit balance in the books of an enterprise and a debit balance in the bank pass book. The bank and the borrower agree upon the maximum size of the overdraft. In effect, an overdraft is a loan by the banker to the customer, but interest is only charged to the extent and period that the overdraft is used.

Double Column Cash Book—Some Observations

1. Contra Entries

The term 'Contra' refers to the opposite side. Contra is an entry in a double entry account representing the reversal or cancellation of an entry on the other side. When both debit and credit aspects of a transaction are recorded in the same account but in different columns, each entry whether in the debit side or in the credit side shall be deemed to be the contra entry of the other. Observe the following examples:

(i) ***Cash deposited into the bank ₹ 500*** : Here, Bank Account is to be debited and Cash Account is to be credited. Debit aspect is to be recorded in the debit side of the Double Column Cash Book (bank column) and credit aspect is to be recorded in the credit side of the Double Column Cash Book (cash column).

(ii) ***Cash withdrawn from Bank for office use ₹ 1,000*** : Here, Cash Account is to be debited and Bank Account is to be credited. Debit aspect is to be recorded in the debit side of the Double Column Cash Book (cash column) and credit aspect is to be recorded in the credit side of the Double Column Cash Book (bank column).

In the above two cases ***Cash*** should be treated as contra of ***Bank*** and ***Bank*** should be treated as contra of ***Cash***. It should be noted that no narration is required for contra entry. In the L.F. column only 'C' is written.

2. Cheque received and deposited into the Bank on the same day

When cheques are received from customers and are deposited on the same date, Bank Account is debited directly and Customer Account is credited. The amount is written in the bank column (Debit side) of the Double Column Cash Book.

3. Cheque received but deposited into the Bank on a later date

When the cheque is received but not deposited into the Bank on the same date, the cheque is first recorded in the cash column of the Double Column Cash Book. Afterwards, when the cheque will be deposited into the bank it will be recorded as if Cash is deposited into the Bank, i.e. Bank Account is to be debited and Cash Account is to be credited.

Example : On 27th December, 2014 a cheque is received from Ram for ₹ 1,000. However, the cheque was deposited into the Bank on 30th December, 2014.

In the examination, if there is no information as to the date of deposit of the cheque, it may be assumed that the cheque has been deposited on the same date.

4. Cheque received but endorsed in favour of a creditor

When cheque is received but endorsed in favour of a creditor, the cheque is first recorded in the cash column. At the time of endorsement, the Party Account is to be debited and Cash Account is to be credited.

Example : On 26th December, 2014 a cheque is received from S. Dey & Co. for ₹ 600. On 29th December, 2014 it was endorsed in favour of K.B. & Co.

Dr. Cash Book (Double Column) Cr.

Date	Particulars	V.N.	L.F.	Cash	Bank	Date	Particulars	V.N.	L.F.	Cash	Bank
2014						2014					
Dec. 26	To S. Dey & Co. A/c (Being a cheque received from S. Dey & Co,)			600		Dec. 29	By K. B. & Co. A/c (Being the cheque endorsed in favour of K.B. & Co.)			600	
27	To Ram A/c Being cheque received from Ram)			1,000		30	By Bank A/c		C	1,000	
30	To Cash A/c		C		1,000						

5. Bearer cheque received

If the bearer cheque is encashed over the counter, Cash Account is debited. If the bearer cheque received is crossed and paid into bank, the Bank Account is debited.

6. Dishonour of a Customer's cheque

When a cheque is received from a customer and it is deposited into the bank for collection but ultimately returned dishonoured, the Customer Account is debited and Bank Account is credited.

Credit Card Sale

Nowadays sales through credit cards are a very common feature. Credit cards are issued by different banks, like Citi Bank, Standard Chartered Bank, State Bank of India, Canara Bank, and others. Presently available most popular credit cards are—Visa Card, Master Card, American Express Card, and others.

The procedures involved are :

1. A small plastic card, called credit card, is issued by a bank to a prospective cardholder, after verifying his credibility. This card would contain an embossed 16-digit card number and name of the cardholder.
2. When goods are intended to be bought through that credit card, seller fills in a form detailing the description of the goods and uses the embossed nature of the credit card to print the data of the customer on the form. The form is to be countersigned by the customer. A carbon copy of the form is given to the customer.
3. Everyday the seller should sum up the different amounts sold like this and should submit all forms thus obtained, to his bank. The amounts are credited to his account as deposit and debited to the bank account of the credit card company.
4. A commission is charged by the credit card company for each such transaction and is extracted from the seller's bank account by direct debit. The rate of commission varies between 1% to 4%.
5. A monthly statement of account is sent by the credit card company to their cardholders who may pay in full or in part. However, if they do not pay in full, they suffer an interest charge until the full amount is paid up.

Accounting for Credit Cards Sale

From the seller's viewpoint, a credit card sale is one equivalent to a cash sale. However, there is a cost involved, i.e., the monthly commission charge.

Journal Entry

(i) Bank Account	Dr.	[Daily total of credit card sales]
To Sales Account		
(ii) Commission Account	Dr.	[Commission on total monthly credit card sales.]
To Bank Account		

Debit Card

A Debit Card is similar in appearance to a Credit Card and which is offered in a similar way in payment for goods and services. The main difference is that in the case of a debit card such payments are then debited to the holder's bank account in exactly the same way as a cheque.

The advantages of a debit card are :

First, it may be used to make larger payments than might by acceptable by cheque (provided there are sufficient funds in the bank account of the cardholder).

Secondly, it can be used to operate automated teller machines (ATM) with a special personal identification number.

Illustration 2

Record the following transactions in a suitable cash book of Mr P. Basu for the month of January, 2015 and show the closing balances of cash and bank (all figures in ₹).

1 He had cash in hand	50,000	5 Deposited the cheque received from Mr Sunil Ranjan	
2 Opened a Bank Account	30,000	5 Withdrawn from Bank for personal use	3,000
2 Received from Mr T. Bose	4,000	5 Paid Eeectricity Bill	52
3 Paid to Mr N. Gopal in cheque	500	5 Paid rates and taxes	100
3 Purchase made in cash	1,000	5 Purchases made in cash	7,000
3 Paid rent	250	5 Cash sales	12,000
3 Withdrawn from Bank	3,000	5 Sold to Sree Nagarjun	5,000
4 Cash sales	5,000	5 Purchased from Mr Nemai Bose	2,000
4 Received a cheque from Sunil Ranjan	10,000	7 Received a cheque from Sree Nagarjun and sent to Bank	3,000
4 Paid wages	200	7 Paid railway freight	250
4 Purchased furniture in cash and paid by cheque	4,000	7 Purchased stamps and stationery	25
4 Cash purchases	3,000	7 Deposited in Bank Account	300

Solution

In the Books of Mr P. Basu

Dr. Cash Book (Double Column) Cr.

Date	Particulars	Cash	Bank	Date	Particulars	Cash	Bank
2015		₹	₹	2015		₹	₹
Jan. 1	To Balance b/f	50,000		Jan. 2	By Bank A/c (C)	30,000	
2	To Cash A/c (C)		30,000	3	By N. Gopal A/c		500
2	To T. Bose A/c	4,000			(Being paid by cheque)		
	(Being cash received)			3	By Purchases A/c	1,000	
3	To Bank A/c (C)	3,000			(Being goods purchased in cash)		
4	To Sales A/c	5,000		3	By Rent A/c	250	
	(Being goods sold for cash)				(Being rent paid)		
4	To Sunil Ranjan A/c	10,000		3	By Cash A/c (C)		3,000
	(Being a cheque received)			4	By Wages	200	
5	To Cash (C)		10,000		(Being wages paid)		
5	To Sales A/c	12,000		4	By Furniture A/c		4,000
	(Being goods sold for cash)				(Being paid by cheque)		
7	To Nagarjun A/c		3,000	4	By Purchases A/c	3,000	
7	(Being a cheque recd & sent to bank)				(Being goods purchased for cash)		
	To Cash (C)		300	5	By Bank (C)	10,000	
				5	By Drawing A/c		3,000
					(Being cash withdrawn from Bank for personal use)		
				5	By Electricity A/c	52	
					(Being electricity bills paid)		
				5	By Rates & Taxes A/c	100	
					(Being rates & taxes paid)		
				5	By Purchases A/c	7,000	
					(Being goods purchased for cash)		
				7	By Freight A/c	250	
					(Being railway freight paid)		

Date	Particulars	Cash	Bank	Date	Particulars	Cash	Bank
				7	By Stationery & Stamps A/c (Being purchase of stationery & stamps)	25	
					By Bank A/c (C)	300	
				7	By Balance c/d	31,823	32,800
		84,000	43,300			84,000	43,300
8	To Balance b/d	31,823	32,800				

Illustration 3

The following are the transactions of Mr Gupta, sole trader, for the 1st Week of October, 2014:

1. Received from Mohan by cheque ₹ 275; Discount allowed to him ₹ 5.
2. Paid Miscellaneous expenses ₹ 25 in cash.
3. Purchased furniture from Maniams and issued a cheque for ₹ 900. Paid postage in cash ₹ 15.
4. Paid Office salaries ₹ 600; Withdrawn from Bank ₹ 500.
5. Paid Suman & Co. by cheque ₹ 1,980 in full settlement of their dues of ₹ 2,000.
6. Cheque in favour of Suman & Co. returned not honoured since date was wrongly mentioned in cheque. Issued a fresh cheque in their favour including ₹ 5 towards bank charges on cheque returned.

The following were the balances on October 1, 2014—Cash ₹ 738; Bank ₹ 12,176.

You are required to write up a Double Column Cash Book.

Solution **In the Books of Mr Gupta**

Dr. **Cash Book (Double Column)** **Cr.**

Date	Particulars	Cash	Bank	Date	Particulars	Cash	Bank
2014		₹	₹	2014		₹	₹
Oct. 1	To Balance b/f	738	12,176	Oct. 2	By Miscellaneous Exp. A/c (Being Misc. Exp. paid)	25	
1	To Mohan A/c (Being cheque recd. from Mohan)		275	3	By Furniture A/c (Being furniture purchased by chq.)		900
4	To Bank A/c (C)	500		3	By Postage A/c (Being postage paid)	15	
				Oct. 4	By Salaries A/c (Being salary paid)	600	
				4	By Cash (C)		500
				5	By Suman & Co. (Being paid by cheque)		1,980
				6	By Bank Charges A/c (Being Bank charges paid by cheq)		5
				7	By Balance c/d	598	9,066
		1,238	12,451			1,238	12,451
Oct. 8	To Balance b/d	598	9,066				

Illustration 4

On 1st May, 2015, G. Flowers, has the following balances in his cash book: Cash in hand ₹ 2,100, Bank O/D ₹ 7,000.

During the month of May :

Cheques were issued as follows :

- 2nd To Surray ₹ 5,000
- 8th To Hampshire ₹ 4,000
- 19th To City Development Corporation ₹ 2,500 in payment of rates.
- 25th Withdrawn from Bank for use as change in the till ₹ 1,000.
- 31st Proprietor withdraw for private purposes ₹ 5,000.

Cheques were received as follows :

- 17th From Mrs Lancashire ₹ 1,300 in payment of monthly account.

On 30th May you are adviced by the bank that this cheque has been returned marked "No Balance".

Cash received during the month :

Cash sales for the week ending 6th May ₹ 6,250, of which ₹ 5,000 was paid to the bank.
Cash sales for the week ending 13th May ₹ 7,500 of which ₹ 6,000 paid to the bank.
Cash sales for the week ending 20th May ₹ 8,000, of which ₹ 7,000 paid to the bank.

Cash sales for the week ending 27th May ₹ 7,500 of which ₹ 5,000 paid to the bank.

Cash paid out during the month :

Wages - 6th, 13th, 20th, 27th : ₹ 1,500 on each day
23rd. Telephone account ₹ 750
29th Delivery ₹ 400.

You are required to draw up a Double Column Cash Book for the month of May and enter the above transactions in date order. Balance the Cash Book as at 31st May.

Solution

In the books of G. Flower

Dr. Cash Book (Double Column) Cr.

Date	Particulars	L F	Cash	Bank	Date	Particulars	L F	Cash	Bank
2015			₹	₹	2015			₹	₹
May 1	To Balance b/d		2,100	—	May 1	By Balance b/d		—	7,000
6	To Sales A/c		1,250	5,000	2	By Surray A/c			5,000
	(Being goods sold for cash)					(Being paid by cheque)			
13	To Sales A/c		1,500	6,000	6	By Wages A/c		1,500	—
	(Being goods sold for cash)					(Being wages paid)			
17	To Mrs Lancashire A/c		—	1,300	8	By Hampshire A/c		—	4,000
	(Being cheque received from Mrs Lancashire and paid into bank)					(Being paid by cheque)			
					13	By Wages A/c (Being wages paid)		1,500	—
20	To Sales A/c		1,000	7,000	19	By Rates A/c		—	2,500
	(Being goods sold for cash)					(Being rates paid to City Development Corporation)			
25	To Bank A/c	C	1,000	—					
	To Sales A/c		2,500	5,000	20	By Wages A/c		1,500	—
27	(Being goods sold for cash)					(Being wages paid)			
30	To Balance c/d		—	1,500	23	By Telephone Charges A/c		750	—
						(Being Telephone charges paid)			
					25	By Cash A/c	C	—	1,000
					27	By Wages A/c		1,500	—
						(Being wages paid)			
					29	By Delivery Charges A/c		400	—
						(Being delivery charges paid)			
					30	By Mrs Lancashire A/c		—	1,300
						(Being the cheque of Mrs Lanca- shire dishounered)			
					31	By Drawings A/c		—	5,000
						(Being withdrawn for bank for personal use)			
					31	By Balance c/d		2,200	—
			9,350	25,800				9,350	25,800

Cash Book with Cash, Bank and Discount Column (Triple Column Cash Book)

The most exhaustive Cash Book is the Triple-column Cash Book, which has three amount columns on either side, viz, cash, bank and discount. The discount column is provided for recording discount. It is suited to large business houses which make and receive payments in cash and by cheques and which receive/allow cash discounts.

Cash column and Bank column of the Cash Book represent Cash Account and Bank Account of the ledger, no separate account for cash and bank are to be opened in the ledger. But in respect of discount column, the Cash Book continues to be just a book of original entry. At the end of a specific period, usually a month, the aggregate of the debit side of the discount column of the Cash Book is posted to the debit side of the Discount Allowed Account, separately maintained in the ledger. Similarly, the aggregate of the credit side of the discount column of the Cash book is posted to the credit of Discount Received Account, separately maintained in the ledger.

In regard to the discount columns of a triple-column cash book, the following points are worth noting :

1. The two discount columns on the two sides are two different accounts—they bear no relationship with each other.
2. These are (in the nature of memoranda) and double entry principle is not followed.
3. Unlike cash and bank columns (which are balanced at the end of a particular period), these two columns are separately totalled and the aggregate amounts are transferred to separate ledger accounts as mentioned earlier.

Discount

Discount is a reduction from a stated amount. In general, it is the difference between a face value and a lower amount paid or received.

There are two kinds of discounts :

(a) Trade Discount; and

(b) Cash Discount.

Trade Discount

Trade Discount represents an allowance which is made by the manufacturers to the wholesalers or by the wholesalers to the retailers and it is calculated as a percentage of list or catalogue prices of goods supplied. Between traders, the trade discount represents the profit that the buyer will make by reselling the goods.

The trade discounts are not separately recorded in the books of account. When entering invoices in the Purchases Day Book or Sales Day Book, only the ***net total*** of the invoices are shown in the total column.

Example : We purchase goods from M/s. A & Co., 20 bales of cotton @ ₹ 1,000 per bale, less 10% trade discount. How will this transaction be recorded in the books of account ?

Purchases Day Book

Date	Particulars	Invoice No.	L.F.	Details (₹)	Total (₹)
	M/s A & Co. 20 bales of cotton @ ₹ 1,000 per bale Less: 10% Trade Discount			 20,000 2,000	 18,000

Dr. Purchases Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To M/s A & Co. A/c	18,000			

Dr. M/s. A & Co. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
				By Purchases A/c	18,000

Similarly, credit sales are recorded in the Sales Day Book after deducting trade discount from list price.

Cash Discount

Cash Discount is allowed to encourage a debtor to payoff his debt within a specified period. If the debtor settles his account within a given time period, he is entitled to reduce his bill by the agreed amount. The invoice sent by the suppliers or to the customers will usually contain details of cash discount. For example : (i) Payment within 7 days, 10% cash discount; (ii) Payment within 14 days, $7^1/_2$% cash discount; and (iii) Payment within 21 days, 5% cash discount. Cash discount is recorded in the books of account when the payment is made within the specified period. The accounting entries are as follows :

(i) When cash discount is allowed

Cash/Bank Account Dr.

Discount Allowed Account Dr..

To Debtors' Account

(ii) When cash discount is received

Creditors' Account Dr.

To Cash/Bank Account

To Discount Received Account

Look at the effect on the accounts in the example below :

Example : On 30th November, 2014 X sells to Y goods costing ₹ 40,000 after a cash discount of 2.5% for prompt payment within 15 days. The Ledger Account will be as follows :

In the books of X

Dr. Y Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.11.2014	To Sales A/c	40,000			

Now, if Y pays on 10th December, 2014, he will pay ₹ (40,000 – 1,000) = ₹ 39,000. Let us assume that the payment was made by cheque. Therefore, Bank Account will be debited and Y Account will be credited. Y's Account now becomes :

Dr. Y Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.11.2014	To Sales A/c	40,000	10.12.2014	By Bank A/c	39,000

From Y's Account, it appears that he owes ₹ 1,000 to X. But it is not true, ₹ 1,000 should be treated as cash discount allowed to Y and Y Account will be credited by that amount. The final position is :

Dr. Y Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.11.2014	To Sales A/c	40,000	10.12.2014	By Bank A/c	39,000
			10.12.2014	By Discount Allowed A/c	1,000
		40,000			40,000

Dr. Discount Allowed Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.11.2014	To Sales A/c	1,000			

It should be noted that discount may be allowed when payment is received by cheque but this discount should be written back if the cheque is dishonoured. The entry for writing back the discount allowed should be done through Journal Proper, not through the Cash Book. Likewise, discount may be received when payment is made by cheque, but this discount should be written back if the cheque previously issued, is dishonoured. However, the entry for bank should be passed through Cash Book.

In the books of Y

Dr. X Account Cr.

Date	Particulars	₹	Date	Particulars	₹
			30.11.2014	By Purchases A/c	40,000

After payment on 10th December, 2014, X's Account will appear as follows :

Dr. X Account Cr.

Date	Particulars	₹	Date	Particulars	₹
10.12.2014	To Bank A/c	39,000	30.11.2014	By Purchases A/c	40,000
10.12.2014	To Discount Received A/c	1,000			
		40,000			40,000

Dr. Discount Received Account Cr.

Date	Particulars	₹	Date	Particulars	₹
			10.11.2014	By X A/c	1,000

Points to remember

Cash discounts are allowed for the following purposes :
(i) To improve the cash inflow of the business for investing the fund elsewhere; and
(ii) To reduce the possibility of bad debts.

Illustration 5

Prepare a triple Column Cash Book from the following transactions for the month of November, 2014 and bring down the balance for the start of next

1 Cash in hand	2,500	16 Paid to Amarnath by cheque	1,450
1 Cash at Bank	10,000	16 Discount received	50
2 Paid into Bank	1,000	19 Paid into Bank	400
5 Bought furniture and issued cheque	2,000	23 Withdrawn from Bank for Private expenses	600
8 Purchased goods for cash	500	24 Received cheque from Patel	1,430
12 Received cash from Mahindar	980	24 Allowed him discount	20
12 Discount allowed to him	20	26 Deposited Patel's cheque into Bank	—
14 Cash Sales	4,000	28 Withdrew cash from Bank for Office use	2,000
		30 Paid rent by cheque	800

Solution

Dr. **Cash Book (Triple Column)** **Cr.**

Date	Particulars	Discount Allowed	Cash	Bank	Date	Particulars	Discount Received	Cash	Bank
2014		₹	₹	₹	2014		₹	₹	₹
Nov. 1	To Balance b/f		2,500	10,000	Nov. 2	By Bank (C)		1,000	
2	To Cash (C)			1,000	5	By Furniture A/c			2,000
12	To Mahindar A/c (Being cash recd.)	20	980			(Being furniture purchased)			
14	To Sales A/c		4,000		8	By Purchases A/c		500	
	(Being Cash sales)					(Being Cash purchases)			
19	To Cash (C)			400	16	By Amarnath A/c	50		1,450
24	To Patel A/c	20	1,430			(Being paid by chq)			
	(Being chq. recd. from				19	By Bank (C)		400	
	Patel and allowed				23	By Drawings			600
	him discount)					(Being cash withdrawn			
26	To Cash (C)			1,430		for personal use)			
28	To Bank (C)		2,000		26	By Bank (C)		1,430	
					28	By Cash (C)			2,000
					30	By Rent A/c			800
						(Being rent paid by chq)			
					30	By Balance c/d		7,580	5,980
		40	10,910	12,830			50	10,910	12,830
Dec. 1	To Balance b/d		7,580	5,980					

Dr. **Discount Allowed Account** **Cr.**

To Sundry Debtors A/c	40		

Dr. **Discount Received Account** **Cr.**

		By Sundry Creditors A/c	50

Tutorial Note s:

(1) Discount allowed ₹ 40 and discount received ₹ 50 should be posted in respective accounts in the ledger.

(2) When cheque is not deposited immediately into the Bank, the cheque is entered first in the Cash column and at the time of deposit, Bank A/c is debited and Cash A/c is credited (See transaction of 24th Nov. of this problem).

Illustration 6

From the following information write up Cash Book (Bank and Discounts columns only) of M H Kabir

(a) His bank balance at the close of business on 26th July 2015 according to his cash book, was ₹ 45,000

(b) The counterfoils of his pay-in-slip give the following details:
29th July : Total deposit ₹ 9,850, consisting of cash from sales ₹ 2,500, a cheque from A James for ₹ 2,475 and a cheque from L. Long for ₹ 4,875. Long's cheque was accepted in full settlement of ₹ 5,000 owed by him.
30th July : Total deposit ₹ 2,500, consisting entirely of cash from sales.
31st July : Total deposit ₹ 3,750, consisting of cash from sales ₹ 1,950 and a cheque from H Kapoor for ₹ 1,800.

(c) The counterfoils of his cheque book show:
29th July : Rabin Hood and Co. ₹ 16,250
30th July : Mukherjee and Co. ₹ 9,500
31st July : Petty cash ₹ 1,500; Self ₹ 5,000; Dewar's Garage ₹ 1,000

The Cheque to Mukherjee and Co. was accepted in full settlement of ₹ 10,000. The Cheque to Dewar's garage was for petrol, oil, repairs, and so on, for the previous month, and no portion of this transaction had gone through the books.

The particulars column of the Cash Book should indicate clearly which ledger accounts should be debited or credited in respect of each Cash Book entry. Balance the Cash Book at the close of the business on 31st July, 2015.

Solution — **In the books of M. H. Kabir**

Dr. — **Cash Book** — **Cr.**

Date	Particulars	L F	Bank	Discount Allowed	Date	Particulars	L F	Bank	Discount Received
2015			₹	₹	2015			₹	₹
July 27	To Balance b/d		45,000	—	July 29	By Rabin Hood & Co. A/c (Being paid by cheque)		16,250	—
29	To Sales A/c (Being cash from sales deposited into the bank)		2,500	—	30	By Mukherjee and Co. A/c (Being paid by cheque and recd disc. of ₹ 500)		9,500	500
"	To A. James A/c (Being the cheque received from A James deposited into the bank)		2,475	—	31	By Petty Cash A/c (Being chq. issued for petty cash)		1,500	
"	To L. Long A/c (Being a cheque of ₹ 4,875 received and deposited into the bank in full settlement of a debt of ₹ 5,000)		4,875	125	"	By Drawings A/c (Being cash withdrawn from bank for private purposes)		5,000	
30	To Sales A/c (Being cash from sales deposited into the bank)		2,500	—	"	By Car Maintainance A/c (Being cheque issued for petrol, oil and repairs)		1,000	
31	To Sales A/c (Being cash from sales deposited into bank)		1,950	—	"	By Balance c/d		27,850	
"	To H Kapoor A/c (Being a cheque of ₹ 1,800 received for H Kapoor and deposited into the bank)		1,800						
			61,100	125				61,100	500
Aug. 1	To Balance b/d		27,850						

Tutorial Notes :

(1) At the end of the month total discount allowed is debited to Discount Allowed Account in the ledger.

(2) At the end of the month total discount received is credited to Discount Received Account in the ledger.

Illustration 7

Reid Limited keeps a full accounting system which includes a Cash Book, ruled to include columns for cash in hand, cash at bank, discount allowed and discount received.

On April 23, 2015, the following balances and totals appeared in the Cash Book (all figures in ₹) :

Cash in hand	4,200
Cash at bank	7,650
Discounts allowed total	420
Discounts received total	950

The following transactions affecting the Cash Book occurred during the last week of April :

April 23 General expenses ₹ 920 were paid in cash.

24 Cash sales totalled ₹ 9,200.

25 A cheque for ₹ 3,040 was received from a debtor, K. Ball, in settlement of his account at this date ₹ 3,200.

26 A Paying-in-slip counterfoil showed that cash ₹ 8,200 had been banked.

27 A cheque was sent to Reid Limited's supplier, Baker Limited, in settlement of the amount due at this date, ₹ 14,000 less 5% cash discount.

28 Notification was received from bank that a cheque for ₹ 2,210 received from T Mc Dermot, a credit customer, during February, 2015 was dishonoured.

30 An old delivery van was sold for ₹ 71,000. A cheque for this amount was received on this date.

30 A cheque was sent to a creditor, Ford Limited, in immediate payment of an invoice received from this supplier on this date. The invoice detailed stock at list price ₹ 8,000 less 25% trade discount, and 5% cash discount.

In the books of Reid Limited, prepare the Three Column Cash Book for the period 23-30 April, 2015, recording all the information given above. Balance the cash and bank accounts and total the discount columns at the end of the month.

Solution

In the books of Reid Limited

Cash Book (Triple Column)

Dr. **Cr.**

Date	Particulars	L F	Cash	Bank	Discount Allowed	Date	Particulars	L F	Cash	Bank	Discount Received
2015			₹	₹	₹	2015			₹	₹	₹
April 23	To Balance b/d		4,200	7,650	420	April 23	By Balance b/d		—	—	950
24	To Sales A/c (Being goods sold for cash)		9,200	—	—	23	By General Exp. A/c (Being general expenses paid)		920	—	—
25	To K Ball A/c (Being a cheque recd. from K Ball for ₹ 3,040 in full settlement of a debt of ₹ 3,200)		—	3,040	160	26	By Bank A/c	C	8,200	—	—
26	To Cash A/c	C	—	8,200	—	27	By Baker Limited A/c (Being paid by cheque and recd discount @ 5% on ₹ 14,000)		—	13,300	700
30	To Delivery Van A/c (Being the sale of old delivery van)		—	71,000	—	28	By Mc Dormot A/c (Being the cheque dishonoured)		—	2,210	—
						30	By Ford Ltd A/c (Note 1) (Being paid by cheque and discount received @ 5% on ₹ 6,000)		—	5,700	300
						30	By Balance c/d		4,280	68,680	—
			13,400	89,890	580				13,400	89,890	1,950

Working Note :

(1) Net amount was due from Ford Limited after 25% trade discount = ₹ 8,000 – ₹ 2,000 = ₹ 6,000. Cash discount is allowed on net amount after deducting trade discount. Therefore, the amount of cash discount will be 5% of ₹ 6,000 = ₹ 300. The amount of cheque will be ₹ 6000 – ₹ 300 = ₹ 5,700.

Illustration 8

Record the following transactions of Keshab in the Cash Book and Journal. Only transactions not suitable for the Cash Book are to be taken to the Journal. Keshab has an overdraft arrangement with the bank subject to a maximum limit of ₹ 5,000.

2015		
April	1	Cash balance brought forward ₹ 1,260.
	1	Bank overdraft brought forward ₹ 3,600.
	1	Advanced to petty cashier by cheque ₹ 500.
	2	Received from Tarun a cheque for ₹ 580 for goods sold in March, 2015. Allowed him discount ₹ 20.
	3	Received from Tanmay ₹ 800. The amount was written-off as bad last year.
	4	Paid cash into bank ₹ 1,500.
	6	Sold goods to Tamal for ₹ 4,000 subject to 10% trade discount and 5% discount for cash in 10 days.
	9	Received from Debesh in full settlement of his account of ₹ 1,600. Somesh's acceptance for ₹ 1,500. Discounted the bill with the banker for ₹ 1,450.
	10	Consignment to Sharma & Co, Baroda, goods worth ₹ 5,000.
	10	Paid freight and insurance on the above ₹ 250.
	11	Tamal gave a cheque in settlement of his account.
	12	Paid Abir by cheque ₹ 1,750, the balance of his account less ₹ 50 discount.
	15	Purchased goods from Sarit for ₹ 3,000 and accepted a bill drawn by him for the amount. Paid carriage on purchase ₹ 150.
	17	Drew cheque for office cash ₹ 500.
	18	Purchased an office desk by cheque ₹ 1,870. Paid cartage thereon in cash ₹ 100.
	20	Somesh's acceptance returned dishonoured noting charges paid by the bank ₹ 20.
	21	Debesh gave a cheque in full settlement of his account.
	25	Goods of the value ₹ 1,800 insured with National Insurance Co for ₹ 1,500 destroyed by fire. The insurance company accepted the claim and sent a cheque for the amount.
	26	Purchased through bank ₹ 5,000, 8% Govt Bonds at ₹ 95. Commission, stamps and fees ₹ 50.

27 Auctioned a typewriter, book value ₹ 500, for ₹ 700.
28 Received from Haran cheque for ₹ 600, in full settlement of account, ₹ 850, he (Haran) being in financial difficulties.
30 Drew cheque for office cash raising the overdraft to the maximum permissible limit.

Solution

In the books of Keshab
Cash Book (Triple Column)

Date	Particulars	Dis. All.	Cash	Bank	Date	Particulars	Dis. Rec.	Cash	Bank
2015		₹	₹	₹	2015		₹	₹	₹
April 1	To Balance b/d		1,260		April 1	By Balance b/d			3,600
2	To Tarun A/c	20		580	1	By Petty Cash A/c			500
	(Being cheque recd					(Being advance to			
	and discount allowed)					petty cashier by			
3	To Bad Debts		800			cheque)			
	Recovery A/c				4	By Bank A/c (C)		1,500	
	(Being bad debts				10	By Consignment to		250	
	recovered)					Baroda A/c			
4	To Cash A/c (C)			1,500		(Being freight and			
9	To Bills Receivable A/c			1,450		insurance paid on			
	(Being bill discounted					consignment)			
	with the bankers)				12	By Abir A/c	50		1,750
11	To Tamal A/c (Note 1)	180		3,420		(Being cheque issued			
	(Being cheque recd					and discount received)			
	and discount allowed)				15	By Carriage Inwards A/c		150	
17	To Bank A/c (C)		500			(Being carriage on			
21	To Debesh A/c			1,620		purchases paid)			
	(Being cheque recd				17	By Cash A/c (C)			500
	in full settlement)				18	By Off. Equipments A/c			1,870
25	To Insurance Claim A/c			1,500		(Being office desk			
	(Being cheque recd					purchased)			
	against claim)				18	By Off. Equipments A/c		100	
27	To Off. Equipments A/c		700			(Being carriage paid			
	(Being sale of an old					on office desk)			
	typewriter)				20	By Debesh A/c			1,520
28	To Haran A/c	250		600		(Being bill dishonoured			
	(Being cheque recd					and noting charges			
	and discount allowed)					paid ₹ 20)			
30	To Bank A/c (C)		1,130		26	By Investments A/c			4,800
30	To Balance c/d			5,000		(Being purchase of			
						₹ 5,000, 8% Govt.			
						Bonds at 95%, other			
						expenses ₹ 50)			
					30	By Cash A/c (C)			1,130
					30	By Balance c/d		2,390	
		450	4,390	15,670			50	4,390	15,670

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

Date	Particulars		L.F.	₹	₹
2015					
April 6	Tamal A/c	Dr.		3,600	
	To Sales A/c				3,600
	(Being goods worth ₹ 4,000 sold at 10% trade discount)				
9	Bills Receivable A/c	Dr.		1,500	
	Discount Allowed A/c	Dr.		100	
	To Debesh A/c				1,600
	(Being a bill received and discount allowed)				
	Discount on Bills A/c	Dr.		50	
	To Bills Receivable A/c				50
	(Being the discount charges paid on bill)				

10	Consignment to Baroda A/c Dr. To Goods Sent on Consignment A/c (Being goods sent on consignment to Sharma & Co.)		5,000	5,000
15	Purchases A/c Dr. To Sarit A/c (Being goods purchased on credit)		3,000	3,000
	Sarit A/c Dr. To Bills Payable A/c (Being the acceptance of a bill)		3,000	3,000
20	Debesh A/c Dr. To Discount Allowed A/c (Being discount previously allowed, now written back)		100	100
25	Stock Destroyed by Fire A/c Dr. To Purchases A/c (Being stock destroyed by fire)		1,800	1,800
	Insurance Claim A/c Dr. Profit and Loss A/c Dr. To Stock Destroyed by Fire A/c (Being insurance claim accepted and the net loss charged to Profit and Loss Account)		1,500 300	1,800
27	Office Equipments A/c Dr. To Profit and Loss A/c (Being the profit on sale of typewriter)		200	200

Working Notes :

(1) Goods sold to Tamal on credit for ₹ 4,000 less 10% trade discount will be recorded in the Sales Day Book (But here it has been recorded in journal).
When Tamal will pay, it will be recorded in the Cash Book.
After trade discount, amount due from Tamal was (₹ 4,000 – ₹ 400) = ₹ 3,600. He is entitled to cash discount of 5% if he is making the payment within 10 days.
Therefore, the amount received from Tamal = ₹ 3,420 (95% of ₹ 3,600) and discount allowed = 5% of ₹ 3,600 = ₹ 180.

The Petty Cash Book

The chief cashier of a firm generally deals with cash receipts and payments which amounts to hundreds or thousands of ₹ everyday. Because of this heavy responsibility for large payments, he delegates the responsibility for small day-to-day transactions to some senior members of the staff. The person responsible for those small or petty payments records such transactions in a petty cash book. Petty cash is the cash balances held in the form of notes and coins rather than bank deposits and is used in payment of minor expenditures. Almost all businesses are to spend small sums of money for variety of small regular expenses, for instance, bus fares, office teas, purchasing of a newspaper, pins, and the like.

Generally, major payments are made by cheque for better control over cash. Inspite of this advantage, payments by cheque in the above cases are impractical. As a solution, a ***Petty Cash Fund*** is established by transferring a small amount of cash from Head Cashier to a person who is designated to be responsible for it—the ***Petty Cashier.***

A cashier is a person whose responsibility with an organisation is to receive and issue cash and to maintain records in connection with that activity. Such person may be a bookkeeper, a receptionist or a reliable employee. The petty cashier will record all the petty transactions in a separate book called ***Petty Cash Book***. The receipts of cash are entered in the debit side of the petty cash book (in the general Cash Book, cash is credited or bank is credited if petty cash is withdrawn by cheque). All payments are entered in the credit side.

Systems of Petty Cash

The cashier is given petty cash either on the ordinary system or on the imprest system.

Ordinary System of Petty Cash : Under this system, the petty cashier is given a lump sum amount of cash. After spending the whole amount, he submits the account to the head cashier.

Imprest System of Petty Cash : Imprest system is a system of controlling petty cash. Under this system, a fixed sum or float (float is a small sum of money available for immediate use) is allocated as sufficient to meet petty cash expenditure for an agreed period of time (say, a week or a month). At the end of the agreed period, the petty cashier submits the account of the amount spent by him. The sum expended by the petty cashier is reimbursed, thus making up the balance to the original sums. From the control point of view, this system has the advantage that at any point of time the petty cash balance plus the total value of vouchers which have not been reimbursed will equal the agreed float.

Advantages of the Imprest System :

1. It saves the time of the Chief Cashier, who is generally a busy person with responsibilities.
2. Petty cashier is not allowed to keep idle cash with him; if the float is found to be more than adequate, its amount will be immediately reduced. This reduces the chances of misuse of cash by the cashier.
3. Since, the ***imprested*** sum is small, it does not provoke the person in charge of it or others in the office to misappropriate it.
4. The record of petty cash is checked by the cashier, periodically, so that a mistake, if committed, is soon rectified.
5. It enables a great saving to be effected in the posting of small items to the ledger accounts since, it uses an analysis system which collects these small items together into weekly or monthly totals. These are posted to the ledger accounts, where the items are individual in nature, for example, small payments to creditors are entered in column called ledger accounts.
6. It trains young staff to handle money with responsibility.

Simple Petty Cash Book

The Simple Petty Cash Book is written just like the Cash Book. Any cash which the petty cashier receives will be recorded in the left-hand side cash column (debit column) and any cash which he pays out will be recorded in the right-hand side payment column. The date and particulars of every transaction will be written in the same date and particulars column. The ruling of a simple Petty Cash Book is given below:

Dr. **Simple Petty Cash Book** **Cr.**

Cash Received	C.B. Folio	Date	Particulars	Voucher No.	Total Payment
Money received					
			Money paid		

The operations of the Simple Petty Cash Book is illustrated below.

Illustration 9

From the following particulars prepare a Petty Cash Book for the month of January 2015 :

			₹
Jan.	1	Drew for petty cash	100
	3	Paid for postage	15
	5	Paid for telephone	2
	8	Paid for cartage	7
	9	Paid for postage	10
	12	Paid for sundries	5
	27	Paid for taxi fare	12

If the imprest amount is ₹ 100, show what amount the petty cashier would be entitled to draw at the beginning of the next month.

Solution

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

Cash Received	C.B. Folio	Date	Particulars	Voucher No.	Total Payment
100		2015 Jan. 1	To Bank		₹
		3	By Postage A/c		15
		5	By Telephone A/c		2
		8	By Cartage A/c		70
		9	By Postage A/c		10
		12	By Miscellaneous Expenses A/c		5
		27	By Travelling Expenses A/c		12
		31	By Balance c/d		49
100					100

49			Feb. 1	To Balance b/d		
51			1	To Bank		

Tutorial Note : Total petty expenses for the period is ₹ 51. At the beginning of February 2015, the petty cashier will get ₹ 51.

Analytical Petty Cash Book

The most advantageous method of recording petty cash payment is to enter them in the Analytical Petty Cash Book. In the Analytical Petty Cash Book, a separate column is used for each commonly occurring item of expenditure such as postage, stationery, travelling, wages, and the like. When a petty expense is recorded in the right-hand total payment column, the same amount is immediately recorded in the appropriate analysis column. At the end of a particular period, all the analysis columns are added and posted to the debit side of the respective accounts.

Under imprest system of petty cash, the new petty cash will be reimbursed, at the end of each week or other convenient period, with the exact amount he has spent. The petty cashier will start the period with same amount of money—the imprest amount.

The following points are worth noting :

1. The pages are not divided down the centre, major space is provided for credit side and the debit side contains only two columns—money column and cash book folio column.
2. The chief item of receipt is the original imprest. Other items include the money collected from private telephone calls, sale of old newspapers, and so on.
3. Money disbursed is recorded in the credit side and then analysed out into number of analysis columns which serve as collection columns for a large number of small items. Thus all the stationery is collected in the 'Stationery' column.
4. Certain payments cannot be added together in the above way, for example, small payments to creditors. A special column is provided, under the heading 'Ledger Account' to record these types of payments. These items are posted separately to their respective accounts in the ledger.

Balancing off the Petty Cash Book

At the time of balancing off the Petty Cash Book, a line is drawn right across the figures on the credit side and all the columns are added up. Then only the analysis columns are closed with a double line, the total column being left open.

The balance of petty cash in hand is found out after deducting the total of the payment column in the credit side from the received column in the debit side. This is inserted in the credit column, the book is balanced off and the balance is brought down.

The ruling of an Analytical Petty Cash Book is given below :

Dr. **Analytical Petty Cash Book** **Cr.**

Cash Recei-ved	C. B. Folio	Date	Particulars	Petty Cash V.No.	Total Payment	Postage	Travelling Expenses	Statio-nery	Sundry Expenses	Ledger Account	Folio

Illustration 10

From the following transactions for the month of March 2015, draw up a Petty Cash Book in analytical form with : (i) Postage and Stamps; (ii) Coolie and Cartage; (iii) Printing and Stationery; (iv) Conveyance; (v) Miscellaneous; and (vi) Ledger Account — columns. Show the reimbursement by the General Cashier to the Petty Cashier on 1.4.2015 under the imprest system of petty cash: (all figures in ₹)

1 Petty cash balance	22.00	22 ₹ 10.00 was paid to coolies for shifting office furniture	
Reimbursement by the general cashier	278.00	23 Mr Ram Murty was paid ₹ 28.50 out of petty cash.	
5 Conveyance ₹ 18.00 paid to an employee.		27 Local travelling expenses reimbursed to office peon	4.00
9 Postal stamps bought	4.50	29 The driver of the office car was given ₹ 15.00 to pay the 'fine' for violation of traffic rules.	
16 Cost of blank papers and carbon papers	11.00	31 ₹ 12.00 was spent to send a registered letter by post.	
19 Tips given to the office peon for extra work	5.00		
21 Purchased memo-books for ₹ 143.00, carrying cost on the same amounted to	2.00		

Solution

Dr. **Analytical Petty Cash Book** **Cr.**

Cash Received	C. B. Folio	Date	Particulars	Petty Cash V.No.	Total Payment	Postage & Stamps	Coolie & Cartage	Printing & Stationery	Conveyance	Miscellaneous	Ledger Account
₹		2015			₹	₹	₹	₹	₹	₹	₹
22.00		March 1	To Balance b/d								
278.00		1	To Bank A/c								
		5	By Conveyance A/c		18.00				18.00		
		9	By Postage & Stamps A/c		4.50	4.50					
		16	By Printing & Stationery A/c		11.00			11.00			
		19	By Miscellaneous Exp. A/c		5.00					5.00	
		21	By Printing & Stationery A/c		145.00			145.00			
		22	By Coolie & Cartage A/c		10.00		10.00				
		23	By Ram Murthy A/c		28.50						28.50
		27	By Conveyance A/c		4.00				4.00		
		29	By Miscellaneous Exp. A/c		15.00					15.00	
		31	By Postage & Stamps A/c		12.00	12.00					
			Total		253.00	16.50	10.00	156.00	22.00	20.00	28.50
			By Balance c/d		47.00						
					300.00						
47		April 1	To Balance b/d								
253		1	To Bank A/c								

Illustration 11

Shri P. Sharma, maintains a columner Petty Cash Book on the imprest system. The Imprest amount is ₹ 400. From the following information write up the Petty Cash Book for the 1st week of January, 2015 (all figures in ₹) :

1 Bought stamps (Voucher No. 1)	50	3 Paid V. Sribastab, a creditor (Voucher No. 6)	62
1 Paid bus fares (Voucher No. 2)	4	4 Paid for postage (Voucher No. 7)	20
2 Paid postages (Voucher No. 3)	10	5 Paid R. Smith, a creditor (Voucher No. 8)	105
2 Bought envelopes (Voucher No. 4)	30	6 Paid train fares (Voucher No. 9)	45
2 Paid for refreshment (Voucher No. 5)	14	7 Restored imprest	

Solution **In the books of P. Sharma**

Dr. **Analytical Petty Cash Book** **Cr.**

Cash Received	C. B. Folio	Date	Particulars	Petty Cash V.No.	Total Payment	Postage	Travelling Expenses	Stationery	Sundry Expenses	Ledger Account	Folio
₹		2015		₹	₹	₹	₹	₹	₹	₹	₹
400	5	Jan. 1	To Cash A/c								
		1	By Postage A/c	1	50	50					
		1	By Travelling Exp. A/c	2	4		4				
		2	By Postage A/c	3	10	10					
		2	By Stationery A/c	4	30			30			
		2	By Refreshment A/c	5	14				14		
		3	By V.Sribastab A/c	6	62					62	CL-25
		4	By Postage A/c	7	20	20					
		5	By R. Smith A/c	8	105					105	CL-29
		6	By Travelling Exp. A/c	9	45		45				
400					340	80	49	30	14	167	
		6	By Balance c/d		60						
					400	GL6	GL7	GL8	GL9		
70		7	To Balance b/d								
330	19	7	To Cash A/c								

The Cash impressed for petty cash purposes are debited in the petty cash book and credited in the main cash book.	These totals are posted to the debit side of the respective account in the general ledger.	These credit items are posted to the debit side of the creditors accounts in the creditor's ledger.

Key Points

- The Cash Book is a subdivision of the book of original entry, recording transactions involving receipts or payments of cash.
- The ***Single Column Cash Book*** makes a record (with narration) of only cash transactions, and it is just like any other Account.
- The Cash Book in which cash and transactions involving receipts and payments by cheques are recorded is called ***Double Column Cash Book***.
- The most exhaustive Cash Book is the ***Triple-column Cash Book***, which has three amount columns on either side, viz, cash, bank and discount. The discount column is provided for recording discount.
- ***Trade Discount*** represents an allowance which is made by the manufacturers to the wholesalers or by the wholesalers to the retailers and it is calculated as a percentage of list or catalogue prices of goods supplied.
- ***Cash Discount*** is allowed to encourage a debtor to payoff his debt within a specified period. If the debtor settles his account within a given time period, he is entitled to reduce his bill by the agreed amount.
- ***Petty cash*** is the cash balances held in the form of notes and coins rather than bank deposits and is used in payment of minor expenditures.
- ***Imprest system*** is a system of controlling petty cash. Under this system, a fixed sum or float (float is a small sum of money available for immediate use) is allocated as sufficient to meet petty cash expenditure for an agreed period of time.

THEORETICAL QUESTIONS

1. What are the different kinds of cash books ?
2. What do you mean by contra entries ? Illustrate with examples.
3. (a) What do you mean by petty cash book ?
   (b) Explain the imprest system of petty cash.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to answer the following questions :

1. A debit entry in the cash account is matched by a credit entry in T. Porwal's Account. What do these entries record?
   A Goods sold to T. Porwal for cash
   B Payment of cash to T. Porwal
   C Purchase of goods from T. Porwal for cash
   D Receipt of cash from T. Porwal
2. Joy occupies part of Natasha's business premises. Which entry in Natasha's books records the rent Joy pays her ?

	Debit Account	*Credit Account*
A	Bank	Rent Payable
B	Bank	Rent Receivable
C	Rent Payable	Bank
D	Rent Receivable	Bank

3. A trader withdraws money from his bank account for personal expenses. Which entry records this in his books ?

	Debit Account	*Credit Account*
A	Bank	Capital
B	Bank	Drawings
C	Capital	Bank
D	Drawings	Bank

4. Which is both a book of journal and a ledger ?
   A Cash Book
   B General Journal
   C Purchases Journal
   D Sales Journal

5. How is the cash purchase of goods for resale entered in books of account ?

	Debit Account	*Credit Accountnt*
A	Cash	Purchases
B	Cash	Creditors
C	Purchases	Cash
D	Creditors	Cash

6. A owes ₹ 1,000 for goods bought on credit. A pays B the amount owed by cheque, less 2.5% cash discount. Which entry in A's book records this ?

	Debit account(s)	*Credit account(s)*
A	B ₹ 1,000	Bank ₹ 975 Discount received ₹ 25
B	Bank ₹ 975 Discount received ₹ 25	B ₹ 1,000
C	B ₹ 1,000	Bank ₹ 975 Discount allowed ₹ 25
D	Bank ₹ 975 Discount allowed ₹ 25	B ₹ 1,000

7. Discount allowed is an
   A Expense
   B Income
   C Receipt
   D Payment
8. A credit balance of ₹ 10,000 in the bank column of the cash book shows that
   A the amount received exceeds the amount paid out by ₹ 10,000
   B ₹ 10,000 has been lost
   C the accounts clerk has made mistakes
   D the bank account has been overdrawn
9. If the bank account shows a credit balance of ₹ 1,000, the accountholder deposits ₹ 400 and draws a cheque for ₹ 300, the balance in the bank account should be
   A ₹ 900 debit
   B ₹ 1,100 debit
   C ₹ 900 credit
   D ₹ 1,100 credit
10. A debit balance of ₹ 5,000 in the cash column of the cash book shows that
   A ₹ 5,000 has been paid out
   B ₹ 5,000 is owing
   C the amount received exceeds the amount paid by ₹ 5,000
   D ₹ 5,000 has been credited into the bank account
11. Yasmin purchased some office equipment for use in her business. The equipment was faulty and she returned it to the supplier who refunded the cost to Yasmin. Which entries in Yasmin's books record the return of the equipment?

	Debit Account	*Credit Account*
A	Bank	Purchase Returns
B	Bank	Office Equipment
C	Purchase Returns	Bank
D	Office Equipment	Bank

12. A trader returns goods to the supplier and received a refund. Which entries record the refund in the trader's books ?

	Debit Account	*Credit Account*
A	Bank	Purchases
B	Bank	Purchases Returns
C	Purchases	Bank
D	Purchases	ReturnsBank

13. Discount allowed in the cash book should be
   A balanced
   B posted to the respective account in the ledger
   C posted to the respective side of the same discount account
   D ignored

14. The words 'Account Payee only' are written as part of a crossing on a cheque. What does this mean?
    A It can be encashed by the named payee
    B It may be paid into any account at any bank
    C It must be credited to an account at the bank on which it is drawn
    D It must be credited to the bank account of the named payee
15. Which of the following is not treated as cash ?
    A Money order
    B Bank Drafts
    C Post-dated Cheques
    D Coins
16. The bank account maintained by the enterprise is a
    A Real Account
    B Nominal Account
    C Personal Account
    D Valuation Account
17. How is the credit card sale recorded in the books of account ?
    A recording in the sales day book as credit sales
    B debiting cash account and crediting sales account in the cash book
    C debiting bank account and crediting sales account in the cash book
    D debiting customers' account and crediting sales account
18. Which of the following phrase represents discount received ?
    A It is a reduction from a stated amount
    B It is a deduction against the amount owed by a debtor in order to encourage early payment
    C It is a discount deducted by a debtor from the invoiced price of goods sold
    D It is a discount deducted by an enterprise from the amount due to him for goods purchased
19. Which of the following phrase does not represent cash ?
    A It is accepted by a banker at face value
    B It is immediately available for the settlement of debts
    C This is an amount that an enterprise has of notes and coins
    D It is a bill of exchange which is to be discounted through bank
20. Which of the following is not true ?
    A The cash book is a substitute for cash account in the ledger
    B A narration is required for a contra entry
    C The cash book records only one aspect of a transaction
    D Like ledger, a cash book is also a book of final entry.

PRACTICAL QUESTIONS

1. From the following particulars, write up a Single Column Cash Book.

2015, January	₹	2015, January	₹
1 Cash in hand	1,600	16 Paid Salary	400
3 Paid for postage	5	17 Paid travelling expenses	100
5 Sold goods to Banerjee & Sons on credit	1,000	19 Cash sales	250
6 Cash sales	400	20 Paid to Ray & Co.	100
8 Deposited cash into bank from office cash	300	22 Paid rent by cheque	300
9 Received from Dutta Bros in cash ₹ 500; Allowed discount	50	24 Sold goods on credit to Bidhan Nandy	500
10 Purchased Stationery	25	25 Purchased goods from Samar Sanyal on credit	250
12 Received cash from Sarajuddin & Sons	300	28 Cash purchases	200
14 Purchased goods from Raha Bros	1,000	31 Cash Sales	500
15 Purchased goods from Rahim & Co. for cash	300		

2. Enter the following transactions in the Cash book with cash, discount and Bank columns.

2015, January	₹	2015, January	₹
1 Balance of cash in hand	400	14 Electricity charges paid	10
1 Balance at bank (overdraft)	5,000	16 Drew cheque for personal use	700
4 Invested further capital of ₹ 10,000 out of which ₹ 6,000 deposited in the bank		17 Cash sales	2,500
5 Sold goods for cash	3,000	18 Collection from Atul ₹ 4,000; deposited into the Bank next day	
6 Collected from debtors of last year ₹ 8,000;		22 Drew cheque for petty cash	150

and discount allowed to him ₹ 20130 Purchased goods for cash	5,500	24 Dividend received by cheque ₹ 50, deposited in the Bank on the same day	
11 Paid Ramvilas, our creditor ₹ 2,500 and discount allowed ₹ 65		25 Commission received by cheque ₹ 230; deposited into bank on 28th	
13 Commission paid to our agent	530	29 Paid from Bank, salary of the office staff	1,500
14 Office furniture purchased from Keshav	200	29 Paid salary of the manager by cheque	500
14 Rent paid	50	30 Deposited cash into bank	1,000

3. From the following information, prepare a Triple-Column Cash Book of A James :
   (a) At the close of business on 24th January, 2015 the Cash Book balances were: office cash ₹ 15,670, bank ₹ 1,56,940 (debit). For the period 1-24 January the entires made in the discount allowed and discount received columns totalled ₹ 11,760 and ₹ 8,330 respectively.
   (b) Some credit customers have settled their accounts by cheque and the cheques here been paid into the bank :

			Amount due (₹)	Cash Discount deducted
January	25	G Long	26,400	2.5%
	28	D Fender	27,600	2.5%
	30	B Keeper	14,800	5%

   (c) Payments made out of office cash :

			₹
January	25	Travelling	2,850
	28	Postage stamps	1,260
	29	Stationery	1,820

   (d) Payments by cheque to settle creditors' accounts :

			Amount due (₹)	Cash Discount deducted
January	25	N Morris	1,06,540	Nil
	26	F Talbot	61,600	2.5%
	30	J Ford	41,950	Nil

   (e) Other payments made by cheque :

			₹
January	26	Telephone bill	17,530
	26	Repairs to Typewriter	4,340
	29	Wages and Salaries	1,36,060

   (f) Cash sales are always paid intact into the bank at the end of the day. The total for 25-31 January, which you can enter in one amount, was ₹ 3,60,045.
   (g) At 31.1.2015, bank statement shows that the cheque sent to J. Ford on 30th January has not yet been cleared.
4. A petty cash book is kept on imprest system, the amount of imprest being ₹ 50 and has six analysis columns for postage, stationery, travelling expenses, repairs, office expenses and ledger accounts. Enter the following:

2015, January	₹	2015, January	₹
1 Petty cash in hand	9.72	12 Paid to Chandaran	17.50
1 Received cash to make up the imprest	40.28	18 Paid railway fare	5.35
7 Brought stamp	4.75	25 Paid for repairs to typewriter	2.90
8 Paid railway fare	7.25	25 Paid for stationery	1.75
8 Paid bus fare	1.05	30 Paid for office expenses	4.00

5. Write the following transactions in a Three-Column Cash Book and bring down the balances:

2015			₹
Dec.	1	Cash in hand	200
		Cash at bank	1,800
	4	Received cash from Sri Ram	95
		Allowed him discount	5
	6	Purchased stationery for cash	20
	7	Paid to Sri Shyam by cheque	330
		Received discount	10
	12	Rahim settled his account for less 5% discount by cheque	500
	18	Paid sundry expenses in cash	30
	23	Paid to Sri Jadu in cash	190
		Received discount	10

	24	Withdrew from bank for office cash	100
	28	Withdrew from bank for personal use	150
	29	Bought goods by cheque	500
	31	Sold goods for cash	200

6. From the following particulars, prepare a Triple-Column Cash Book for the month of January, 2015 :

			₹
Jan.	1	Cash in hand	2,500
		Cash at bank	12,600
	2	Received cash from Roy	2,900
		Allowed him discount	100
	7	Purchased goods for cash	2,000
	12	Received from Sen	3,000
		Allowed him discount	120
	14	Paid Shyam by cheque	4,000
		Received discount	230
	16	Jadu settled his account for (less 5% discount) in cash	5,000
	20	Paid salary to domestic servants in cash	300
	21	Purchased furniture in cash	600
	22	Paid Madhu in cash	2,500
		Received discount	200
	24	Withdrew from bank for office use	3,000
	25	Repaid loan from Paritosh (including interest ₹ 250)	5,500
	28	Withdrew from bank and paid tuition fees for children	500
	29	Sold goods for cash	5,600
		Paid carriage thereon	60

7. The following items have yet to be recorded in the Cash Book of J A Summerfield for the first week in January 2015.

1	Balance in Cash Account	50
1	Overdrawn bank balance	263
	Cheque counterfoils show :	
3	J B Smith Ltd (cash discount taken ₹ 4)	120
4	A E Evans Ltd	146
5	K L M Spares (cash discount taken ₹ 3)	127
6	Restoring the petty cash imprest	45
	Paying in counterfoils show :	
3	M S Supplies	136
4	J O Jones (cash discount taken ₹ 4)	246

The following additional items should also be recorded in the Cash Book :

The *bank statement* shows :	₹
Direct debit payment — Shop Insurances plc	100
Credit transfer received – ABC Traders	120
Bank charges	23
Bank interest paid	46
The week's till rolls show a cash receipts total of	467
There were cash payments of :	
Part time wages	40
Postage stamps	27

It is the business's policy to retain a cash float of ₹ 50 at the end of each week and pay the rest of the cash into the Bank. This was done on 7 January, 2015.

Record the information in the Cash Book and balance the Cash Book on 7 January, 2015.

Guide to Answers

Multiple Choice

1. D 2. B 3. D 4. A 5. C 6. A 7. A 8. D 9. D 10. C 11. B 12. B 13. B 14. D 15. C 16. C 17. C 18. D 19. D 20. B

Practical Questions

1. Cash in hand ₹ 2,120. 2. Cash in hand ₹ 8,310; Cash at bank ₹ 3,430; Discount allowed ₹ 200; Discount received ₹ 65. 3. Cash in hand ₹ 9,740; Cash at bank ₹ 2,17,215; Discount allowed ₹ 13,850; Discount received ₹ 9,870. 4. Cash in hand ₹ 5.45. 5. Cash in hand ₹ 200. 6. Cash in hand ₹ 920. 7. Cash deposited into bank ₹ 400; Cash in hand ₹ 50; Cash at bank ₹ 32; Discount allowed ₹ 4 and Discount received ₹ 7.

6

Bank Reconciliation Statement

Introduction

A business concern can open an account with the bank by paying an initial sum of money. The banker acts as a custodian of the spendable funds of the business. The customer may deposit cash or cheque with the aid of a 'Paying-in-slip' and can withdraw money by means of a cheque. Since the banker is the trustee of the customer, the bank provides to its customer a ***Bank Statement*** at regular intervals (generally during the 1st week of each month), which summarizes payments as well as deposits and other charges for the period. In fact, Bank Statement is a copy of the customer's account in the Bank's Ledger.

To ascertain the bank balance, a concern has two sources of information:

1. Bank column of the cash book; and
2. Bank Statement (Pass Book).

On principle, the two balances should be *equal and opposite* on a stated date. But usually these two balances do not agree. The main reason for the difference in balances is owing to the fact that no party intimates the other every time a transaction takes place. It is interesting to know that many of the transactions of the customer are intimated to the banker by a third party (for instance, when a cheque is presented). Disagreement in balances may also arise owing to mistake or mistakes in the Cash Book or Bank Statement.

Since the two balances are different, if all the facts are brought together, it should be possible for them to be reconciled by means of a Bank Reconciliation Statement.

By reconciliation, the Cash Book balance can be proved by comparing it with the bank statement. Bank Reconciliation is an important part of the internal control system over cash balance lying in the bank. As a prudent policy, Bank Reconciliation should be done by a person who is not in charge of the Cash Book.

Bank Reconciliation Statement

Bank Reconciliation Statement is a statement which contains a complete and satisfactory explanation of the differences in balances as per the Cash Book and Bank Statement.

The preparation of Bank Reconciliation Statement is not a part of the double entry bookkeeping system. It is just a procedure to prove the Cash Book balance.

It should be noted that : (1) a Bank Reconciliation Statement is to be prepared whenever a Bank Statement is received; and (2) it is prepared on a stated day.

Importance of Bank Reconciliation

Bank reconciliation is an usual and valued practice of almost all business concerns. Valued because, it is an important mechanism of internal control of cash inflow and outflow. Both of them must tally as per Cash Book with the Bank Statement. This brings into focus errors and irregularities, if any. Because of the fear of detection, people in charge of maintaining and recording the cash have to be careful.

Usually, for the purpose of prevention, the two functions of bank reconciliation and of recording cash transactions are separated from each other. With this separation of functions, the system of check automatically operates and chances of pilferage or embezzlement are reduced. The employees cannot prepare unauthorised cheques, and get them encashed, without entering the transaction in the account. If they want to, they should enter into collusion with each other, which is more circuitous and, therefore, difficult than when both the jobs are entrusted to the same person. Therefore, just as a judge should not be the legislator, likewise cash recording and cash dealing with the books should be in separate hands, and they are kept in separate hands in well managed concerns.

Need for Bank Reconciliation Statement

1. It reflects the actual bank balance position.
2. It helps to detect any mistake in the Cash Book and in the Pass Book.
3. It prevents frauds in recording the banking transactions.
4. It explains any delay in the collection of cheques.
5. It identifies valid transactions recorded by one party but not by the other.

Causes of Difference

The differences in the two balances arise from the following three causes :

1. Timing: There may be a time gap between recording transactions in the customer's book and bank's book. For example, when a cheque is issued to a party, it is recorded immediately in the customer's book, but the bank will record it only when it makes payment against that cheque.

Similarly, when a cheque is deposited, it is recorded in the Cash Book immediately, but the bank will record it only when it collects money in respect of that cheque.

2. Transactions: For some transactions, the bank has earlier knowledge and it adjusts its records before the business. Some differences may arise from the bank's actions that have not been intimated to the customer. For example, interest credited by the bank or bank charges debited by the bank. The customer comes to know of these transactions only when he receives the Bank Statement.

3. Errors: Some differences in balance may arise owing to errors committed by the bank or by the person responsible for preparing the Cash Book. For the first two reasons, discussed above, neither of the parties is wrong nor would it be a mistake to 'correct' them. But for the present reason, the books are to be properly rectified.

Some of the items that frequently cause a difference

1. ***Cheque issued but not yet presented for payment :*** When a cheque is issued to a supplier or a third party, it is immediately entered in the Cash Book by crediting the bank and this has the effect of reducing the bank balance in the depositor's book. But the receiving party may not present the cheque to the bank for payment immediately. The bank debits the customer's account only when the cheque has been presented and paid for. So long as it is not presented, the balance shown in the Pass Book or Bank Statement is more than the balance shown by the depositor's Cash Book. Suppose, opening favourable balance as per Cash Book and Pass Book was ₹ 2,000. A cheque was issued in favour of R. Saxena for ₹ 1,000.

Dr.	Cash Book (Bank Column only)		Cr.
To Balance b/f	2,000	By R. Saxena A/c	1,000
		By Balance c/d	1,000
	2,000		2,000

Bank Statement

Date	Particulars	Dr. (Withdrawn)	Cr. (Deposited)	Balance (₹)
	Balance b/f			2,000 (Cr.)

If R. Saxena fails to present the cheque for payment during this period, the balance as per the Bank Statement would show more than the balance as per the Cash Book of ₹ 1,000.

2. ***Cheques deposited but not yet collected*** : Whenever a person receives a cheque from a third person and deposits it, he debits Bank Account in his own books, and credits the account of the person from whom the cheque has been received. His bank balance, therefore, is increased. The bank, however takes some time in collecting the cheque; and it would credit the customer's account only when the amount has been realised. Until the cheque has been collected, the balance appearing in the Pass Book would be less than the balance appearing in the Bank Account or Cash Book.

Opening favourable balance as per the Cash Book and Pass Book was ₹ 2,000. A cheque was received from P. Sharma for ₹ 500 and deposited into the Bank.

Dr.	Cash Book (Bank Column only)		Cr.
To Balance b/f	2,000	By Balance c/d	2,500
To P. Sharma A/c	500		
	2,500		2,500

Bank Statement

Date	Particulars	Dr. (Withdrawn)	Cr. (Deposited)	Balance (₹)
	Balance b/f			2,000 (Cr.)

If the bank fails to collect the cheque during this period, it would not credit the customer's account with ₹ 500. So, the balance as per the Bank Statement would show ₹ 500 less than the balance as per the Cash Book.

3. ***Bank charges not entered in the Cash Book*** : The bank charges some amount from each customer by way of incidental charges, collection charges, and the like and debits his account for this reason from time to time. As soon as these charges are made, the bank debits the customer's account in its own books and this reduces the bank balance. But the customer learns about these charges only, when he receives the Bank Statement or Pass Book and then he credits Bank Account in his own books. Until then, the bank balance as per the Pass Book would be less than the bank balance as per the Cash Book or Bank Account. Suppose, opening favourable balance as per the Cash Book and Pass Book was ₹ 2,000. The bank has charged ₹ 50 as bank charges.

Dr.	Cash Book (Bank Column only)		Cr.
To Balance b/f	2,000	By Balance c/d	2,000

Bank Statement

Date	Particulars	Dr. (Withdrawn)	Cr. (Deposited)	Balance (₹)
	Balance b/f			2,000 (Cr.)
	To Bank charges	50		1,950 (Cr.)

The Pass Book balance has decreased from ₹ 2,000 to ₹ 1,950, whereas the Cash Book balance remained unchanged.

4. ***Interest credited by Bank not entered in the Cash Book*** : When the bank allows interest to a customer, it credits the customer's account and his bank balance would increase. But the customer comes to know about it only at the end of the month, and then he would pass an appropriate entry. Until then, the bank balance as per the Pass Book would be more than the balance as per the Cash Book or Bank Account. Suppose, opening

favourable balance as per the Cash Book and Pass Book was ₹ 2,000. The bank has credited ₹ 100 as interest but not entered it in the Cash Book.

Dr. **Cash Book (Bank Column only)** **Cr.**

To Balance b/f	2,000	By Balance c/d	2,000

Bank Statement

Date	Particulars	Dr. (Withdrawn)	Cr. (Deposited)	Balance (₹)
	Balance b/f			2,000 (Cr.)
	By Interest		100	2,100 (Cr.)

The balance of the Pass Book/Bank Statement has increased from ₹ 2,000 to ₹ 2,100 whereas the Cash Book balance has remained at ₹ 2,000.

5. ***Amount directly deposited into Bank by Debtors***: When any amount is directly deposited by a debtor into the Bank Account of the depositor, the bank would credit the depositor's account immediately but the customer would know about it only after receiving advice from his bank. Until then, the bank balance, as per the Pass Book would show more than the balance as per the Cash Book.

Suppose, opening favourable balance as per the Cash Book and Pass Book was ₹ 2,000. Mr. B. Sarkar, a debtor, has deposited ₹ 500 directly into the bank but is yet to receive any information from the bank.

Dr. **Cash Book (Bank Column only)** **Cr.**

To Balance b/f	2,000	By Balance c/d	2,000

Bank Statement

Date	Particulars	Dr. (Withdrawn)	Cr. (Deposited)	Balance (₹)
	Balance b/f			2,000 (Cr.)
	By Cash		500	2,500 (Cr.)

The balance of the Pass Book/Bank Statement has increased from ₹ 2,000 to ₹ 2,500, whereas the Cash Book balance has remained at ₹ 2,000.

6. ***Credit Transfer***: A business may receive into its bank account revenue from a variety of sources without direct knowledge of those. It may receive regular payments such as rent from property owned or dividends or interest from investments. When the bank collects dividends, it would credit the customer's account and his bank balance will increase. But the customer would know about it only after receiving advice from the bank. Until then, the bank balance as per the Pass Book would be more than the balance as per the Cash Book. Suppose, opening favourable balance as per the Cash Book and Pass Book was ₹ 2,000. The bank has collected a dividend of ₹ 1,000 but nothing has been intimated by bank in this respect to the customer.

Dr. **Cash Book (Bank Column only)** **Cr.**

To Balance b/f	2,000	By Balance c/d	2,000

Bank Statement

Date	Particulars	Dr. (Withdrawn)	Cr. (Deposited)	Balance (₹)
	Balance b/f			2,000 (Cr.)
	By Cash (Dividend)		1,000	3,000 (Cr.)

The balance of the Bank Statement has increased from ₹ 2,000 to ₹ 3,000 whereas the Cash Book balance has remained at ₹ 2,000.

7. ***Standing Order :*** A standing order is an instruction to a bank by a customer to make a fixed payment regularly on stated days to some third party (ies). When a business unit requires to make regular payments for an item like salaries, the business unit may save itself the trouble of remembering to write several cheques and hand these over to the employees each month by making a standing order at the bank to pay salaries to its employees. The bank will then automatically pay the employees the same amount of money each month until further notice is received from the business unit. Since the business unit does not prepare cheques for its employees each month, these will be unrecorded in the cash book. When the business unit receives the bank

statement, it will check that salaries have been paid in accordance with standing orders and then make the necessary double entries in the ledger. The regular payment made by the bank may be monthly, quarterly, annually or at any convenient interval.

8. ***Direct Debit :*** Direct debit is an instruction given to a bank by its customer to allow charges to be made periodically to the account at the instance of some third party. Therefore, a direct debit is also a standing order with the exception that the receiver can alter the date or the amount of payment. Direct debits are used where the date and the amount of the payment due vary from one period to the next, for example, electricity or telephone bills. A business unit gives authority to the recipient of the payment to change the date or the amount paid. In this way, the business unit avoids the trouble of frequently altering the amount payable on a standing order. A bank generally accepts direct debit instructions only in respect of approved third parties. The banker also undertakes to indemnify the customer if the facility is improperly used.

Payment through standing order / direct debit will lead to difference between the balance as per Cash Book and Pass Book. For example, when the bank pays insurance premium on behalf of its customer, it would debit the customer's account and his bank balance would decrease. But the customer will know about it only after receiving advice from the bank. Until then, the bank balance as per the Pass Book will be less than the balance as per the Cash Book. Suppose, opening favourable balance as per the Cash Book and Pass Book was ₹ 2,000. The bank has paid insurance premium of ₹ 500 as per standing order but nothing has been intimated by the Bank in this respect.

Dr. Cash Book (Bank Column only) Cr.

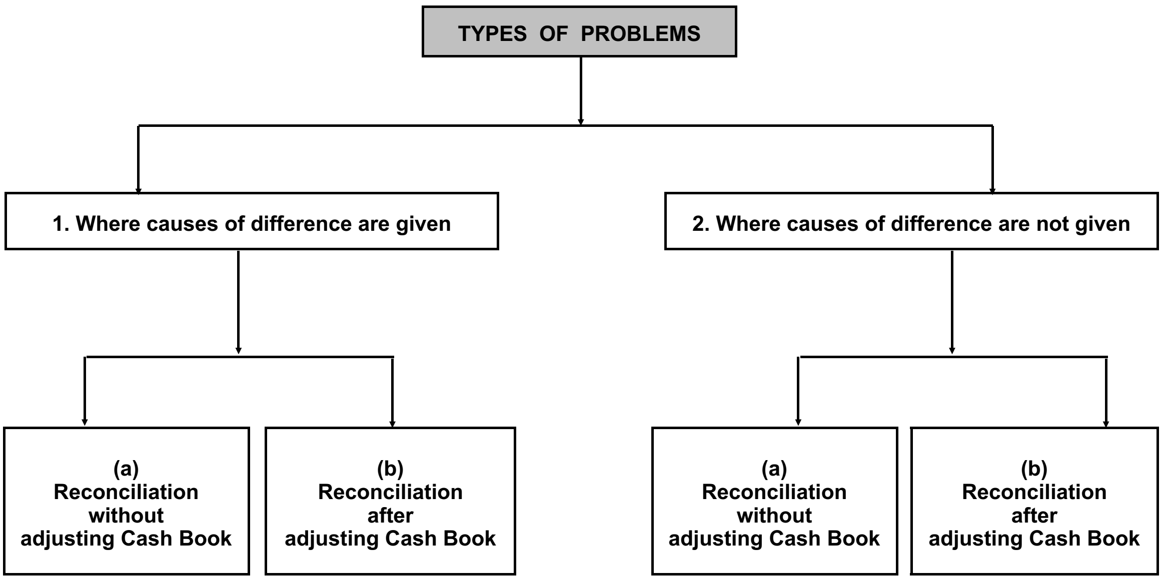
To Balance b/f	2,000	By Balance c/d	2,000

Bank Statement

Date	Particulars	Dr. (Withdrawn)	Cr. (Deposited)	Balance (₹)
	Balance b/f			2,000 (Cr.)
	To Cash (Insurance Premium)	500		1,500 (Cr.)

The balance of the Bank Statement has decreased from ₹ 2,000 to ₹ 1,500 whereas the Cash Book balance has remained at ₹ 2,000.

7. ***Errors and Omissions*** : Errors and omissions either in the Cash Book or in the Pass Book may lead to differences between the bank balance as per the Pass Book and Cash Book.



1.(a) Where causes of difference are given and Bank Reconciliation Statement is to be prepared without adjusting the Cash Book

(i) When bank favourable balance as per the Cash Book is given

If we start Reconciliation Statement with bank favourable balance as per the Cash Book, we are to ascertain the impact of each item (causing a difference) on the Pass Book favourable balance. In other words, we will have to see whether a particular item increases or decreases the favourable balance as per the Pass Book.

Now add : Those items which increase the Pass Book favourable balance more than the Cash Book favourable balance. Examples are:

(a) Cheques issued but not presented;
(b) Interest credited by bank not entered in the Cash Book; and
(c) Cash directly deposited into the bank but not recorded in the Cash Book etc.

Deduct : Those items which decrease the Pass Book favourable balance more than the Cash Book favourable balance. Examples are:

(a) Cheques deposited but not credited by the bank;
(b) Bank charges not recorded in the Cash Book; and
(c) Direct payment by bank as per standing order not recorded in the Cash Book etc.

Illustration 1

From the following particulars, prepare a Bank Reconciliation Statement as on 31st December, 2014.

(i) Bank balance as per the Cash Book ₹ 25,450.
(ii) A number of cheques were deposited in the bank but on 31st December, 2014 a cheque for ₹ 500 was not credited in the Pass Book.
(iii) Several cheques aggregating ₹ 5,000 were issued but only cheques for ₹ 4,500 were presented to the Bank for payment.
(iv) The bank had directly collected dividend ₹ 400 and interest ₹ 300 but this was not entered in the Cash Book.
(v) In accordance with the instructions, the bank honoured a bill for ₹ 2,000 but the debit note was sent to the trader only on 2nd January, 2015.
(vi) Bank charges ₹ 20 were not entered in the Cash Book.
(vii) The debit balance for November was shown short in the Cash Book by ₹ 300.
(viii) The Bank Pass Book revealed that a cheque for ₹ 250 received from a person had been dishonoured, but no entry was passed in the Cash Book.

Solution **Bank Reconciliation Statement as on 31.12.2014**

		₹	₹
	Bank balance as per the Cash Book (Dr.)		25,450
Add:	(iii) Cheque issued but not presented for payment (₹ 5,000 — ₹ 4,500)	500	
	(iv) Bank had directly collected dividend and interest but were not entered in the cash book (₹ 400 + ₹ 300)	700	
	(vii) Debit balance was shown short in the Cash Book	300	1,500
			26,950
Less:	(ii) Cheque deposited but not credited in the Pass Book	500	
	(v) Bank honoured a bill but the debit note was sent only on 2.1.2015	2,000	
	(vi) Bank charges not entered in the Cash Book	20	
	(viii) Cheque had been dishonoured, but no entry passed in the Cash Book	250	2,770
	Bank balance as per the Pass Book (Cr.)		24,180

Illustration 2

Ranganath has two accounts with Hanuman Bank Ltd, styled Account No. 1 and Account No.2. On 31.12.2014, his Cash Book showed balances of ₹ 5,400 and ₹ 2,70,400 in the two accounts respectively.

On an examination of the bank's statements, the following were noticed:

(a) ₹ 27,000 have been transferred from Account No. 2 to Account No. 1 by the bank without advice to Ranganath.
(b) ₹ 10 have been the bank's incidental charges in respect of each account, which have also not been advised.
(c) Cheques for ₹ 5,421 issued on Account No. 1 late in December have not yet been presented to the bank.
(d) A cheque for ₹ 4,272 deposited by Ranganath into A/c No. 2 has been credited by the Bank into A/c No. 1.

You are required to prepare Reconciliation Statements showing the balance as per Bank Statements.

Solution

Bank Reconciliation Statement of Ranganathan (A/c No. 1) as on 31.12.2014

			₹	₹
		Bank balance as per the Cash Book (Dr.)		5,400
Add:	(a)	Transfer from Account No. 2 without advice	27,000	
	(c)	Cheque issued but not yet presented to the Bank	5,421	
	(d)	Cheque deposited into Account No. 2 wrongly credited to Account No. 1	4,272	36,693
				42,093
Less:	(b)	Incidental charges debited in the Pass Book not recorded in the Cash Book	10	10
		Bank balance as per the Pass Book (Cr.)		42,083

Bank Reconciliation Statement of Ranganathan (A/c No. 2) as on 31.12.2014

			₹	₹
		Bank balance as per the Cash Book (Dr.)		2,70,400
Less:	(a)	Transfer to Account No. 1 without advice	27,000	
	(b)	Incidental charges debited in the Pass Book not recorded in the Cash Book	10	
	(d)	Cheque deposited into Account No. 2 wrongly credited to Account No. 1	4,272	31,282
		Bank balance as per the Pass Book (Cr.)		2,39,118

Illustration 3

The Treasurer of the Calcutta Club is attempting to reconcile the balance shown in the Cash Book with that appearing on the Bank Statement. According to the Cash Book, the balance at the bank as at 31st May, 2015 was ₹ 1,900 while the Bank Statement disclosed an overdraft amount of ₹ 470. Upon investigation, the Treasurer discovers the following errors:

(a) A cheque paid to S Ltd for ₹ 340 had been entered in the Cash Book as ₹ 430.
(b) Cash paid to the bank for ₹ 100 had been entered in the Cash Book as ₹ 90.
(c) A transfer of ₹ 1,500 to the Savings Bank had not been entered in the Cash Book.
(d) A receipt of ₹ 10 shown on the Bank Statement has not been entered in the Cash Book.
(e) Cheques drawn amounting to ₹ 40 had not been presented into the bank.
(f) The Cash Book balance had been incorrectly brought down at 1st June, 2015 as a debit balance of ₹ 1,200 instead of a debit balance of ₹ 1,100.
(g) Bank charges of ₹ 20 did not appear in the Cash Book.
(h) Receipts of ₹ 900 paid into the bank on 31st May, 2015 did not appear on the Bank Statement until 1.6.2015.
(i) A standing order payment of ₹ 30 had not been entered in the Cash Book.
(j) A cheque for ₹ 50 previously received and paid into the bank had been returned by the bank marked 'account closed'.
(k) The bank received a direct deposit of ₹ 100 from an anonymous member.
(l) Cheques paid into the bank had been incorrectly totalled. The total amount should have been ₹ 170 instead of ₹ 150.

Draw up a Bank Reconciliation Statement as at 31st May, 2015.

Solution

Calcutta Club
Bank Reconciliation Statement as on 31.05.2015

			₹	₹
		Bank balance as per the Cash Book (Dr.)		1,900
Add:	(a)	Cheque paid for ₹ 340 had been entered in the Cash Book as ₹ 430	90	
	(b)	Cash paid to the Bank ₹ 100 had been entered in the Cash Book as ₹ 90	10	
	(d)	A receipt of ₹ 10 shown in the Bank Statement not recorded in the Cash Book	10	
	(e)	Cheque drawn but not presented to the Bank	40	
	(k)	Direct deposit by a member into the Bank not recorded in the Cash Book	100	250
				2,150
Less:	(c)	Transfer to Saving Bank had not been recorded in the Cash Book	1,500	
	(f)	A debit balance of the Cash Book of ₹ 1,100 brought forward as ₹ 1,200	100	
	(g)	Bank charges not recorded in the Cash Book	20	
	(h)	Receipts of ₹ 900 paid into the Bank on 31st May, 2015 did not appear in the Bank Statement until 1.6.2015	900	
	(i)	A payment made by bank as per standing order not recorded in the Cash Book	30	
	(j)	Cheque dishonoured but not entered in the Cash Book	50	
	(l)	Cheque deposited ₹ 170 wrongly totalled as ₹ 150	20	2,620
		Bank balance as per the Pass Book (Dr.)		470

(ii) When bank overdraft as per the Cash Book is given

If we start Reconciliation Statement with bank overdraft as per the Cash Book, then we are to ascertain the impact of each item (causing difference) on Pass Book overdraft. In other words, we will have to see whether a particular item increases the overdraft as per the Pass Book or decreases as per the Pass Book.

Now add: Those items which increase the Pass Book overdraft more than the Cash Book overdraft. Examples are:

(a) Cheque deposited but not credited by the bank;
(b) Bank charges not yet recorded in the Cash Book; and
(c) Direct payment by the bank as per standing order not recorded in the Cash Book.

Deduct: Those items which decrease the Pass Book overdraft more than the Cash Book overdraft. Examples are:

(a) Cheque issued but not presented for payment to the bank;
(b) Interest credited by the bank not entered in the Cash Book; and
(c) Cash directly deposited into the bank but not yet recorded in the Cash Book.

Illustration 4

From the following particulars, prepare the Bank Reconciliation Statement:

		₹
(i)	Bank overdraft as per the Cash Book.	16,200
(ii)	A cheque deposited as per Bank Statement but not recorded in the Cash Book.	700
(iii)	Debit side of the Bank Column cast short.	100
(iv)	A cheque for ₹ 5,000 deposited but collection as per the Bank Statement.	4,996
(v)	A party's cheque returned dishonoured as per the Bank Statement only.	530
(vi)	Bills collected directly by the bank.	3,500
(vii)	Bank charges recorded twice in the Cash Book.	25
(viii)	A bill for ₹ 8,000 discounted for ₹ 7,960 returned dishonoured by the bank, noting charges being	15
(ix)	Cheques deposited but not yet collected by the bank.	2,320
(x)	Cheques issued but not yet presented for encashment.	1,250

Solution **Bank Reconciliation Statement as on ...**

			₹	₹
		Bank Overdraft per the Cash Book		16,200
Add:	(iv)	Cheque for ₹ 5,000 deposited but collection as per Bank statement ₹ 4,996	4	
	(v)	Cheque returned dishonoured as per the Bank statement only	530	
	(vii)	Bill for ₹ 8,000 discounted for ₹ 7,960 returned dishonoured by the bank, noting charges being ₹ 15	8,015	
	(ix)	Cheque deposited but not collected	2,320	10,869
				27,069
Less:	(ii)	Cheque deposited but not recorded in the Cash Book	700	
	(iii)	Debit side of the bank column cast short	100	
	(vi)	Bills collected directly by the bank	3,500	
	(vii)	Bank charges recorded twice in the Cash Book	25	
	(x)	Cheques issued but not yet presented for encashment	1,250	5,575
		Bank overdraft as per the Pass Book (Dr.)		21,494

Illustration 5

The Cash Book of Gupta showed an overdraft of ₹ 30,000 on 31.12.2014. The scrutiny of the entries in the Cash Book and the Pass book revealed that:

(i) On 22nd December, cheques totalling ₹ 6,000 were sent to bankers for collection, out of which a cheque for ₹ 1,000 was wrongly recorded on the credit side of the Cash Book and cheques amounting to ₹ 300 could not be collected by the bank within the year.

(ii) A cheque for ₹ 4,000 was issued to a supplier on 28th December, 2014. The cheque was presented to the bank on 4th January, 2015.

(iii) There were debits in the Pass Book for interest ₹ 2,000 on overdraft and bank charges ₹ 600 not recorded in the Cash Book.

(iv) The credit side of the Bank Column of the Cash Book was undercast by ₹ 100.

(v) A cheque for ₹ 1,000 was issued to a creditor on 27th December but unfortunately, the same was not recorded in the Cash Book. The cheque was, however, duly encashed within 31st December.

(vi) As per standing instructions, the banker collected dividend of ₹ 500 on behalf of Gupta and credited the same to his account within 31st December, 2014. The fact was, however, intimated to Gupta on 3rd January, 2015.

You are required to prepare a Bank Reconciliation Statement as on 31st December, 2014.

Solution

Gupta

Bank Reconciliation Statement as on 31.12.2014

		₹	₹
	Bank Overdraft as per the Cash Book (Cr.)		30,000
Add:	(i) Cheques deposited but not collected	300	
	(ii) Debits in the Pass Book for interest on overdraft and the bank charges not recorded in the Cash Book	2,600	
	(iii) The credit side of the Bank column of the Cash Book was undercast	100	
	(iv) Cheque issued to a creditor not recorded in the Cash Book, but it was duly encashed within 31.12.2014	1,000	4,000
			34,000
Less:	(i) Cheque wrongly recorded on the credit side of the Cash Book (₹ 1,000 x 2)	2,000	
	(ii) Cheque issued but not presented for payment	4,000	
	(v) Dividend collected by the Bank not recorded in the Cash Book	500	6,500
	Bank balance as per the Pass Book (Dr.)		27,500

Illustration 6

Mr. Jones is having Accounts (A and B) with the Central Bank of India.

On 31.12.2014, his ledger shows a balance of ₹ 5,000 in Account A and an overdraft of ₹ 2,250 in Account B. On verifying the ledger entries with the respective Bank Statements, the following mistakes were noticed:

(i) A deposit of ₹ 1,500 made into 'A' on 20.12.2014 has been entered in the ledger in account 'B'.

(ii) A withdrawal of ₹ 500 from Account A on 20.11.2014 has been entered in the ledger in Account B.

(iii) Two cheques of ₹ 500 and ₹ 750 deposited in Account A on 1.12.2014 (and entered in the books in Account B) have been dishonoured by the bankers. The entries for the dishonour of these cheques have been entered in the books in Account B.

(iv) In the Account A and B Mr. Jones has issued on 29.12.2014 cheques for ₹ 10,000 and ₹ 1,000 respectively and those have not been cashed till 31.12.2014.

(v) Incidental charges of ₹ 10 and ₹ 25 charged in the Account A and B respectively have not been entered in the books.

(vi) The bank credited an interest of ₹ 50 for Account A and has charged interest of ₹ 275 for Account B which have not been recorded in books.

(vii) The deposits of ₹ 5,000 and ₹ 3,500 made into the Accounts A and B both on 30.12.2014 have not been given credit by the bank till 31.12.2014.

Draw the Bank Reconciliation Statements for the above two accounts.

Solution

Mr. Jones

Bank Reconciliation Statement (Account No. A) as on 31.12.2014

		₹	₹
	Bank balance as per Ledger		5,000
Add:	(i) A deposit made into Account 'A' wrongly entered in Account 'B' in the Ledger	1,500	
	(iv) Cheque issued but not presented	10,000	
	(vi) Interest credited by bank not entered in the ledger	50	11,550
			16,550
Less:	(ii) A withdrawal from Account 'A' has been entered in the ledger in Account 'B'	500	
	(v) Incidental charges not entered in the ledger	10	
	(vii) Cheque deposited but not credited by the Bank	5,000	5,510
	Bank balance as per the Pass Book (Cr.)		11,040

Bank Reconciliation Statement (Account No. B) as on 31.12.2014

		₹	₹
	Bank Overdraft as per Ledger		2,250
Add:	(iii) A deposit made into Account 'A' has been wrongly entered in the ledger in Account 'B'	1,500	
	(v) Incidental charges not entered in the ledger	25	
	(vi) Interest charged by bank has not been recorded in the ledger	275	
	(vii) Cheque deposited but not credited by the Bank	3,500	5,300
			7,550
Less:	(ii) A withdrawal from Account 'A' has been entered in the ledger in Account 'B'	500	
	(iv) Cheque issued but not presented	1,000	1,500
	Bank Overdraft as per the Pass Book (Dr.)		6,050

Illustration 7

The Balance Sheet and Profit and Loss Account of a trader show the following two items :

Bank balance — Overdrawn	₹ 36,200
Profit and Loss Account — Trading profit for the year	₹ 2,31,750

However, the balance as shown on the bank statement does not agree with balance as shown in the cash book. Your investigation of this matter reveals the following differences, and additional information :

1. Cheque payments entered in the cash book but not presented to the bank until after the year end — ₹ 31,380.

2. Bankings entered in the cash book but not credited by the bank until after the year end — ₹ 4,250.
3. Items shown on bank statements but not entered in the cash book —
   Bank charges — ₹ 2,450
   Standing order — Loan repayments 12 instalments @ ₹ 360 each
   Standing order — Being quarterly rent of godown ₹ 1,250, due on each quarter day.
   Dividend received on investment ₹ 900.
4. Cheques for ₹ 350 and ₹ 1,400 received from customers were returned by the bank as dishonoured, but no entries concerning these events have been made in the cash book.
5. The cheques were returned by the bank for the following reasons —
   (i) the ₹ 350 cheque requires an additional signature and should be honoured in due course;
   (ii) the ₹ 1,400 cheque was unpaid due to the bankruptcy of the drawer and should be treated as a bad debt.
6. The loan repayments of ₹ 360 represent ₹ 300 capital and ₹ 60 interest.
7. A cheque for ₹ 450 received from a customer in settlement of his account had been entered in the cash book as ₹ 4,500 on the payments side, analysed to the purchases ledger column and later posted.

You are required to prepare :

(a) a Statement reconciling the cash book balance with the bank statement; and

(b) a Statement showing the effect of the alterations on the trading profit.

Solution

Bank Reconciliation Statement as on . . .

	₹	₹
Bank Overdraft as per Cash Book		36,200
Add: (i) Cheque deposited but not yet credited by bank	4,250	
(ii) Cheques dishonoured but not recorded in the Cash Book (₹ 350 + 1,400)	1,750	
(iii) Bank charges not yet recorded in the Cash Book	2,450	
(iv) Loan repayment (as per standing order) not recorded in the Cash Book (₹ 360 x 12)	4,320	
(v) Rent of godown (as per standing order) not recorded in the Cash Book (₹ 1,250 x 4)	5,000	17,770
		53,970
Less: (i) Cheques issued but not presented for payment	31,380	
(ii) Dividend on investment not recorded in the Cash Book	900	
(iii) Cheque received from customer for ₹ 450 has been entered in the Cash Book as cash purchase of ₹ 4,500	4,950	37,230
Bank Overdraft as per Bank Statement		16,740

Effect of the Alterations on Trading Profit

Particulars	₹	₹
Profit as per last Profit and Loss Account		2,31,750
Add: (i) Wrong entry in the Cash Book as cash purchase	4,500	
(ii) Dividend received from investment not recorded	900	5,400
		2,37,150
Less: (i) Bad Debts	1,400	
(ii) Bank Charges	2,450	
(ii) Interest Paid	720	
(iii) Godown Rent	5,000	9,570
Revised Profit		2,27,580

(iii) When Bank favourable balance as per the Pass Book is given

If we start Reconciliation Statement with bank favourable balance as per the Pass Book, we are to ascertain the impact of each item (causing differences) on Cash Book favourable balance. In other words, we have to see whether a particular item increases or decreases the favourable balance as per the Cash Book.

Now, add: Those items which increase the Cash Book favourable balance more than the Pass Book favourable balance.

Examples are:

(a) Cheques deposited but not credited by the bank.

(b) Bank charges not yet recorded in the Cash Book; and

(c) Direct payment by the bank as per the standing order not yet recorded in the Cash Book.

Deduct: Those items which decrease the Cash Book favourable balance more than the Pass Book favourable balance.

Example are:

(a) Cheques issued but not presented for payment to the bank;

(b) Interest credited by the bank but not entered in the Cash Book; and

(c) Cash directly deposited into the bank but not yet recorded in the Cash Book.

Illustration 8

Shri Rambharose requests his friend Daulatram to compile the Bank Reconciliation Statement based on the data collected as on June 2015, by his accountant prior to his sudden illness:

The Bank Statement showed a favourable balance of ₹ 9,214.

(i) On 29th June, the bank credited the sum of ₹ 1,650 in error.
(ii) Certain cheques, valued at ₹ 4,500 issued before 30.6.2015 were not cleared.
(iii) A hire purchase payment of ₹ 950 made by a standing order was not entered in the Cash Book.
(iv) A cheque of ₹ 600 received, deposited and credited by the Bank, was accounted as a receipt in the cash column of the Cash Book.
(v) Other cheques for ₹ 8,500 were deposited in June, but cheques for ₹ 6,000 only were cleared by the bankers.

Solution

Rambharose
Bank Reconciliation Statement as on 30.06.2015

		₹	₹
	Balance as per Bank Statement		9,214
Add:	(iii) Payment as per standing order not recorded in the Cash Book	950	
	(v) Cheques deposited but not credited by bank (₹ 8,500 – ₹ 6,000)	2,500	3,450
			12,664
Less:	(i) Wrong credit by Bank	1,650	
	(ii) Cheques issued but not presented	4,500	
	(iv) Cheque of ₹ 600 wrongly entered in the cash column of the Cash Book	600	6,750
	Bank balance as per the Cash Book (Favourable)		5,914

Illustration 9

Prepare a Bank Reconciliation Statement from the following particulars:

		₹
	Bank balance as per the Pass Book	10,000
(i)	Cheque deposited into the bank but no entry was passed in the Cash Book	500
(ii)	Cheque received but not sent to bank	1,200
(iii)	Credit side of the Bank Column cast short	200
(iv)	Insurance premium paid directly by the bank under standing advice	600
(v)	Bank charges entered twice in the Cash Book	20
(vi)	Cheque issued but not presented to the bank for payment	500
(vii)	Cheque received entered twice in the Cash Book	1,000
(viii)	Bills discounted dishonoured not recorded in the Cash Book	5,000

Solution **Bank Reconciliation Statement as on ...**

		₹	₹
	Bank balance as per the Pass Book		10,000
Add:	(ii) Cheque received but not sent to the Bank	1,200	
	(iii) Credit side of the Bank column cast short	200	
	(iv) Insurance premium paid directly not recorded in the Cash Book	600	
	(vii) Cheque received entered twice in the Cash Book	1,000	
	(viii) Bill dishonoured not recorded in the Cash Book	5,000	8,000
			18,000
Less:	(i) Cheque deposited into the Bank but no entry was passed in the Cash Book	500	
	(v) Bank charges recorded twice in the Cash Book	20	
	(iv) Cheque issued but not presented to the Bank	500	1,020
	Bank balance as per the Cash Book		16,980

(iv) When bank overdraft as per the Pass Book is given

If we start Reconciliation Statement with bank overdraft as per the Pass Book, we are to ascertain the impact of each item (causing difference) on the Cash Book overdraft balance. In other words, we have to see whether a particular item increases or decreases the overdraft as per Cash Book

Now add: Those items which increase the overdraft of the Cash Book more than the Pass Book overdraft balance. For example :

(a) Cheques issued but not presented for payment to the bank;
(b) Interest credited by the bank but not entered in the Cash Book; and
(c) Cash directly deposited into the bank but not yet recorded in the Cash Book etc.

Deduct: Those items which decrease the overdraft balance of the Cash Book more than the Pass Book overdraft. For example,

(a) Cheques deposited but not credited by the bank;
(b) Bank charges not yet recorded in the Cash Book; and
(c) Direct payment by the bank as per the standing order not yet recorded in the Cash Book etc.

Illustration 10

From the following information, prepare a Bank Reconciliation Statement as at 31.3.2015 of Alfa & Co., who had an overdraft balance of ₹ 5,750.60 as per the Pass Book as on that date:

		₹
(i)	Cheque deposited into the bank but not shown in the Pass Book	3,537.30
(ii)	Cheque drawn but not cashed at the bank	2,500.20
(iii)	Dividend of ₹ 2,000 collected by the bank directly on 31.3.2015 under the advice of Alfa & Co., was not recorded in the Cash Book.	
(iv)	Debit side of the Cash Book was wrongly overcast by	500
(v)	Cheques amounting to ₹ 370 were deposited into the bank, but it was recorded in the debit side of the Pass Book.	

Solution

Alfa & Company
Bank Reconciliation Statement as on 31.03.2015

		₹	₹
	Bank Overdraft as per the Pass Book		5,750.60
Add:	(ii) Cheque drawn but not cashed at Bank	2,500.20	
	(iii) Dividend collected by the Bank directly on 31.3.2015 was not recorded in the Cash Book	2,000.00	4,500.20
			10,250.80
Less:	(i) Cheque deposited into Bank but not shown in the Pass Book	3,537.30	
	(iv) Debit side of the Cash Book was wrongly overcast	500.00	
	(v) Cheque deposited into the Bank but recorded in the debit side of the Pass Book	740.00	4,777.30
	Bank Overdraft as per the Cash Book		5,473.50

Illustration 11

The Pass Book of Bank Account No. 1 of Ghose and Co. Calcutta shows an overdraft of ₹ 17,950 on July 31, 2015, but this does not agree with the bank balance as shown by the Cash Book of the firm. On scrutiny, the following discrepancies are revealed:

(i) Out of cheques amounting to ₹ 4,350 drawn by the firm on July 27, cheques amounting to ₹ 2,650 only are cashed up to July 31.
(ii) The firm paid ₹ 7,000 into the bank, but the bank credited the same to Account No. 2 in the name of the firm.
(iii) Interest and bank charges amounting to ₹ 1,200 debited by the bank to the Firm's account have not been entered in the firm's books.
(iv) Out of ₹ 11,300 paid in by the firm in cash and by cheques on July 31, cheques amounting to ₹ 4,750 are credited to the firm's account on August 4, 2015.
(v) A cheque of ₹ 900 credited in the Pass Book on July 28 being dishonoured is debited to the firm's account on August 2.
(vi) Bankers have credited the firm's account with ₹ 16,000 for interest collected by them on Government papers held by them but the same has not been entered in the firm's books.
(vii) A payment of ₹ 250 from Account No. 2 has been wrongly debited by the bankers to Account No. 1.

Prepare the Bank Reconciliation Statement as at 31st July, 2015 for Bank Account No. 1.

Solution

Ghose & Company
Bank Reconciliation Statement as on 31.07.2015

		₹	₹
	Bank Overdraft as per the Pass Book (Dr.)		17,950
Add:	(i) Cheques drawn but not cashed (₹ 4,350 — ₹ 2,650)	1,700	
	(v) Cheque credited in the Pass Book on July 28 being dishonoured, debited to Firm's A/c in August 2 (Note)	900	
	(vi) Banker credited Firm's A/c for interest collected by them but it has not been entered in firm's books	16,000	18,600
			36,550
Less:	(ii) Bank credited an amount to A/c No. 2 instead of A/c No. 1	7,000	
	(iii) Interest and bank charges debited by the bank to firm's Account have not been entered in the firm's book	1,200	
	(iv) Cheques paid into bank but not credited to Firm's A/c	4,750	
	(vii) A payment from A/c No. 2 has been wrongly debited by the bank to A/c No. 1	250	13,200
	Bank Overdraft as per the Cash Book (Cr.)		23,350

Tutorial Note : The cheque of ₹ 900 was dishonoured, but the bank wrongly credited the firm's account by the same amount. Owing to this error in the Pass Book, the Pass Book overdraft was reduced by ₹ 900 and the Cash Book overdraft was increased by ₹ 900. In effect, to add ₹ 900. (It is assumed that the required entry for dishonour of cheque was passed in the cash book.) It should be further mentioned that if no entry for dishonour of the cheque was passed in the Cash Book, no adjustment for this item is required in the Bank Reconciliation Statement. Then the bank overdraft as per the Cash Book will be ₹ 22,450.

Illustration 12

Prepare the Bank Reconciliation Statement as on 30th November, 2014, from the following information of Mr. Merchant:

(i) Balance as per the Pass Book on 30.11.2014 (Dr.) ₹ 20,000.

(ii) On 5.10.2014, Mr. Merchant deposited a cheque for collection of ₹ 1000 and made entry in Cash Book, appears in the Pass Book on 6.12.2014 at ₹ 990.

(iii) Cheques issued to parties but not presented for payment till 30.11.2014 are of ₹ 525, ₹ 835 and ₹ 900.

(iv) Cheques deposited for collection but not collected by the bankers till 30.11.2014, ₹ 8760 and ₹ 410.

(v) Interest on investment collected by the bankers on 30.11.2014, ₹ 955 entered in the Cash Book on 4.12.2014 on receipt of bank intimation.

(vi) Bank charges ₹ 90 (dated 27.11.2014) not entered in the Cash Book.

(vii) Cheque deposited for collection on 30.11.2014 but returned dishonoured on 6.12.2014 of ₹ 945.

(viii) Bankers have made a mistake in balancing by showing overdrawn balance in excess by ₹ 1,000 on 30.11.2014, which was rectified in the Bank Pass Book on 7.12.2014 when notified.

Solution

Mr. Merchant
Bank Reconciliation Statement as on 30.11.2014

			₹	₹
		Bank Overdraft as per the Pass Book		20,000
Add:	(iii)	Cheque issued to parties but not presented for payment till 30.11.2014 (₹ 525 + ₹ 835 + ₹ 900)	2,260	
	(v)	Interest on investment collected by bankers on 30.11.2014 but intimation sent on 4.12.2014	955	3,215
				23,215
Less:	(ii)	Cheque deposited on 5.10.2014 for collection was not entered in the Pass Book during the period	1,000	
	(iii)	Cheque deposited but not collected by the bank till 30.11.2014 (₹ 8,760 + 410)	9,170	
	(vi)	Bank charges of ₹ 90 not entered in the Cash Book	90	
	(vii)	Cheque deposited for collection on 30.11.2014 but returned dishonoured on 6.12.2014	945	
	(viii)	Bank's mistake in balancing by showing overdraft balance in excess	1,000	12,205
		Bank Overdraft as per the Cash Book		11,010

1(b) Where causes of difference are given and the Bank Reconciliation Statement is to be prepared *after* adjusting the Cash Book

In practice, the Bank Reconciliation Statement is prepared after adjusting the Cash Book. Adjustment of the Cash Book is optional when the Bank Reconciliation Statement is prepared during the different months of the financial year. However, the Cash Book must be adjusted at the end of the financial year and this adjusted balance of the Cash Book is to be shown in the Balance Sheet.

In the examination, quite often students are asked to prepare the Bank Reconciliation Statement after making the necessary adjustments in the Cash Book. In the question, either bank favourable/overdraft balance as per the Cash Book is given or the bank favourable/overdraft balance as per the Pass Book is given.

(i) Where bank favourable/overdraft balance as per the Cash Book is given

In this situation, the following steps should be taken for the preparation of the Bank Reconciliation Statement.

Step 1 Draw up a Cash Book (with Bank Column only). Write down the favourable balance in the debit side of the Cash Book and the overdraft balance in the credit side of the Cash Book.

Step 2 Make the necessary entries in the Cash Book in respect of the following:

(a) Amount recorded in the Pass Book but not yet recorded in the Cash Book such as (i) Bank charges debited by the bank; (ii) Dividend collected directly by the bank; (iii) Payment made by the bank as per standing order; (iv) Dishonour of cheques and bills receivable not yet recorded in the Cash Book

(b) All errors that have crept in the Cash Book such as (i) Overcasting in the debit/credit column of the Cash Book; (ii) Undercasting in the debit/credit column of the Cash Book; (iii) Amount entered twice in the Cash Book; (iv) Wrong amount entered in the Cash Book and the like.

Step 3 Balance off the Cash Book and bring down the adjusted Cash Book balance.

Step 4 Prepare the Bank Reconciliation Statement in the usual manner taking the adjusted Cash Book balance and leaving those items which have already been considered in the adjusted Cash Book.

Observe the entries in the Cash Book

Dr. **Cash Book (Bank Column)** **Cr.**

Date	Particulars	L.F.	₹	Date	Particulars	L.F.	₹
	To Balance b/f To Dividend A/c (Being dividend collected by Bank directly) To Interest A/c				By Bank Charges A/c (Being bank charges debited by Bank) By Sundry Expenses A/c (Being direct payment made by the bank)		

	(Being interest credited by Bank) To Customer's A/c (Being directly deposited by customer)			By Interest A/c (Being interest charged by Bank) By Party A/c (Being B/R dishonoured)		

Tutorial Notes **(1)** No errors of the Pass Book are to be considered for adjusting the Cash Book; **(2)** Items correctly entered in the Cash Book are not to be considered for adjusting the Cash Book.

The following illustration will make the matter more clear:

Illustration 13

According to the Cash Book of A, there was a balance of ₹ 1,050 in favour on 30.6.2015 in his business Bank Account. However, according to his Bank Statement this account was overdrawn. On investigation you find that :

(i) The receipts column of the Cash Book has been overadded by ₹ 1,100.

(ii) Cheques drawn and entered in the Cash Book in June 2015 amounting to ₹ 1,670 were not presented until July, 2015.

(iii) Discount received from a supplier of ₹ 100 had been included with the cheque entered in the Bank Column of the Cash Book in April 2015.

(iv) An amount of ₹ 750 paid directly into A's account by a customer not entered in the Cash Book.

(v) A cheque payment of ₹ 1,230 in April 2015 had been entered in the Cash Book as ₹ 1,320.

(vi) The bank had charged the business account with a cheque for ₹ 2,200 in February 2015, which should have been passed through A's private account.

(vii) Bank charges of ₹ 80 at 31.12.2014 and ₹ 100 at 30.6.2015 had not yet been entered in the Cash Book.

(viii) Cheque to the value of ₹ 3,780 received from customers were recorded in the Cash Book on 28.6.2015 but not entered by the bank until 2.7.2015.

You are asked to make appropriate adjustments in the Cash Book as at 30.6.2015, and prepare a Statement reconciling the adjusted Cash Book balance with the balance shown by the Bank Statement.

Solution

In the Books of A
Bank Reconciliation Statement as on 30.06.2015
(Without adjustment in the Cash Book)

		₹	₹
	Bank balance as per the Cash Book (Dr.)		1,050
Add:	(ii) Cheque drawn but not presented	1,670	
	(iii) Discount received wrongly entered in the bank column of the Cash Book	100	
	(iv) Direct deposit by customer into the bank not recorded in the Cash Book	750	
	(v) Cheque payment of ₹ 1,230 wrongly entered in the Cash Book as ₹ 1,320	90	2,610
			3,660
Less:	(i) Receipt column of the cash book has been over added	1,100	
	(vi) Bank had charged the business account in place of private account	2,200	
	(vii) Bank charges not recorded in the Cash Book (₹ 80 + ₹ 100)	180	
	(viii) Cheque deposited but not entered in the Cash Book	3,780	7,260
	Bank Overdraft as per the Pass Book		3,600

If the Bank Reconciliation Statement is to be prepared after adjusting the Cash Book, then a Cash Book to be drawn up (with Bank Column only) and necessary entries in the Cash Book to be made for: (1) errors crept into the Cash Book; and (2) items not recorded in the Cash Book.

Now, observe each item of the previous illustration.

(1) The receipts column of the Cash Book had been over added by ₹ 1,100

It is an error in the debit side of the Cash Book. So, Cash Book to be credited by ₹ 1,100.

(2) Cheque drawn and entered in the Cash Book in June, 2015 amounting to ₹ 1,670 were not presented until July, 2015.

This item has already been entered in the Cash Book. So, no adjustment is required in the Cash Book.

(3) Discount received from a supplier of ₹ 100 had been included with the cheque entered in the Bank Column of the Cash Book in April, 2015.

It is an error in the credit side of the Cash Book. So, the Cash Book is to be debited by ₹ 100.

(4) An amount of ₹ 750 paid directly into A's account by a customer not entered in the Cash Book.

This item has not been entered in the Cash Book. So, the Cash Book is to be debited by ₹ 750 and the customer is to be credited by the same amount.

(5) A cheque payment of ₹ 1,230 in April, 2015 had been entered in the Cash Book as ₹ 1,320.

There is an error in the payment side of the Cash Book for ₹ 90. So, the Cash Book is to be debited by ₹ 90.

(6) The bank had charged the business account with the cheque for ₹ 2,200 in February 2015, which should have been passed through A's private account

It is an error in the Pass Book. So, no adjustment is necessary in the Cash Book.

(7) Bank charges of ₹ 80 at 31.12.2014 and ₹ 100 at 30.6.2015 had not yet been entered in the Cash Book.

This item has not been entered in the Cash Book. So, the Cash Book is to be credited by ₹ 180 and bank charges account to be debited.

(8) Cheque to the value of ₹ 3,780 received from customer were recorded in the Cash Book on 28.5.2015 but not entered by the bank until 2.7.2015.

This item has already been entered in the Cash Book. So, no adjustment in the Cash Book is required.

The final working will be as follows:

Solution

In the Books of A

Dr. Cash Book (Bank Column) Cr.

Date	Particulars	L.F.	₹	Date	Particulars	L.F.	₹
2015	To Balance b/f		1,050	2015	By Error (Overcasting)		1,100
June 30	To Discount Received A/c		100	June 30	By Bank Charges A/c		180
	To Customers A/c (Direct deposit)		750		By Balance c/d		710
	To Error (₹ 1,320 — ₹ 1,230)		90				
			1,990				1,990

Bank Reconciliation Statement as on 30.06.2015

			₹	₹
		Bank balance as per the Amended Cash Book		710
Add:	(ii)	Cheques drawn but not presented	1,670	1,670
				2,380
Less:	(vi)	Bank charges business account with a cheque which should have been passed through A's personal account	2,200	
	(viii)	Cheque received but not recorded	3,780	5,980
		Bank Overdraft as per the Pass Book		3,600

Illustration 14

Following are the transactions recorded in the bank column of the Cash Book of Sri Madhab for the month ending 31.12.2014 :

Dr. Cash Book (Bank column) Cr.

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Dec. 19	To Cash	54,000	Dec. 1	By Balance b/d	60,000
24	To Buddha	36,000	8	By Ram	3,000
26	To Chaitanya	15,000	10	By Laksman	600
31	To Balance c/d	11,460	19	By Bharat	360
			24	By Satrughna	52,500
		1,16,460			1,16,460

On receipt of the Bank Statement on 31.12.2014, Sri Madhab collected the following information :

(a) Credit transfer not recorded in the Cash Book ₹ 300.

(b) Interest on Government Bond collected by the bank but not entered in Cash Book ₹ 1,620.

(c) Cheques for ₹ 20,000 deposited but the bank collected only ₹ 5,000.

(d) Dividend collected by the bank directly but not intimated the same to Sri Madhab ₹ 1,500.

(e) Bank charges recorded twice in the Cash Book ₹ 510.

(f) Interest on overdraft charged by the bank but not recorded in the Cash Book ₹ 1,500.

(g) Cheques for ₹ 66,100 issued by him but presented to the bank for payment only ₹ 10,000.

You are asked to amend the Cash Book and prepare a Bank Reconciliation Statement from the above information.

Solution

In the books of Madhab

Dr. Amended Cash Book (Bank Column) Cr.

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Dec. 31	To Credit Transfer A/c	300	Dec. 31	By Balance b/d	11,460
	To Interest on Investment A/c	1,620		By Interest A/c	1,500
	To Dividend A/c	1,500			
	To Bank Charges A/c (wrongly recorded twice)	510			
	To Balance c/d	9,030			
		12,960			12,960

Bank Reconciliation Statement as on 31.12.2014

Particulars	₹
Bank Overdraft as per Amended Cash Book (Cr.)	9,030
Add: Cheques deposited but not yet collected by the bank (₹ 20,000 – 5,000)	15,000
	24,030
Less: Cheques issued but not yet presented for payment (₹ 66,100 – 10,000)	56,100
Bank Balance as per Bank Statement (Cr.)	32,070

Illustration 15

Sri A Basu maintained two separate banking accounts, one with United Bank of India and the other with State Bank of India. On 31 December 2014 the bank balances as per United Bank of India Statement and State Bank of India Statement were ₹ 2,556 and ₹ 2,548 respectively. But the bank balances in Basu's books on that date were ₹ 2,870 (Dr.bal.) and ₹ 4,680 (Dr.bal.) respectively. On scrutiny of these records, the following information was ascertained:

(i) A cheque for ₹ 250 from Sri D.Ray which was directly remitted to the United Bank of India was not entered in Basu's book.

(ii) A cheque for ₹ 700 drawn on State Bank of India and paid to M/s Sen & Co. was entered in the United Bank of India A/c in Basu's Cash Book.

(iii) Payment of ₹ 1,020 by United Bank of India to Life Insurance Corporation of India under a standing order was not recorded in Basu's Cash Book.

(iv) Cheques lodged but not yet credited ₹ 212 for United Bank of India and ₹ 1,600 for SBI.

(v) A cheque for ₹ 57 paid into SBI, was returned dishonoured but this was not recorded in Basu's book.

(vi) Bank charges of ₹ 32 and ₹ 45 for United Bank of India and State Bank of India respectively were not accounted for by Sri Basu.

(vii) ₹ 350 recorded to be deposited into State Bank of India on 30.12.2014 was actually credited by the bank on 4.1.2015.

(viii) There were no unpresented cheques except one for ₹ 620 drawn on State Bank of India.

Ascertain the actual bank balance of Sri A. Basu on 31.12.2014 and prepare a Bank Reconciliation statement.

Solution

In the Books of Sri A. Basu
Cash Book (Bank Column)

Dr. **Cr.**

Date	Particulars	UBI	SBI	Date	Particulars	UBI	SBI
2014	To Balance b/f	2,870	4,680	2014	By UBI A/c		700
Dec. 31	To D. Ray's A/c	250		Dec. 31	By Insurance Premium A/c	1,020	
	To SBI A/c	700			By Party A/c		57
					By Bank Charges A/c	32	45
					By Balance c/d	2,768	3,878
		3,820	4,680			3,820	4,680

Bank Reconciliation Statement (UBI) as on 31.12.2014

		₹	₹
	Bank balance as per the Amended Cash Book (Dr.)		2,768
Less:	Cheque lodged but not credited	212	212
	Bank balance as per the Pass Book (Cr.)		2,556

Bank Reconciliation Statement (SBI) as on 31.12.2014

		₹	₹
	Bank balance as per the Amended Cash Book (Dr.)		3,878
Add:	(viii) Cheque issued but not presented	620	620
			4,498
Less:	(iv) Cheuqe lodged but not credited	1,600	
	(vii) Cheque deposited but not credited	350	1,950
	Bank balance as per the Pass Book (Cr.)		2,548

Illustration 16

Alexander furnishes you with the following information and asks you to —

(i) record the transactions in the Cash Book with bank column for November 2014 (without narration); and

(ii) prepare Reconciliation Statements with State Bank of India as on 31st October and 30th November, 2014.

(a) On October 31, 2014 there was bank overdraft of ₹ 14,000 as per Cash Book and cash in hand ₹ 7,500. Bank statement as on that date showed cheques deposited but not realised of ₹ 40,000 while cheques issued but not presented for payment amounted to ₹ 60,000.

(b) During the month, customers paid ₹ 4,50,000 which were deposited into bank. Of these cheques of ₹ 50,000 were deposited on 30th November, 2014 and realised subsequently. The bank realised all the other cheques and charged

₹ 300 as collection expenses. These charges are to be entered in the Cash Book and not kept as reconciliation items.

(c) Cheques issued during the month totalled to ₹ 4,20,000. Bank statement showed that cheques presented for payment totalled to ₹ 4,50,000 only of which one cheque of ₹ 7,000 issued in October, 2014 was returned on 5.11.2014 for want of Alexander's signature on the cheque. Alexander paid cash to the payee of the cheque and cancelled the cheque. The bank charged ₹ 25 for cheque return.

(d) Cheques presented for payment during the month included cash withdrawn from bank ₹ 15,000, 40% of this cash is handed over on various dates to the petty cashier while 50% is taken by Alexander for his personal use.

(e) Bank charged ₹ 100 for cheque book issued.

Solution

In the books of Alexander

Dr. Cash Book (Double Column) Cr.

Date	Particulars	Cash ₹	Bank ₹	Date	Particulars	Cash ₹	Bank ₹
2014				2014			
Nov. 1	To Balance b/d	7,500		Nov. 1	By Balance b/d		14,000
	To Debtors A/c		4,50,000		By Bank Charges A/c :		
	To Creditors A/c				Collection charges		300
	(Return of cheque)		7,000		By Cash A/c (C) (Note 1)		15,000
	To Bank A/c (C)	15,000			By Creditors A/c (Note 1)	7,000	4,05,000
					By Petty Cash A/c	6,000	
					By Drawings A/c	7,500	
					By Bank Charges A/c :		
					Cheque return		25
					Cheque book		100
				30	By Balance c/d	2,000	22,575
		22,500	4,57,000			22,500	4,57,000

Bank Reconciliation Statement as on 31.10.2014

	₹
Bank Overdraft as per Cash Book	14,000
Add: Cheques deposited but not cleared	40,000
	54,000
Less: Cheques issued but not presented for payment	60,000
Bank Balance as per Bank Statement (Cr.)	6,000

Bank Reconciliation Statement as on 30.11.2014

	₹
Bank Balance as per Cash Book	22,575
Add: Cheques issued but not presented for payment (₹ 60,000 + 4,20,000 – 4,50,000)	30,000
	52,575
Less: Cheques deposited but not cleared (₹ 4,50,000 – 4,00,000)	50,000
Bank Balance as per Bank Statement (Cr.)	2,575

Working Notes :

(1) Cheques issued during the month of November amounting to ₹ 4,20,000 and these include ₹ 15,000 for withdrawal of cash. Therefore, cheques for ₹ 4,05,000 were issued to creditors.

(2) Out of ₹ 15,000, 40%, i.e., ₹ 6,000 was paid to petty cashier and 50%, i.e., ₹ 7,500 was taken by Alexander for personal use. The balance 10%, i.e., ₹ 1,500 was retained as cash in hand.

Illustration 17

On 31st October, 2013 Laxmichand's Cash Book showed cash balance of ₹ 3,000 and overdraft of ₹ 53,450 in Current Account with Bank of India.

During November, 2013 the following transactions took place :

(i) Cash sales ₹ 60,000. The entire proceeds were deposited in bank.

(ii) Credit sales ₹ 1,90,000.

(iii) Collections from credit customers ₹ 1,50,000 by cheques in full payment of invoices of October, 2013 totalling to ₹ 1,53,000.

(iv) Credit purchases ₹ 1,55,000.

(v) Cheques of ₹ 1,32,000 issued to suppliers against purchases bills of October, 2013 of ₹ 1,34,000.

(vi) Advances received from customers ₹ 30,000 by cheques against supplies to be made in December, 2013.

(vii) Advances given to suppliers ₹ 25,000 by cheques against supplies to be made in December, 2013.

(viii) Amount withdrawn from bank ₹ 10,000 of which ₹ 4,000 was for personal use and the balance was for meeting cash expenses.

(ix) Expenses paid during the month ₹ 9,000 of which ₹ 5,000 was paid by cheques and the balance was paid out of cash.

(x) Cash paid on behalf of an up-country customer ₹ 4,500.

(xi) Bank charges of ₹ 150 debited by the bank in October, 2013 were recorded through the Cash Book on 10th November, 2013 on receipt of the bank statement for October, 2013.

On 10th December, 2013 Laxmichand received the statement for November, 2013 from the bank.

The following summary of the said statement for November, 2013 was prepared :

Particulars	Withdrawal ₹	Deposit ₹	Balance ₹
Balance on 31.10.2013			(Cr.) 12,500
Deposit realised :			
(i) Cash		60,000	(Cr.) 72,500
(ii) Customers' cheques deposited in:			
October, 2013		5,000	(Cr.) 77,500
November, 2013		1,70,000	(Cr.) 2,47,500
Bank charges on realisation of customers' cheques	400		(Cr.) 2,47,100
Cash paid	10,000		(Cr.) 2,37,100
Cheques honoured :			
Issued before November 1, 2013	68,100		(Cr.) 1,69,000
Issued before November 30, 2013	1,56,000		(Cr.) 13,000

Laxmichand notes that cheques of ₹ 2,500 deposited in the bank before 1.11.2013 were not yet realised by November 30, 2013. Likewise cheques of ₹ 5,500 issued before November 1, 2013 were not presented for payment by November 30, 2013.

Laxmichand asks you to —

(a) write the Cash Book with discount, cash and bank columns for November, 2013 on the basis of information available by November end (without narration);

(b) prepare Bank Reconciliation Statement as on :
(i) October 31, 2013 starting with the balance as per bank statement;
(ii) November 30, 2013 starting with the balance as per Cash Book.

Solution

In the books of Laxmichand

Cash Book (Triple Column)

Dr. **Cr.**

Date	Particulars	Discount Allowed ₹	Cash ₹	Bank ₹	Date	Particulars	Discount Received ₹	Cash ₹	Bank ₹
2013					2013				
Nov. 1	To Balance b/f		3,000		Nov. 1	By Balance b/f			53,450
	To Sales A/c		60,000			By Bank A/c (C)		60,000	
	To Cash A/c (C)			60,000		By Creditors A/c	2,000		1,32,000
	To Debtors A/c	3,000		1,50,000		By Creditors A/c (Advance)			25,000
	To Debtors A/c (Advance)			30,000		By Cash A/c (C)			10,000
	To Bank A/c (C)		10,000			By Drawings A/c		4,000	
						By Expenses A/c		4,000	5,000
						By Up-country Customer A/c		4,500	
						By Bank Charges A/c			150
						By Balance c/d		500	14,400
		3,000	73,000	2,40,000			2,000	73,000	2,40,000

Bank Reconciliation Statement as on 31.10.2013

	₹	₹
Bank Balance as per Bank Statement (Cr.)		12,500
Add: Cheques deposited but not yet credited (₹ 5,000 + 2,500)	7,500	
Bank charges not recorded in Cash Book	150	7,650
		20,150
Less: Cheques issued but not presented for payment (₹ 68,100 + 5,500)		73,600
Bank Overdraft as per Cash Book		53,450

Bank Reconciliation Statement as on 30.9.2013

	₹	₹
Bank Balance as per Cash Book (Cr.)		14,400
Add: Cheques issued but not presented for payment :		
for October	5,500	
for November (₹ 1,32,000 + 25,000 + 5,000 – 1,56,000)	6,000	11,500

		25,900
Less: Cheques deposited but not yet credited :		
for October	2,500	
for November (₹ 1,50,000 + 30,000 – 1,70,000)	10,000	
Bank charges not recorded in Cash Book	400	12,900
Bank Balance as per Bank Statement (Cr.)		13,000

Illustration 18

Robin had completed his draft final accounts for the year ended 31 March, 2015, which showed a profit of ₹ 81,208, when he realised that no Bank Reconciliation Statement had been prepared at that date.

When checking the Cash Book against the bank statement and carrying out other checks, he found the following :

(1) A cheque for ₹ 1,000 had been entered in the Cash Book but had not yet presented.

(2) Cheques from customers totalling ₹ 2,890 entered in the Cash Book on 31 March, 2015 were credited by the bank after 31 March, 2015.

(3) Bank charges of ₹ 320 appear in the bank statement on 30 March, 2015 but have not been recorded by Robin.

(4) A cheque for ₹ 12,900 drawn by Robin to pay for a new item of plant had been wrongly entered in the Cash Book and the Plant Account as ₹ 2,900. Deprecitaion of ₹ 290 had been charged to the Profit and Loss Account for this plant.

(5) A cheque for ₹ 980 from a credit customer paid in on 26 March was dishonoured after 31 March, 2015 and Robin decided that the debt would have to be written-off as the customer was now untraceable.

(6) A cheque for ₹ 2,400 in payment for some motor repairs had wrongly been entered in the Cash Book as a debit and posted to the credit of Motor Vehicles Account. Depreciation at 25% p.a. (straight line) is charged on motor vehicles with a full year's charge calculated on the balance at the end of each year.

(7) The total of the payments side of the Cash Book had been understated by ₹ 1,000. On further investigation it was found that the debit side of the Purchases Account had also been understated by ₹ 1,000.

(8) Robin had instructed his bank to credit the interest of ₹ 160 on the Deposit Account to the Current Account. This, the bank had done on 28 March. Robin had made an entry on the payments side of the Cash Book for this ₹ 160 and had posted it to the debit of Interest Paid Account.

(9) Robin had wrongly paid an account for ₹ 870 for repairs to his house with a cheque drawn on the business account. The entry in the Cash Book had been debited to Repairs to Premises Account.

(10) The Cash Book showed a debit balance of ₹ 4,890 before any correcting entries had been made.

You are required to :

(a) Prepare an Adjusted Cash Book showing the revised balance which should appear in Robin's Balance Sheet at 31 March, 2015.

(b) Prepare a Bank Reconciliation Statement as on 31 March, 2015.

(c) Draw up a Statement for Robin showing the effect on his profit for the adjustments necessary to correct the errors found.

Solution

In the books of Robin
Adjusted Cash Book

Dr. **Cr.**

Date	Particulars	Bank ₹	Date	Particulars	Bank ₹
2015			2015		
Mar. 31	To Balance b/d	4,890	Mar. 31	By Bank Charges A/c	320
	To Interest Paid A/c	160		By Plant A/c	10,000
	To Interest Received A/c	160		By Customers A/c	980
	To Balance c/d	11,890		By Repairs to Motors A/c	2,400
				By Motor Vehicles A/c	2,400
				By Error in Addition	1,000
		17,100			17,100

Robin
Bank Reconciliation Statement as on 31st March, 2015

	₹	₹
Bank Balance as per Cash Book — Overdraft		11,890
Add: Cheques deposited but not credited by bank	2,890	
Less: Customer's cheque already adjusted in Cash Book	980	1,910
		13,800
Less: Cheques issued but not presented for payment		1,000
Bank Balance as per Bank Statement (Overdraft)		12,800

Statement of Effect on Profit

Particulars	₹	₹
Profit as per Draft Accounts		81,208
Add: Interest adjustments (₹ 160 + 160)	320	
Repairs of own house charged to business account	870	1,190
		82,398
Less: Bank charges not recorded in the Cash Book	320	
Bad Debts	980	
Purchases understated	1,000	
Depreciation on Plant (Note 1)	1,000	
Additional depreciation on Motor Vehicles (Note 2)	600	
Motor repairs wrongly credited to Motor Vehicles Account	2,400	6,300
Revised Profit		76,098

Working Notes :

(1) A new plant of ₹ 12,900 had been recorded as ₹ 2,900 and depreciation of ₹ 290 had been charged. Therefore, the rate of depreciation = ₹ 290 / ₹ 2,900 × 100 = 10%. 10% depreciation on balance Plant for ₹ 10,000 (₹ 12,900 – ₹ 2,900) is to be charged to the Profit and Loss Account. Therefore, profit will be reduced by ₹ 1,000.

(2) Motor repairs of ₹ 2,400 has been wrongly credited to Motor Vehicles Account. Therefore, less depreciation @ 25% on ₹ 2,400 had been charged. To rectify this, ₹ 600 is to be deducted from profit.

Illustration 19

The following is the summary of a Cash Book as presented to you for the month of December, 2014.

Date	Particulars	L.F.	₹	Date	Particulars	L.F.	₹
	Receipts		1,469		Balance b/f		761
	Balance c/f		554		Payments		1,262
			2,023				2,023

All receipts are banked and payments are made by cheque. On investigation you discover :

1. Bank charges of ₹ 136 entered in the Bank Statement had not been entered in the Cash Book.
2. Cheques drawn amounting to ₹ 267 had not been presented to the bank for payment.
3. Cheques received totalling ₹ 762 had been entered in the Cash Book and paid into the bank, but had not been credited by the bank until January, 2015.
4. A cheque for ₹ 22 had been entered as a receipt in the Cash Book instead of as a payment.
5. A cheque for ₹ 25 had been debited by the bank erroneously.
6. A cheque received for ₹ 80 had been returned by the bank and marked 'No funds available', no adjustment had been made in the Cash Book.
7. All dividends receivable are credited directly to the bank account during December, amount totalling ₹ 62 was credited by the bank and no entries made in the Cash Book.
8. A cheque drawn for ₹ 6 had been incorrectly entered in the Cash Book as ₹ 66.
9. The balance brought forward should have been ₹ 711.
10. The Bank Statement as on 31st December, 2014 showed an overdraft of ₹ 1,162. You are required to:
    (1) Show the adjustment required in the Cash Book, and, (2) Prepare a Bank Reconciliation Statement as on 31.12.2014.

Solution

In the Books of ...

Dr. Cash Book (Bank Column) Cr.

Date	Particulars	L.F.	₹	Date	Particulars	L.F.	₹
2014	To Dividend A/c		62	2014	By Balance b/d		554
Dec. 31	To Error (66 — 6)		60	Dec. 31	By Bank Charges A/c		136
	To Error (761 — 711)		50		By Party A/c (₹ 22 x 2)		44
	To Balance c/d		642		By Party A/c		80
			814				814

Bank Reconciliation Statement as on 31.12.2014

Particulars	₹	₹
Bank Overdraft as per the Amended Cash Book (Dr.)		642
Add: 3. Cheque paid but not credited by the bank	762	
5. Cheque for ₹ 25 had been debited by the Bank erroneously	25	787
		1,429
Less: 2. Cheque drawn but not presented	267	267
Bank Overdraft as per the Pass Book		1,162

(ii) Where bank favourable/overdraft balance as per the Pass Book is given

In this situation, the following steps should be taken:

Step 1 Prepare a Bank Reconciliation Statement taking the balance as per Pass Book as the starting point.

Step 2 Find out the balance as per the Cash Book on the basis of the above statement.

Step 3 Draw up a Cash Book (Bank Column only). Write down the above balance in the debit/credit side of the Cash Book as per its nature (favourable/overdraft).

Step 4 Make the necessary entries in the Cash Book in respect of : (1) Amount recorded in the Pass Book but not recorded in the Cash Book; and (2) All errors that have crept in the Cash Book.

Step 5 Balance off the Cash Book and bring down the adjusted Cash Book balance.

Step 6 Prepare Bank Reconciliation Statement in the usual manner taking adjusted Cash Book balance and leaving those items which have already been considered in the adjusted Cash Book.

Illustration 20

When Transit Co. Ltd. received its Bank Statement showing a favourable balance of ₹ 7,392 for the period ended on 30 June 2015, this did not agree with the balance in the Cash Book.

An examination of the Cash Book and Bank Statement disclosed the following:

1. A deposit of ₹ 492 paid on 29th June, 2015 had not been credited by the bank until 1st July, 2015.
2. Bank charges amounting to ₹ 17 had not been entered in the Cash book.
3. A debit of ₹ 42 appeared on the Bank Statement for an unpaid cheque, which had been returned marked ‘Out of date’. The cheque had been re-dated by the customer and paid into the bank again on 3rd July, 2015.
4. A standing order for payment of annual subscription amounting to ₹ 10 had not been entered in the Cash Book.
5. On 25th June, the managing director had given the cashier a cheque for ₹ 100 to pay into his personal account at the bank. The cashier had paid it into the Company’s account by mistake.
6. On 27th June, two customers of Transit Co. Ltd., had paid direct to the company’s bank account ₹ 499 and ₹ 157 respectively in payment for goods supplied. The advices were not received by the company until 1st July and were entered in the Cash Book under that date.
7. On 30th March, 2015 the company had entered into a hire-purchase agreement to pay by banker’s order a sum of ₹ 26 on the 10th day of each month, commencing, April. No entries had been made in the Cash book.
8. ₹ 364 paid into the bank had been entered twice in the Cash Book.
9. Cheques issued amounting to ₹ 4,672 had not been presented to the bank for payment until after 30th June, 2015.
10. A customer of the company, who received a cash discount of $2\text{-}^1/_2\%$ on his account of ₹ 200 paid the company a cheque on 10th June. The cashier erroneously entered the gross amount in the bank column of the Cash Book.

You are required :

(a) To show the necessary adjustments in the Cash Book of Transit Co. Ltd., bringing down the correct balance on 30th June, 2015; and,

(b) To prepare a Bank Reconciliation Statement on that date.

Solution

Transit Company Limited

Bank Reconciliation Statement as on 30.06.2015

			₹	₹
		Bank balance as per the Pass Book		7,392
Add:	1.	Deposited but not credited by bank	492	
	2.	Bank charges had not been entered in the Cash Book	17	
	3.	Cheque returned marked ‘Out of date’ entered in the Cash Book	42	
	4.	Payment as per standing order not entered in the Cash Book	10	
	7.	Payment as per order not entered in the Cash Book (₹ 26 x 3)	78	
	8.	Deposit entered in the Cash Book twice	364	
	10.	Discount allowed wrongly entered in the bank column	5	1,008
				8,400
Less:	6.	Cash directly deposited by customer not entered in the cash book (₹ 499 + 157)	656	
	5.	Cheque of M.D. wrongly deposited into company’s account	100	
	9.	Cheques issued but not presented to Bank	4,672	5,428
		Bank Balance as per Cash Book		2,972

In the Books of Transit Company Limited

Dr. **Cash Book (Bank Column)** **Cr.**

Date	Particulars	L.F.	₹	Date	Particulars	L.F.	₹
2015	To Balance b/f		2,972	2015	By Bank Charges A/c		17
June 30	To Customer's A/c		656	June 30	By Subscription A/c		10
					By Hire Vendors A/c		78
					By Errors		364
					By Discount Allowed A/c		5
					By Balance c/d		3,154
			3,628				3,628

Bank Reconciliation Statement as on 30.06.2015

		₹	₹
	Bank balance as per the Amended Cash Book		3,154
Add:	5. Cheque of Managing Director wrongly deposited in Company's Account	100	
	9. Cheque issued but not presented	4,672	4,772
			7,926
Less:	1. Deposited but not credited by Bank	492	
	3. Cheque returned by bank as out of date not entered in the Cash Book	42	534
	Bank Balance as per Pass Book		7,392

2 (a) Where causes of difference are not given, but extract of the Cash Book and Pass Book are given

In the practical situation no readymade causes of discrepancies are available. Bank Reconciliation Statement is required to be prepared from the extract of the Cash Book and the Pass Book. In this situation the causes of discrepancies are to be searched out first and then the Bank Reconciliation Statement to be prepared.

(i) When both the Cash Book and the Pass Book of the same period are given, following steps are taken

Step 1 Compare the amount of the deposits listed on the Bank Statement (Pass Book) with the amount of the deposits listed on the Cash Book Bank Column (debit side) Place tick marks () in the Cash Book and on the Bank Statement beside the items that agree. Any unticked items in the Cash Book represent deposits not yet recorded by the bank. Now list down these items under the heading, 'Cheques/money deposited but not yet credited by the Bank'. Any unticked items in the Bank Statement represent deposits not yet recorded in the Cash Book. List down these items under the heading 'Amount credited by the bank not yet recorded in the Cash Book'.

Step 2 Compare the amount of the withdrawals listed on the Bank Statement (Pass Book) with the amount of the payments listed on the credit side of the Cash Book (Bank Column). Place tick marks ( ) in the Cash Book and on the Bank Statement beside the items that agree. Any unticked items in the Cash Book represent payments not yet recorded by the bank. Now list down these items under the heading 'Cheques issued/drawn but not presented for payment to the bank'. Any unticked items in the Bank Statement will be withdrawals not yet recorded in the Cash Book. Now list down these items under the heading 'amount debited by the bank not yet recorded in the Cash Book'.

Dr. **Cash Book (Bank Column)** **Cr.**

Date	Particulars	L.F.	₹	Date	Particulars	L.F.	₹
2015 Jan. 1	To Balance b/f		✓ 300	2015			
15	To G. Roy		✓ 30				
25	To A. Mukherjee		40				
30	To P. Sharma		20				

Bank Statement

Date	Particulars	Dr. (Withdrawn)	Cr. (Deposited)	Balance (₹)
2015 Jan. 1	Balance b/f			✓ 300 (Cr.)
15	By Cheque		✓ 30	
20	By ITC Dividend		25	
30	By Interest on deposit		5	

From the above it is clear that :

1. Cheque deposited but not credited by the Bank : A Mukherjee ₹ 40 + P Sharma ₹ 20 = ₹ Total ₹ 60

2. Amount credited by the Bank not recorded in the Cash Book : ITC Dividend ₹ 25 + Interest on deposit ₹ 5 = Total ₹ 30

Dr. **Cash Book (Bank Column)** **Cr.**

Date	Particulars	L.F.	₹	Date	Particulars	L.F.	₹
2015 Jan. 1	To Balance b/f		500	2015 Jan.1	By P. Halder (Ch.No. 825)		✓ 200
				10	By O.P. Khanna (Ch.No. 826)		✓ 50
				20	By K.D. Rowan (Ch.No.827)		100
				30	By R.P. Singh (Ch.No. 828)		50

Bank Statement

Date	Particulars	Dr. (Withdrawn)	Cr. (Deposited)	Balance (₹)
2015 Jan. 1	Balance b/f			500 (Cr.)
8	To Cheque (825)	✓ 200		
15	To Cheque (826)	✓ 50		
25	To Bank charges	10		
30	To Insurance Premium	100		

From the above it is clear that :

1. Cheque issued but not presented to the Bank for payment : K.D. Rowan ₹ 100 + R.P. Singh ₹ 50 = Total ₹ 150

2. Amount debited by Bank not recorded in the Cash Book : Bank charges ₹ 10 + Insurance Premium ₹ 100 = Total 110.

Step 3 And finally, list any other discrepancy item under the appropriate discrepancy heading. For example, show any errors discovered in the Cash Book and in the Bank Statement.

Step 4 Prepare Bank Reconciliation Statement in the usual manner after taking into consideration all the listed items and closing balances of the Cash Book or Pass Book/Bank Statement. The following illustration will make the matter more clear.

Illustration 21

The following were the bank column of the Cash Book of Prakash Agarwal.

Dr. **Cash Book (Bank Column)** **Cr.**

Date	Particulars	L.F.	₹	Date	Particulars	L.F.	₹
2014 Dec.1	To Balance b/f		450	2014 Dec.2	By P. K. Sharma		150
8	To R. Sen		210	6	By T. Khanna		60
10	To P. Dasgupta		600	8	By Abdul Amin		10
15	To B. K. Roy		780	12	By L. Narayan		120
22	To P. Patel		100	16	By K. Kundu		400
28	To H. Kabir		$\boxed{240}$	22	By C. Banerjee		$\boxed{300}$
31	To T.K. Basu		$\boxed{300}$	24	By T. Sen		40
				28	By Wages		250
				30	By B. K. Agarwal		$\boxed{150}$
				31	By L.N. Mishra		$\boxed{80}$
				31	By Balance c/d		1,120
			2,680				2,680

Bank Statement

Date	Particulars	Dr. (Withdrawn)	Cr. (Deposited)	Balance (₹)
2014 Dec 1	Balance b/f			450 Cr.
6	Cheque	150		300 Cr.
10	Cheque	60		240 Cr.
12	Deposit		210	450 Cr.
13	Cheque	10		440 Cr.
14	Deposit		600	1,040 Cr.
15	Bank charges	$\boxed{5}$		1,035 Cr.
15	Cheque	120		915 Cr.
19	Deposit		780	1,695 Cr.
20	Cheque	400		1,295 Cr.
25	Deposit		100	1,395 Cr.
28	Cheque	40		1,355 Cr.
29	Cash	250		1,105 Cr.
31	Standing order — Club subscription	$\boxed{100}$		1,005 Cr.

You are required to prepare a Bank Reconciliation Statement

Solution **List of causes of difference**

1. Cheque deposited but not credited by Bank : H. Kabir ₹ 240 + T. K. Basu ₹ 300 = ₹ 540
2. Cheque issued but not presented : C. Banerjee ₹ 300 + B. K. Agarwal ₹ 150 + L. N. Mishra ₹ 80 = ₹ 530
3. Amount debited by Bank not entered in the Cash Book : Bank charges ₹ 5 + Subscription ₹ 100 = ₹ 105

Bank Reconciliation Statement as on 31.12.2014

			₹	₹
		Bank balance as per the Cash Book		1,120
Add:	2.	Cheque issued but not presented to the Bank	530	530
				1,650
Less:	1.	Cheque deposited but not credited by the Bank	540	
	3.	Bank charges debited by the Bank, not recorded in the Cash Book	5	
	3.	Subscription paid by bank, as per standing order, not recorded in the Cash Book	100	645
		Bank balance as per the Pass Book (Cr.)		1,005

Illustration 22

You are given below the Cash Book (bank column) and the Bank Statement which reveals that the bank balance as per Cash Book of Mr T Sinha for the month of January, 2014 did not agree with the bank balance as per Bank Statement. You are asked to mention the reasons of disagreement and prepare a Bank Reconciliation Statement as on 31.12.2014 :

Dr. Cash Book (Bank column) Cr.

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Jan. 1	To Balance b/f	5,780	Jan. 2	By J K Traders	3,500
3	To A K Roy	2,500	4	By Rent (paid to H Kar)	750
11	To S Bros.	5,250	7	By B Ghosh	1,200
16	To Cash	2,000	15	By French Motor Car Co.	2,450
20	To N Singh	1,420	26	By Insurance Premium (LIC)	600
			31	By Balance c/f	8,450
		16,950			16,950

Bank Statement

Date	Particulars	Dr. (Withdrawals) ₹	Cr. (Deposits) ₹	Balance ₹
2014				
Jan. 1	Balance b/f			(Cr.) 5,780
4	A K Roy		2,500	8,280
4	H Kar (Rent)	750		7,530
6	J K Traders	3,500		4,030
8	Bank Charges	150		3,880
15	S Bros		5,250	9,130
16	Cash		2,000	11,130
16	French Motor Car Co	2,450		8,680
25	Interest		120	8,800
31	Dividend		600	(Cr.) 9,400

Solution

The reasons for disagreement :

(1) Cheque received from N Singh and deposited into bank, not yet credited ₹ 1,420.
(2) Cheque issued to B Ghosh not yet presented for payment ₹ 1,200.
(3) Cheque issued to LIC but not yet presented for payment ₹ 600.
(4) Bank charges not yet recorded in the Cash Book ₹ 150.
(5) Bank interest not yet recorded in the Cash Book ₹ 120.
(6) Dividend collected by the bank directly not yet recorded in the Cash Book ₹ 600.

T Sinha
Bank Reconciliation Statement as on 31.12.2014

		₹	₹
Bank Balance as per Cash Book			8,450
Add:	(2) Cheque issued to B Ghosh but not yet presented for payment	1,200	
	(3) Cheque issued to LIC but not yet presented for payment	600	
	(5) Interest credited by the bank but not yet recorded in the Cash Book	120	
	(6) Dividend collected by the bank not yet recorded in the Cash Book	600	2,520
			10,970
Less:	(1) Cheque from N Singh deposited into bank not yet credited	1,420	
	(4) Bank charges not yet recorded in the Cash Book	150	1,570
Bank Balance as per Bank Statement			9,400

(ii) When both the Cash Book and the Pass Book of the same period and also the Bank Reconciliation Statement of the previous period are given

In this situation, the following steps should be followed for preparing the Bank Reconciliation Statement.

Step 1 Compare the amount of the deposits listed on the Bank Statement with the amount of deposits listed on the debit side of the Cash Book (Bank Column). Place tick marks ( ) in the Cash Book and recorded in the Bank Statement beside the items that agree. Also compare the previous months' Reconciliation Statement with the deposit column of the Bank Statement to make sure that any deposit then in transit has been recorded on the current month's statement. Place tick marks ( ) (in the previous months' Reconciliation Statement) on the items 'Cheque deposited but not credited by bank'. Any unticked items in the Cash Book and in the previous month's Statement represent deposits not yet recorded by the bank.

Now, list down these items under the heading 'Cheques/money deposited but not yet credited by the bank'.

Any unticked items in the Bank Statement represent deposits not yet recorded in the Cash Book.

Now, list down these items under the heading 'Amount credited by the bank not yet recorded in the Cash Book'.

Step 2 Compare the amount of withdrawals listed on the Bank Statement with the amount of the payment listed on the credit side of the Cash Book (Bank Column). Place tick marks ( ) in the Cash Book and in the Bank Statement beside, the items that agree. Also compare the previous month's Reconciliation Statement with the withdrawals listed on the Bank Statement to ascertain whether there still are outstanding cheques from the last reconciliation or not. Place tick marks ( ) (in the previous month's Reconciliation Statement) on the items 'Cheque issued but not presented to the bank for payment' and on the Bank Statement beside the items that agree.

Any unticked item in the Cash Book and in the previous month's Reconciliation Statement represents payment not yet recorded by the bank. Now list down these items under the heading 'Cheques issued/drawn but not presented for payment to the bank'.

Any unticked item in the Bank Statement will be withdrawals not yet recorded in the Cash Book. Now list down these items under the heading 'Amount debited by the Bank not yet recorded in the Cash Book'.

Step 3 And finally, list any other discrepancy item under the appropriate discrepancy heading.

Step 4 Prepare Bank Reconciliation Statement in the usual manner after taking into consideration all the listed items and the closing balance of the Cash Book or Bank Statement/Pass Book.

The following illustration will make the matter more clear.

Illustration 23

P. Sengupta reconciled his Cash Book with the Bank Statement every month. His Bank Reconciliation Statement for the month of November was as follows:

Bank Balance as per Bank statement 30.11.2014		(O/D) ₹ 4,500
Add: Cheque issued but not presented to the Bank for payment :		
Jimi Bros	54	
S. Sarkar	$\boxed{110}$	
P. Usha	26	190
		4,690

The following is the extract of the Bank Column in the Cash Book for the month of December, 2014, and a copy of the Bank Statement for the same period.

Dr. Cash Book (Bank Column) Cr.

Date		Particulars	L.F.	₹	Date		Particulars	L.F.	₹
2014					2014				
Dec.	1	To Mondal & Sons		4,180	Dec.	1	By Balance b/d		4,690
	4	To L & T Limited		750		5	By GKW Ltd		46
	5	To CMC Computers		3,420		8	By Hari & Sons		$\boxed{92}$
	19	To Sree Printers		221		16	By P K Finance		110
	23	To MMC Ltd		540		23	By H B & Co.		$\boxed{249}$
	29	To K & Co.		$\boxed{399}$		29	By Quality Printers		$\boxed{75}$
						31	By Balance c/d		4,248
				9,510					9,510

Bank Statement

Date		Particulars	Dr. (Withdrawn)	Cr. (Deposited)	Balance (₹)
2014					
Dec.	1	Balance b/f			4,500 (Dr.)
		Jimi Bros	54		4,554 (Dr.)
	2	Mondal & Sons		4,180	374 (Dr.)
	4	L & T Ltd		750	376 (Cr.)
		S. Sarkar	110		266 (Cr.)
	5	General Insurance	$\boxed{65}$		201 (Cr.)
		CMC Computer		3,420	3,621 (Cr.)
	8	GKW	46		3,575 (Cr.)
	19	P.K. Finance	110		3,465 (Cr.)
		Bank charges	$\boxed{66}$		3,399 (Cr.)
	22	Sree Printers		221	3,620 (Cr.)
	23	C Ltd. —Credit transfer		$\boxed{365}$	3,985 (Cr.)
	29	MMC Ltd.		540	4,525 (Cr.)
		Bank Commission	$\boxed{45}$		4,480 (Cr.)
		Mondal & Sons — refer to drawer	$\boxed{4{,}180}$		300 (Cr.)

Solution

List of Causes of Difference

1. Cheque deposited but not credited by the Bank ₹ 399 (K & Co.)
2. Amount credited by Bank not recorded in the Cash Book ₹ 365 (C Ltd.)
3. Cheque issued but not presented : P. Usha ₹ 26 + Hari & Sons ₹ 92 + HB & Co. ₹ 249 + Quality Printers ₹ 75 = ₹ 442
4. Amount debited by the bank not recorded in the Cash Book : General Insurance ₹ 65 + Bank charges ₹ 66 + Bank Commission ₹ 45 + Dishonour of cheque ₹ 4,180 = ₹ 4,356.

Dr. Cash Book (Bank Column) Cr.

Date	Particulars	L.F.	₹	Date	Particulars	L.F.	₹
2014				2014			
Dec.31	To Balance b/d		4,248	Dec. 31	By Insurance premium		65
	To C Ltd.		365		By Bank charges		66
					By Bank Commission		45
					By Mondal & Sons		4,180
					By Balance c/d		257
			4,613				4,613

Bank Reconciliation Statement as on 31.12.2014

		₹	₹
	Bank Balance as per the Amended Cash Book		257
Add:	Cheque issued but not presented for payment	442	442
			699
Less:	Cheque deposited but not credited by the Bank	399	399
	Bank balance as per the Pass Book (Cr.)		300

Four Column Bank Reconciliation Statement

The purpose of preparing a regular bank reconciliation statement is to reconcile the balance as per pass book and the adjusted bank balance as per cash book. In a four-column bank reconciliation statement, the following reconciliations are made :

1. The pass book balance and the cash book balance at the beginning of a period.
2. The pass book balance and the cash book balance at the end of the same period.
3. The receipts as per pass book and as per cash book for the same period.
4. The payments as per pass book and as per cash book for the same period.

The preparation of a four-column bank reconciliation statement can be illustrated with the following example :

Balances as per pass book :	₹	Cheques deposited but not credited :	₹
June 30, 2015	40,000	June 30, 2015	20,000
July 31, 2015	60,000	July 31, 2015	40,000
July receipts as per pass book	1,00,000	Cheques issued but not presented :	
July payments as per pass book	80,000	June 30, 2015	40,000
Bank service charges for June	40	July 31, 2015	80,000
Bank service charges for July	60	July receipts as per cash book	1,20,000
Balances as per cash book		July payments as per cash book	1,19,980
June 30, 2015	20,040		
July 31, 2015	20,060		

In preparing a four-column bank reconciliation statement, following are the steps to be followed :

Step 1 To complete the bank reconciliations at the beginning and at the end of the period. The first column indicates the reconciliation at the beginning of the period (30.6.2015) and the fourth column indicates the reconciliation at the end of the period (31.7.2015).

Step 2 Complete the balances as per pass book and the balances as per cash book rows, for instance, ₹ 1,00,000 and ₹ 80,000; ₹ 1,20,000 and ₹ 1,19,980.

Step 3 Enter the reconciling items in the appropriate receipts or payments column. To illustrate this step, consider each of the reconciling items in the example :

(a) Cheques deposited but not credited at the end of June will be cleared during July and it is included in the receipts of July (as per pass book). This amount (₹ 20,000) should be deducted from the July bank receipts to arrive at the correct receipts for July.

(b) Cheques deposited but not credited at the end of July will be cleared in August. It is not included in bank receipts in July. Therefore, it (₹ 40,000) must be added to the July bank receipts to arrive at the correct receipts of July.

(c) Cheques issued but not presented at the end of June will be cleared during July. It is included in the July payments (as per pass book). This amount (₹ 40,000) must be deducted to arrive at the correct payments of July.

(d) Cheques issued but not presented at the end of July will be cleared during August. It represents payments of July. Therefore, they must be added to the bank payments to arrive at the correct payments for July.

(e) The bank service charge (₹ 40) for the month of June represents a June payment which is not recorded in the cash book until June bank statement is received sometime in July. Therefore, this bank charge must be deducted from July cash book payments to arrive at the correct payments for July.

(f) The bank serve charge ₹ 60 for the month of July is an actual payment for July, but it is not recorded in the cash book until August, when July bank statement is received. Therefore, this amount must be added to arrive at the correct payment for July.

Four-Column Bank Reconciliation Statement (all figures in ₹)

Particulars	Reconciliation (30.6.2015)	July Receipts	July Payments	Reconciliation (31.7.2015)
Balances as per pass book	40,000	1,00,000	80,000	60,000
Cheques deposited but not credited				
June 30, 2015	20,000	(a) (20,000)		
June 31, 2015		(b) 40,000		40,000
Cheques issued but not presented				
June 30, 2015	(40,000)		(c) (40,000)	
July 31, 2015			(d) 80,000	(80,000)
Adjusted balances as per pass book	20,000	1,20,000	1,20,000	20,000
Balances as per cash book	20,040	1,20,000	1,19,980	20,060
Bank service charges				
June, 2015	(40)		(e) (40)	
July, 2015			(f) 60	(60)
Adjusted balances as per cash book	20,000	1,20,000	1,20,000	20,000

Illustration 24

X Company provides the following information :

	₹		₹
Balances as per pass book :		Bank service charges :	
June 30, 2015	10,203	June 2015	10
July 31, 2015	12,000	July 2015	20
July receipts as per pass book	15,000	Balances as per cash book :	
July payments as per pass book	13,203	June 30, 2015	11,713
Cheques issued but not presented :		July 31, 2015	11,020
June 30, 2015	5,000	July receipts as per cash book	11,500
July 31, 2015	4,000	Wrong debit in June, corrected by the bank in July	500
Cheues deposited but not cleared :			
June 30, 2015	6,000		
July 31, 2015	3,000		

You are required to prepare a four-column Bank Reconciliation Statement for the month of July, 2015.

Solution Four-Column Bank Reconciliation Statement for the month of July, 2015 (all in rupees)

Particulars	Reconciliation (30.6.2015)	July Receipts	July Payments	Reconciliation (31.7.2015)
Balances as per pass book	10,203	15,000	13,203	12,000
Cheques deposited but not presented				
June 30, 2015	6,000	(6,000)		
June 31, 2015		3,000		3,000
Less : Cheques issued but not presented				
June 30, 2015	(5,000)		(5,000)	
July 31, 2015			4,000	(4,000)
Wrong debit in June, corrected in July	500	(500)		
Adjusted balances as per pass book	11,703	11,500	12,203	11,000
Balances as per cash book	11,713	11,500	*12,193	11,020
Bank service charges				
June, 2015	(10)		(10))	
July, 2015			20	(20)
	11,703	11,500	12,203	11,000

* Opening cash book balance + receipts as per cash book – Closing stock book balance = payments as per cash book.
₹ (11,713 + 11,500 – 11,020) = ₹ 12,193.

Key Points

- Bank Reconciliation Statement is a statement which contains a complete and satisfactory explanation of the differences in balances as per the Cash Book and Bank Statement.
- A standing order is an instruction to a bank by a customer to make a fixed payment regularly on stated days to some third party (ies).
- Direct debit is an instruction given to a bank by its customer to allow charges to be made periodically to the account at the instance of some third party.

THEORETICAL QUESTIONS

1. What do you mean by Bank Reconciliation Statement? Why is it prepared?
2. What do you mean by Bank Reconciliation? When is Reconciliation necessary?
3. What are the different causes for discrepancy between the balance as per the Cash Book and the Pass Book?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below.

1. All Bank Reconciliation Statement is prepared :
   A at the end of each week
   B at the end of each month
   C at the end of the accounting year
   D whenever a bank statement is received

2. Which one of the following is not a reason for the disagreement between Cash Book balance and Bank Statement balance ?
   A unpresented cheques
   B direct receipts by the bank
   C error(s) in the cash book
   D bank overdraft
3. When the receiver can change both the date and the amount of payment, it is known as
   A uncredited cheques
   B direct debit
   C standing order
   D credit transfer
4. Which of the following will find a place in the bank reconciliation statement ?
   A unpresented cheques
   B direct debit
   C direct receipts by the bank
   D credit transfer
5. Which of the following is not a reason for discrepancy in the balances of both the cash book and the bank statement?
   A unpresented cheques
   B post-dated cheques
   C deposit not credited
   D credit transfer
6. A current account holder had only ₹ 1,200 in his account and a cheque for ₹ 2,000 issued by him was paid out by the bank. Pick the most appropriate term to describe the above situation.
   A bank deficit
   B bank deposit
   C bank overdraft
   D bank loan
7. Which of the following a credit balance in the cash book indicates ?
   A the account is closed
   B cash in hand
   C cash at bank
   D bank overdraft
8. In checking a bank statement against the bank account details in the cash book, that a direct debit for rent has not been entered in the cash book. Do you ?
   A debit the bank account and credit the rent account
   B debit the rent account and credit the bank account
   C debit the rent account and credit the bank statement
   D not enter the direct debit as it reflects only the bank statement
9. Why is a bank reconciliation statement prepared ?
   A to calculate the bank balance for the balance sheet
   B to check the amount owing from debtors
   C to show how much has been paid to creditors
   D to show the amount of petty cash in hand
10. Which of the following phrases represents credit transfer ?
   A these are fees for bank services
   B it is a system of periodical payments
   C a business may receive into its bank account revenue from a variety of sources without direct knowledge of these.
   D it is another name for standing order.
11. Which of the following does not represent bank reconciliation ?
   A it is based upon the information contained in the bank statement
   B it should be prepared by a person who neither handles nor records cash
   C it is an important part of the internal control system over cash balance lying at the bank
   D the bank column of the cash book finds a place in the trial balance.

12. Which one of the following is a genuine bank reconciliation statement item, as opposed to an error or omission which requires an entry in the cash book ?
    A a credit transfer
    B overdraft interest
    C a standing order
    D an unpresented cheque
13. Which one of the following item requires an entry in the cash book at the time of preparing bank reconciliation statement under amended cash book method ?
    A cheques issued but not presented
    B cheque deposited but not credited
    C bank charges
    D cheque received and recorded in the cash book but not yet deposited into the bank.
14. A bank reconciliation statement starts at the debit balance shown in the cash book.
    How are uncredited deposits and unpresented cheques shown in the bank reconciliation statement ?

	Uncredited deposits	*Unpresented cheques*
A	added	added
B	added	deducted
C	deducted	added
D	deducted	deducted

15. Which of the following correctly describe(s) why a bank reconciliation is prepared ?
    (i) to identify entries which have been generated by the bank, but not recorded in the cash book
    (ii) to identify errors in the entries in the cash book
    A (i) only
    B (ii) only
    C both (i) and (ii)
    D neither (i) nor (ii)
16. Kabita pays her mortgage by instructing the bank to make monthly payments of a fixed amount from her current account. When the mortgage rate changes she issues revised instructions to the bank. Which method of payment is Kabita using ?
    A standing order
    B payable order
    C direct debit
    D crossed cheque
17. Mr. Albert is the Managing Director of Dey's Medical Ltd. He signs his name on a company cheque for ₹ 25,000 in accordance with the bank mandate. The company name appears on the cheque.
    If the bank dishonours the cheque as the company has insufficient funds in the account, who is liable for ₹ 25,000?
    A Mr. Albert
    B the bank
    C Dey's Medical Ltd.
    D no one

PRACTICAL QUESTIONS

1. The Cash Book of P.H. Ltd. shows a favourable bank balance of ₹ 3,856 on 30 June 2015. After comparing the entries in the Cash Book with the entries on the related Bank Statement you find that :
   (i) Cheques amounting to ₹ 218 entered in the Cash Book, have not yet been presented for payment to the bank.
   (ii) An amount of ₹ 50 entered on the debit side of the Cash Book has not been banked.
   (iii) An amount of ₹ 95 has been credited by the bank to the account in error.
   (iv) The Bank has credited and then debited the Bank Statement with an amount of ₹ 48 being Z's cheque which it forwarded on 1st July, 2015 marked 'insufficient funds — return to drawer'.
   (v) Interest of ₹ 10 has been charged by the bank, but not yet entered in the Cash Book.
   (vi) A Cheque from a customer entered in the Cash Book as ₹ 88 has been correctly entered in the bank as ₹ 188.
   You are required to prepare a Bank Reconciliation Statement.
2. From the following particulars, ascertain the bank balance as per the Pass Book of Mr. Kesari as at 31.3.2015.
   (i) Credit balance as per the Cash Book as at 31st March 2015 ₹ 38,721.
   (ii) Interest charged by the Bank ₹ 879 recorded in the Pass Book only.

(iii) Out of cheques worth ₹ 2,400 deposited for collection up to March 31st, value of cheques collected ₹ 1,879 only.
(iv) Dividends on shares collected by the bankers with no intimation to Mr. Kesari ₹ 850.
(v) Out of cheques issued during the last week of March, cheques not presented for payment were ₹ 1,850.
(vi) The bank had credited ₹ 200 on March 30, 2015, which sum should have been credited to Mrs. Kesari's Account.
(vii) Incidental charges debited by the Bank with no advice ₹ 20.

3. On 31st March 2015 a Bank Statement was received by your client. The balance at the bank, as shown by the Pass Book, on behalf of your client as on that date was ₹ 10,500. This balance did not agree with the Cash Book balance. On enquiry the following points were discovered.
(i) On 28th March 2015 three cheques of ₹ 500, ₹ 600 and ₹ 1,200 were deposited by your client but these cheques were not credited by the bank during the period.
(ii) On 27th March, 2015, the client issued two cheques of ₹ 750 and ₹ 350 to his creditors but these were not presented by them to the bank for payment.
(iii) An interest amounting to ₹ 150 was credited in the Pass Book, but was not entered into the Cash Book.
You have been requested to ascertain the correct balance as per the Cash Book.

4. From the following information prepare a Bank Reconciliation Statement as at 31.12.2014:
(i) Balance as per the Pass Book (Dr.) ₹ 7,550.
(ii) Cheques drawn, but not cashed at the Bank ₹ 3,500.
(iii) Cheques deposited into bank but not shown in Pass Book ₹ 4,570.
(iv) Dividend of ₹ 2,000 collected by the bank directly on 30.12.2014 was not recorded in the Cash Book.
(v) Cheque amounting to ₹ 730 was deposited into the bank, but it was recorded in the debit side of the Pass Book.
(vi) Debit side of the Cash Book was wrongly overcast by ₹ 500.
(vii) Bank charges recorded twice in the Cash Book ₹ 25.

5. Prepare a Bank Reconciliation Statement as on 31.12.2014 from the following information and show the bank balance, as on that date, as per the Cash Book :
(i) Bank overdraft, as on 31.12.2014 as per the Pass Book ₹ 7,891.50.
(ii) Cheques issued before, but presented for payment after 1st January, 2015 ₹ 532.25.
(iii) Cheques deposited with the bank on or before 30th December, but collected after 1st January, 2015 ₹ 631.75.
(iv) ₹ 786 was repaid by debtors on 30.12.2014 by depositing the money directly into the bank. The information was received from the bank on 2.1.2015.
(v) There was a wrong entry in the Bank Column on the debit side of the Cash Book amounting to ₹ 300.00
(vi) Dividend received ₹ 125.00 though credited in the Pass Book prior to 30.12.2014 was recorded in the Cash Book on 3.1.2015.

6. From the following particulars, calculate the Cash Book balance of a merchant as on 31st December, 2014 by means of Bank Reconciliation Statement:
(i) Balance as per the Pass Book (Dr.) ₹ 4,475.70.
(ii) A cheque for ₹ 399.50 was deposited on 24th December but the same was returned by the bank on 29th, for which no entry was made in the Cash Book.
(iii) A bill for ₹ 1,020 received from a debtor previously discounted for ₹ 1,000 was dishonoured and the bank debited the account of the merchant, but the same was not recorded in the Cash Book.
(iv) Two cheques issued on 27th December, but not encashed before 5th January, next : ₹ 650.40 and ₹ 498.30.
(v) A cheque for ₹ 300 was debited twice in the Cash Book.
(vi) Interest on overdraft for ₹ 56 and the bank charges for ₹ 17 were not passed through the Cash Book.
(vii) Dividend of ₹ 200 collected by the bank on behalf of the merchant was not recorded in the Cash Book

7. From the following information, prepare a Bank Reconciliation Statement as at 31st December, 2014 for Messrs New Steel Ltd:

		₹
(i)	Bank overdraft as per the Cash Book	2,45,900
(ii)	Interest debited by the bank on 26th December, 2014 but no advice received	27,870
(iii)	Cheque issued before 31st December, 2014 but not yet presented to bank	66,000
(iv)	Transport subsidiary received from State Government directly by the bank but not adviced to the company	42,500
(v)	Draft deposited in the bank, but not credited till 31.12.2014	13,500
(vi)	Bills for collection credited by the bank till 31st December, 2014 but no advice received by the company	83,600
(vii)	Amount wrongly debited to Company Account by the bank for which no details are available	7,400

8. Perfect Private Limited has two accounts with Ever Bank Ltd. The accounts were known as Account I and Account II. As at 31st December, 2014, the balance as per account book reflected the following :
   Account I : ₹ 1,25,000 (Regular balance; Account II : ₹ 1,11,250 (overdraft balance).
   The accountant failed to tally the balance with the Pass Book and the following information was available
   (i) The bank has charged interest on Account II ₹ 11,375 and credited interest on Account I ₹ 1,250. These were not recorded by the accountant.
   (ii) ₹ 12,500 drawn on December 10, 2014 from Account I was recorded in the books of Account II.
   (iii) Bank charges of ₹ 150 and ₹ 1,125 for Account I and Account II were not recorded in the books.
   (iv) A deposit of ₹ 17,500 in Account I was wrongly entered in Account II in the Books.
   (v) Two cheques of ₹ 12,500 and ₹ 13,750 deposited in Account I, but entered in Account II in the books, were dishonoured. The entries for dishonoured cheques were entered correctly in Account II.
   (vi) Cheques issued for ₹ 1,50,000 and ₹ 15,000 from Account I and II respectively, were not presented until January 5, 2015.
   (vii) Cheques deposited ₹ 1,25,000 and ₹ 1,17,500 in Accounts I and II respectively, were credited by the bank only on February 2, 2015.
   You are required to prepare the Bank Reconciliation Statement, for Account II.

9. From the following particulars, find out the adjusted bank balance as per the Cash Book and prepare thereafter, the Bank Reconciliation Statement as on 31-12-2014 for a sole-proprietor:

		₹
(i)	Bank overdraft as per the Cash Book	80,000
(ii)	Cheque deposited as per bank the statement but not entered in the Cash Book	3,000
(iii)	Cheques recorded for collection but not sent to the bank	10,000
(iv)	Credit side of the Bank Column cast short	1,000
(v)	Premium on proprietor's LIP paid on standing advice	5,000
(vi)	Bank charges recorded twice in the Cash Book	100
(vii)	Customer's cheque returned as per Bank Statement only	4,000
(viii)	Cheques issued but dishonoured on technical grounds	3,000
(ix)	Bills collected by the Bank directly	20,000
(x)	Cheque for ₹ 50,000 deposited but collection as per Bank Statement	49,980
(xi)	Cheque received entered twice in the Cash Book	5,000

10. On checking Surendra's Cash Book with the Bank Statement for the month of March 2015, you find the following:
   (i) Cash Book showed an overdraft of ₹ 4,500
   (ii) The payment side of the Cash Book has been undercast by ₹ 150.
   (iii) A cheque for ₹ 750 drawn on his savings deposits above has been shown as drawn on current account in Cash Book.
   (iv) Under instructions from Surendra, the bank has transferred interest ₹ 900 from his deposit account to his current account on April 3, 2015. This amount had, however, been taken in the Cash Book before March 31, 2015.
   (v) Cheques amounting to ₹ 7,500 drawn and entered in the Cash Book had not been presented.
   (vi) Cheques amounting to ₹ 6,000 sent to the bank for collection, though entered in the Cash Book, had not been credited by the bank.
   (vii) Bank charges of ₹ 75 as per the Bank Statement of Account had not been taken in the Cash Book.
   (viii) Dividends of the amount of ₹ 3,000 had been paid direct to the bank but not entered in the Cash Book.
   (ix) A cheque issued to Rafiq for ₹ 200 was replaced when out of date. But it was entered in the Cash Book again, no other entry having been recorded.
   (x) Both cheques were issued but not presented as shown above.
   You are required to arrive at the balance as it would appear in the Bank Statement as on March 31, 2015.

11. Prepare a Bank Reconciliation Statement as on December 31, 2014 of Mr. Pandit from the following particulars after finding out the adjusted bank balance as per the Cash Book:

		₹
(i)	Bank overdraft as per the Cash Book	3,500
(ii)	Cheques issued but not encashed during the year	2,200
(iii)	Cheques deposited but not credited by the bank during the year	660
(iv)	Cheques deposited as per Bank Statement not entered in the Cash Book	950
(v)	Bank charges not recorded in the Cash Book	150
(vi)	Interest charged by the bank recorded twice in the Cash book	450
(vii)	Club dues of Mr. Pandit paid by the bank as per standing instructions not recorded in the Cash Book	100
(viii)	Cheque issued by Mr. Pandit dishonoured.	1,200

12. On 30th September, 2014, the Bank Account of P according to Bank Column of the Cash Book was overdrawn to the extent of ₹ 4,500. On the same date the Bank Statement showed a balance of ₹ 880 in favour of P. An examination of the Cash Book and Bank Statement reveals the following :
    (i) A cheque of ₹ 1,200 deposited on 29th September, 2014, was credited by the Bank only on 3rd October, 2014.
    (ii) A payment by cheque for ₹ 150 has been entered twice in the Cash Book.
    (iii) On 29th September, 2014, the bank credited an account of ₹ 1,700 received from a customer of P, but the advice was not received by P until 1st October 2014.
    (iv) Bank charges of ₹ 70 has not been entered in the Cash Book.
    (v) On 9th September, 2014, the bank credited ₹ 2,500 to P in error.
    (vi) A bill of exchange of ₹ 1,200 was discounted by P with his bank. This bill was dishonoured on 28th September 2014, but no entry had been made in the books of P.
    (vii) Cheque issued upto 30th September 2014, ₹ 6,000 but not presented for payment upto that date totalled ₹ 3,500.

    You are required : (a) To show appropriate rectifications required in the Cash Book of P, to arrive at the correct Balance on 30th September 2014; and (b) To prepare a Bank Reconciliation Statement as on that date.
13. On 30th November 2014, the Cash Book of Imran Khan showed a debit balance on the current account with the Scottish Bank Ltd. of ₹ 5,620.

    The Bank Statement at that date showed a balance due to the bank of ₹ 5,536. The following additional information has been obtained:
    (a) The credit side of the Cash Book for June 2014 does not cross add, the error being the over-statement of the bank drawn column by ₹ 237.
    (b) A deposit receipt for ₹ 4,000 was uplifted on 1st October, 2014 with interest thereon for ₹ 440. ₹ 3,000 was relodged on deposit receipt and the balance lodged in the current account. No entries have been made in the books in respect of these transactions.
    (c) The Cash Book includes an entry for a cheque for ₹ 534 received from a customer in October, 2014. The cheque was, however, postdated and was still held by the cashier on 30th November, 2014.
    (d) No entries have been made in the Cash Book in respect of bond interest payments made by standing order amounting to ₹ 125 per month.

        The payments are due on the first of each month commencing on 1st April, 2014 and all payments have been made on the due dates.
    (e) A bill of exchange was received from a customer of ₹ 7,119, which was the balance due by the customer as shown by his sales ledger account. The bill was discounted with the bank, the sum of ₹ 6,300 being received and lodged in the current account. The cashier has entered the bill at its full value in the Cash Book.
    (f) No entries have been made in the books in respect of bank overdraft interest and bank charges of ₹ 701 and ₹ 67 respectively debited by the bank during the year, while amounts of ₹ 267 and ₹ 53 respectively were accrued but unapplied as at 30th November, 2014.
    (g) Amounts totalling ₹ 4,887 received from customers by credit transfer during the year have not been recorded in the Cash Book.
    (h) The following bank lodgements have been entered in the Cash Book as having been made prior to 1st December, 2014:

Pay-in-slip dated	*Credited on bank statement*	*Amount of lodgement*
29th November, 2014	30th November, 2014	16,621
30th November, 2014	1st December, 2014	13,157
1st December, 2014	2nd December, 2014	12,418

    (i) Cheque payments amounting to ₹ 10,976, including cheques for ₹ 631 that were outstanding at 30th November, 2014, had not been debited on the bank statement by 30th November 2014.

    Prepare the bank reconciliation at 30th November, 2014.
14. On 30th November, 2014, the Cash Book of Mrs. P. Ali showed an overdrawn position of ₹ 3,630 although her Bank Statement showed only ₹ 2,118 overdrawn.

    Detailed examination of the two records revealed the following:
    (i) The debit side of the Cash Book had been undercast by ₹ 300.
    (ii) A cheque for ₹ 1,560 in favour of X Suppliers Ltd. had been omitted by the bank from its Statement, the cheque having been debited to another customer's account.
    (iii) A cheque for ₹ 182 drawn for payment of telephone bill had been entered in the Cash Book as ₹ 128 but was shown correctly in the Bank Statement.

(iv) A cheque for ₹ 210 from A. Banerjee having been paid into bank was dishonoured and shown as such on the Bank Statement, although no entry relating to the dishonoured cheque had been made in the Cash Book.
(v) The bank had debited a cheque for ₹ 126 to Mrs. Ali's account in error; it should have been debited by them to Mr. Kali's account.
(vi) A dividend of ₹ 90 had been collected by the bank but not recorded in the Cash Book.
(vii) Cheques totalling ₹ 1,260 drawn on November had not been presented for payment.
(viii) Cheque of ₹ 1,080 deposited on 30th November had not been credited by the bank.
(ix) Interest amounting to ₹ 228 had been debited by the bank but not entered in the Cash Book.

You are required to prepare a bank reconciliation statement on 30th November, 2014.

15. On 30th June 2015 the Bank Column of the Cash Book of M showed a credit balance of ₹ 11,810. On examination of the Cash Book and Bank Statement, you find that:
(i) Cheques issued amounting to ₹ 17,520 in June 2015 had been entered in the Cash Book as ₹ 17,250. These cheques were not presented at the bank for payment until July 2015.
(ii) A cheque for ₹ 350 paid into the bank in May 2015 had been debited by the bank in error in June 2015.
(iii) Interest of ₹ 880 charged by the bank was not entered in the Cash Book.
(iv) Cheque received and recorded in the Cash Book but not sent to the bank for collection ₹ 1,240.
(v) Payment received from a customer direct by the bank ₹ 2,730 but no entry was made in the Cash Book.
(vi) ₹ 4,490 was entered in the Cash Book as paid into bank on 30.06.2015 but not credited by the bank until the following day.
(vii) The payment side of the Cash Book had been undercast by ₹ 100.

You are required to show the necessary corrections in the Cash Book.
Also, prepare a Statement reconciling the amended Cash Balance with that shown in the Bank Pass Book as on 30th June 2015.

16. On 30 June 2015, Sri C. Chandra's Cash Book showed that he had an overdraft of ₹ 300 on his current account at the bank.
On checking the Cash Book with the Bank Statement, you find the following:
(1) Cheque drawn, amounting to ₹ 500, had been entered in the Cash Book but had not been presented.
(2) Cheque received amounting to ₹ 400, had been entered in the Cash Book but had not been credited by the bank.
(3) On instructions from Sri C. Chandra, the bank had transferred interest, ₹ 60 from his deposits account to his current account, recording the transfer on 5th July 2015. This amount had, however, been credited in the Cash Book as on 30th June 2015.
(4) Bank charges ₹ 35, shown in the Bank Statement had not been entered in the Cash Book.
(5) The payments side of the Cash Book had been undercast by ₹ 10.
(6) Dividends amounting to ₹ 200 had been paid direct to the Bank and not entered in the Cash Book.
(7) A cheque for ₹ 50 drawn on deposit account had been shown in the Cash Book as drawn on current account.
(8) A cheque issued to B. Banerjee for ₹ 25 was replaced when out of date.
It was entered again in the Cash Book no other entry being made. Both cheques were included in the total of unpresented cheques shown above.

You are required : (1) To indicate the appropriate adjustments in the Cash Book, and,
(2) To prepare a statement reconciling the amended balance with that shown in the Bank Statement.

17. The following were extracted from the Bank Columns of the Cash Book of S. Sweetcorn

Dr. Cash Book (Bank Column) Cr.

Date	Particulars	L.F.	₹	Date	Particulars	L.F.	₹
2015 Mar.15	Cash		18,000	2015 Mar.1	By Balance		20,000
18	C. Croydon		12,000	6	By P. People		1,000
19	A. Ash		5,000	7	By W. Wright		200
				15	By. D. Dobson		120
				30	By W. Whipple		17,500
				31	By Balance c/d		

On 31st March, 2015 he received the following Bank Statement from his bank :

Bank Statement

Date	Particulars	Dr. (Withdrawn)	Cr. (Deposited)	Balance (₹)
March 1	Balance (Dr.)			20,000
5	Interest	500		20,500
12	Charges	120		20,620
15	D. Dobson	120		20,740
15	Cash		18,000	2,740

18	C. Croydon			12,000	9,260
25	Interest on Securities			540	9,800
28	Credit transfers — Poster			100	9,900
31	Dividend Warrant			500	(Cr.) 10,400

You are requested to :

(1) Rewrite the cash book for March 2015, bringing it upto date, showing the new balance at 31st March, 2015;

(2) Prepare a statement to reconcile the difference between the new upto date balance in the Cash Book and the balance in the Bank statement on 31st March, 2015.

18. On 15th May, 2015 Mr Lakes received his monthly Bank Statement for the month ended on 30th April, 2015. The Bank Statement contained the following details :

Mr Lakes

Statement of Account with Hong Kong Bank Limited (* Balance indicates account is overdrawn)

Date		Particulars	Payments	Receipts	Balance
April	1	Balance			1,053.29
	2	236127	210.70		842.59
	3	Bank Giro Credit	—	192.35	1,034.94
	6	236126	15.21		1,019.73
	6	Charges	12.80		1,006.93
	9	236129	43.82		963.11
	10	427519	19.47		943.64
	12	236128	111.70		831.94
	17	Standing Order	32.52		799.42
	20	Sundry Credit	—	249.50	1,048.92
	23	236130	77.87		971.05
	23	236132	59.09		911.96
	25	Bank Giro Credit	—	21.47	933.43
	27	Sundry Credit	—	304.20	1,237.63
	30	236133	71.18		1,166.45

For the corresponding period Mr Lakes' own records contained the following bank account

Date		Particulars	₹	Date		Particulars			₹
April	1	Balance	827.38	April	5	Purchases	Ch. No.	128	111.70
	2	Sales	192.35		10	Electricity	Ch. No.	129	43.82
	18	Sales	249.50		16	Purchases	Ch. No.	130	87.77
	24	Sales	304.20		18	Rent	Ch. No.	131	30.00
	30	Sales	192.80		20	Purchases	Ch. No.	132	59.09
					25	Purchases	Ch. No.	133	71.18
					30	Wages	Ch. No.	134	52.27
					30	Balance			1,310.00
			1,766.23						1,766.23

Prepare a Statement reconciling the balance at 30th April as given by the Bank Statement to the balance at 30th April as stated in the Bank Account.

Guide to Answers

Multiple Choice

1. D 2. D 3. B 4. A 5. B 6. C 7. D 8. B 9. A 10. C 11. D 12. D 13. C 14. C 15. C 16. A 17. C

Practical Questions

1. **Add: [i,iii,vi] Less: [ii,iv,v]; Bank Balance as per Pass Book ₹ 4,161**
2. **Add: [ii,iii,vii] Less: [iv,v,vi]; O/D as per Pass Book ₹ 37,241**
3. **Add: [i] Less: [ii,iii]; Bank balance as per Cash Book ₹ 11,550**
4. **Add: [ii,iv,vii] Less: [iii,v,vi]; Bank O/D as per Cash Book ₹ 6,545**
5. **Add: [ii,iv,vi] Less: [iii, v] Bank O/D as per Cash Book ₹ 8,403**
6. **Add: [iv, vii]; Less: [ii, iii, v, vi] Bank O/D as per Cash Book ₹ 4,031.90**
7. **Add: [ii, iii, vii]; Less: [iii, iv, v] Bank O/D as per Pass Book ₹ 1,02,570.**
8. **Add: [i, iv, v, vii]; Less: [ii, vi] Bank O/D as per Pass Book ₹ 2,31,250.**
9. **Debit [ii,vi,ix] Credit [iv,v,vii,x ₹ 20; xiii] Add [iii] Less [viii]**
   Amended Cash Book balance ₹ 71,920

Tutorial Note: Cheque issued but dishonoured ₹ 3,000, on technical ground, should not be recorded in the Cash Book but a fresh cheque to be issued.

10. Add: [ii,iv,vi,vii] Less: [iii,v,viii] No treatment for (ix) as per Pass Book ₹ 375.

11. Add: [iii,v,vii] Less:[ii,iv,vi,viii] Bank balance as per Pass Book ₹ 390

12. Bank Overdraft as per Amended Cash Book ₹ 3,920; Bank balance as per Pass Book ₹ 880.

13. Taking cash book debit balance of ₹ 5,620. Add: (a); (b); (g); (i) and Less : (c); (d); (e); (f); (h). No adjustment is required for ₹ 267 and ₹ 53 because these amounts have not yet been credited by the bank (uplifted means encashed).

14. Taking bank overdraft as per bank statement — ₹ 2,118, Add : (i); (ii); (vi); and (vii) Less: (iii); (iv); (v); (viii) and (ix).

15. Bank O/D as per Amended Cash Book ₹ 10,330; Add: [iii, iv, v]; Less: [i] Bank Balance as per Pass Book ₹ 760.

16. Bank Balance as per Amended Cash Book ₹ 50; Add: [1]; Less: [2, 3] Bank Balance as per Pass Book ₹ 65.

17. Bank Overdraft as per Amended Cash Book ₹ 3,300; Bank Balance as per Bank Statement (Cr.) ₹ 10,400.

18. List of causes of difference :

(i) Cheque deposited but not credited ₹ 192.80
(ii) Cheques issued but not presented ₹ 30 + ₹ 52.27
(iii) Wrong debit by bank on 10th April ₹ 19.47
(iv) Amount credited by bank not recorded in the Cash Book ₹ 21.47
(v) Wrong credit by bank (₹ 87.77 – ₹ 77.87) ₹ 9.90
(vi) Bank charges not recorded in the Cash Book ₹ 12.80
(vii) Payment as per standing order not recorded in the Cash Book ₹ 32.52.

7

Accounting Concepts and Conventions

Generally Accepted Accounting Principles (GAAP)

Generally accepted accounting principles are the conventions, rules and procedures necessary to define accepted accounting practice at a particular time. These principles provide a foundation for measuring and disclosing the results of business transactions and events. They include both conventions, bases and presentation practices.

Generally accepted accounting principles are conventional — that is, they become generally accepted by agreement rather than by formal derivation from a set of postulates or basic concepts. The principles have developed on the basis of experience, reason, custom, usage, and, to a significant extent, practical necessity. These principles are so widely used and accepted that may be produced to underlie all accounting statements.

From the above, it can be comprehended that generally accepted accounting principles instruct an accountant what to do in the usual case when he has no reason to doubt that the affairs of the organisation are being honestly conducted. Since he has reason to believe that this basic assumption is false, an entirely different situation confronts him.

Accounting Concepts and Conventions

A generally accepted set of rules can provide uniformity in the accounting system, the accounting procedure and presentation of accounting results. In developing the structure of accounting theory and to relate the theory to its practice, the accounting profession has agreed to take for granted certain basic concepts. Accounting assumptions are those broad concepts that develop generally accepted accounting principles, i.e., upon which accounting is based. Certain ideas are assumed or accepted in account in order to provide a unifying theoretical structure and internal logic of accounting. These assumptions are ***rules of the game*** and they have been developed from common accounting practices. These assumptions help accounting statements to become comparable, leading to better analysis and comparison of performances.

Basic Concepts and Conventions

1. Business Entity Concept

According to entity concept, business is considered separate and distinct from the owners of the enterprise. This concept starts with the fact that the business unit is a separate entity with its own identity. We must, for the purposes of bookkeeping, keep the owner and his business quite separate. Only those economic events which affect the business unit are recorded. Assuming that the business unit is a separate entity, accounting records are kept only from the point of view of the business unit and not the owners. For example, Mr. X starts a business, styled 'X & Co.'; accounts are to be prepared only from the point of view of 'X & Co.'—as if it was a different person from the owner. If the owner invests capital into the business, this is treated as if the owner is lending cash to the business. If a part of the capital is taken back by the owner, this is treated as a repayment of loan. For accounting purposes, a partnership firm has a separate entity apart from its partners. Likewise, the existence of a company does not depend on the life span of any of the shareholders.

This concept is applied to all forms of business organisations for the following reasons :

(a) It gives a solution to the problem of separating out business transactions from personal transactions.
(b) To ascertain the return on capital employed.
(c) To ensure the proper use of funds provided by the owners.
(d) To hold title to property in the name of the firm.
(e) To enter into transactions with outsiders in the name of the firm.

Advantages

(1) This concept stresses the importance of the business unit.
(2) This concept can be applied to any form of business organisation.
(3) It is the basis of the double entry system of book-keeping.
(4) It helps in separating out the business transactions from the personal transactions of the owner(s).
(5) This concept can be applied along with proprietary and fund concepts.
(6) It is possible to measure how successful or otherwise the business has been in terms of profit or loss.

Disadvantages

(1) Accounting is done from the viewpoint of the business unit, which is an artificial person.
(2) This concept sometimes coincides with the legal fact.
(3) To some extent, present accounting practice is not based on this concept.
(4) The owners cannot be identified with the existence of the business unit.
(5) This concept does not stress the importance of the proprietor(s).
(6) It is not concerned with increase of wealth of the owner(s).

2. Money Measurement Concept

Money is what money does. It is the medium of exchange. It provides a uniform way to measure the value of goods and services. It makes exchange more efficient. Finally, money is a store of value. Money is one form in which wealth can be maintained. The accounting system uses money as its basic unit of measurement. All business transactions are recorded in terms of money. This is because money is a useful way of converting accounting data into a common unit. Most of the resources of a business can be expressed in terms of money value. Under this concept, *only those transactions which can be measured in terms of money are to be recorded in the books of account.*

There are two *problems* with this concept. First, the concept assumes a stability in the value of money, e.g., Re 1 a year from now will buy the same amount as it does today. Secondly, many factors of vital importance to the business are outside the purview of accounting. This is because they are matters of opinion and cannot be expressed in monetary terms. Such matters include quality of management, growth of competition, changes in the nature of demand, and so on.

For the above two reasons, the money measurement concept is not ideal. It is recognised by all accountants that the concept has its limitations and inadequacies. Yet, it is accepted for accounting purposes because there is no difficulty in adopting the money measurement rule and it is not possible to employ a better measurement scale that can be easily understood by the users of accounting information.

3. Going Concern Concept

Accounting is based on the assumption that the accounting unit is to remain in operation into the foreseeable future in pursuit of its goals and objectives. When a business is inaugurated, except for terminable ventures, it is assumed that the termination of the business is not certain. Based on this idea, this concept assumes that the business will continue in operation for as long as possible and will not be dissolved in the foreseeable future, unless we have some strong evidence to suggest that this is not the case. From the accountant's standpoint, Profit and Loss Account and Balance Sheet are drawn up on the assumption that the business unit will continue functioning in the foreseeable future. This concept can be regarded as supporting the valuation of assets at historical cost or replacement cost. If this method is not adopted, the assets of the business unit would have to be shown at the net realisable value, i.e. at the amount they would sell for in the market at the Balance Sheet date. This concept is the basis of the conventional classification scheme, for instance, fixed / current assets, long term / current liabilities.

This concept assumes that the entity will continue operating under the same economic conditions and in the same general environment, but does not assume that the business will be profitable as long as it exists. This concept also does not imply that the business will continue for ever.

This concept relates to the future which is, by definition, uncertain. Therefore, many factors can be used to determine whether a business unit is a going concern. They include the following:

(a) ***Liquidity :*** The business unit must have sufficient liquid assets (assets which can be in the form of cash or can be easily converted into cash, i.e. current assets other than stock) to pay its current liabilities at present or in the future. A shortage of liquid assets may lead to the risk of insolvency. Various ratios can be formulated and applied to ascertain the liquidity of a business unit.

(b) ***Capital structure :*** A 'going concern' business unit must have a sound capital structure (the composition of an enterprise's sources of funds, especially long-term) to overcome any short-term or long-term difficulties. Capital structure of a business unit is influenced by several factors such as cost of various sources of capital, dividend policy, the risk of insolvency, stability of earnings, and the like.

(c) ***Market :*** A business enterprise cannot continue as a going concern without a continuing demand for the goods it deals in and/or the services it supplies.

(d) ***Management ability :*** A business enterprise should be managed efficiently and effectively to produce a competitive product and to see that the objectives of the enterprise are achieved. To keep the business unit going, the plans, policies, procedures and practices are to be used properly and attention concentrated on those areas that are not going according to plan.

4. Historical Cost Concept

Historical cost refers to the cost at the time of acquisition. Since accounting is basically the recording of past happenings, accountants use the acquisition price as the most objective measurement inasmuch as it is supported by the evidence of a transaction. It is a fundamental concept of accounting which is based on the historical record of the transactions, i.e., an asset is ordinarily recorded at its cost and this cost becomes the basis for subsequent accounting for the asset. If a plot of land is purchased, say for ₹ 10,000, it will appear in the books at that figure without considering the market value of the asset at any other point of time. It follows from this concept, that if nothing is paid for acquiring an asset, it will not be recorded at all. Let us take the example of Goodwill — it should be recorded in the books only when it is purchased. This concept is modified in practice by applying the concept of conservatism (valuing closing stock at cost or market value whichever is less). Furthermore, when the real worth of an asset changes with the passage of time, for various reasons, accounting records are changed to reflect changes in market value by revaluations of assets.

This concept provides uniformity in accounting records under conditions of stable prices. Historical cost values can well be retained in view of their familiarity to accountants.

The major drawback of historical cost concept stems from rapid inflation, which leads to serious distortions in the measurement of income. Since historical costs are matched against current incomes, there is an understatement of the real-value of the non-monetary assets of the business unit and an overstatement of the net income.

The reliance of business on historical cost is no accident. Alternatives to it have been advanced before. But a pragmatic consideration of the possibilities has always found historical cost, in spite of its acknowledged limitations, to be superior.

5. Realisation Concept

Realisation is the process of converting non-cash resources and rights into money. This concept is governed by the concept of conservatism. Revenue should only be brought into account when it is actually realised. However, it is not always easy to determine when revenue is realised. In determining profit, credit sales are taken into consideration. But, in future, customers may not pay their dues or may return the goods. In fact, the actual income may turn out to be less than what it was estimated to be. Therefore, the problem arises about recognising and recording revenue in the books of account for a specific accounting period. Revenue can be recognised at the point of sale or when cash is collected or at any intermediate point.

In general, revenue is recognised at the point of sale or at the performance of a service. The point at which a sale is made, depends on the terms of the contract between the buyer and the seller. But a sale is complete only when the goods are delivered by the seller and accepted by the buyer. To recognise a revenue, there is no need to wait until the cash is received. When revenue is recognised, it is included in the Profit and Loss Account.

There are several exceptions to this rule:

1. Long-term contract work-in-progress—revenue is recognised before completion of the job.
2. Cash basis—where debt collection is doubtful.
3. Hire-purchase transactions—revenue is recognised in proportion to the instalments over price.
4. Unrealised holding gains and losses—these may occur between the points of purchase and sale.

6. Accrual Concept

Any increase in the owner's equity is called revenue and, any decrease in it is called an expense. Income is the excess of revenues over expenses. In calculating profit for any financial period, expenses and revenues are matched in a more realistic way, i.e. they concern the same goods and the same time period. The accrual concept is an accounting system which recognises revenues and expenses as they are earned or incurred, respectively, without regard to the date of receipt or payment. This concept is one of the consequences of the periodicity concept. In the preparation of a Profit and Loss Account for an accounting period, revenues and expenses are recognised as they are earned or incurred respectively, and not when cash is received or paid. The earning of a revenue and the expense incurred for earning it, can be accurately related to specific time periods, but the receipts and payments may not be related to the period under consideration. This concept requires proper apportionment of expenses to time periods by the inclusion of prepayments and accruals in a Balance Sheet.

Illustration 1

J.P. & Co. draws up accounts each year to 31st March. Rent is paid for the business premises six months in advance on 1st July and 1st January each year. Recent rent payments and dates were as follows :

	₹
1st July, 2013	40,000
1st January, 2014	40,000
1st July, 2014	50,000
1st January, 2015	50,000

What amount would be charged for rent in the year 2009-10 Profit and Loss Account ?

Solution

	₹
1 April, 2009 to 30th June, 2014 (3/6 × ₹ 40,000)	20,000
1 July, 2009 to 31st December, 2014 (6/6 × 50,000)	50,000
1 January, 2010 to 31st March, 2015 (3/6 × 50,000)	25,000
Rent expenses for the year 2014-15	95,000

It is to be noted that during the accounting period 2014-15 (1st April, 2009 to 31st March, 2015) J.P. & Co. paid ₹ 1,00,000 (₹ 50,000 + ₹ 50,000) as rent but rent expenses of that period (based on accrual concept) is ₹ 95,000.

In the Balance Sheet ₹ 25,000 will be shown as an asset "**Rent Paid in Advance**".

7. Periodicity Concept

Since the going concern concept postulates that the business will keep functioning continuously, accountants choose some convenient segment of time to ascertain income for that period. This periodicity concept requires that a Profit and Loss Account and a Balance Sheet should be prepared at regular intervals to ascertain information about the business unit for all sorts of purposes—performance evaluation, tax computation, budgetary control and the like. Period-income determination leads to a comparison of the results of successive periods. In fact, periodicity is the consistency of accounting periods. For the purpose of convenient comparison of profits and losses and of other expenses, it is necessary that the periods of measurement should be equal. Since the lifespan of the business unit is segregated into equal parts, most of the problems of accounting measurement arise out of the periodicity concept. This is because accounting periods are often out of correspondence with natural cycles of business activity. The main difficulty arises in deciding what revenues and what expenses are to be taken into consideration for one accounting period and, in consequence, much effort is demanded to prepare the periodic accounts. A business transaction should be identified with a particular period. But, there may be transactions relating to several accounting periods. For example, if a business unit buys a plant for ₹ 1,00,000 with a stipulated lifespan of 5 years, the transaction relates to five accounting periods. The transaction for one accounting period is not the cost of the asset, but the depreciation of the asset charged in one accounting period. The main implication of the periodicity concept is the application of the arbitrary allocation and apportionment of indirect costs, i.e., judgement and guessing will always be required to measure such items as depreciation, doubtful debts, and so on.

The periodicity concept results in the following advantages :

(a) Uniformity and consistency in accounting treatment for profit ascertainment and asset valuations.
(b) Proper matching of periodic revenues and expenses to achieve the objectives of accounting.
(c) Comparability of financial statements of different periods is facilitated.

8. Consistency Concept

Consistency concept relates to the method of measurement in accounting. Accounting principles are not static or unchanging. It is possible to adopt a variety of principles and procedures for financial events. If, in treating a given event, two or more contradictory methods are used, it may yield conflicting results. Whatever accounting method a business unit decides to adopt, a consistent approach has to be followed.

It is very important that the accountant be consistent in applying principles and procedures to similar situations, because inconsistency in reporting can cause misleading interpretations and, therefore, wrong conclusions. The user must be sure that the accounts for a particular business unit for successive years are comparable with each other. Comparability does require that the entity apply the same accounting principles on a consistent basis. Therefore, consistency is essential in improving comparability across accounting periods. This concept gives confidence to the users of accounting information. Though consistency is obligatory for sound financial accounting, this does not mean that changes cannot be made in a business unit's accounts. In the event of any change (when there are good reasons for it), a note must be appended along with the statements indicating the alteration/s.

In accounting, whenever the question of consistency arises, it is spoken of in three different senses:

(i) ***Vertical consistency*** : It means the consistency within a given set of statements of a firm at a specific date and for a specific time. An example of inconsistency within a statement is the recording of an asset in the Balance Sheet at cost and charging of the related depreciation on the basis of replacement cost in the Profit and Loss Account.

(ii) ***Horizontal consistency*** : It means the intra-firm consistency between different accounting periods. There should be consistency in applying accounting methods to different accounting periods. The Profit and Loss Account and the Balance Sheet of an accounting period must be made out on the basis that the figures stated are consistent with those of the earlier years.

(iii) ***Third dimensional consistency*** : It means the inter-firm consistency between a particular organisation and the other organisations in similar industry or trade. It refers to the use of similar measurement concepts and procedures for related items by different firms in the same industry.

9. Prudence (or Conservatism) Concept

This is a basic accounting concept which requires that a degree of caution is necessary when making estimates required under conditions of uncertainty, so that assets or income are not over-stated and liabilities or expenses are not under-stated. Revenue can only be recorded in the books of account when there is a reasonable certainty about its realisation. At the same time, provision must be made for all possible liabilities. It is not important whether the amount of liability is known with certainty or is based on estimation. To illustrate, inventories are recorded at their cost or market price, whichever is lower. Likewise, if there is an anticipation that a debt may not be realised, a specific amount is set aside from profit as a provision for doubtful debts. This concept is expressed as : "Recognise all losses and anticipate no gains". This concept attempts to state the lowest likely value of assets and profits, and the highest likely amount of any losses or liabilities incurred.

Following are the three main arguments for prudence principle :

First, it is necessary to compensate for the frequent over-optimisation in preparing financial statement.

Second, overstating profit is potentially disastrous because it can lead to a reduction of capital.

Third, it is the only practical way of dealing with uncertainty about potential revenue, expenses, asset values and liabilities.

10. Materiality Concept

Materiality implies significance, substance, importance and consequence. The materiality concept permits other concepts to be ignored if the effects are not considered material. The concept of materiality is the threshold for recognition of a transaction in accounting process. Since materiality is primarily related to relevance, this concept deals with the relative importance of economic data. In the accounting sense, an item is recorded only when it is considered to be useful or important to the user of a financial statement. Thus, accountants do not record those transactions which are insignificant and recording those would create more problems than solutions.

Again, as no benefit is gained from excessive precision, accounting statements are not made complicated by including trivial matters—only a reasonable approximation is considered acceptable. It means, accountants take the simpler course of action, even though less exact. For example, a brand new pencil is an asset to the business unit. Whenever the pencil is used, a part of the asset is consumed. Although the pencil is still in use at the year-end, its original cost is so insignificant that it would be a waste of time to evaluate and include it in closing stock. Instead, it is written-off as revenue in the period it was purchased. To make the figures manageable without affecting the accuracy of the accounting data, only round figures (figures to the nearest rupee) are generally shown in the financial statement of any organisation.

Whether an item is material or not depends on personal judgement and common sense. There cannot be any hard and fast rule for that. What is important is that omission of information from the financial statements should not impair the decision of a user of accounting information.

11. Matching Concept

Since the matching concept is an essential part of accrual accounting, these two are often used interchangeably. Like accrual concept, the matching concept also results from periodicity concept. The matching concept requires that the expenses for an accounting period should be matched against related revenues, rather than recognising revenues as being earned at the time when cash is received or recognising expenses when cash is paid. For ascertaining profit, a misleading impression would be given if the cash received during a particular period is simply compared with the cash paid out during the same period. This is because, the exact period in which the cash is either received or paid may bear no relationship to the period in which the business transaction took place. As most businesses keep accounts on accrual basis, it is necessary that the accounting system match periodically the revenues earned against expenses incurred. The result of this matching being, the net income or net loss. This method requires proper allocation of costs into appropriate period so that relevant incomes and expenses are matched. The profit of an accounting period is the revenues from transactions less expenses incurred in producing those revenues. If expenses cannot be traced to specific items of revenues, they are generally written-off in the year in which they are incurred.

12. Full Disclosure

Disclosure is an accounting principle that requires full (adequate) disclosure of all material (significant) matters affecting the financial statements that would be of interest to the users of accounting information. The full disclosure principle specifies that there should be complete and understandable reporting on the financial statements of all significant information relating to the economic affairs of the entity. Full disclosure requires that financial statements be designed and prepared to portray accurately the economic events that have affected the firm for the period and to contain information sufficient to make them useful, and not misleading to the users. Full disclosure is required when alternative policies are available (FIFO, LIFO), principles peculiar to particular industry and unusual or innovative application of accounting principles.. While preparing financial statements, it should be ensured that significant facts or information are not omitted. It would increase the relevance and reliability of financial statements.

13. Substance over Form

Substance over form is an accounting concept whereby transactions and other events are accounted for and presented in accordance with their economic reality rather than their legal form. In accounting, substance should normally take precedence over form in deciding how a particular transaction should be recorded.

The legal form of a transaction is frequently descriptive of its economic substance. However, the form occasionally misrepresents the characteristics that are relevant to users. If the substance can be reliably determined, the accountant should describe the transaction in terms of the substance rather than the form. Accounting for hire-purchase transactions, for example, is based on the above concept, i.e., it looks at the substance of the transaction rather than its legal form. The hire-purchaser can record the asset at its cash down price, while paying for it by instalments over an agreed period of time.

Illustration 2

In preparing the accounts of your company, you are faced with a number of problems. These are summarised below :

(a) The managing director wishes the company's good industrial relations to be reflected in the accounts.
(b) The long-term future success of the company is extremely uncertain.
(c) Although the sales have not yet actually taken place, some reliable customers of the company have placed several large orders that are likely to be extremely profitable.
(d) One of the owners of the company has invested his drawings in some stocks and shares.
(e) At the year end, an amount is outstanding for electricity that has been consumed during the accounting period.
(f) Fixed assets would now cost a great deal more than they did when they were originally purchased.
(g) During the year, the company purchased ₹ 100 worth of pencils; these had all been issued from stock and were still in use at the end of the year.
(h) The company has had a poor trading year, and the owners believe that a more balanced result could be presented if a weighted average stock valuation method was adopted, instead of present FIFO method.
(i) A debtor who owes a large amount to the company is rumoured to be going into liquidation.
(j) The company owns some shares in a quoted company which the accountant thinks are worthless.

You are required to: (i) state which accounting concept the accountant should follow in dealing with each of the above problems; (ii) explain briefly what each concept means.

Solution

(a) **Money measurement concept**. Only those transactions which are capable of being measured in terms of money are to be recorded in the books of account.
(b) **Going concern concept**. The business will continue in operation for as long as possible and will not be dissolved in the foreseeable future, unless there is some strong evidence to suggest that this is not the case.
(c) **Realisation concept**. Revenue is recognised at the point of sale or at the performance of a service.
(d) **Entity concept**. The organisation is a separate entity with its own identity and the accounts and transactions are classified and analysed from the point of view of that entity.
(e) **Accrual concept.** An accounting system which recognises revenues and expenses as they are earned or incurred, respectively, without regard to the date of receipt or payment.
(f) **Historical cost concept**. An asset is recorded at its cost and this cost becomes the basis for subsequent accounting for the asset.
(g) **Materiality concept**. An item is recorded only when it is considered to be useful or important to the user of a financial statement.
(h) **Consistency concept.** Whatever accounting method a business unit decides to adopt, a consistent approach has to be followed.
(i) **Conservatism concept**. Where there is a reasonable choice of accounting treatments, it is desirable to have early recognition of unfavourable events.
(j) **Cost/conservatism concept**. Shares in a quoted company should be valued at the lower of cost or market price. Both these values are objective. The accountant's opinion is subjective.

Key Points

- Generally accepted accounting principles are the conventions, rules and procedures necessary to define accepted accounting practice at a particular time.
- According to entity concept, business is considered separate and distinct from the owner of the enterprise.
- Under money measurement concept, only those transactions which can be measured in terms of money are to be recorded in the books of accounts.
- Going concern concept assumes that the entity will continue operating under the same economic conditions and in the same general environment, but does not assume that the business will be profitable as long as it exists.

THEORETICAL QUESTIONS

1. What do you mean by Generally Accepted Accounting Principles (GAAP) ?
2. Why realisation concept is important for the purpose of determination of profits ?
3. Explain vertical consistency and horizontal consistency.
4. What is materiality concept ?
5. What is 'Substance over Form' concept ?
6. What do you mean by matching concept ?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below.

1. What does the going concern concept mean ?
   A a business is profitable
   B a business will continue to operate for the foreseeable future
   C the assets of a business exceed its liabilities
   D the assets of a business should be valued at disposal value
2. When a businessman introduces capital into his business, the transaction is debited in the Cash Book and credited to his Capital Account. Of which accounting concept is this an example ?
   A business entity
   B going concern
   C matching
   D prudence
3. A company does not include the value of skills gained by its employees from training programmes in its financial statements. Which accounting concept is being applied ?
   A consistency
   B materiality
   C money measurement
   D substance over form
4. There is great uncertainty about the continuance of a business. This has caused the proprietor to make a large reduction in the valuation of the year-end stock. Which accounting concept does this illustrate ?
   A going concern
   B matching
   C materiality
   D consistency
5. The treasurer of a club has decided not to include subscriptions owing by members in the Balance Sheet at the year-end. Which accounting concept is being applied ?
   A accrual
   B going concern
   C money measurement
   D prudence

6. What is an example of the prudence concept ?
   A accrued expenses are treated as a liability
   B drawings are deducted from capital
   C profit is not over-stated
   D only items with a monetary value are included in accounting
7. A trader who sells food does not include food that is past its 'sell by' date in his stock in the Balance Sheet.
   A matching
   B prudence
   C realisation
   D going concern
8. Two values of closing stock are given, i.e., the cost is ₹ 40,000 and the market value is ₹ 45,000, the lower value, i.e., the cost of ₹ 40,000 will be chosen in favour of the market value of ₹ 45,000 so that the profit will not be over-stated. The choice is the reverse if the market value is lower than the cost.
   Which concept is being applied ?
   A realisation
   B historical cost
   C conservatism
   D consistency
9. State which accounting concept the accountant should follow in dealing with the following :
   Although the sales have not yet actually taken place, some reliable customers of the company have placed several large orders that are likely to be extremely profitable.
   A consistency
   B conservatism
   C historical cost
   D realisation
10. State which accounting concept the accountant should follow in dealing with the following :
   At the year end, an amount is outstanding for electricity that has been consumed during the accounting period.
   A conservatism
   B historical cost
   C accrual
   D realisation
11. State which accounting concept the accountant should follow in dealing with the following :
   Fixed assets would now cost a great deal more than they did when they were originally purchased.
   A historical cost
   B materiality
   C consistency
   D conservatism
12. State which accounting concept the accountant should follow in dealing with the following :
   During the year, the company purchased Rs 100 worth of pencils; these had all been issued from stock and were still in use at the end of the year.
   A realisation
   B conservatism
   C materiality
   D accrual
13. State which accounting concept the accountant should follow in dealing with the following :
   The company has had a poor trading year, and the owners believe that a more balanced results could be presented if a weighted average stock valuation method was adopted, instead of present FIFO method.
   A materiality
   B consistency
   C going concern
   D accounting period

14. State which accounting concept the accountant should follow in dealing with the following :
    A debtor who owes a large amount to the company is rumoured to be going into liquidation.
    A conservatism
    B historical cost
    C materiality
    D accrual
15. State which accounting concept the accountant should follow in dealing with the following :
    The company owns some shares in a quoted company which the accountant thinks are worthless.
    A consistency
    B conservatism
    C realisation
    D materiality

Guide to Answers

Multiple Choice

1. B 2. A 3. C 4. A 5. D 6. C 7. B 8. C 9. D. 10. C 11. A 12. C 13. B 14. A 15. B

8

Bases of Accounting

Cash and Accrual Basis of Accounting

Cash Basis of Accounting

Cash basis of accounting is a method of accounting in which transactions are recorded in the books of account when cash is actually received or paid and not when the transactions take place. This method recognises revenues and gains when cash is actually received. Similarly, it recognises expenses and losses when cash is paid. No attempt is made to record prepayments or accruals.

Net profit / Net income under this method represents simply the difference between cash receipts and cash payments. This method of accounting is widely used by professionals and other service enterprises (for example, physicians, lawyers and others).

Features

1. It records transactions only when cash is actually received or paid out.
2. Income is earned when cash is received and expenses are incurred when cash is paid.
3. No record is made for prepayments or accruals.
4. It does not follow double entry system of book keeping. Therefore, profit is ascertained by means of a statement.
5. This method is not suitable for a going concern business.
6. It is widely used by professionals and other service enterprises.

Advantages

1. Transactions are recorded only when all phases of transactions are complete.
2. Recording of transactions are simple.
3. This method does not require estimates and judgements of the accountant.
4. Reliability of accounting information is increased.
5. This method reflects the actual inflow and outflow of cash.
6. This method is most suitable for firms that do not maintain significant amount of inventories and does not extend credit to their customers.

Disadvantages

1. This method of accounting is inappropriate for most businesses.
2. It does not take into account fixed assets, debtors, creditors, inventories, prepayments, accruals etc.
3. No Trading, Profit and Loss Account and Balance Sheets can be prepared.
4. Generally accepted accounting principles do not recognise this basis.
5. This method does not recognise changes in resources and obligations of a business unit.
6. An accurate view of the trend of the periodic income cannot be provided.

Computation of Net Income Under Cash Basis

At the time of calculating net income under cash basis, the following points must be remembered :

1. All incomes received in cash during the year are to be taken into consideration whether it is related to current year, previous year or future year(s).
2. All expenses paid in cash during the year are to be taken into consideration whether it is related to current year, previous year or future year(s).
3. Incomes accrued but not yet received in cash are not to be taken into consideration.
4. Expenses outstanding but not yet paid are not to be taken into consideration.

Illustration 1

Dr P K Srinivasan started his profession as a medical practitioner on 1.1.2014. His income and expenses for the year ended on 31st December 2014 are as follows :

	₹
Fees received in cash	35,100
Rent of chamber paid	10,800
Rent of chamber paid in advance (included in the above)	800
Fees accrued but not yet received	2,000
Salary of compounder paid	5,400
Salary of compounder outstanding	500

You are required to ascertain the net income from profession under Cash Basis of Accounting for the year ended on 31st December, 2014.

Solution **Computation of Net Income (under Cash Basis) of Dr P K Srinivasan for the year ended 31st December, 2014**

Particulars	₹	₹
Fees received in cash		35,100
Less: Expenses paid in cash —		
(i) Rent of Chamber	10,800	
(ii) Salary of Compounder	5,400	16,200
Net Income Under Cash Basis		18,900

Accrual Basis of Accounting

Accrual basis of accounting is an accounting system which records revenues and expenses as they are earned or incurred, not as cash received or paid respectively. This basis of accounting arises from the concept of periodicity. A business follows accrual basis of accounting if income and expenses are measured when the transactions take place, without taking into consideration inflow and outflow of cash. Profit, under accrual basis of accounting, is the excess of revenues over expenses for a given accounting period. But the receipts of incomes or payments of expenses may be related to a different accounting period. Therefore, profit of an accounting period does not reflect cash receipts and cash payments for that period. For proper matching of expenses against revenues, this method takes into account prepayments and accruals. In effect, the earning of income and the expenses incurred in earning it, can be accurately reflected to a specific accounting period.

Features

1. It records revenues and expenses as they are earned or incurred, not as cash received or paid.
2. It is suitable for any business entity, profit making or non-profit making.
3. This basis of accounting does not reflect the actual inflow or outflow of cash.

4. It takes into account prepayments and accruals.
5. It is the basis of double entry system of book keeping.
6. This method is not simple, as compared to cash basis of accounting.
7. This method is not suitable for terminable ventures.
8. Under this method, profit is calculated by matching expenses against revenues.

Advantages

1. This method is widely used by most businesses.
2. Trading, Profit and Loss Account and Balance Sheet can be prepared.
3. Generally accepted accounting principles recognise this basis of accounting.
4. It ensures proper matching of expenses against incomes.
5. An accurate view of the trend of periodic income can be provided.
6. It helps comparison of accounting statements.

Disadvantages

1. This method is not simple.
2. It requires estimates and judgements of the accountant. Therefore, accounting practice may be inconsistent.
3. It is possible to adopt a variety of accounting principles and procedures.
4. This method does not reflect the actual inflow and outflow of cash.
5. It is not suitable for any organisation where realisation of income is doubtful.
6. This method is suitable only for a going concern.

Distinction Between Cash Basis and Accrual Basis

	Cash Basis		Accrual Basis
1.	It records only cash transactions.	1.	It records both cash and credit transactions.
2.	It is not the basis of the double entry system of book-keeping.	2.	It is the basis of the double entry system of book-keeping.
3.	Income is earned when cash is received and expenses are incurred when cash is paid.	3.	Income and expenses are measured when transactions take place.
4.	Profit is the difference between cash receipts and cash payments.	4.	Profit is the difference between revenue and expenses.
5.	No attempt is made to record prepayments or accruals.	5.	Prepayments and accruals are recorded.
6.	Trading, Profit and Loss Account and Balance Sheet cannot be prepared.	6.	Trading, Profit and Loss Account and Balance Sheet can be prepared.
7.	Expenses for an accounting period are not matched against income.	7.	Expenses for an accounting period are properly matched against income.
8.	It is suitable for a terminable venture.	8.	It is suitable for a going concern.
9.	It is widely used by professionals and other service enterprises.	9.	It is widely used for most businesses.
10.	Generally accepted accounting principles do not recognise this basis.	10.	Generally accepted accounting principles recognise this basis.

Computation of Net Income Under Accrual Basis

At the time of calculating net income under accrual basis the following points must be remembered:

1. Incomes relating to the current year are to be taken into consideration whether received in cash or not.
2. Incomes of the previous year received in the current year are to be deducted from the total income received in cash during the year.

3. Incomes of the future year received in the current year are to be deducted from the total income received in cash during the year.
4. Accrued incomes of the current year not yet received are to be added with the total income received in cash during the year.
5. Only expenses relating to the current year are to be taken into consideration whether paid or not.
6. Outstanding expenses of the previous year paid during the current year are to be deducted from the total expenses paid during the year.
7. Prepaid expenses are to be deducted from the total expenses paid during the year.
8. Outstanding expenses of the current year are to be added with the total expenses paid during the year.

Illustration 2

Taking information of ***Illustration 1*** calculate net income of Dr P K Srinivasan under Accrual Basis for the year ended 31st December, 2014 :

Solution **Computation of Net Income (under Accrual Basis) of Dr P K Srinivasan for the year ended 31st December, 2014**

Particulars	₹	₹	₹
Fees received in cash			35,100
Add: Fees accrued but not yet received			2,000
			37,100
Less: Expenses —			
(i) Rent chamber paid	10,800		
Less: Rent paid in advance	800	10,000	
(ii) Salary of compounder paid	5,400		
Add: Outstanding salary	500	5,900	15,900
Net Income Under Accrual Basis			21,200

Mixed Basis of Accounting

Mixed basis of accounting is the mixture of cash basis of accounting and accrual basis of accounting. Under this method, income is recorded when cash is actually received. It does not take into consideration any accrued income. However, expenses are recorded as they are incurred, not when cash is paid. All outstanding and prepaid expenses are taken into consideration for calculating actual expenses of the accounting period.

Features

1. It records income when cash is actually received.
2. It records expenses when it is incurred, not when cash is paid.
3. No record is made for accrued income.
4. All outstanding and prepaid expenses are taken into consideration for calculating actual expenses of the relevant accounting period.
5. It is the most conservative method of accounting.

Computation of Net Income Under Mixed Basis

At the time of calculating net income under mixed basis, the following points must be remembered:

1. All incomes received in cash during the year are to be taken into consideration whether it is related to current year, previous year or future year(s).
2. Incomes accrued but not yet received in cash are not to be taken into consideration.
3. Only expenses relating to the current year are to be taken into consideration ***whether paid or not***.
4. Outstanding expenses of the previous year paid during the current year are to be deducted from the total expenses paid during the year.
5. Prepaid expenses are to be ***deducted*** from the total expenses paid during the year.
6. Outstanding expenses of the current year are to be ***added*** with the total expenses paid during the year.

Illustration 3

Taking information of ***Illustration 1*** calculate net income of Dr P K Srinivasan under mixed basis for the year ended 31st December, 2014 :

Solution **Computation of Net Income (under Mixed Basis) of Dr P K Srinivasan for the year ended 31st December, 2014**

.Particulars		₹	₹
Fees received in cash			35,100
Less: Expenses			
(i) Rent of Chamber paid	10,800		
Less: Rent paid in advance	800	10,000	
(ii) Salary of compounder paid	5,400		
Add: Outstanding salary	500	5,900	15,900
Net Income Under Mixed Basis			19,200

Illustration 4

Ascertain the net income of Sri Arpan Barua for the year ended 31.12.2014 on cash basis and on accrual basis of accounting from the following particulars :

	₹
Fees received in cash in 2014 (gross)	16,200
Fees outstanding on 31.12.2014	950
Expenses paid in cash in 2014 (gross)	4,250
Expenses outstanding on 31.12.2014	500
Fees received in advance on 31.12.2014	300
Prepaid expenses on 31.12.2014	250

Solution **Computation of Net Income (under Cash Basis) of Sri Arpan Barua for the year ended 31st December, 2014**

Particulars	₹
Fees received in cash (gross)	16,200
Less: Expenses paid in cash (gross)	4,250
Net Income Under Cash Basis	11,950

Computation of Net Income (under Accrual Basis) of Sri Arpan Barua for the year ended 31st December, 2014

Particulars	₹	₹
Fees received in cash (gross)		16,200
Add: Fees outstanding on 31.12.2014		950
		17,150
Less : Fees received in advance on 31.12.2014		300
		16,850
Less : Expenses paid in cash (gross)	4,250	
Add : Expenses outstanding on 31.12.2014	500	
	4,750	
Less : Prepaid expenses on 31.12.2014	250	4,500
Net Income Under Accrual Basis		12,350

Illustration 5

Dr P K Das started his profession on 1st January, 2014 as medical practitioner. His incomes and expenses for the year 2014 relating to his profession were as under :

	₹
Fees received in cash	24,000
Fees accrued but not received	6,000
Rent paid for the chamber	6,000
Outstanding rent	2,000
Salary to staff paid	6,000
Salary paid in advance to staff (included in the above)	1,000
Miscellaneous expenses paid	200

You are required to compute the net income of Dr Das from his profession for the year ended 31.12.2014 under : (i) Cash Basis; (ii) Accrual Basis.

Solution **(i) Computation of Net Income (under Cash Basis) of Dr P K Das for the year ended 31st December, 2014**

Particulars	₹	₹
Fees received in cash		24,000
Less : Expenses paid in cash —		
Rent	6,000	
Salary to Staff	6,000	
Miscellaneous expenses	200	12,200
Net Income Under Cash Basis		11,800

(ii) Computation of Net Income (under Accrual Basis) of Dr P K Das for the year ended 31st December, 2014

Particulars	₹	₹	₹
Fees received in cash			24,000
Add : Fees accrued but not received			6,000
			30,000
Less : Expenses—			
Rent paid	6,000		
Add : Outstanding rent	2,000	8,000	
Salary paid	6,000		
Less : Paid in advance	1,000	5,000	
Miscellaneous expenses		200	13,200
Net Income Under Accrual Basis			16,800

Illustration 6

Mr A Roy gives the following information relating to his income and expenditures for the year ended 31.12.2014 :

	₹
Fees received in cash (gross)	50,500
Fees earned but not yet received	4,500
Fees received in advance	3,000
Fees for 2013 received	2,000
Staff salaries paid (gross)	8,200
Salaries paid in advance	1,200
Salaries for 2013 paid	1,000
Rent paid for office (gross)	7,100
Outstanding office rent	600
Rent for 2013 paid	500
Telephone charges paid	1,600

Calculate his net income for the year 2014.

Solution **Computation of Net Income (under Cash Basis) of A Roy for the year ended 31st December, 2014**

Particulars	₹	₹
Fees received in cash		50,500
Less : Expenses paid in cash—		
Staff salaries (gross)	8,200	
Rent paid for the office (gross)	7,100	
Telephone charges paid	1,600	16,900
Net Income Under Cash Basis		33,600

Computation of Net Income (under Accrual Basis) of A Roy for the year ended 31st December, 2014

Particulars	₹	₹	₹
Fees received in cash		50,500	
Add : Fees earned but not yet received		4,500	
		55,000	
Less : Fees received in advance		3,000	
		52,000	
Less : Fees received for 2013		2,000	50,000

Less : Expenses —			
Staff salary (gross)	8,200		
Less : Salary paid in advance	1,200		
	7,000		
Less : Salary for 2013 paid	1,000	6,000	
Rent paid for office (gross)	7,100		
Add : Outstanding office rent	600		
	7,700		
Less: Rent for 2013 paid	500	7,200	
Telephone charges paid		1,600	14,800
Net Income Under Accrual Basis			35,200

Illustration 7

From the following particulars, calculate the 'Net Income' of Sri Tapas Roy, an eminent Chartered Accountant for the year ended 31.12.2014 under (i) Cash Basis, and (ii) Accrual Basis:

	₹
Fees received in cash in 2014	1,14,000
Expenses paid in cash in 2014	30,000
Fees received in advance as on 31.12.2014	18,000
Fees accrued but not received as on 31.12.2014	3,600
Outstanding expenses as on 1.1.2014	4,800
Fees accrued but not received as on 1.1.2014	4,800
Prepaid expenses as on 1.1.2014	4,200
Outstanding expenses as on 31.12.2014	2,400
Fees received in advance as on 1.1.2014	12,000
Prepaid expenses as on 31.12.2014	3,600

Solution **(i) Computation of Net Income (under Cash Basis) of Sri Tapas Roy for the year ended 31st December, 2014**

Particulars	₹
Fees received in cash in 2014	1,14,000
Less : Expenses paid in cash 2014	30,000
Net Income Under Cash Basis	84,000

(ii) Computation of Net Income (under Accrual Basis) of Sri Tapas Ray for the year ended 31st December, 2014

Particulars	₹	₹
Fees received in cash in 2014	1,14,000	
Less : Fees received in advance as on 31.12.2014	18,000	
	96,000	
Add : Fees accrued but not received as on 31.12.2014	3,600	
	99,600	
Less : Fees accrued but not received as on 1.1.2014	4,800	
	94,800	
Add: Fees received in advance as on 1.1.2014	12,000	1,06,800
Less : Expenses —		
Expenses paid in cash 2014	30,000	
Less : Outstanding expenses as on 1.1.2014	4,800	
	25,200	
Add : Prepaid expenses as on 1.1.2014	4,200	
	29,400	
Add : Outstanding expenses as on 31.12.2014	2,400	
	31,800	
Less : Prepaid expenses as on 31.12.2014	3,600	28,200
Net Income Under Accrual Basis		78,600

Conversion of Profit Under Cash Basis into Profit Under Accrual basis

Profit / net income under cash basis and accrual basis may vary widely. Sometimes, it may be required to convert profit under cash basis into profit under accrual basis. For the purpose of conversion, the following steps are to be followed :

Step 1 Calculate profit / net income under cash basis in the usual manner.

Step 2

Add the following items —

(i) Outstanding expenses at the beginning of the year.
(ii) Income received in advance at the beginning of the year.
(iii) Income accrued but not yet received at the end of the year.
(iv) Prepaid expenses at the end of the year.
(v) Any other adjustments.

Step 3

Deduct the following items —

(i) Outstanding expenses at the end of the year.
(ii) Income received in advance at the end of the year.
(iii) Income accrued but not yet received at the beginning of the year.
(iv) Prepaid expenses at the beginning of the year.
(v) Any other adjustments.

Step 4 Find out the balance. This balance will represent profit / net income under accrual basis.

Illustration 8

Mr A K Das gives the following particulars of his incomes and expenses for the year 2014. Ascertain his net income for the year under (i) the Accrual Basis and (ii) the Mixed Basis of Accounting :

	₹
Incomes	
Received during 2014 (gross)	2,17,500
Arrear fees received this year	26,400
Advance fees received this year	8,300
This year's fees received in 2013	6,200
This year's fees not yet received	13,800
Expenses	
Paid during 2014 (gross)	58,000
Expenses for 2013 paid this year	7,300
Expenses for this year paid in 2013	1,500
Expenses for this year not yet paid	4,800
Expenses for next year paid this year	6,200

Solution **(i) Computation of Net Income (under Accrual Basis) of Dr A K Das for the year ended 2014**

Particulars	₹	₹
Income received during 2014	2,17,500	
Less : Arrear fees received this year	26,400	
	1,91,100	
Less : Advance fees received this year	8,300	
	1,82,800	
Add : This year's fees received in 2013	6,200	
	1,89,000	
Add : This year's fees not yet received	13,800	2,02,800
Less : Expenses paid during 2014 (gross)—	58,000	
Less : Expenses for 2013 paid this year	7,300	
	50,700	
Add : Expenses for this year paid in 2013	1,500	

	52,200	
Add : Expenses for this year not yet paid	4,800	
	57,000	
Less : Expenses for next year paid this year	6,200	50,800
Net Income Under Accrual Basis		1,52,000

(ii) Computation of Net Income (under Mixed Basis) of Dr A K Das for the year ended 2014

Particulars	₹	₹
Income received during 2014 (See tutorial Note)		2,17,500
Less : Expenses under accrual basis —		
Expenses paid during 2014 (gross)	58,000	
Less : Expenses for 2013 paid this year	7,300	
	50,700	
Add : Expenses for this year paid in 2013	1,500	
	52,200	
Add : Expenses for this year not yet paid	4,800	
	57,000	
Less : Expenses for next year paid this year	6,200	50,800
Net Income Under Mixed Basis		1,66,700

Tutorial Note : Under mixed basis of accounting, incomes are taken on cash basis but expenses are taken under accrual basis.

Illustration 9

From the following statement of M Deb of Calcutta, prepare a Profit and Loss Account on cash basis for the year ended 31st December, 2014:

		₹
Salary received in cash		30,000
Accrued salary		2,500
Salary for 2015, received in 2014		2,000
Expenses due but not paid		1,000
Expenses paid for —	₹	
2013	2,000	
2014	10,000	
2015	1,400	13,400

Convert the profit ascertained on cash basis to the profit on accrual basis by preparing a statement.

Solution

Profit and Loss Account of M Deb (under Cash Basis) for the year ended 31st December, 2014

Dr. **Cr.**

Particulars		₹	Particulars	₹
To Expenses for —			By Salaries	30,000
2013	2,000			
2014	10,000			
2015	1,400	13,400		
To Net Profit		16,600		
		30,000		30,000

Statement Showing the Conversion of Profit Under Cash Basis into Profit Under Accrual Basis

Particulars	₹	₹
Net Profit Under Cash Basis		16,600
Add : (i) Expenses paid for 2013 —	2,000	
(ii) Accrued Salary	2,500	
(iii) Expenses paid for 2015	1,400	5,900
		22,500
Less : (i) Expenses due but not paid	1,000	
(ii) Salary for 2012 received in 2014	2,000	3,000
Net Profit Under Accrual Basis		19,500

Illustration 10

The following Income and Expenditure Account has been prepared by Md. Selim, a Chartered Accountant, on cash basis for the year ended 31.12.2014 :

Expenditure	₹	Income	₹
Salaries	96,600	Fees received from audit work	2,52,000
Membership subscription	44,800	Fees received from legal advice	1,00,800
News papers and magazines	11,200		
House rent	32,000		
Conveyance expenses	71,400		
Electricity charges	4,480		
Office expenses	21,000		
Excess of Income over Expenditure	71,320		
	3,52,800		3,52,800

Additional information —	₹
(i) Fees accrued	49,000
(ii) Fees received in advance	28,000
(iii) Arrear fees received	21,000
(iv) Salary paid in advance	8,400
(v) Outstanding rent	9,800
(vi) Outstanding office expenses	4,200

Prepare Income and Expenditure Account on accrual basis for the year ended 31st December, 2014.

Solution **Income and Expenditure Account of Md. Selim (under Accrual Basis) for the year ended 31st December, 2014**

Expenditure	₹	₹	Income	₹	₹
To Salaries	96,600		By Fees received from audit work (Note 1)		2,52,000
Less : Salary paid in advance	8,400	88,200	By Fees received from legal advice		1,00,800
To Membership Subscriptions		44,800			
To Newspapers and magazines		11,200			
To House Rent	32,000				
Add : Outstanding rent	9,800	41,800			
To Conveyance expenses		71,400			
To Electricity charges		4,480			
To Office expenses	21,000				
Add : Outstanding office expenses	4,200	25,200			
To Excess of Income over Expenditure		65,720			
		3,52,800			3,52,800

Working Note : (1) Calculation of Fees Received from Audit Work under Accrual Basis

	₹
Fees received in cash	2,52,000
Add: Fees accrued	49,000
	3,01,000
Less: Fees received in advance	28,000
	2,73,000
Less: Arrear fees received	21,000
	2,52,000

Conversion of Profit Under Accrual Basis into Profit Under Cash Basis

For the purpose of converting the profit under accrual basis into profit under cash basis, the following steps are to be followed :

Step 1

Calculate profit / net income under accrual basis in the usual manner.

Step 2

Add the following items —

(i) Outstanding expenses at the end of the year.
(ii) Income received in advance at the end of the year.
(iii) Income accrued but not yet received at the beginning of the year.
(iv) Prepaid expenses at the beginning of the year.
(v) Any other adjustments.

Step 3

Deduct the following items —

(i) Outstanding expenses at the beginning of the year.
(ii) Income received in advance at the beginning of the year.
(iii) Income accrued but not yet received at the end of the year.
(iv) Prepaid expenses at the end of the year.
(v) Any other adjustments.

Step 4

Find out the balance. This balance will represent profit / net income under cash basis.

Illustration 11

Mr D Basu is a lawyer. Particulars of the income and expenses for the year ended 31.12.2014 are as follows:

	₹
Fees received from clients in cash	64,800
Salary of clerks and assistants paid	24,000
Rent of chamber paid (gross)	27,000
Salary of clerks and assistants outstanding	2,160
Accrued fees	14,400
Rent of chamber paid in advance (included in above)	1,800
Miscellaneous expenses	5,040
Telephone charges	2,880

You are required to ascertain Mr Basu's net income for the year ended 31.12.2014 under accrual basis. Convert the net income ascertained under accrual basis into net income under cash basis.

Solution **Computation of Net Income (under Accrual Basis) of Mr D Basu for the year ended 31st December, 2014**

Particulars	₹	₹	₹
Fees received in cash		64,800	
Add : Accrued fees		14,400	79,200
Less : Expenses —			
Salary of clerks and assistant	24,000		
Add : Outstanding	2,160	26,160	
Rent of chamber (gross)	27,000		
Less : Paid in advance	1,800	25,200	
Miscellaneous expenses		5,040	
Telephone charges		2,880	59,280
Net Income Under Accrual Basis			19,920

Statement Showing the Conversion of Net Income Under Accrual Basis into Net Income Under Cash Basis

Particulars	₹	₹
Net Income Under Accrual Basis		19,920
Add : Outstanding Salary		2,160
		22,080
Less : Rent of chamber paid in advance	1,800	
Accrual fees not yet received	14,400	16,200
Net Income Under Cash Basis		5,880

Journal Entries for Conversion of Cash Basis Accounting into Accrual Basis Accounting

Under cash basis of accounting, no adjustment is made for outstanding expenses, prepaid expenses, accrued income, income received in advance. For conversion of cash basis into accrual basis, adjustments are to be made for the above items by passing the following entries :

1. For Outstanding Expenses

Profit and Loss Adjustment Account Dr.
To Outstanding Expenses Account

2. For Prepaid Expenses

Prepaid Expenses Account Dr.
To Profit and Loss Adjustment Account

3. For Accrued Income

Accrued Income Account Dr.
To Profit and Loss Adjustment Account

4. For Income Received in Advance

Profit and Loss Adjustment Account Dr.
To Income Received in Advance Account

If there is any increase in the profit due to the conversion, then it is credited to Capital Account by passing the following entry :

Profit and Loss Adjustment Account Dr.
To Capital Account

If there is any decrease in the profit due to the conversion, the entry will be opposite, i.e.,

Capital Account Dr.
To Profit and Loss Adjustment Account

Illustration 12

From the following, pass Journal Entries to convert cash basis into accrual basis of accounting :

Rent outstanding	₹ 600
Accrued interest	₹ 1,000
Insurance premium prepaid	₹ 100
Apprenticeship premium received in advance	₹ 1,000

Solution

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Profit and Loss Adjustment A/c Dr.		600	
	To Outstanding Rent A/c			600
	(Being the adjustment for outstanding rent in connection with the conversion of cash basis of accounting into accrual basis of accounting)			
	Accrued Interest A/c Dr.		1,000	
	To Profit and Loss Adjustment A/c			1,000
	(Being the adjustment for accrued interest in connection with the conversion of cash basis into accrual basis of accounting)			
	Insurance Premium Prepaid A/c Dr.		100	
	To Profit and Loss Adjustment A/c			100
	(Being the adjustment for prepaid insurance premium in connection with the conversion of cash basis into accrual basis of accounting)			
	Profit and Loss Adjustment A/c Dr.		1,000	
	To Apprenticeship Premium Received in Advance A/c			1,000
	(Being the adjustment for apprenticeship premium received in advance in connection with the conversion of cash basis into accrual basis of accounting)			

Key Points

- ***Cash basis of accounting*** is a method of accounting in which transactions are recorded in the books of account when cash is actually received or paid out and not when the transactions take place.
- ***Accrual basis of accounting*** is an accounting system which recognises revenues and expenses as they are earned or incurred, not as cash received or paid respectively.

THEORETICAL QUESTIONS

1. What do you mean by cash and accrual basis of accounting ?
2. State the advantages and disadvantages of cash and accrual basis of accounting.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below :

1. Revenue is recognised at the point of sale under
   A cash basis
   B accrual basis
   C none of these
2. Cash basis of accounting is widely used
   A by professionals
   B for most businesses
   C none of these
3. Charges and obligations of a business unit are recognised by
   A cash basis
   B accrual basis
   C none of these
4. Estimates and judgements are required in
   A cash basis
   B accrual basis
   C none of these
5. In order to determine gross profit, an adjustment is made for opening and closing stocks in
   A cash basis
   B accrual basis
   C none of these

PRACTICAL QUESTIONS

1. You are required to ascertain the income from profession under : (a) cash basis; and (b) accrual basis of Dr P K Srinivasan. His incomes and expenses for the year 2015 are as follows :

Particulars	₹	Particulars	₹
Fees received in cash	17,550.00	Accrual fees	1,485.00
Rent of chamber paid	5,400.00	Salary of compounder paid	2,700.00
Rent of chamber paid in advance (included above)	202.50	Salary of compounder outstanding	540.00

2. You are required to ascertain the net income under :
   (a) cash basis; and (b) accrual basis of Mr P L Mehta from the following information relating to his income and expenditure for the year ended 31st December, 2014 :

Particulars	₹	Particulars	₹
Fees received in cash (Gross)	1,39,175.00	Fees received in advance	6,175.00
Fees earned but not received	14,250.00	Outstanding rent of the chamber	7,600.00
Rent of chamber paid	14,962.50	Staff salaries paid in advance	2,850.00
Staff salaries paid (Gross)	15,200.00	Telephone charges paid	2,280.00

Guide to Answers

Multiple Choice

1. B 2. A 3. B 4. B

Practical Questions

1. **Income under cash basis : ₹ 9,100; Income under accrual basis : ₹ 10,205.**
2. **Income under cash basis : ₹ 1,06,732.50; Income under accrual basis : ₹ 1,10,057.50.**

9

Inventories

Introduction

Inventory is another term for 'Stock-in-Trade'. For most businesses, inventory is one of the largest assets (25% to 30% of the total assets of the enterprise). The major source of revenue of a trading organisation is the sale of these inventories. Inventories have an effect on the profit and loss of the organisation as opening inventories are included in and closing inventories are deducted from ***Cost of Sales***. Therefore, inventories should be properly compiled periodically and recorded in the books of account for proper measurement of periodic profit and for inclusion in the Balance Sheet at the end of the accounting period.

For a trading company, the inventory includes all goods owned and held for sale in the ordinary course of business.

But for a manufacturing business, there are three major types of inventories :

(a) raw materials;
(b) work-in-progress; and
(c) finished goods.

As inventories (stock-in-trade) on hand at the end of the accounting period affect both Profit and Loss Account and Balance Sheet, it is extremely important that inventories are accurately ***valued*** at the end of the accounting period.

The Institute of Chartered Accountants of India has issued ***Accounting Standard for Valuation of Inventories — AS-2***.

In this chapter, we will cover the accounting for and valuation of inventories.

Objectives of Accounting for Inventories

A major objective of accounting for inventories is the proper determination of income through the process of matching appropriate costs against revenues (AICPA).

To ascertain the trading profit of a particular period, revenues for the period must be matched or set off by all the related expenses in producing those revenues. Proper inventory accounting will help to determine what portion of the cost of goods available for sale should be deducted from the revenues of the current period and what portion is to be carried forward as inventory to be matched against revenues in the next 'accounting period.'

Effects of Errors in Valuing Inventory

The errors in valuing inventory have effect both on the Profit and Loss Account and the Balance Sheet. When there is an error in valuing inventory, it means inventory is either overstated or understated. Also, the closing inventory of one year becomes the opening inventory for the subsequent period.

The effects are as under:

1. If the closing inventory is understated, the net profit for the period will also be understated and, in effect, the current assets of the business will be understated. The above effects will be reversed when the closing inventory is overstated.
2. If the opening inventory is understated, the net profit for the period will be overstated, and if the opening inventory is overstated, the net profit for the period will be understated.

Accounting Standard [AS-2 : Valuation of Inventories]

Meaning of Important Terms

Inventories : Inventories are assets

(a) held for sale in the ordinary course of business (e.g., finished car ready to be despatched to dealers);

(b) in the process of production for such sale (e.g., car in the assembly lines); or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services (e.g., tyre, battery, headlights, etc.).

Inventories do not include machinery spares which can be used only in connection with an item of fixed asset and whose use is expected to be irregular, e.g., spray guns used in the 'paint shop' of an automobile company's workshop.

Net Realisable Value (NRV) : Net realisable value is the estimated selling price, in the ordinary course of business, less cost of completion, and the estimated cost necessary to make the sale.

Illustration 1

X Ltd. has an item in stock which cost ₹ 10,000 and can be sold for ₹ 12,000. However, before it can be sold, it will require to be modified at a cost of ₹ 1,500. The expected selling expenses of the item are an additional ₹ 1,000.

Calculate the Net Realisable Value (NRV) of the item.

Solution

NRV = Selling Price – Modification Cost – Expected Selling Expenses

= ₹ 12,000 – 1,500 – 1,000 = ₹ **9,500**.

Fair Value : Fair value is the value for which an item could be sold between willing independent traders.

For example, X has a contract to supply 100 quintals of sugar to a biscuit manufacturing company @ ₹ 3,500 per quintal. The price is fixed for 3 months, January to March, 2015. At the end of January the market price of sugar is ₹ 3,600 per quintal. X buys 100 quintals at the market price, i.e., ₹ 3,600 per quintal. Here, fair value is ₹ 3,600 and Net Realisable Value is ₹ 3,500 less selling cost.

Measurement of Inventories

Inventories should be valued at the ***lower of cost and net realisable value***.

Illustration 2

The following information is available from the books of account of a trader. Stock which cost ₹ 20,000 can now be replaced for ₹ 14,000. The estimated net realisable value of this stock is ₹ 17,000. It is proposed that the stock should be written down to ₹ 17,000. Give your view.

Solution

As per AS—2, inventories should be valued at cost or NRV whichever is lower. Here, cost is ₹ 20,000 and NRV is ₹ 17,000. Therefore, stock should be valued at ₹ 17,000 being the lowest. ***Replacement value will not be taken into consideration***.

Cost of Inventories

For valuation of inventories, the determination of ***cost*** is very important. The cost of inventories should comprise:

(i) all costs of purchase;
(ii) costs of conversion; and
(iii) other costs incurred in bringing the inventories to their present location and condition.

Costs of Purchase : The costs of purchase consists of the purchase price including duties and taxes (other than those can be reclaimed from the authorities), freight inwards and other expenditure directly attributable to the acquisition (e.g., brokerage on purchase, packing cost for transportation, etc.).

Trade discounts, rebates, duty drawbacks and other similar items are deducted from cost.

Illustration 3

Pepsi India Ltd. purchased 20,000 kgs. of oranges from farmers of Hosierpur @ ₹ 10 per kg. Orange collecting agents' commission were paid @ ₹ 1 per kg. ₹ 8,000 were paid for lorry hire charges for transporting it to Noida Plant. 5% of the oranges were damaged in transit and discarded. This loss is a normal loss. Calculate the cost of purchase per kg. of orange.

Solution

	₹
(i) Purchase Price (20,000 × ₹ 10)	2,00,000
(ii) Collecting agents' commission (20,000 × ₹ 1)	20,000
(iii) Transportation cost	8,000
Total Cost of (20,000 – 1,000) = 19,000 kgs.	2,28,000

Purchase cost per kg. $= \frac{2,28,000}{19,000} =$ **₹ 12**

Costs of Conversion : The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting raw materials into finished goods.

For example, Wills Ltd. is having a readymade garment factory in Ludhiana, Punjab, where two products are manufactured — sports T-shirt and Track suit. Direct labour hours of 24,000 are used in each period. Cutting is done by computer controlled automatic machine. However, stitching is done manually. Workers are paid ₹ 50 for stitching one T- shirt and ₹ 100 for stitching one Track suit. At the time of calculating cost of T-shirt ₹ 50 is to be added and for calculating cost of Tract suit ₹ 100 is to be added.

Fixed production overheads are those indirect cost of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance cost of cutting machine in the above example, depreciation of factory building and the cost of factory management and administration.

The allocation of fixed production overheads for the purpose of their inclusion in the cost of conversion is based on the ***normal capacity*** of the production facility. This is the average expected output over a number of periods, taking into account production reductions due to planned maintenance and normal holidays.

For example, before Diwali you close the factory for routine maintenance and cleaning. You follow 5 days a week and single shift each day. At the time of calculating normal capacity all these factors must be taken into consideration. It should not be calculated on the basis of calendar days.

Low production levels, or idle plant for abnormal reasons are not taken into consideration in determining the allocation rate of fixed production overheads.

For example, productions were suspended for 4 weeks for flood. The fixed production overheads incurred during that time should not be included in the cost of inventory.

Unallocated overheads are recognised as an ***expense*** in the period in which they are incurred. In periods of abnormally-high production, the overhead allocation rate is ***reduced***, so that, inventories are not measured above cost.

For example, Normal output of your factory is 20,000 units per month. You normally charge fixed overhead per unit @ ₹ 20. To complete a special order from China, your factory works overtime every weekends for last 4 months. The new level of output is 25,000 units per month.

Total fixed overhead per month = ₹ 20 × 20,000 = ₹ 4,00,000.

Under changed circumstances, the fixed overhead rate will be reduced :

$$\textbf{New Rate} = \frac{4,00,000}{25,000} = ₹\ 16$$

Variable production overheads are those indirect costs which vary directly or near directly, with the volume of production, such as indirect materials, indirect labour etc.

Variable production overheads are assigned to each unit of production on the basis of actual use of the production facilities.

For example, Wills Ltd.'s ready made garment factory has a centralised ironing facility. It cost ₹ 300 per productive hours to run.

T-shirt takes 1 minute and Track suit takes 2 minutes for ironing.

Therefore, variable production overhead to be assigned to T-shirt = ₹ 5 $\left(\frac{300}{60} \times 1\right)$ **and**

Track suit = ₹ 10 $\left(\frac{300}{60} \times 2\right)$

Joint Products and By-products

A production process may result in more than one product being produced simultaneously.

When a group of individual products is simultaneously produced, and each product has a significant relative sales volume, the outputs are usually called ***Joint Products***. Those products which are part of the simultaneous production process and have a minor sales volume or insignificant sales volume are called ***by-products***.

In case of joint products, when the costs of conversion of each product are not separately identifiable, they are allocated between products on a rational and consistent basis. The joint cost may be allocated on the basis of relative sales value of each product, either when they complete or when they are separately identifiable in the production process.

For example, Haldia Petrochemicals Ltd. incurs per batch joint product cost of ₹ 30,00,000 for the production of two joint products X and Y. Both products can be sold at split-off point. X can be sold @ ₹ 80 per unit and Y can be sold @ ₹ 40 per unit. The production were — X 50,000 units and Y 50,000 units.

In this case, the joint cost of ₹ 30,00,000 will be allocated as follows :

Joint Product Cost — ₹ 30,00,000		**Sale of 50,000 units @ ₹ 80**	**40,00,000**
		Sale of 50,000 units @ ₹ 40	**<u>20,00,000</u>**
	Split-off point	**Total Sales**	**<u>60,00,000</u>**

(i) Product X should bear 2/3 of ₹ 30,00,000	**₹ 20,00,000**
(ii) Product Y should bear 1/3 of ₹ 30,00,000	**₹ 10,00,000**
	₹ 30,00,000

Each unit of X will bear ₹ 40 (₹ 20,00,000 / 50,000)

Each unit of Y will bear ₹ 20 (₹ 10,00,000 / 50,000)

Most by-products as well as scrap or waste materials, by its nature, is immaterial. If this is the case, then it is measured at net realisable value, and this value is deducted from the cost of the main product.

Other Costs : Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition.

These would include inward transport and storage cost prior to completion of production or the cost of designing products for specific customers.

It should be noted that interest and other borrowing costs are not included in the cost of inventories.

Excise Duty on Finished Goods

Excise duty is a manufacturing expense and therefore, it should be included in the valuation of finished goods. The Guide Note on "Accounting Treatment for Excise Duty" issued by the Institute of Chartered Accountants of India is very important in this respect and it is given below :

"Since the liability for excise duty arises when the manufacture of the goods is completed, it is necessary to create a provision for liability of unpaid excise duty on stock lying in factory or bonded warehouse. The estimate of such liability can be made at the rate in force on the Balance Sheet date. The excise duty paid provided on finished goods should, therefore, be included in the inventory valuation."

It should be noted that if the excise duty is refundable, it should not be included in the cost of raw materials consumed to produce the W.I.P. or the finished goods.

Cost Excluded from Inventories

In determining the cost of inventories it is appropriate to exclude certain costs and recognise them as expenses in the period in which they are incurred. Examples of such costs are :

(a) abnormal amounts of wasted materials, labour or other production costs;

(b) storage costs, unless those costs are necessary in the production process prior to a further production stage;

(c) administrative overheads that do not contribute to bringing the inventories to their present location and condition; and

(d) selling and distribution costs.

Illustration 4

(i) When valuing stock at cost, which of the following shows the correct method of arriving at cost ?

	Include inward transport cost	Include production overheads
A	YES	NO
B	NO	YES
C	YES	YES
D	NO	NO

(ii) According to AS – 2 (Inventories), which of the following costs should be included in valuing the inventories of a manufacturing company ?

(i) carriage inwards
(ii) carriage outwards
(iii) depreciation of factory plant
(iv) general administrative overheads

A all four items
B (i), (ii) and (iv) only
C (i), (iii) and (iv) only
D (i) and (iii) only

Solution

(i) At the time of valuation of stock at cost, inward transparent cost as well as production overheads are to be included. Therefore, answer "**C**" is correct.

(ii) For determining the cost of inventories, carriage inwards and depreciation of factory plant are to be taken into consideration. However, carrying outwards and general administrative overheads will not be taken into consideration. Therefore, answer "**D**" is correct.

Illustration 5

Which of the following costs may be included when arriving at the cost of finished goods inventory for inclusion in the financial statements of a manufacturing company ?

(i) carriage inwards
(ii) carriage outwards
(iii) depreciation of factory plant
(iv) finished goods storage costs
(v) factory supervisor's salary

A all five
B (i) and (v) only
C all except (iv)
D all except (ii) and (iv)

Solution

For calculating cost of finished goods inventory, carriage inwards, depreciation of factory plant and factory supervisor's salary are included. However, carriage outwards and finished goods storage cost are excluded. Therefore, answer "**D**" is correct.

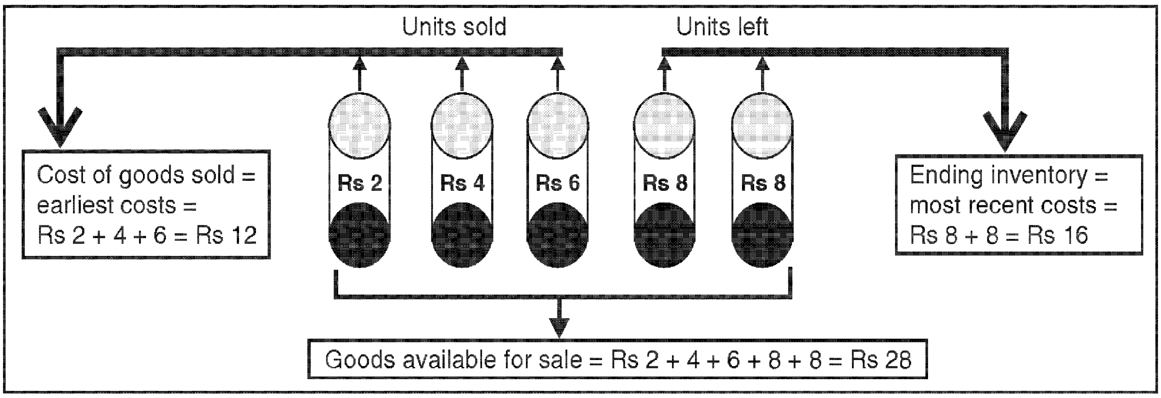
Cost Formulas

Inventory prices are seldom stable. In many cases inventories lose their identity and are substantially indistinguishable from one another, though may be acquired at varying rates. A very important valuation problem arises while assigning costs to inventory items. No problem would arise if prices never changed. Once the unit cost of each inventory item is known, some method must be used to assign costs to closing inventory and cost of goods sold. There are several methods for assigning cost to inventory items.

1. Specific Identification Method This method is adapted by the enterprises to determine the cost of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects. For example, X Ltd. deals in paintings of renowned artists. As the paintings are not interchangeable, X Ltd. should follow 'Specific Identification Method' for valuation of closing inventory and cost of goods sold.

2. First In First Out Method (FIFO) This method is based on the premise that the first item purchased is the first item sold, that is, all the inventories are sold in the order in which they are acquired. Since the oldest stock in the inventory is sold first, the calculation of the inventory is on the basis that the inventories in hand represent the ones most recently purchased or produced and the cost of goods sold represents the cost of items acquired in the earlier purchases.

FIFO METHOD

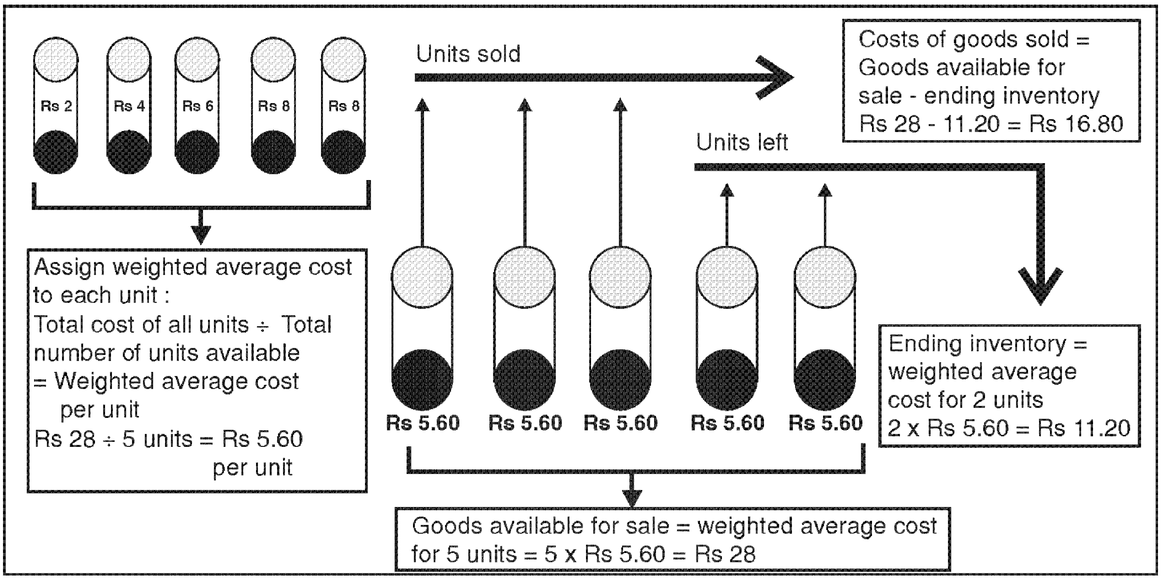


3. Weighted Average Method Under this method, the costs to be assigned to inventories are ascertained by applying to the closing inventory an average cost computed by dividing the total cost of units by the total number of such units. The average cost is calculated by applying the following formula:

$$\text{Weighted Average Cost Per Unit} = \frac{\text{Opening Inventory + Purchases (in amount)}}{\text{Opening Inventory + Purchases (in units)}}$$

The value of the closing inventory is ascertained by multiplying the number of units on hand (from the physical count) by the weighted average cost per unit (see the diagram below).

WEIGHTED AVERAGE METHOD



Techniques for the Measurement of Cost — Standard Cost Method and the Retail Method

Techniques for the measurement of the cost of inventories, such as the standard cost method or the retail method may be used for convenience if the results approximate the actual cost.

Standard Cost Method: Standard costs take into account normal levels of consumption of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of current conditions.

The Retail Method: The retail method is often used in the retail trade for measuring inventories of large numbers of rapidly changing items that have similar margins and for which it is impracticable to use other costing method. The cost of the inventory is determined by reducing from the sales value of the inventory the appropriate percentage gross margin. The percentage used takes into consideration inventory which has been marked down to below its original selling price. An average percentage for each retail department is often used.

Net Realisable Value (NRV)

Inventories should not be carried in excess of amounts expected to be realised from their sale or use. It may be necessary to write down the cost of the inventory to NRV for different reasons, e.g.,

(i) Damage to the inventories
(ii) Obsolescence
(iii) General decline in the market price for the goods
(iv) Estimated costs necessary to make the product saleable

For calculating NRV, the following points are to be taken into consideration :

1. Review Items Individually

Inventories are usually written down to net realisable value on an ***item-by-item*** basis. In some circumstances, however, it may be appropriate to group similar or related items. This may be the case with items of inventory relating to the same product line that have similar purposes or end uses and are produced and marketed in the same geographical area and cannot be practicably evaluated separately from other items in that product line.

It is not appropriate to write down inventories based on a classification of inventory, for example, finished goods, or all the inventories in a particular business segment.

Illustration 6

Lexus Motors Ltd. a dealer in second hand cars has 5 vehicles in stock at the end of the financial year 2008-09. These are:

Car	Fiat	Ambassador	Maruti Esteem	Maruti 800	Zen	Total (₹)
Cost (₹)	90,000	1,15,000	2,75,000	1,00,000	2,00,000	7,80,000
Net Realisable Value (₹)	95,000	1,55,000	2,65,000	1,25,000	2,30,000	8,70,000

You are required to calculate the value of stock to be included in the Balance Sheet of the company.

Solution

For calculating the value of stock, each item is to be reviewed individually. The valuation of stock is to be done as follows :

Car	Fiat	Ambassador	Maruti Esteem	Maruti 800	Zen	Total (₹)
Value (₹)	90,000	1,15,000	2,65,000	1,00,000	2,00,000	7,70,000

It should be noted that the appropriate stock figure is not ₹ 7,80,000 but ₹ 7,70,000 as calculated above.

Illustration 7

As at 31st December, 2014 the original cost of stock held by A amounted to ₹ 6,345 whilst the total net realisable value of this stock was estimated at ₹ 7,894 — A has analysed these figures as follows :

Item	Cost (₹)	Net Realisable Value (₹)
Readymade Garments	3,169	3,078
Clothing	2,789	4,157
Undergarments	387	659
	6,345	7,894

You are required to value the Stock as per AS—2.

Solution

At the time of valuation of stock, cost and net realisable value of each item is to be considered ***separately***. The value of stock as per AS—2 will be as follows :

Item	Cost (₹)	Net Realisable Value (₹)	Value to be taken (₹)
Readymade Garments	3,169	3,078	3,078
Clothing	2,789	4,157	2,789
Undergarments	387	659	387
Value of Stock			6,254

2. Contract Price and Market Price

Estimates of net realisable value also take into consideration the purpose for which the inventory is held. For example, the net realisable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price. If the sales contracts are for less than the inventory quantities held, the net realisable value of the excess inventory is based on general selling prices.

For example, X Ltd. purchased 10,000 barrels of crude oil @ ₹ 4,400 per barrel. At the end of the period, it has a contract to sell 10,000 barrels @ ₹ 4,000 per barrel. However, the market price is ₹ 3,600 per barrel at the year end.

Here, for the purpose of calculating net realisable value, the contract price ₹ 4,000 per barrel is to be taken into consideration. The value of stock will be : 10,000 × ₹ 4,000 = ₹ **400,00,000**.

Taking the above example, let us assume that X Ltd. has a contract to sell 9,000 barrels @ ₹ 4,000 per barrel. Here net realisable value is to be calculated as follows :

9,000 @ ₹ 4,000 per barrel	₹ 360,00,000
1,000 @ ₹ 3,600 per barrel	₹ 36,00,000
Total	₹ 396,00,000

Illustration 8

X Limited has purchased 1,00,000 units of a product @ ₹ 800 per unit on 1.1.2015. On the Balance Sheet date, i.e., 31.3.2015 there were 20,000 units in stock. Of these, 5,000 units are earmarked against sale contract at a price of ₹ 900 each. The market price of the product has dropped to ₹ 750. How the closing stock will be valued on 31.3.2015 ?

Solution

The inventory will be valued as under :	₹
Inventory held against contract 5,000 × (lower of ₹ 800 and ₹ 900)	40,00,000
Inventory held for resale 15,000 × (lower of ₹ 800 and ₹ 750)	1,12,50,000
Total value of inventory	1,52,50,000

3. No write down when finished goods will be sold at cost or above cost

Materials and other supplies held for use in production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost.

However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed NRV, the materials are written down to NRV. In such circumstances, the replacement cost of the materials may be the best available measure of their NRV.

Illustration 9

Stock consists of 1,742 units of a raw material purchased at ₹ 7.30 each, but the unit price of the item has fallen to ₹ 6.50. The price reduction is apprehended to be permanent. The firm has already decided that if the price reduction last longer than six months, it will reduce the sale price of the finished goods from ₹ 10.90 to about ₹ 10.

Calculate the Value of Stock.

Solution

In this case, though the unit price has fallen to ₹ 6.50 from ₹ 7.30, the stock will be valued @ ₹ 7.30 because it will not exceed the revised selling price of ₹ 10.

Therefore, the value of stock will be : 1,742 × ₹ 7.30 = ₹ **12,716.60**.

Illustration 10

X Limited uses a single raw material and converts that into a finished product. During the year ended 31.3.2010, the manufacturing cost of the product was as follows:

	₹
Raw materials — 4 units @ ₹ 10 each	40
Conversion cost	30
Manufacturing Cost	70

The finished product is sold @ ₹ 85 per unit.

On 31.3.2008, there was a fall in the sale price of the finished product to ₹ 60, because of steep fall in the raw material prices. Currently, raw materials are available in the market @ ₹ 5 each. On 31.3.2008, there was 50,000 units of raw materials in stock purchased at the above rate.

Calculate the value of inventory on 31.3.2010.

Solution

In this case manufacturing cost is ₹ 70 but the sale of finished goods has fallen to ₹ 60, because of decline of the raw material price from ₹ 10 to ₹ 5. Inventories to be valued at net realisable value.

In this circumstances, the replacement cost of the material may be the best available measure of its net realisable value.

Therefore, the value of closing stock on 31.3.2010 will be : 50,000 × ₹ 5 = ₹ **2,50,000**.

Disclosure

The financial statements should disclose:

(a) the accounting policies adopted in measuring inventories, including the cost formula used; and

(b) the total carrying amount of inventories and its classification appropriate to the enterprise.

Information about the carrying amounts held in different classifications of inventories and the extent of the changes in these assets is useful to financial statement users. Common classifications of inventories are raw materials and components, work in progress, finished goods, stores and spares, and loose tools.

General Illustrations

Illustration 11

DCM Ltd manufactures textiles. The company accountant asks your advice about the following product lines:

Lime Green Tartan : Manufactuing cost ₹ 9,000. This stock has been on a shelf since 2000. The accountant believes that the only way of selling it would be to shred it and bundle it (at a cost of ₹ 500) and sell it as industrial cleaning wipes for an anticipated sale price of ₹ 5,000.

Power Strangers : Originally printed to meet a high demand for garments linked to a popular television serial, there is no further demand for the textile in this country. Stocks cost ₹ 16,000, and the only possible source of revenue would be to export the material at a cost of ₹ 2,750 for use as dusters in Australia. Administration costs to handle the sale are estimated at ₹ 2,650, and the sale price is estimated at ₹ 4,000.

Explain, with reasons, how each of the above product lines should be accounted for in the annual accounts of the company for the year ended 31 March, 2013.

Solution

Inventories should be valued at the lower of cost and net realisable value.

Lime Green Tartan : Manufacturing cost is ₹ 9,000 but the net realisable value is ₹ 4,500 (₹ 5,000 – ₹ 500). Therefore, ₹ 4,500 is to be taken as value of stock for annual accounts of the company.

Power Strangers : Cost is ₹ 16,000 but the net realisable value is negative (₹ 4,000 – ₹ 2,750 – ₹ 2,650). Therefore, the value of stock should be taken as nil.

Illustration 12

X Limited has three major categories of goods: X, Y and Z. The following information is available on 31.3.2015 in respect of these (figures in rupees):

Items	Historical Cost	Replacement Cost	Net Realisation Value
X	50,000	53,000	37,000
Y	65,000	60,000	64,000
Z	50,000	54,000	72,000

Calculate the value of inventory as on 31.3.2015.

Solution

Inventories are valued at lower of historical cost or net realisable value. Replacement cost is relevant when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value. Therefore, the inventory will be valued as under:

Item	Amount (₹)
X	37,000
Y	64,000
Z	50,000
Tota l valu e of inventory	1,51,000

Illustration 13

The company deals in three products A, B and C, which are neither similar nor interchangeable. At the time of closing of its accounts for the year 2014-10, the Historical Cost and Net Realisable Value of the items of closing stock are determined as follows :

Items	Historical Cost (₹ in Lakhs)	Net Realisable Value (₹ in Lakhs)
A	40	28
B	32	32
C	16	24

What will be the value of closing stock ?

Solution

As per para 5 of AS—2, inventories should be valued at the lower of cost and net realisable value.

As per para 14 of AS—2, the cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects should be assigned by specific identification of their individual costs.

As per para 21 of AS—2, inventories are usually written down to NRV on an item-by-item basis.

Statement Showing the Calculation of Closing Stock (figures in Lakhs)

Items	Historical Cost	Net Realisable Value	Valuation of Closing Stock
A	40	28	28
B	32	32	32
C	16	24	16
Total	88	84	76

Therefore, the value of closing stock is ₹ 76,00,000.

Illustration 14

X Ltd has included in its accounts an item of stock which had cost it ₹ 50,000. The business has no further use for this stock. It can be scrapped for ₹ 25,000 or sold for the following (all figures in rupees):

Sale Proceeds	40,000
Less: Trade discount	4,000
	36,000
Less: Cash discount	1,000
	35,000
Less: Cost of disposal	2,500
	32,500

What figure should be included in the accounts for this item ?

Solution

Cost — ₹ 50,000

Net Realisable Value	₹	
Sale Proceeds	40,000	∴ Lower of cost and net realisable value = ₹ 33,500. Therefore, ₹ 33,500 is to be included in accounts for this item. It should be noted that cash discount would appear in the Profit and Loss Account.
Less: Trade discount	4,000	
	36,000	
Less: Cost of disposal	2,500	
	33,500	

Illustration 15

How do you value the closing stock under the following situation?

Closing stock consists of 4,800 units purchased @ ₹ 5 each. At the year end, the firm realised that the closing stock is not that it would choose to acquire the market place. An equivalent product is available in the market which can be acquired @ ₹ 4 each. In effect, the firm has to reduce the selling price of the product from ₹ 6.25 to ₹ 4.75. The closing stock, in its present physical form, can be sold in the market @ ₹ 2.25 each. If the firm wants to replace the existing stock by the new equivalent product, it has to pay an additional amount of ₹ 1.50 per unit.

Solution

The firm has the following two options:

(i) To sell the stock at ₹ 2.25 each and re-acquire the stock at ₹ 4 each. In this case, it has to incur an additional cost of ₹ 1.75 (₹ 4.00 – ₹ 2.25) per unit.

OR

(ii) To replace the stock by paying at ₹ 1.50 per unit.

Obviously, the second option is cheaper. Therefore, the value of the stock = 4,800 × (₹ 4.00–1.50) = ₹ **12,000**.

Illustration 16

The Directors of ITC Limited have valued their stocks at ₹ 4,50,000 at 31 December, 2014. Some of the stock items have been drawn to the attention of the company's auditors :

(i) Two categories of stocks, VX and LX have been valued at ₹ 23,000. The auditors ascertain that the valuation was based on what the directors considered was the lower of cost and net realisable value, calculated as follows:

Item		Cost of Raw Materials [1]	Attributable Production Overheads Incurred [2]	Attributable Distribution Overheads to be Incurred [3]	Expected Selling Price [4]
VX	(₹)	16,000	2,000	2,400	17,000
LX	(₹)	4,000	1,000	2,000	8,000
	(₹)	20,000	3,000	4,400	25,000
Cost	{ [1] + [2] }	23,000			
Net Realisable Value	{ [3] + [4] }				29,400

(ii) A raw material, Opprobrium, was bought at several different prices during the year, and the closing stock was valued at ₹ 44,000. The stock has previously been valued on a FIFO basis. Stock is valued on a periodic basis. Details of the stock are :

Month	Received (Tonnes)	Cost per Tonne (₹)	Issues (Tonnes)
Jan.	500	35	200
Mar.	300	45	500
Jun.	600	65	400
Nov.	800	90	100

There were no stocks of Opprobrium on 1 January, 2014.

You are required to recalculate the value of ITC Limited's Closing Stock at 31 December on the basis of AS—2.

Solution

(i) As per Para 21 of AS—2, '***Inventories are usually written down to net realisable value on an item-by-item basis***.' Therefore, at the time of valuation of stock, cost and net realisable value of each item is to be considered separately. The value of stock as per AS—2 will be as follows :

Item	Cost [Note 1] (₹)	NRV [Note 2] (₹)	Value to be taken (₹)
VX	18,000	14,600	14,600
LX	5,000	6,000	5,000
Value of Stock			19,600

Working Notes :

(1) Calculation of Cost

Item	VX (₹)	LX (₹)
Cost of Raw Materials	16,000	4,000
Add: Attributable Production Overhead	2,000	1,000
Cost	18,000	5,000

(2) Calculation of Net Realisable Value (NRV)

Item	VX (₹)	LX (₹)
Expected Selling Price	17,000	8,000
Less: Attributable Distribution Overhead to be Incurred	2,400	2,000
NRV	14,600	6,000

(ii) As per Para 16 of AS—2, the cost of Inventories should be assigned by using FIFO, or Weighted Average Cost Formula. The company is using FIFO method. Therefore, FIFO method is to be adopted to determine the cost of raw materials — 'Opprobrium'.

Total Quantity Received	2,200 (tonnes)
Total Issue	1,200 (tonnes)
Quantity in hand	1,000 (tonnes)

Cost of Closing Inventory is Calculated as Under

	₹
800 (tonnes) @ ₹ 90	72,000
200 (tonnes) @ ₹ 65	13,000
1,000	85,000

Therefore, the cost of stock will be ₹ 85,000

Revised Value of Stock

Particulars	₹	₹
Value of Stock (as determined by the Directors)		4,50,000
Adjustment for Change in the Value of VX, LX and Opprobrium :		
(i) Reduction in the value of VX + LX (₹ 23,000 – ₹ 19,600)	(3,400)	
(ii) Increase in the value of Opprobrium (₹ 85,000 – ₹ 44,000)	41,000	37,600
Revised Value of Stock		4,87,600

Illustration 17

State with reference to Accounting Standard, how will you value the inventories in the following cases:

(i) Raw materials were purchased at ₹ 100 per kilo. Price of the raw material is on decline. Finished goods in which raw materials were incorporated are expected to be sold at below cost. 10,000 kg of raw materials are on stock at the year end. Replacement cost is ₹ 80 per kg.

(ii) In a production process, normal wastage is 5% of input. 5,000 MT of input were put in process resulting in a wastage of 300 MT. Cost per MT of input is ₹ 1,000. The entire quantity of waste is on stock at the year end.

(iii) Per kg. of finished goods consisted of:
Material cost ₹ 100 per kg.
Direct labour cost ₹ 20 per kg.
Direct variable production overhead ₹ 10 per kg.
Fixed production charges for the year on normal capacity of one lakh kg. is ₹ 10 lakh. 2,000 kg. of finished goods are in stock at the year end.

Solution

(i) As per para 24, when there has been a decline in the prices of materials and it is estimated that the cost of the finished products will exceed net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value.
Therefore, in this case, the materials will be valued at ₹ 80 per kg. Total value ₹ 8,00,000.

(ii) Input : 5,000 MT; Normal wastage : 5%, i.e., 5% of 5,000 MT = 250 MT.
Actual wastage : 300 MT; Abnormal wastage 300 MT – 250 MT = 50 MT.
As per para 13, in determining the cost of inventories, it is appropriate to exclude abnormal amounts of wasted materials or expenses in the period in which they are incurred.
Therefore, in this case, the entire cost of abnormal wastage, i.e., 50 × ₹ 1,000 = ₹ 50,000 should be charged to the Profit and Loss Account.

(iii) As per para 9, the allocation of fixed production overheads for the purpose of their inclusion in the costs of conversion is based on the normal capacity of the production facilities.
Therefore, in this case, the cost per kg. of finished goods will be calculated as under:

	₹
Materials	100
Direct labour	20
Direct variable production overheads	10
Fixed production overheads	*10
	140

$$\text{Fixed production overheads per kg.} = \frac{\text{Rs } 10,00,000}{1,00,000} = \text{Rs } 10 \text{ per kg.}$$

Therefore, the value of 2,000 kg. of finished goods = 2,000 × ₹ 140 = ₹ 2,80,000.

Accounting for Inventories

There are two alternative methods that may be adopted in accounting for inventories :

1. Perpetual Inventory Method
2. Periodic Inventory Method (Physical Inventory Method)

1. Perpetual Inventory Method

Perpetual inventory method is a method where the inventory accounting is kept continuously up-to-date and involves the continual recording of additions to and issues or sales of materials on a daily basis. The method is applicable to those businesses where the sale items are of high value and have a number of sale transactions daily. Under this system, a Ledger Account (Inventory Account) is maintained which shows the cost of goods sold at any time during the accounting period. When a perpetual inventory is kept, a physical inventory should be taken at least once in a year.

2. Periodic Inventory Method

Under this method, a physical inventory is usually taken only at the year-end or at regular intervals. The inventory on hand, and hence, the cost of goods sold, are determined by means of physical count at periodic intervals or at the end of the period. This method is costly as well as inconvenient.

To ascertain the cost of goods sold under this method, the books of account must show the following:

(a) opening and closing inventory for the period; and

(b) the cost of the purchased inventory during the period.

This is generally done as under:

	₹
Inventory at the beginning of the period	***
Add: Purchases of inventory during the period	***
Cost of the goods available for sale	***
Less: Inventory at the end of the period	***
Cost of goods sold	***

Following is the system of working of the Periodic Inventory Method:

1. Last year's closing inventory becomes the opening inventory for the current year. Trading Account is debited with the opening inventory.
2. Purchases for the period are recorded in the Purchases Account and this account is closed by transferring to Trading Account as above.
3. The closing inventory, which is based on physical count, is recorded in an account called Closing Stock Account. This account is transferred to the Trading Account by debiting Closing Stock Account and crediting Trading Account. This account has a life for one day only. This is because, it becomes opening stock of the next accounting period.
4. The resultant figure (the balancing figure in the Trading Account) is the cost of goods sold.

Recording Inventory Acquisitions and Sales

Sl. No.	Perpetual Inventory System	Periodic Inventory System
1.	**Purchase of Inventory** Inventory A/c Dr. To Suppliers A/c	**Purchase of Inventory** Purchases A/c Dr. To Suppliers A/c
2.	**Return of Inventory** Suppliers A/c Dr. To Inventory A/c	**Return of Inventory** Suppliers A/c Dr. To Purchases Returns A/c
3.	**Freight paid** Inventory A/c Dr. To Cash A/c	**Freight paid** Carriage Inward A/c Dr. To Cash A/c
4. (i)	**Sale of Inventory** Sundry Debtors A/c Dr. To Sales A/c	**Sale of Inventory** Sundry Debtors A/c Dr. To Sales A/c
(ii)	Cost of Goods Sold A/c Dr. To Inventory A/c	No entry is passed
5. (i)	**Return of goods by customer** Sales Returns A/c Dr. To Sundry Debtors A/c	**Return of goods by customer** Sales Returns A/c Dr. To Sundry Debtors A/c
(ii)	Inventory A/c Dr. To Cost of Goods Sold A/c	No entry is passed

In contrasting the two inventory systems, notice the following :

1. The perpetual system uses no Purchase Account. It records all purchases in the Inventory Account. The periodic system uses a Purchases Account.
2. The perpetual system records goods returned to suppliers by directly reducing the Inventory Account. The periodic system uses Purchases Returns Account.

3. The perpetual system records cost of goods and reduces inventory when goods are sold.
   The periodic system calculates cost of goods sold on the basis of the inventory remaining on hand at the end of the period and records cost of goods sold through the closing process.
4. The perpetual system records customer returns by reducing cost of goods sold and increasing inventory. The periodic system makes no entry in stock for goods returned.
5. The cost of goods sold and inventory amounts are readily available at any time under the perpetual system. Under periodic system cost of goods sold and inventory amounts are usually not available until they are calculated at the year end.

Recording Transaction in Stores Ledger / Stock Cards

Earlier in this chapter, it has been stated that there are a number of acceptable methods for assigning cost to inventories, such as Specific Identification, FIFO and Weighted Average Cost.

Stores Ledger is useful where an enterprise has a large number of different inventory items on hand and individual items cannot be identified / traced. The stores ledger will help to identify the quantity and cost of item on hand.

At the time of recording transaction in Stores Ledger / Stock Cards, the management will need to adopt either FIFO method or Weighted Average Method.

The following illustrations will explain the procedures of recording transaction in stores ledger / stock cards.

Illustration 18

The following transactions took place during the month of January 2015 in DCM Limited.

Jan. 1	Opening Stock 500 units @ ₹ 35	Jan. 15	Purchases 1,200 units @ ₹ 34
Jan. 5	Purchases 1,000 units @ ₹ 38	Jan. 18	Sales 1,000 units
Jan. 7	Sales 300 units	Jan. 23	Purchases 900 units @ ₹ 30
Jan. 12	Sales 800 units	Jan. 28	Sales 1,200 units

Calculate the Cost of Closing Stock based on FIFO method.

Solution

DCM Limited
Store Ledger (FIFO Method)

Date	Purchases			Sales			Balance		
2015	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)
Jan. 1							500	35	17,500
5	1,000	38	38,000				500 1,000	35 38	17,500 38,000
7				300	35	10,500	200 1,000	35 38	7,000 38,000
12				200 600	35 38	7,000 22,800	400	38	15,200
15	1,200	34	40,800				400 1,200	38 34	15,200 40,800
18				400 600	38 34	15,200 20,400	600	34	20,400
23	900	30	27,000				600 900	34 30	20,400 27,000
28				600 600	34 30	20,400 18,000	300	30	9,000
Cost of Closing Stock									9,000

Illustration 19

The following details are available in respect of material ZA 234 for the month of September, 2014.

Sept. 1	Opening Stock 1,000 kg. @ ₹ 20 per kg.	Sept. 20	Purchases 1,000 kg. @ ₹ 26.25 per kg.
Sept. 10	Purchases 500 kg. @ ₹ 23 per kg.	Sept. 30	Issued 750 kg.
Sept. 15	Issued 750 kg.		

Calculate the Cost of Stock as on September 30, 2014 under the Weighted Average (Perpetual) Method.

Solution **Store Ledger [Weighted Average (Perpetual) Method]**

Date	Purchases			Issues			Balance		
2014	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)
1							1,000	20	20,000
10	500	23	11,500				1,500	21	31,500
15				750	21	15,750	750	21	15,750
20	1,000	26.25	26,250				1,750	24	42,000
30				750	24	18,000	1,000	24	24,000
Cost of Closing Stock							1,000		24,000

Illustration 20

A Company, started on 1 January, 2014, purchased raw materials during 2014 as stated below:

January 2	800 kg @ ₹ 62 per kg.	July 10	3,000 kg @ ₹ 56 per kg
February 26	1,200 kg @ ₹ 57 per kg	September 18	1,500 kg @ ₹ 60 per kg
April 13	2,500 kg @ ₹ 59 per kg	November 29	1,000 kg @ ₹ 65 per kg

While preparing its final accounts on 31st December, 2014, the company had 1,300 kg of raw materials in its godown.

Calculate the Cost of Closing Stock of raw materials according to (1) First-in-first-out basis, and (ii) Weighted Average Basis (Periodic).

Solution **Valuation of Closing Stock**

'First-In-First-Out' Basis. Raw materials in hand were 1,300 kg. It should be valued at the rate of last two consignments. So the Cost of Closing stock will be:

		₹
300 kg	@ ₹ 60 per kg	18,000
1,000 kg	@ ₹ 65 per kg	65,000
1,300 kg		83,000

Weighted Average Basis (Periodic)

Date		Price	Quantity	Value (₹)
2014	Jan. 2	62	800	49,600
	Feb. 26	57	1,200	68,400
	Apr. 13	59	2,500	1,47,500
	Jul. 10	56	3,000	1,68,000
	Sep. 18	60	1,500	90,000
	Nov. 29	65	1,000	65,000
			10,000	5,88,500

$$\textit{Weighted Average Price} = \frac{\text{Rs } 5{,}88{,}500}{10{,}000} = \text{Rs } 58.85$$

Cost of Closing Stock = 1,300 x ₹ 58.85

= ₹ 76,505

Illustration 21

At the beginning of December 2014, Quality Brush Company had in stock 10,000 brushes valued at ₹ 10 each. Purchases and Issues during the month were as follows :

Purchases		Issues	
Dec. 7	4,000 Brushes @ ₹ 12.50	Dec. 16	16,000 Brushes
Dec. 14	6,000 Brushes @ ₹ 15.00	Dec. 28	10,000 Brushes
Dec. 24	8,000 Brushes @ ₹ 16.50		

You are required to compute the Cost of Closing Stock on the basis of Weighted Average (Perpetual) Method.

Solution **Quality Brush Company**

Stores Ledger [Weighted Average (Perpetual) Method]

Date	Receipts			Issues			Balance		
2014	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)
Dec. 1							10,000	10.00	1,00,000
7	4,000	12.50	50,000				14,000	10.71	1,50,000
14	6,000	15.00	90,000				20,000	12.00	2,40,000
16				16,000	12.00	1,92,000	4,000	12.00	48,000
24	8,000	16.50	1,32,000				12,000	15.00	1,80,000
28				10,000	15.00	1,50,000	2,000	15.00	30,000

Therefore, the Cost of Closing Stock will be ₹ 30,000.

Illustration 22

P Limited price the issues using the Weighted Average (Perpetual) Method. The following relate to transactions in the month of March 2015. Opening balance 2,000 units @ ₹ 10 each.

	Purchases		Issues
March 4	1,500 units @ ₹ 8 per unit	March 2	1,000 units
March 15	1,300 units @ ₹ 9.50 per unit	March 6	1,200 units
March 22	2,000 units @ ₹ 10 per unit	March 20	2,000 units
		March 26	1,500 units

Calculate the Cost of Closing Stock taking two decimal places.

Solution

P Limited
Store Ledger [Weighted Average (Perpetual) Method]

Date	Purchases			Issues			Balance		
2015	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)
March 1							2,000	10	20,000
2				1,000	10	10,000	1,000	10	10,000
4	1,500	8	12,000				2,500	8.80	22,000
6				1,200	8.80	10,560	1,300	8.80	11,440
15	1,300	9.50	12,350				2,600	9.15	23,790
20				2,000	9.15	18,300	600	9.50	5,490
22	2,000	10	20,000				2,600	9.80	25,490
26				1,500	9.80	14,700	1,100	9.81	10,790
Cost of Closing Stock							1,100		10,790

Illustration 23

Slow and Steady Limited follows the First-in-First-Out (FIFO) Method of inventory valuation. The following particulars are available in respect of an item of raw material for the month of January 2015.

Jan. 1	Opening balance 2,500 kg. @ ₹ 18 per kg.	Jan. 22	Issue 7,000 kg.
Jan. 4	Purchases 3,000 kg. @ ₹ 20 per kg.	Jan. 28	Purchases 2,000 kg. @ ₹ 22 per kg.
Jan. 6	Issues 5,000 kg.	Jan. 31	Issues 4,500 kg.
Jan. 18	Purchases 10,000 kg. @ ₹ 21 per kg.		

Calculate the Cost of Closing Stock on the basis of FIFO Method.

Solution

Slow and Steady Limited
Store Ledger (FIFO Method)

Date	Purchases			Issues			Balance		
2015	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)
Jan. 1							2,500	18	45,000
4	3,000	20	60,000				2,500 3,000	18 20	45,000 60,000
6				2,500 2,500	18 20	45,000 50,000	500	20	10,000
18	10,000	21	2,10,000				500 10,000	20 21	10,000 2,10,000
22				500 6,500	20 21	10,000 1,36,500	3,500	21	73,500
28	2,000	22	44,000				3,500 2,000	21 22	73,500 44,000
31				3,500 1,000	21 22	73,500 22,000	1,000	22	22,000
Cost of Closing Stock									22,000

Illustration 24

The following are the details of a space part of Sriram Mills :

1.1.2015	Opening stock Nil	1.1.2015	Purchases 100 units @ ₹ 30 per unit
15.1.2015	Issued for consumption 50 units	1.2.2015	Purchases 200 units @ ₹ 40 per unit
15.2.2015	Issued for consumption 100 units	20.2.2015	Issued for consumption 100 units
1.3.2015	Purchases 150 units @ ₹ 50 per unit	15.3.2015	Issued for consumption 100 units

Find out the value of stock as on 31.3.2015 if the company follows :

1. First-in-First Out basis and
2. Weighted Average (Perpetual) basis.

Solution

Sriram Mills
(1) Store Ledger (FIFO Method)

Date	Purchases			Issues			Balance		
2015	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)
Jan. 1	100	30	3,000				100	30	3,000
15				50	30	1,500	50	30	1,500
Feb. 1	200	40	8,000				50 200	30 40	1,500 8,000
15				50 50	30 40	1,500 2,000	150	40	6,000
20				100	40	4,000	50	40	2,000
Mar. 1	150	50	7,500				50 150	40 50	2,000 7,500
15				50 50	40 50	2,000 2,500	100	50	5,000
Cost of Closing Stock							100		5,000

Sriram Mills
(2) Store Ledger [Weighted Average (Perpetual) Method]

Date	Purchases			Issues			Balance		
2015	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)	Quantity	Rate	Value (₹)
Jan. 1	100	30	3,000				100	30	3,000
15				50	30	1,500	50	30	1,500
Feb. 1	200	40	8,000				250	38	9,500
15				100	38	3,800	150	38	5,700
20				100	38	3,800	50	38	1,900
Mar. 1	150	50	7,500				200	47	9,400
15				100	47	4,700	100	47	4,700
Cost of Closing Stock							100		4,700

Problems of Stock Taking

Under periodic inventory system, at the end of the last day of the accounting year, stocks in hand are verified and valued. But in case of big organizations, it may not be possible to verify the stock exactly on the last date of the accounting period. In such a case, stock is taken either few days earlier or later, according to the situation.

If the stock is taken on a later date, the following adjustments are required to arrive at the stock as on the closing date:

Let us start with the value of stocks on that later date...
Add: Sales (at cost) between two dates, i.e. date of taking stock and closing date.
Add: Purchases returns during the said period.
Add: Any undercasting in stock sheet.
Add: Any goods in transit.
Less: Purchases between the two dates, i.e. date of taking stock and closing date.
Less: Sales returns (at cost price) between the above two dates.
Less: Any overcasting in stock sheet.
Less: Any goods held on consignment basis.
Less: Any goods included in stock but title of such has been transferred to the buyer.

Illustration 25

Asim's financial year ends on 31st March but actual stock has not been taken till the 8th April, when it is ascertained at ₹ 12,500.

You find that :

(i) Sales are entered in the sales book on the day of despatch and in the returns inward book on the day the goods are received back.

(ii) Purchases are entered in the purchases day book on the day the invoices are received.

(iii) Sales between 31st March and 8th April as per sales day book and cash book are ₹ 860.

(iv) Purchases between 31st March and 8th April as per the purchases day book are ₹ 600 but goods amounting to ₹ 200 are not received till the stock was taken.

(v) Of goods invoiced during March, goods amounted to ₹ 500 were not received till 31st March, of which goods worth ₹ 350 were received betwen 31st March and 8th April.

(vi) Rate of gross profit is $33^1/_3$% on cost.

Ascertain the value of stock as on 31st March.

Solution

Statement showing the Value of Physical Stock on 31st March, ...

Particulars	₹	₹
Stock on 8th April (Physical)		12,500
Add: (iii) Cost of goods sold during 1st April and 8th April (Note 1)		645
		13,145
Less: (iv) Goods purchased between 1st April and 8th April (₹ 600 – 200)	400	
Less: (v) Goods purchased in March but received between 31st March and 8th April	350	750
Stock on 31st March (to be credited to Trading Account)		12,395

Working Note :

(1) Sales	860
Less: Profit @ $33^1/_3$% on Cost or 25% on Sales	215
Cost of Goods Sold	645

Illustration 26

Ashoke's financial year ends on 31st March, but actual stock is not taken until next 6th April when it is ascertained at ₹ 33,500.

You find that :

(i) Sales are entered in the sales day book on the same day as despatched and returns inward in the return book the day the goods are received back.

(ii) Purchases are entered in the purchases day book on the day the invoices are received.

(iii) Purchases between 31st March and 6th April as per the purchases day book are ₹ 120 but goods amounting to ₹ 40 were not received till the stock was taken.

(iv) Sales between 31st March and 6th April as per sales day book and cash book are ₹ 1,720.

(v) Goods invoiced during March but not received till 31st March ₹ 100, of which goods worth ₹ 70 were received with 6th April.

(vi) The rate of gross profit to Sales is 25%.

Ascertain the value of stock as on 31st March.

Solution

Statement showing the Value of Physical Stock on 31st March, ...

Particulars	₹	₹
Stock on 6th April (Physical)		33,500
Add: (iv) Cost of goods sold during 1st April and 6th April (Note 1)		1,290
		34,790
Less: (iii) Goods purchased between 1st April and 6th April (₹ 120 – 40)	80	
Less: (v) Goods invoiced during March but received between 1st April and 6th April	70	150
Stock on 31st March (to be credited to Trading Account)		34,640

Working Note :

(1) Sales	1,720
Less: Gross Profit @ 25% on Sales	430
Cost of Goods Sold	1,290

Illustration 27

FY Ltd conducts physical stock taking every year at the end of the accounting year. Owing to certain difficulties, it was not possible for it to conduct physical stock taking at the end of the accounting year ending 30th June, 2015. Physical stock was taken on 8th July, 2015 when it was valued at ₹ 34,500.

The following transactions took place during 1st July to 8th July, 2015:

1. Net sales during the period were ₹ 9,340. These goods were sold at the usual rate of gross profit of 25% on cost except goods which realized ₹ 840 on the basis of 20% profit on cost.
2. Purchase during the period were ₹ 7,500 of which ₹ 800 worth of goods were delivered to the company only on 10th July, 2015.
3. Sales returns during the period were ₹ 1,500 of which 50% were out of the sales at 20% gross profit mentioned above.
4. On 5th July 2015, goods worth ₹ 4,000 were received, which were to be sold on consignment basis.

You are required to prepare a statement showing clearly the value of the stock to be taken into account in FY Ltd's final accounts for the year ended 30th June, 2015.

Solution **FY Limited**

Statement showing the Value of Physical Stock on 30th June, 2015

Particulars	₹	₹
Stock on 8th July, 2015		34,500
Add: Cost of goods sold during 1st July and 8th July 2015 (Note 1)		7,500
		42,000
Less: Cost of goods returned during 1st July and 8th July 2015 (Note 2)	1,225	
Less: Purchased during 1st July and 8th July 2015 (₹ 7,500 – ₹ 800)	6,700	
Less: Goods held on consignment	4,000	11,925
Stock on 30th June, 2015 (to be credited to Trading Account)		30,075

Working Notes

Cost of goods sold	₹	₹	Cost of goods returned	₹	₹
(a) Sales at cost plus 25% (9,340 – 840)	8,500		(a) Selling price	750	
Less: 20% profit on sales	1,700	6,800	*Less*: Profit 20% on sales	150	600
(b) Sales at cost plus 20%	840		(b) Selling price	750	
Less: 16.67% profit on sales	140	700	*Less:* Profit 16.67% on sales	125	625
		7,500			1,225

Illustration 28

Alpha Ltd. prepares accounts on 31st March each year. On 31st March 2015 its stock taking expert was ill and the preparation of the physical inventory was delayed until 3rd April 2015 on which date the stock valued at cost amounted to ₹ 2,40,000.

An examination of inventories and related financial records discloses that between 1st and 3rd April 2015:

1. Sales totalled ₹ 40,000 including: (i) ₹ 2,000 in respect of goods which left the warehouse on 29th March 2015; and (ii) ₹ 4,000 in respect of goods not despatched until 12th April 2015. The rate of gross profit to sales was 30%.
2. Returns from customers totalled ₹ 6,000.
3. Purchases totalled ₹ 18,000 which included: (i) ₹ 6,000 for goods received in March 2015; and (ii) ₹ 3,000 for goods received in 10th April, 2015.
4. Returns to suppliers totalled ₹ 4,000.
5. There were arithmetical errors in the stock sheets on 3rd April, 2015 resulting in an over-valuation of ₹ 4,600.

Prepare a statement showing the correct amount of the company's stock at cost on 31st March, 2015.

Solution **Alpha Limited**

Statement showing the Value of Physical Stock on 31st March, 2015

Particulars	₹	₹
Stock on 3rd April 2015		2,40,000
Add: Cost of goods actually despatched between 1st and 3rd April 2015 (Note 1)	23,800	
Add: Returned to Supplier	4,000	27,800
		2,67,800
Less: Cost of goods actually received between 1st and 3rd April 2015 (Note 2)	9,000	
Less: Cost of goods returned (₹ 6,000 – 1,800)	4,200	
Less: Errors (over-valuation)	4,600	17,800
Value of Stock as on 31st March, 2015		2,50,000

Working Notes

(1) Out of the total sales of ₹ 40,000, goods valued at ₹ 2,000 were delivered before 1st April and goods valued at ₹ 4,000 were despatched after 3rd April. Hence goods actually despatched between 1st and 3rd April were ₹ 34,000 only. ₹ 34,000 X 0.7 = ₹ 23,800.

(2) Out of the total purchases of ₹ 18,000, goods costing ₹ 6,000 were received before 1st April and goods costing ₹ 3,000 were received after 3rd April. Hence actual goods received were ₹ 9,000 only.

Illustration 29

X's financial year ends on the last Wednesday in September, but actual stock is not taken until the following Saturday, when it is ascertained at ₹ 33,500. You find that:

(i) Sales are entered in the Sales Day Book on the same day as despatched and Returns Inwards in the Returns Book the day the goods are received back.

(ii) Purchases are entered in the Purchases Day Book as the invoices are received.

(iii) Purchases between Wednesday and Saturday as per Purchases Day Book were ₹ 120, but of these, goods amounting to ₹ 40 were not received until after the stock was taken.

(iv) Sales between Wednesday and Saturday as per Sales Day Book and Cash Sales Book were ₹ 1,720.

(v) Goods invoiced during September (prior to the last Wednesday) but not received until after Wednesday amounted to ₹ 100, of which goods worth ₹ 70 were received between Wednesday and Saturday.

(vi) Goods sold in the previous week for ₹ 60 were returned on Monday but did not reach X until Thursday.

(vii) The rate of Gross Profit to sales is 25%.

Ascertain the value of the stock as at the end of the financial year assuming that the NRV is higher than cost and that the Purchases and Sales Day Books are not to be amended.

Solution **Statement showing the Value of Physical Stock on Wednesday**

Particulars	₹	₹
Stock on Saturday		33,500
Add: Cost of goods sold and delivered during Wednesday and Saturday (Note 1)	1,290	
Add: Goods invoiced during September (prior to last Wednesday and recorded in the Purchase Day Book but not physically received before Wednesday)	100	1,390
		34,890
Less: Goods received between Wednesday and Saturday	70	
Less: Goods purchased and physically received between Wednesday and Saturday (₹ 120 – ₹ 40)	80	
Less: Cost of goods returned by customers out of last year's sale (Note 2)	45	195
Cost of Closing Stock at the year end		34,695

Working Notes

(1) Sales ₹ 1,720 less G.P. 25% on sales = ₹ 1,290.

(2) As per the policy of Mr. X, goods returned are recorded only when the goods are physically received back. Here, goods were received after Wednesday but before Saturday. These items were included in the stock on Saturday. The cost of goods returned to be deducted (₹ 60 less 25% Gross Profit) = ₹ 45.

Illustration 30

A firm prepares accounts annually up to 30th November and stock taking takes place in the following weekend. In the year 2014, stock taking commenced on 4th December when the value of stock on that date was found ₹ 25,000. From the following information, you are required to ascertain the value of stock on 30th November 2014:

1. The average rate of gross profit is 20% on sales.
2. Goods outwards are entered in the Sales Day Book as on the day of despatch.
3. Goods inward are entered in the Purchases Day Book as on the date of the invoice.
4. Sales during the period 1st to 4th December, as shown by the Sales Day Book and the Cash Book ₹ 1,500.
5. Purchase during the same period as shown by the Purchases Day Book amounted to ₹ 1,200, but of these goods to the value of ₹ 200 were not received until 4th December.
6. Goods invoiced during November and not received until December totalled ₹ 1,600. Of these, goods to the value of ₹ 1,000 were received during the period 1st to 4th December and ₹ 600 after 4th December.
7. In November, goods were sent to a customer on sale or return basis. The sale price was ₹ 1,000. The goods were still returnable by the customer on 30th November.

Solution **Statement showing the Value of Physical Stock on 30the November, 2014**

Particulars	₹	₹
Value of Stock as on 4th December 2014		25,000
Add: Cost of goods sold between 1st and 4th December (₹ 1,500 – 300)	1,200	
Add: Cost of goods with customers on sale or return (₹ 1,000 – 200)	800	
Add: Purchase made before 30th November, but goods received after 4th December	600	2,600
		27,600
Less: Goods purchased and received between 1st & 4th December (₹ 1,200 – 200)		1,000
Value of Stock on 30th November, 2014		26,600

Illustration 31

Raja makes up his annual accounts to 31st December each year. He was unable to take stock of physical inventory till 9th January 2015 on which date the physical stock at cost was valued at ₹ 75,200.

You are required to ascertain the value of physical stock at cost on 31st December 2014 from the following information regarding the period from 1st January, 2015 to 9th January, 2015.

(a) Purchases of goods amounted to ₹ 25,600 of which goods worth ₹ 4,700 had been received on 28.12.2014 and goods worth ₹ 5,900 had been received on 12.1.2015.

(b) Sales of goods amounted to ₹ 38,400 of which goods of a sale value of ₹ 3,600 had not been delivered at the time of verification and goods of a sale value of ₹ 6,000 had been delivered on 29.12.2014.

(c) Sales return amounted to ₹ 1,800 which included a return of ₹ 720 relating to the goods sold and delivered between 1.1.2015 to 9.1.2015.

(d) A sub-total of ₹ 12,000 on one of the stock sheets had been carried to the summary of stock sheets as ₹ 21,000.

(e) In respect of goods costing ₹ 4,000 received prior to 31st December 2014 invoice had not been received up to the date of verification of stock.

(f) The rate of gross profit was 20% on the cost price.

Solution **Statement showing the Value of Physical Stock on 31st December, 2014**

Particulars	₹	₹
Stock as on 9th January, 2015		75,200
Add: Cost of goods sold and despatched during 1st and 9th January, 2015 (Note 1)		24,000
		99,200
Less: Goods actually received during 1st and 9th January, 2015 (Note 2)	15,000	
Less: Cost of goods returned	900	
Less: Wrong carry forward (₹ 21,000 – 12,000)	9,000	24,900
Value of Stock on 31st December, 2014		74,300

Working Notes

(1) Cost of goods sold	₹	**(2) Goods actually received during 1st and 9th January, 2015**	₹
Sales	38,400	Purchases	25,600
Less: Goods not despatched	3,600	*Less:* Goods received on 28.12.2014	4,700
	34,800		20,900
Less: Goods despatched on 29.12.2014	6,000	*Less:* Goods received on 12.1.2014	5,900
	28,800		15,000
Less: Gross profit 20% on cost, i.e., 16.67% on sales	4,800	**(3) Cost of goods returned**	
	24,000	Return	1,800
(4) No adjustment is required for item (e) , on the assumption that the purchase was recorded at the time of receiving the goods.		*Less:* Return from Sale of 1st & 9th January	720
			1,080
		Less: Gross profit 20% on cost	180
			900

Illustration 32

Krishna Udyog Limited makes up its accounts to December 31 each year. The company was unable to take stock by physical inventory till 14th January, 2015 on which date the stock at cost was valued at ₹ 1,85,000. It was, therefore, necessary to estimate the value of stock in hand as on December 31, 2014.

You ascertain the following facts regarding the period January 1 to January 14, 2015:

1. Purchases totalled ₹ 48,000 and included: (i) ₹ 5,000 in respect of goods received in December, 2014: (ii) ₹ 6,000 in respect of goods received on January 19, 2015; (iii) ₹ 2,000 in respect of goods received but returned to suppliers on January 7, 2015 for which no credit note has been received or passed through the books.
2. Sales totalled ₹ 60,000 and included: (i) ₹ 1,500 in respect of goods which left the warehouse on December 28, 2014; (ii) ₹ 2,800 in respect of goods which were not despatched until January 16,2015; (iii) ₹ 750 in respect of goods invoiced and despatched on January 10, 2015 but returned by the customers on January 12, for which no credit note had been passed but which were, in fact, included in the stock taken on January 14, 2015.

3. Other returns to suppliers totalled ₹ 1,400 and other returns by customers were ₹ 450.
4. The rate of gross profit was 20% on the selling price with the exception of an isolated purchase on January 7, 2014 of 100 similar articles which had cost ₹ 11,000. Of these articles, 50 were sold on January 7, 2015 for ₹ 6,500 and the remainder had been included at cost in the stock taken on January 14, 2015.

Prepare a statement showing the estimated value of stock held on December 31, 2014 at Cost.

Solution

Krishna Udyog Limited

Statement showing the Value of Physical Stock on 31st December, 2014

Particulars	₹	₹
Stock on January 14, 2015		1,85,000
Add: Cost of goods sold during 1st and 14th January, 2015 (Note 1)	45,460	
Add: Purchase returns during 1st and 14th January, 2015	1,400	46,860
		2,31,860
Less: Purchases during 1st and 14th January, 2015 (Note 2)	40,000	
Less: Cost of goods returned during 1st and 14th January, 2015 ₹ (450 – 90)	360	40,360
Value of Stock on 31st December, 2014		1,91,500

Working Notes

(1) Cost of goods sold		₹	**(2) Calculation of purchases**	₹
Sales during 1st and 14th January		60,000	Purchases as given	48,000
Less: Goods not despatched	2,800		*Less:* Goods received on 19.01.2014	6,000
Less: Returned on January 12	750	3,550		42,000
		56,450	*Less:* Goods returned on 7th January	2,000
Less: Sales of isolated purchase		6,500		40,000
Sale of normal item at a profit of 20%		49,950		
Less: Gross profit 20% on sales		9,990	(3) Since the purchase of ₹ 48,000 included ₹ 5,000 in respect of goods received in December , 2014, we may assume that the entry in respect of ₹ 5,000 must have been made during Jan 1 & 14th, 2015 So it should be treated as purchase of 2015 and it should be deducted from ₹ 1,85,000. To fulfil this we must not deduct it from ₹ 48,000.	
		39,960		
Add: Cost of abnormal 50 articles		5,500		
		45,460		

If the stocks are taken on an earlier date.

In this case, the following adjustments are necessary to arrive at the stocks as on the closing date.

Let us start with the value of goods on that earlier date ....

Add: Purchases between the two dates.

Add: Sales returns (at cost price) between the two dates.

Less: Sales (at cost) between the two dates.

Less: Purchases returns during the same period.

Add: Goods lying with consignee (at cost).

Add: Goods on approval with customers (at cost).

Illustration 33

Determine the value of stock to be taken for Balance Sheet as at 31st March, 2015 from the following information :

The stock was physically verified on 23rd March 2015 and was valued at ₹ 6,00,000. Between 23rd March 2015 and 31st March 2015 the following transactions had taken place :

1 Purchases ₹ 50,000 of this, goods worth ₹ 20,000 were delivered on 5th April, 2015.
2. Out of goods sent on consignment, goods worth ₹ 30,000 (at cost) were unsold.
3. Sales was of ₹ 1,70,000. This includes goods worth ₹ 40,000 sent on approval. Half of these were returned before 31st March. As regards remaining, no intimation was received.
4. Normally the firm sells goods on cost plus 25%. However, a lot of goods costing ₹ 30,000 was sold for ₹ 15,000.

Solution **Statement showing the Value of Physical Stock on 31st March, 2015**

Particulars	₹	₹
Stock on 23rd March, 2015		6,00,000
Add: Purchases during 23rd and 31st March (₹ 30,000 + 20,000 in transit)	50,000	
Add: Goods lying with consignee at cost	30,000	
Add: Goods on approval with customer at cost (₹ 20,000 – ₹ 4,000)	16,000	96,000
		6,96,000
Less: Cost of goods sold during 23rd and 31st March (Note 1)	1,08,000	
Less: Cost of Abnormal Sales	30,000	1,38,000
Value of Stock on 31st March, 2015		5,58,000

Working Notes : (1) Cost of goods sold during 23rd March & 31st March, 2015

	₹	₹
Sales		1,70,000
Less: Sales of abnormal items	15,000	
Less: Sent on approval	20,000	35,000
		1,35,000
Less: Gross Profit @ 25% of cost, i.e., 20% on sales		27,000
		1,08,000

Key Points

- A major objective of accounting for inventories is the proper determination of income through the process of matching appropriate costs against revenues.
- Inventories are assets
  - (a) held for sale in the ordinary course of business (e.g., finished car ready to be despatched to dealers);
  - (b) in the process of production for such sale (e.g., car in the assembly lines); or
  - (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services (e.g., tyre, battery, headlights, etc.).
- **Net Realisable Value (NRV)** : Net realisable value is the estimated selling price, in the ordinary course of business, less cost of completion, and the estimated cost necessary to make the sale.
- The cost of inventories should comprise:
  - (i) all costs of purchase;
  - (ii) costs of conversion; and
  - (iii) other costs incurred in bringing the inventories to their present location and condition.
- Perpetual inventory method is a method where the inventory accounting is kept continuously up-to-date and involves the continual recording of additions to and issues or sales of materials on a daily basis.

THEORETICAL QUESTIONS

1. What do you mean by Inventory ?
   What are the objectives of accounting for Inventories ?
2. What are the effects of errors in valuing inventory ?
3. What do you mean by Perpetual and Periodic Inventory Methods ?
   How inventory acquisitions and sales are recorded under Perpetual Inventory System and Periodic Inventory System?
4. Explain what is meant by the term '*stock is valued at the lower of cost and net realisable value*', which is found in AS—2 (Valuation of Inventories).

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below :

1. Which of the following is correct ?
   A Inventories are assets held for use in the construction of the building, e.g., air conditioners
   B Inventories are assets held for sale in the ordinary course of business
   C Inventories includes machinery spares which is used irregularly
2. Net realisable value is
   A the estimated selling price *plus* cost of completion *minus* selling expenses
   B the estimated selling price *less* cost of competition
   C the estimated selling price in the ordinary course of business, *less* cost of completion less selling expenses
3. The purchase price, transport and handling cost, tax and import duties are all examples of
   A cost of purchase
   B cost of conversion
   C cost of purchase, cost of conversion and other costs

4. The cost of inventories should comprise
   A cost of purchase, cost of conversion and other cost like interest
   B cost of purchase, cost of conversion and other cost like post manufacturing storage cost
   C cost of purchase, cost of conversion and other cost like primary packing cost
5. Standard Costs Method or the Retail Method is used as a tool of measurement of cost. Retail Method is
   A sale price plus mark up
   B sale price less gross margin
   C none of the above
6. Reasons for inventories being sold for less than their cost could be:
   (i) Damage to the inventories and obsolescence
   (ii) General fall in the market price of the goods
   (iii) Fall in the production cost for use of better technology
   A all three
   B (i) and (iii) only
   C (i) and (ii) only
7. Amar restores and sells second hand motorcycles. At 31st December, 2014, he had one motorcycle in inventory. Details of this were :
   Model: Bajaj Boxer
   Details : This item cost ₹ 10,000 and in December, 2014 Amar had also spent ₹ 750 on repairs. He has not yet sold it but is confident to sell it in a motorcycle fair in February 2007 for at least ₹ 15,000. It will cost Amar ₹ 250 to transport motorcycle to the fair.
   The value of motorcycle to be included in the final account for 2006 is
   A ₹ 10,000
   B ₹ 15,000
   C ₹ 10,750
8. Amar also holds an inventory of parts, which he values on the periodic weighted average basis. During the year 2014 his purchases of parts was :

Month	Quantity (units)	Cost per unit (₹)
January	400	20
June	500	22
September	300	24

   At 31st September, 2014 he had 300 units in inventory. On 1st January, 2014 he had no parts in inventory.
   The value of inventory of parts at 31st December, 2014 is
   A ₹ 6,600
   B ₹ 6,000
   C ₹ 6,550
9. Following the physical stock taking, the value of total stock is ₹ 1,22,357. The auditors find the following additional information :
   (i) 370 units of stock which cost ₹ 0.40 per unit have been valued @ ₹ 4.00 each.
   (ii) The stock value including damaged goods at their original cost of ₹ 2,885. These goods could be sold for ₹ 3,600 after incurring repairing cost of ₹ 921.
   The correct value of year end stock is :
   A ₹ 1,20,877
   B ₹ 1,20,671
   C ₹ 1,20,819
10. X has closing stock which cost ₹ 38,750. This includes some damaged items which cost ₹ 3,660. It will cost X ₹ 450 to repair these. He will be able to sell them for ₹ 1,500 after the repairs are completed. What is the correct value of X's closing stock ?
   A ₹ 38,750
   B ₹ 36,590
   C ₹ 36,140

11. On 31 March, 2015, inventory code AXN-205 had 1,000 items in inventory. The original cost of this inventory was ₹ 4,600. Alternative valuations were obtained at 31 March, 2015 for this inventory item. Which value should be used in the accounts at 31st March, 2015 as per AS-2 ?
    A original cost ₹ 4,600
    B replacement cost ₹ 3,200
    C net realisable value ₹ 3,400
12. On 31 March, 2015, stock consists of 1,500 units of a raw material purchased @ ₹ 8 each, but the unit price of the item has fallen to ₹ 7. The price reduction is apprehended to be permanent. The firm has already decided that if the price reduction lasts longer than six months it will reduce the sale price of the finished goods from ₹ 12 to ₹ 11. The value of closing stock is :
    A ₹ 16,500
    B ₹ 10,500
    C ₹ 12,000
13. According to AS-2 Inventories, which of the following costs should be included in valuing the inventories of a manufacturing company ?
    (i) freight and insurance
    (ii) carriage outwards
    (iii) depreciation of factory plant
    (iv) general administrative overheads
    A all four items
    B (i), (ii) and (iv) only
    C (ii) and (iii) only
    D (i) and (iii) only
14. During the year to 31 December, 2014 Amar bought goods for resale at a cost of ₹ 7,55,500. His inventory at 1 January 2014 was valued at ₹ 1,57,400. He did not count his inventory at 31 December, 2014 but he knows that his sales for the year to 31 December, 2014 were ₹ 9,18,000. All sales were made at a mark up of 20%. Based on the information above, what was the value of Amar's inventory at 31 December, 2014 ?
    A ₹ 1,36,300
    B ₹ 1,47,900
    C ₹ 1,66,900
15. Karim is an antiques dealer. His inventory includes a clock which cost ₹ 15,800. Karim expects to spend ₹ 700 on repairing the clock which will mean that he will be able to sell it for ₹ 26,000.
    At what value should the clock be included in Karim's inventory ?
    A ₹ 15,100
    B ₹ 15,800
    C ₹ 25,300

PRACTICAL QUESTIONS

1. State how will you deal with each of the following ?
    (i) Stock which cost ₹ 20,000 can now be replaced for ₹ 14,000. The estimated net realisable value of this stock is ₹ 17,000. It is proposed that the stock should be written down to ₹ 17,000.
    (ii) During the stock-taking it was found that of the total stock of ₹ 8,35,000, approximately ₹ 93,000 of stock was missing and had been misappropriated. A further ₹ 50,000 of stock was estimated to be obsolete, with very little likelihood of resale.
    (iii) Some stock has been omitted from the closing stock figure. The omitted stock had originally cost ₹ 30,000 but could be sold only for ₹ 20,000.
    (iv) Stock costing ₹ 9,000 lying in godown for last 10 years. It can only be sold for ₹ 2,500 after incurring ₹ 500 delivery charges..
2. From the following transactions extracted from the books of accounts of X Ltd as on 31st December, 2014, work out the Cost of Closing stock under the following three methods of pricing:
    (i) FIFO and (ii) Weighted Average (Periodic).

Dec. 1	Opening Stock 300 units @ ₹ 9.70	Dec. 20	Issue 210 units
Dec. 3	Purchases 250 units @ ₹ 9.80	Dec. 25	Purchases 150 units @ ₹ 10.30
Dec. 11	Issue 400 units	Dec. 26	Issue 100 units
Dec. 15	Purchases 300 units @ ₹ 10.05		

3. Calculate the Cost of Closing stock under FIFO method:
2015 Jan. 1 Opening stock 200 pieces @ ₹ 2 each.

	Purchases		Issues
Jan. 5	100 pieces @ ₹ 2.20 each	Jan. 2	150 pieces
Jan. 10	150 pieces @ ₹ 2.40 each	Jan. 7	100 pieces
Jan. 20	180 pieces @ ₹ 2.50 each	Jan. 12	100 pieces
		Jan. 28	200 pieces

4. From the following information, calculate the Cost of Closing stock on 31st March, 2015 using FIFO method.

Purchases			Issues	
Date	Units	Rate	Date	Units
3.1.2015	200	5.2	9.1.2015	1,000
15.1.2015	1,400	5.5	17.1.2015	1,000
21.1.2015	800	5.4	23.1.2015	1,000
14.2.2015	2,000	5.3	16.2.2015	1,000

5. With the help of the following information, calculate the Cost of Closing stock using Weighted Average (Perpetual) method.

Sept. 1	Opening balance 24,000 kg @ ₹ 7,500 per MT	Sept. 13	Purchases 10,000 kgs @ ₹ 7,800 per MT
Sept. 1	Purchases 44,000 kgs @ ₹ 7,600 per MT	Sept. 18	Issues 24,000 kgs
Sept. 1	Issue 10,000 kgs	Sept. 22	Purchases 50,000 kgs @ ₹ 8,000 per MT
Sept. 5	Issue 16,000 kgs	Sept. 28	Issues 30,000 kgs
Sept. 12	Issue 24,000 kgs	Sept. 30	Issues 22,000 kgs

6. From the records of an oil distributing company, the following summarized information is available for the month of March, 2015:
   (i) Sales for the month ₹ 9,45,000.
   (ii) Opening stock as on 1.3.2015 1,00,000 litres @ ₹ 3.00 per litre.
   (iii) Purchases (including freight and insurance) : March 5 2,00,000 litres @ ₹ 2.85 per litre; March 27 1,00,000 litres @ ₹ 3.03 per litre.
   (iv) Closing stock as on 31.3.2015 1,30,000 litres.
   (v) General administrative expenses for the month ₹ 25,000.

   On the basis of the above information, work out the following using FIFO method of inventory valuation: (a) Cost of Closing stock on 31.3.2015; (b) Cost of goods sold during March 2015; and (c) Profit or loss for March 2015.
7. B. Ltd started on 1st January, 2014, purchased raw materials during 2014 as given below :

Jan. 1	1,000 kg @ ₹ 70	March 15	700 kg @ ₹ 72	Sept. 15	1,000 kg @ ₹ 65
Jan. 25	1,500 kg @ ₹ 60	July 29	1,400 kg @ ₹ 70	Dec. 20	1,200 kg @ ₹ 60
Feb. 5	1,200 kg @ ₹ 65				

   While preparing its final accounts on 31st December, 2014, the company had 3,000 kg of raw materials in its godown. Calculate the Cost of Closing stock of raw materials according to FIFO method.

Problems of Stock Taking

8. On account of unavoidable circumstances M/s Mahesh Electricals could not do stock taking on 31.12.2014. However the stock was taken on January 10, 2015.
The following are details of transactions from January 1st to 10th on which day Inventory was taken:
Purchased in Jan. upto 10th 45,000; Goods received after 10th 5,000; Purchase returns 3,000; Purchases include special items for ₹ 11,000; Sales ₹ 80,000; Sales Returns ₹ 2,000; Sale of goods invoiced but delivered after 10th ₹ 8,000; Sales include half the quantity of special item purchased for Balance left in the Stock ₹ 6,600; Gross Profit Ratio 25%. Inventory taken on 10th Jan. ₹ 1,75,000. Find out the value of the stock as on 31.12.2014.
9. Sundaram closed his books of account on 31st March, 2015, but due to certain difficulties, it was not possible for him to conduct physical stock-taking on that date. Physical stock was taken on 7th April when it was valued at ₹ 45,000. An examination of the records of inventories from 1st to 7th April revealed the following:
   (a) Net sales during the period were ₹ 10,200. These goods were sold at the usual rate of gross profit of 25% on cost except goods which realised ₹ 1,200 on the basis of 20% profit on cost.
   (b) Purchases during the period were ₹ 8,000 of which ₹ 1,000 worth of goods were delivered on 9th April only.
   (c) Sales returns during the period were ₹ 1,200 of which 50% were out of the sales at 20% gross profit mentioned above.

(d) On 5th April, Sundaram received certain goods costing ₹ 5,000 to be sold by him on consignment basis.

You are required to prepare a statement showing clearly the value of the stock to be taken into account in Sundaram's final accounts for the year ended 31st March, 2015.

10. The financial year of Shri X ends on 31st March 2015 but the stock in hand was physically verified only on 7th April 2015. You are required to determine the Cost of Closing stock at cost at 31st March 2015 from the following information:
    (i) The stock (valued at cost) as verified on 7th April 2015 was ₹ 15,000.
    (ii) Sales have been entered in the Sales Day Book only after the dispatch of the goods and Sales Returns only on receipt of the goods.
    (iii) Purchases have been entered in the Purchases Day Book on receipt of the purchase invoice irrespective of the date of receipt of the goods.
    (iv) Sales as per the Sales Day Book for the period 1st April, 2015 to 7th April 2015 (before the actual verification) amounted to ₹ 6,000 of which goods of a sale value of ₹ 1,000 had not been delivered at the time of verification.
    (v) Purchases as per the Purchases Day Book for the period 1st April 2015 to 7th April 2015 (before the actual verification) amounted to ₹ 6,000 of which goods for purchases of ₹ 1,500 had not been received prior to 31st March 2015.
    (vi) In respect of goods costing ₹ 5,000 received prior to 31st March 2015, invoices had not been received up to the date of verification of stocks.
    (vii) The gross profit is 20% on sales.

11. Moon Ltd keeps no stocks records, but a physical inventory of Stock is made at the end of the quarter and the valuation is taken at Cost. The Company's year ends on 30.9.2014 and Draft Accounts have been prepared to that date. The Stock Inventory taken on 30.9.2014 was, however, mislaid and you have been advised to value the Closing Stock as on 30.9.2014 with the Stock figure as on 30.6.2014 and some other information as available to you are :
    (i) The Cost of Stock on 30.6.2014 as shown by the inventory was ₹ 80,000.
    (ii) On 30th June, Stock sheets showed the following discrepancies: (a) A page total of ₹ 5,000 had been carried to the summary as ₹ 6,000; and (b) The total of a page had been undercast by ₹ 200.
    (iii) Invoice of purchase entered in the Purchase Book during the months from July to September, 2014 totalled ₹ 70,000. Of this ₹ 3,000 related to goods received prior to 30th June, 2014. Invoices entered in October 2014 relating to goods received in September 2014 totalled ₹ 4,000.
    (iv) Sales invoiced to customers from July to September, 2014 totalled ₹ 90,000. Of this, ₹ 5,000 related to goods despatched on or before 30.6.2014. Goods despatched to customers before 30.9.2014 but invoiced on October 2014 totalled ₹ 4,000.
    (v) During the final quarter, Credit notes at invoiced value of ₹ 1,000 had been issued to customers in respect of goods returned during that period.
    (vi) The Gross margin earned by the Company is 25% of cost.

    You are required to prepare a statement showing the amount of stock at cost as on 30.9.2014.

Guide to Answers

Multiple Choice

1. B 2. C 3. A 4. C 5. B 6. C 7. C 8. C 9. C 10. C 11. C 12. C 13. D 14. B 15. B.

Practical Questions

1. **(i) Yes, it should be written-down to ₹ 17,000; (ii) Stock will be reduced by ₹ 1,43,000 (₹ 93,000 + ₹ 50,000); (iii) ₹ 20,000 will be added to the value of stock; (iv) Stock lying in godown for 10 years should be valued at ₹ 2,000 (₹ 2,500 – ₹ 500).**
2. **FIFO—₹ 2,952; Weighted Average—₹ 2,877.**
3. **FIFO—₹ 200.**
4. **FIFO—₹ 12,020.**
5. **Cost of Closing stock—₹ 15,952.**
6. **FIFO—(a) ₹ 3,88,500; (b) ₹ 7,84,500; (c) ₹ 1,35,500.**
7. **FIFO—₹ 1,93,000.**
8. **Value of stock ₹ 1,91,050.**
9. **Value of stock ₹ 40,220.**
10. **Value of stock ₹ 9,500.**
11. **Value of stock (at cost) on 30.9.2014 — ₹ 79,800. Adjusted cost of sales — ₹ 70,400. Cost of adjusted purchases — ₹ 71,000.**

10

Depreciation Accounting

Introduction

Depreciation is an attempt to spread the cost of a long-lived asset, as an expense to the Profit and Loss Account, over its useful economic life.

Most fixed assets, such as building, plant, machinery, office equipments, and the like have a limited useful life. These assets are acquired not primarily for resale but in anticipation that these assets will benefit the business in the form of generating revenue over a number of future accounting periods. Although the expenditure is made early in the life of the assets, they provide for benefits throughout their useful life.

When a fixed asset is acquired, it is recorded in the accounts at its acquisition cost, i.e. the price paid to acquire it (whether purchased against cash or credit is irrelevant). This is because, as per cost convention, the acquisition cost of an asset is capitalised (capitalisation means that an expenditure on the acquisition of an asset is not charged immediately as a cost against revenue in the Profit and Loss Account, but is carried forward as a fixed asset in the Balance Sheet), which is regarded as a prepayment for the services to be enjoyed by the business concern over the estimated useful life of the asset. The acquisition cost should, therefore, be written off as an expense during its useful life, i.e. a portion of the cost should be charged against profit as an expense in each of the accounting periods in which the asset is gainfully used. This accounting process of gradually converting the unexpired costs of fixed assets into expenses over a series of accounting periods is called ***depreciation***. Though depreciation is a measure (however incorrect) of a reduction in the use value of an asset, it does not refer to physical deterioration or decrease in its market value. It is not concerned with measurement of the value of an asset at any point of time. The written down value of a fixed asset appearing in the Balance Sheet is not likely to agree with the amount that could be realised from its sale. In essence, ***depreciation is the process of allocating the cost of a fixed asset (less any residual value) over its estimated useful life in a rational and systematic manner***. Since depreciation is a method of spreading the cost of the asset over its working life, it may be charged even though the asset may be thought to have appreciated in value in money terms (e.g. land and buildings) as it may provide for obsolescence if it can be anticipated. Obsolescence is the process of becoming obsolete. It is the decline in value of a fixed asset through external causes such as technological change or change in demand. In accounting, its significance is that it is one of the factors leading to a reduction in the useful economic life of a fixed asset.

In this respect , the provision of AS—6 (Depreciation Accounting) is relevant and is given below.

Accounting Standard [AS–6 : Depreciation Accounting]

Objectives

Depreciation has a significant effect in the preparation of the financial statements of an enterprise. It will influence the profit / loss and value of assets of the enterprise. Different enterprises adopt different accounting policies for depreciation.

The main objective of this accounting standard is to prescribe the ***guidelines for charging depreciation*** for different assets.

Scope

This statement deals with depreciation accounting and applies to all depreciable assets, except the following items to which special considerations apply —

(i) forests, plantations and similar regenerative natural resources;
(ii) wasting assets including expenditure on the exploration for and extraction of minerals, oils, natural gas and similar non-regenerative resources;
(iii) expenditure on research and development;
(iv) goodwill;
(v) live stock.

This statement also does not apply to land unless it has a limited useful life for the enterprise.

Definitions

Depreciation
Depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time or obsolescence through technology and market changes. Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset. Depreciation includes amortisation of assets whose useful life is predetermined.

Depreciable Assets
Depreciable assets are assets which

(i) are expected to be used during more than one accounting period; and
(ii) have a limited useful life; and
(iii) are held by an enterprise for use in the production or supply of goods and services, for rental to others, or for administrative purposes and not for the purpose of sale in the ordinary course of business.

Useful Life
Useful life is either :

(i) the period over which a depreciable asset is expected to be used by the enterprise; or
(ii) the number of production or similar units expected to be obtained from the use of the asset by the enterprise.

Depreciable Amount
Depreciable amount of a depreciable asset is its historical cost, or other amount substituted for historical cost in the financial statements, less the estimated residual value.

Factors in the Measurement of Depreciation

The amount of depreciation to be charged for a particular fixed asset will depend upon the following three factors :

(i) Cost of the asset
(ii) Useful life of the asset
(iii) Residual value of the asset

Cost of the Asset

The cost of an asset is the basis for calculation of depreciation. For the purpose of determination of cost of an asset, the following points are important as stated in AS—10 "Accounting for Fixed Assets" :

(a) Where an asset is purchased from a supplier: The cost of a fixed asset should comprise its purchase price and any attributable cost of bringing the asset to its working condition for its intended use.

Examples of directly attributable costs are :

(i) site preparation;
(ii) initial delivery and handling costs;
(iii) installation cost, such as special foundations for plant; and
(iv) professional fees, for example, fees of architects and engineers.

(b) Where an asset is self-constructed : The cost of a self-constructed fixed asset should comprise those costs that relate directly to the specific asset and those that are attributable to the construction activity in general and can be allocated to the specific asset.

(c) Where a fixed asset is acquired either in exchange or in part exchange for another asset: The asset acquired should be recorded either :

(i) at its fair value; or
(ii) the net book value of the asset given up, adjusted for any balancing payment or receipt of cash or other consideration.

Useful Life of the Asset

The useful life of an asset is its ***service life*** which can be defined as the number of accounting periods during which it will be useful to the business. The physical life of an asset may be considered longer than its economic life. When the operating cost of an asset is considered to be more than the revenue which it generates, it has exceeded its economic life and should not be kept in use. Since there is no way to measure correctly how long an asset will be useful, the asset's useful economic life is always estimated.

The useful life of a depreciable asset should be estimated after considering the following factors:

(i) expected physical wear and tear;
(ii) obsolescence;
(iii) legal or other limits on the use of the asset, e.g., safety limitation or the expiry dates of assets taken on lease.

Estimation of useful life of the asset is very difficult. It is a matter of judgment and depending on the experience of the enterprise with similar assets. Depreciation will vary directly with the useful life of the asset. If the estimated life is too long, each year's depreciation charge will be less and profits in the periods before disposal will be inflated.

Residual Value of the Asset

Residual value of asset is the estimated value of a fixed asset at the end of its economic life. It is the amount which is expected to be received when the asset is sold after being removed from service. The purpose of estimating residual value is to ascertain the ***depreciable amount*** (acquisition cost – residual value), which is allocated to different accounting periods during which the asset is gainfully employed. Depreciable amount is calculated as under:

Acquisition cost (say)	₹ 11,00,000
Less : Residual Value (say)	₹ 1,00,000
Depreciable Amount	₹ 10,00,000

Example : It is the policy of Sita Travel (P) Ltd. to keep their tourist bus in service for 5 years only. The company has purchased one new tourist bus for ₹ 25,00,000. A similar bus purchased 5 years back can be sold at present for ₹ 5,00,000 (Net). Here ₹ 5,00,000 is a reasonable estimate for the residual value of the new bus.

The depreciable amount will be ₹ 20,00,000 (₹ 25,00,000 – 5,00,000).

Annual depreciation = ₹ 20,00,000 / 5 = ₹ 4,00,000.

Unless the residual value of the asset is guaranteed (e.g., buyback by the manufacturer at a guaranteed amount), the residual value will only be ***estimate*** because of future uncertainties.

In some cases, residual value is insignificant and it is taken as zero for calculating the amount of depreciation. The higher the residual value, the lower will be the depreciation charge. In effect, the profits of the previous periods will be inflated and there may be a loss on disposal of the asset.

Reasons for Charging depreciation

1. If depreciation is not charged for, periodic expenses will be understated. In effect, profits for that period will be overstated.
2. To present a true and fair view of the state of affairs of business, the assets must be valued correctly on the Balance Sheet. Unless depreciation is charged, the value of the assets will be overstated in the Balance Sheet. As a result, the fixed assets would stand in the books at an amount which is in excess of their true value to the business. In effect, net worth will be overstated.
3. If depreciation is not charged, the cost of production will be understated. In effect, pricing of the product will be inappropriate.
4. A fixed asset is to be sold at the end of its useful life or may be even before. If no depreciation is provided, the written-down value of the asset on the date of sale cannot be ascertained. In effect, the profit or loss on the sale of that asset cannot be determined.
5. A fixed asset is to be replaced by a new one after the end of its useful life. If depreciation is not charged, the profit available for distribution will be overstated. It may be possible that the whole of the profits may be withdrawn during the life of that asset. In effect, the business may not have sufficient funds to replace the asset.
6. Capital is invested for purchasing fixed assets. If depreciation is not charged, expired cost of capital invested in fixed assets will not be recovered. In effect, the business will not be able to maintain its capital.
7. Certain types of business organisations, e.g., joint stock companies are under obligation to charge depreciation on fixed assets according to the provisions of the law.

Methods of Calculating Depreciation

There are several methods of allocating depreciation over the useful life of the assets. Those most commonly employed in industrial and commercial enterprises are the straightline method and the reducing balance method. The management of a business selects the most appropriate method(s) based on various important factors e.g., (i) type of asset, (ii) the nature of the use of such asset and (iii) circumstances prevailing in the business. A combination of more than one method is sometimes used. In respect of depreciable assets which do not have material value, depreciation is often allocated fully in the accounting period in which they are acquired [***Para 12 of AS—6***]. No particular method is specified by AS—6. However, it has been stated in para 20 that ***the depreciable amount of a depreciable asset should be allocated on a systematic basis to each accounting period during the useful life of the asset.***

1. Straight Line / Equal Instalment Method

This is the most popular method because of its simplicity and consistency. It requires allocation of an equal amount to each period. A fixed amount of the original cost is charged as depreciation every year. Thus, the asset is written down in value each year by the same amount. This amount is such that the book value of the asset may be reduced to zero or its residual value, as the case may be, at the end of its life. Since this method assumes that the cost of the asset expires at a steady (straight line) function of time, the acquisition cost less salvage value is divided by the estimated economic life. *The rate of depreciation is the reciprocal of the estimated useful life.* If the useful life of an asset is 10 years, the depreciation rate will be 1/10 or 10%. This may be put in the shape of a formula as under :

$$\textit{Annual Depreciation} = \frac{\textit{Cost of the Asset} - \textit{Residual Value}}{\textit{Estimated Economic Life}}$$

Example

If a machine costs ₹ 1,20,000 on 1.1.2015, has a salvage value at ₹ 20,000 and a life of 10 years, assuming the accounting year ends on 31st December, the depreciaion per annum will be :

$$Depreciation = \frac{1,20,000 - 20,000}{10} = ₹\ 10,000$$

The profit will not be reduced by ₹, 1,20,000 in 2015 but by ₹ 10,000 in each of the years 2015 – 2019.

This method is appropriate for those assets where the use of time is an important factor, e.g. benefits to be derived from the use of the asset within a fixed time period. Examples are: lease, patents, copyrights, etc. This method is often used for other assets, when the following two conditions are satisfied : (1) the asset renders uniform service throughout its service life; and , (2) it does not involve repair or maintenance cost (or it is equal throughout its service life).

Advantages

1. It is simple to calculate and easy to understand.
2. It can reduce the book value of the asset to zero.
3. The valuation of the asset each year in the Balance Sheet is reasonably fair.

Disadvantages

1. This method ignores the fact that the service yielding ability of the assets fall while the repairs and maintenance costs increase with the passage of time. Though each year's charge for depreciation is the same, the charge for repairs and renewals goes on increasing as the asset becomes older. Therefore, the charge to the Profit and Loss Account increases over the years.
2. If an additional asset is acquired, the amount to be charged as depreciation needs to be recalculated.

Methods of Recording Depreciation

The Ledger Account entries for depreciation are quite straightforward. There are two ways or methods of recording depreciation in the books:

The First Method — ***When no provision for Depreciation Account is maintained***

Under this method, depreciation is directly charged to an Asset Account by debiting Depreciation Account and crediting the Asset Account. At the end of the accounting period, Depreciation Account is closed by transferring it to the Profit and Loss Account. In the Balance Sheet, the asset appears at its written down value (cost less depreciation provided to-date). Here, actual cost of an asset and the total amount of depreciation that has been provided (to-date) cannot be ascertained from the Balance Sheet.

Journal Entries

1. Depreciation Account	Dr.
To Asset Account	
2. Profit and Loss Account	Dr.
To Depreciation Account	

The Second Method — ***When Provision for Depreciation Account is maintained***

Under this method (in contrast to the above), depreciation is not directly charged to the Asset Account.

The depreciation for the period is debited to Depreciation Account and credited to '***Accumulated Depreciation Account***' or ***Provision for Depreciation Account.*** As in the previous method, Depreciation Account is closed by transferring it to the Profit and Loss Account. In the Balance Sheet, asset appears at its original cost and the accumulated depreciation is shown as a deduction from the Asset Account. Here, from the Balance Sheet, the original cost of the asset and the total depreciation to-date that has been charged on that asset can be easily ascertained. As the year passes, the balance of the accumulated depreciation goes on increasing since constant credit is given to this account in each accounting year. After the expiry of the useful life, these two accounts are closed by debiting Accumulated Depreciation Account and crediting Asset Account—any balance in Asset Account is transferred to the Profit and Loss Account.

Journal Entries

1. Depreciation Account Dr.
   To Accumulated Depreciation Account
2. Profit and Loss Account Dr.
   To Depreciation Account

Illustration 1

B. Brown purchased a machine by cheque for ₹ 90,000 on 1st January, 2013. Its probable working life was estimated at 10 years and its probable scrap value at the end of that time at ₹10,000. It was decided to write off depreciation by equal annual instalments. You are required to pass necessary Journal entries for first two years and show necessary accounts and the Balance Sheet:

(a) When no Provision for Depreciation Account is maintained;
(b) When Provision for Depreciation Account is maintained.
[It was decided to close books each year on December 31.]

Solution

$$\textit{Annual Depreciation} = \frac{90,000 - 10,000}{10} = ₹\ 8,000$$

(a) When no Provision for Depreciation Account is maintained.

In the Books of B. Brown
Journal

Date	Particulars		Dr. ₹	Cr. ₹
2013 Jan. 1	Machinery A/c To Bank A/c (Being the purchase of machinery by cheque)	Dr.	90,000	90,000
Dec.31	Depreciation A/c To Machinery A/c (Being the depreciation charged to machinery)	Dr.	8,000	8,000
"	Profit & Loss A/c To Depreciation A/c (Being the depreciation transferred to Profit & Loss Account)	Dr.	8,000	8,000
2014 Dec.31	Depreciation A/c To Machinery A/c (Being the depreciation charged to machinery)	Dr.	8,000	8,000
"	Profit & Loss A/c To Depreciation A/c (Being the depreciation transferred to Profit & Loss Account)	Dr.	8,000	8,000

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 Jan.1	To Bank A/c	90,000	2013 Dec.31	By Depreciation A/c	8,000
			"	By Balance c/d	82,000
		90,000			90,000
2014 Jan.1	To Balance b/d	82,000	2014 Dec.31	By Depreciation A/c	8,000
			"	By Balance c/d	74,000
		82,000			82,000
2015 Jan.1	To Balance b/d	74,000			

Dr. Depreciation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 Dec.31	To Machinery A/c	8,000	2013 Dec.31	By P & L A/c	8,000
2014 Dec.31	To Machinery A/c	8,000	2014 Dec.31	By P & L A/c	8,000

Balance Sheet as on 31st December, 2013 (includes)

Liabilities	₹	Assets	₹
		Machinery	82,000

Balance Sheet as on 31st December, 2014 (includes)

Liabilities	₹	Assets	₹
		Machinery	74,000

(b) When Provision for Depreciation Account is maintained

In the Books of B. Brown
Journal

Date	Particulars		Dr. ₹	Cr. ₹
2013 Jan.1	Machinery A/c	Dr.	90,000	
	To Bank A/c			90,000
	(Being the purchase of machinery by cheque)			
Dec.31	Depreciation A/c	Dr.	8,000	
	To Accumulated Depreciation A/c			8,000
	(Being the depreciation provided for the accounting period)			
"	Profit & Loss A/c	Dr.	8,000	
	To Depreciation A/c			8,000
	(Being the depreciation transferred to Profit & Loss Account)			
2014 Dec.31	Depreciation A/c	Dr.	8,000	
	To Accumulated Depreciation A/c			8,000
	(Being the depreciation provided for the accounting period)			
"	Profit & Loss A/c	Dr.	8,000	
	To Depreciation A/c			8,000
	(Being the depreciation transferred to Profit & Loss Account)			

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 Jan.1	To Bank A/c	90,000	2013 Dec.31	By Balance c/d	90,000
2014 Jan.1	To Balance b/d	90,000	2014 Dec.31	By Balance c/d	90,000
2015 Jan.1	To Balance b/d	90,000			

Dr. Depreciation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 Dec.31	To Accumulated Depreciation A/c	8,000	2013 Dec.31	By P & L A/c	8,000
2014 Dec.31	To Accumulated Depreciation A/c	8,000	2014 Dec.31	By P & L A/c	8,000

Dr. Accumulated Depreciation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 Dec.31	To Balance c/d	8,000	2013 Dec.31	By Depreciation A/c	8,000
2014 Dec.31	To Balance c/d	16,000	2014 Jan.1	By Balance b/d	8,000
			Dec.31	By Depreciation A/c	8,000
		16,000			16,000
			2015 Jan.1	By Balance b/d	16,000

Balance Sheet as on 31st December, 2013 (includes)

Liabilities	₹	Assets	₹
		Machinery (At cost)	90,000
		Less: Accumulated Depreciation	8,000
			82,000

Balance Sheet as on 31st December, 2014 (includes)

Liabilities	₹	Assets	₹
		Machinery (At cost)	90,000
		Less: Accumulated Depreciation	16,000
			74,000

2. Diminishing Balance Method

Where the straight line method assumes that the net cost of an asset should be allocated to successive periods in uniform amounts, the diminishing balance method assumes that the rate of allocation should be constant through time. Under this method, instead of a fixed amount, a fixed rate on the reduced balance of the asset is charged as depreciation every year. Since a constant percentage rate is being applied to the written down value, the amount of depreciation charged every year decreases over the life of the asset. Though the percentage at which depreciation is charged remains fixed, the amount of depreciation goes on diminishing year after year. This method assumes that an asset should be depreciated more in the earlier years of use than later years because the maximum loss of an asset occurs in the early years of use. The fixed percentage rate, to be applied to the allocation of net costs as depreciation, can be obtained by the following formula :

$r = 1 - \sqrt[n]{\frac{s}{c}}$ (This formula cannot be applied if the asset has no or insignificant scrap value.)

where
n = the expected useful life in years;
s = the scrap value;
c = the acquisition cost;
r = the rate of depreciation to be applied.

Proof
depreciation at the end of the 1st year = rc;
written down value at the end of the 1st year = c – rc = c(1—r)
written down value at the end of the 2nd year = $c(1-r)^2$
similarly, written down value at the end of the nth year = $c(1-r)^n$
therefore, $c(1-r)^n = s$ or $r = 1 - \sqrt[n]{\frac{s}{c}}$

Example :
If the cost of a machine is ₹ 10,000 and scrap value after 4 years is ₹ 2,000, the rate of depreciation is calculated as under :

$$r = 1 - \sqrt[4]{\frac{2,000}{10,000}} = 33.33\%$$

The amount of depreciation to be charged is computed as follows :

1. The rate of depreciation to be charged (r) is calculated by applying the above formula.
2. The first year's depreciation is calculated by multiplying the rate by the acquisition cost of the asset.
3. For the second and subsequent years, the depreciation is computed by multiplying its rate by the written down value (cost *less* accumulated depreciation) of the asset at the beginning of the year.
4. No further depreciation is charged when the written down value declines to its estimated salvage value. There may be some small difference between the estimated and resulting residual values. This arises because the depreciation rate is generally calculated to the nearest to two decimal places.

Taking the above example, the calculation of depreciaton for each of the four years would be as follows:

Year	Computation	Annual Depreciation	Accumulated Depreciation	Written Down Value
1	₹ 10,000 x 33.33%	3,333	3,333	6,667
2	₹ 6,667 x 33.33%	2,222	5,555	4,445
3	₹ 4,445 x 33.33%	1,482*	7,037	2,963
4	₹ 2,963 x 33.33%	963**	8,000	2,000

* Rounded to the nearest rupee.
** In the last year, the depreciation is adjusted to the amount (₹ 24) to bring the carrying value of the asset to its estimated scrap value.

Advantages

1. As the decreasing charge for depreciation cancels out the increasing charges for repairs over the years, it gives a fair charge for depreciation.
2. No recalculation is necessary when additional assets are purchased.
3. This method is applicable for income tax purposes.
4. The impact of obsolescence can be reduced if a significant part of the cost is written off in early life.

Disadvantages

1. This method lacks simplicity—the ascertainment of the percentage to be applied.
2. This method cannot be applied for assets with a very short life.
3. The asset is never fully depreciated.
4. The cost should be spread over evenly throughout the economic life of an asset or should be spread according to use. This method follows neither principle.

Distinction Between Straight Line and Diminishing Balance Methods

Sl. No.	Straight Line	Sl. No.	Diminishing Balance
1.	A fixed amount of depreciation is charged.	1.	A fixed rate of depreciation is charged.
2.	The rate of depreciation is the reciprocal of the life of the asset.	2.	The rate of depreciation is ascertained by applying a formula.
3.	The asset may or may not have scrap value.	3.	The asset must have a significant scrap value.
4.	The amount of depreciation per year is the same.	4.	The amount of depreciation goes on reducing.
5.	In the first year, the depreciation is charged on the cost of the asset, less scrap value, if any.	5.	In the first year, the depreciation is charged on the cost of the asset.
6.	At the end of its life, the book value of the asset becomes zero.	6.	The book value of the asset never reduces to zero.

Illustration 2

Thompson Bros. purchased machinery by cheque for ₹ 1,00,000 on 1st January, 2013. The estimated scrap value of the machinery is ₹ 20,000. At the end of each year, depreciation is provided at the rate of 10% per annum by the diminishing balance method. Show Machinery Account and Balance Sheet for the first two financial years which is ending on December, 31st every year :

(a) When no Provision for Depreciation Account is maintained; and

(b) When Provision for Depreciation Account is maintained.

Solution

1. Depreciation for 2013 = 1,00,000 x 10% = ₹ 10,000; 2. Depreciation for 2014 = (1,00,000 – 10,000) x 10% = ₹ 9,000.

(a) When no provision for Depreciation Account is maintained

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 Jan.1	To Bank A/c	1,00,000	2013 Dec.31	By Depreciation A/c	10,000
			"	By Balance c/d	90,000
		1,00,000			1,00,000
2014 Jan.1	To Balance b/d	90,000	2014 Dec.31	By Depreciation A/c	9,000
			"	By Balance c/d	81,000
		90,000			90,000
2015 Jan.1	To Balance b/d	81,000			

Dr. Depreciation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 Dec.31	To Machinery A/c	10,000	2013 Dec.31	By P & L A/c	10,000
2014 Dec.31	To Machinery A/c	9,000	2014 Dec.31	By P & L A/c	9,000

Balance Sheet as on 31st December, 2013 (includes)

Liabilities	₹	Assets	₹
		Machinery	90,000

Balance Sheet as on 31st December, 2014 (includes)

Liabilities	₹	Assets	₹
		Machinery	81,000

(b) When Provision for Depreciation Account is maintained

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 Jan.1	To Bank A/c	1,00,000	2013 Dec.31	By Balance c/d	1,00,000
2014 Jan.1	To Balance b/d	1,00,000	2014 Dec.31	By Balance c/d	1,00,000
2015 Jan.1	To Balance b/d	1,00,000			

Dr. **Accumulated Depreciation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013 Dec.31	To Balance c/d	10,000	2013 Dec.31	By Depreciation A/c	10,000
2014 Dec.31	To Balance c/d	19,000	2014 Jan.1	By Balance b/d	10,000
			Dec.31	By Depreciation A/c	9,000
		19,000			19,000
			2015 Jan.1	By Balance b/d	19,000

Dr. **Depreciation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013 Dec.31	To Accumulated Depreciation A/c	10,000	2013 Dec.31	By Profit & Loss A/c	10,000
2014 Dec.31	To Accumulated Depreciation A/c	9,000	2014 Dec.31	By Profit & Loss A/c	9,000

Balance Sheet as on 31st December, 2013 (includes)

Liabilities	₹	Assets	₹
		Machinery (At cost)	1,00,000
		Less: Accumulated Depreciation*	10,000
			90,000

Balance Sheet as on 31st December, 2014 (includes)

Liabilities	₹	Assets	₹
		Machinery (At cost)	1,00,000
		Less: Accumulated Depreciation*	19,000
			81,000

* Alternatively, it can be shown on the liabilities side of the Balance Sheet.

Charges for Depreciation and Materiality Concept

It is not fair to assume that a fixed asset is always purchased on the very first day of the accounting period. Assets are generally purchased in the course of the accounting period. When an asset is purchased in any month of the accounting period, it is not necessary to compute the amount of depreciation to be charged to the nearest day or week. As we know, the charge for depreciation is a mere estimate and the application of the concept of materiality does not allow a misleading impression of great precision. Therefore, depreciation is calculated to the nearest whole month. If an asset is acquired on 17th March and the concern follows the calender year as its accounting year, depreciation should be calculated for 9 months only (from 1st April – 31st December). If the asset is acquired on 4th March, depreciation should be calculated for 10 months only.

Another popular approach is to charge depreciation for 6 months only in the year of acquisition, ignoring the actual date of acquisition. This is known as ***'half-year convention'*** and is based on the mean of the opening and closing values of the asset. This method assumes that the actual purchase dates of several fixed assets generally 'average-out' to approximately mid-year. Therefore, any time during the accounting period, when an asset is accquired, half-year's depreciation is provided for the year of acquisition. It should be noted that the same rule is applied in the year when an asset is sold.

In examination, if no date of acquisition is given, the 'half-year convention' should be followed.

Profit and Loss on Disposal of Fixed Assets

Owing to technological developments, a depreciated asset becomes obsolete and it may be sold out before its useful life. The business enterprise may also sell an asset which it no longer requires. It is quite common that the sale value of such asset may not be equal to its written down value (net book value). If the asset is sold at a price which is more than its written down value, it produces a profit.

On the contrary, when the asset is sold at a price which is less than its written down value, it is a case of loss on sale of an asset. It has already been stated that depreciation is a mere estimate. Its accuracy depends on the correctness of the forecasting regarding the useful life of the asset and its scrap value. It is only on sale of an asset that the real position can be determined.

In this connection, para 26 of AS—10 is relevant. It states that ***losses arising from the retirement or gains or losses arising from disposal of fixed asset which is carried at cost should be recognised in the profit and loss statement***.

Journal Entries

The Journal entries for disposal or sale of asset will depend upon the method of recording depreciation.

1. When no provision for Depreciation Account is maintained

When the asset appears in the Balance Sheet at its written down value, on disposal, the written down value of such assets (at the beginning of the year of disposal) is transferred to 'Assets Disposal Account' and profit and loss on sale of assets are ascertained with the help of that account. The detailed entries are given below:

(a) For transferring to Assets Disposal Account

Assets Disposal Account Dr. (W.D.V. of the asset
To Asset Account at the beginning of the year of disposal)

(b) For charging depreciation of current year on disposed asset

Depreciation Account Dr.
To Assets Disposal Account

(c) For sale proceeds

Bank Account Dr.
To Assets Disposal Account

(d) If the credit side of the Assets Disposal Account is greater than the debit side, there is profit on diposal and it is transferred to Profit and Loss Account

Assets Disposal Acount Dr.
To Profit and Loss Account

(e) If the debit side of the Assets Disposal Account is greater than the credit side, there is loss on disposal and it is transferred to Profit and Loss Account

Profit and Loss Acount Dr.
To Assets Disposal Account

Illustration 3

Mr. Vaid of Calcutta purchased the required machine on 1.4.2012 for ₹ 65,000. He engaged Kabul to erect the units, who charged ₹ 5,000 and agreed to wait a month for his payment.

The machinery was depreciated at 10% p.a. on the Fixed Instalment Method — and accounting year being April-March.

On 1.10.2014, a single unit which cost ₹ 10,000 originally was sold for a cash price of ₹ 7,000. On the same date, a new machine costing ₹ 10,000 (paid for by cheque) was installed.

Write out the Machinery Account for the years 2012-13, 2013-14, 2014-15 and Machinery Disposal Account.

Solution

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2012 April 1	To Bank A/c	65,000	2013 Mar. 31	By Depreciation A/c	7,000
"	To Kabul A/c	5,000	"	By Balance c/d	63,000
		70,000			70,000
2013 April 1	To Balance b/d	63,000	2014 Mar. 31	By Depreciation A/c	7,000
			"	By Balance c/d	56,000
		63,000			63,000
2014 April 1	To Balance b/d	56,000	2014 Oct. 1	By Machinery Disposal A/c (Note 1)	8,000
Oct. 1	To Bank A/c	10,000	2015 Mar. 31	By Depreciation A/c (Note 2)	6,500
			"	By Balance c/d	51,500
		66,000			66,000
2015 April 1	To Balance b/d	51,500			

Dr. **Machinery Disposal Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Oct. 1	To Machinery A/c	8,000	2014 Oct. 1	By Cash A/c	7,000
			"	By Depreciation A/c (1/2 year)	500
			"	By Profit & Loss A/c (loss)	500
		8,000			8,000

Working Notes: **(1) Original cost of machin**e is ₹ 10,000. Depreciation @ 10% for 2 years = ₹ 2,000. Therefore, W.D.V. of the machine sold = ₹ 10,000 – ₹ 2,000 = ₹ 8,000. **(2) Depreciation for 2014-15:** 10% on ₹ (70,000 – 10,000) = ₹ 6,000 + 10% of ₹ 10,000 for 6 months = ₹ 500. Total ₹ 6,500.

Illustration 4

M/s Suba Pharmaceuticals has imported a machine on 1st July, 2012 for ₹ 1,60,000, paid customs duty and freight ₹ 80,000 and incurred erection charges ₹ 60,000. Another local machinery costing ₹ 1,00,000 was purchased on January, 1,2013. On 1st July, 2014, a portion of the imported machinery (value one-third) got out of order and was sold for ₹ 34,800. Another machinery was purchased to replace the same for ₹ 50,000. Depreciation is to be calculated at 20% p.a. on the straight line method. Show the Machinery Account for 2012, 2013 and 2014. Assume calendar year is the accounting year.

Solution

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

Date	Particulars	₹	Date	Particulars	₹
2012 July 1	To Bank A/c (Purchase price)	1,60,000	2012 Dec.31	By Depreciation A/c (1/2 year)	30,000
"	To Bank A/c (Customs Duty and Freight)	80,000	"	By Balance c/d	2,70,000
"	To Bank A/c (Erection charges)	60,000			
		3,00,000			3,00,000
2013 Jan.1	To Balance b/d	2,70,000	2013 Dec.31	By Depreciation A/c (Note 1)	80,000
"	To Bank A/c (new machine)	1,00,000	"	By Balance c/d	2,90,000
		3,70,000			3,70,000
2014 Jan.1	To Balance b/d	2,90,000	2014 July.1	By Machinery Disposal A/c (Note 2)	70,000
July 1	To Bank A/c	50,000	Dec.31	By Depreciation A/c (Note 1)	65,000
			"	By Balance c/d	2,05,000
		3,40,000			3,40,000
2015 Jan.1	To Balance b/d	2,05,000			

Dr. **Machinery Disposal Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 July.1	To Machinery A/c (Note 2)	70,000	2014 July.1	By Depreciation A/c (1/2 year)	10,000
			"	By Profit & Loss A/c (Loss)	25,200
			"	By Bank A/c (sale proceeds)	34,800
		70,000			70,000

Working Notes : **(1) Calculation of Depreciation**

	Acquired	Original cost	2007	2013	2014
1st Machinery	1.7.2007	3,00,000	30,000	60,000	**40,000
2nd Machinery	1.1.2013	1,00,000		20,000	20,000
3rd Machinery	1.7.2014	50,000			*5,000
TOTAL			30,000	80,000	65,000

* 1/2 year; ** 20% of ₹ 2,00,000 ₹ (3,00,000 – 1,00,000 machinery sold).

(2) Calculation of W.D.V. on 1.7.2014 (without depreciation for 2014)	₹
Original cost on 1.7.2007 (1/3 of ₹ 3,00,000)	1,00,000
Less: Depreciation for 2007 (1/2 year)	10,000
	90,000
Less: Depreciation for 2013	20,000
	70,000

Alternatively, all adjustments regarding disposal of asset can be done in the Asset Account itself without opening Assets Disposal Account separately. In such a situation, the entries will be as follows :

(a) For current year's depreciation on disposed asset

Depreciation Account Dr.
To Asset Account

(b) For sale proceeds

Bank Account Dr.
To Asset Account

(c) For profit on sale

Asset Account Dr.
To Profit and Loss Account

(d) For loss on sale

Profit and Loss Account Dr.
To Asset Account

For calculating profit or loss on sale, the following points should be remembered :

1. If the sale proceeds is greater than the written down value on the date of disposal, the surplus represents profit.
2. If the sale proceeds is less than the written down value on the date of disposal, the deficit represents loss.

Illustration 5

Bajaj and Co. close their accounts on 31st March every year. They purchased the machineries as follows :

(i) Purchased the machineries costing ₹ 1,20,000 on 1.7.2012.
(ii) On 1.1.2013, some machineries were purchased costing ₹ 1,20,000.
(iii) On 1.10.2013, again purchased some machinery costing ₹ 20,000.
(iv) On 1.1.2014 purchased a new machinery for ₹ 60,000.
(v) One machinery costing ₹ 40,000 which was purchased on 1.7.2007, was sold for ₹ 12,000 on 1.4.2014.
(vi) They charged depreciation @ 33.33% on the written down value method.
(vii) They have the practice to charge depreciation for the full year even if the machinery is used for a part of the year.

Prepare Machinery Account in the books of Bajaj & Co. for the three years—2012-13, 2013-14, 2014-15.

Solution

In the books of Bajaj and Co.

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2012, July 1	To Bank A/c	1,20,000	2013, Mar. 31	By Depreciation A/c ($33^1/_3$% of ₹ 2,40,000)	80,000
2013, Jan. 1	To Bank A/c	1,20,000	"	By Balance c/d	1,60,000
		2,40,000			2,40,000
2013, Apr. 1	To Balance b/d	1,60,000	2014, Mar. 31	By Depreciation A/c ($33^1/_3$% of ₹ 2,40,000)	80,000
Oct. 1	To Bank A/c	20,000	"	By Balance c/d	1,60,000
2014, Jan. 1	To Bank A/c	60,000			
		2,40,000			2,40,000
2014, Apr. 1	To Balance b/d	1,60,000	2014, Apr 1	By Bank A/c (sold)	12,000
			"	By Profit & Loss A/c (Note 1)	5,778
			2015, Mar. 31	By Depreciation A/c (Note 2)	47,407
			"	By Balance c/d	94,815
		1,60,000			1,60,000

Working Notes :

(1) Calculation of Loss on Sale of Machinery		(2) Depreciation for 2014-15	
Cost of machinery on 1.7.2012	40,000	W.D.V. of machine on 1.4.2014	1,60,000
Less: Depreciation for 2012-13 @ 33-1/3%	13,333	Less: W.D.V. of machine sold on 1.4.2014	17,778
W.D.V. on 1.4.2013	26,667	W.D.V. of machine in use	1,42,222
Less: Depreciation for 2013-14	8,889	Depreciation for 2014-15 @ 33-1/3% of ₹. 1,42,222	47,407
W.D.V. on 1.4.2014	17,778		
Less: Sale value	12,000		
Loss	5,778		

Illustration 6

Kalyani Industries depreciates its machinery at 10% p.a. on straight line basis. On 1st April, 2014 the balance in Machinery Account was ₹ 8,50,000 (original cost ₹ 12,00,000). On 1st July, 2014 a new machine was purchased for ₹ 25,000. On 31st

December, 2014 an old machine having written down value of ₹ 40,000 on 1.4.2014 (original cost ₹ 60,000) was sold for ₹ 30,000. Show the Machinery Account for the year ended on 31st March, 2015.

Solution

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 April 1	To Balance b/d	8,50,000	2014 Dec. 31	By Bank A/c (sale of old machine)	30,000
July 1	To Bank A/c (new machine)	25,000	"	By Depreciation A/c (Note 2)	4,500
			"	By Profit & Loss A/c (Note 2)	5,500
			2015 Mar. 31	By Depreciation A/c (Note 1)	1,15,875
			"	By Balance c/d	7,19,125
		8,75,000			8,75,000

Working Notes:

(1) Calculation of Depreciation for 2014-15	₹	(2) Calculation of Loss on Sale of Machinery	₹
Opening Balance (original)	12,00,000	Written down value on 1.4.2014	40,000
Less: Original cost of machine sold	60,000	Less: Depreciation (@ 10% p.a. on ₹ 60,000 for 9 months)	4,500
	11,40,000	written down value on 31.12.2014 (Date of sale)	35,500
Depreciation @ 10%p.a. (old machine)	1,14,000	Less: Sale value	30,000
Depreciation for 9 months (new machine)	1,875	**Loss**	5,500
	1,15,875		

Illustration 7

On 1st January, 2011, machinery was purchased by X for ₹ 50,000. On 1st July, 2012, additions were made to the extent of ₹ 10,000. On 1st April, 2013, further additions were made to the extent of ₹ 6,400. On 30th June, 2014, machinery, original value of which was ₹ 8,000 on 1st January, 2011, was sold for ₹ 6,000. Depreciation is charged @ 10% p.a. on original cost.

Show Machinery Account for the years from 2011 to 2014 in the books of X. X closes his books on 31st December.

Solution

In the Books of X

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2011 Jan. 1	To Bank A/c (Purchase)	50,000	2011 Dec.31	By Depreciation A/c	5,000
			"	By Balance c/d	45,000
		50,000			50,000
2012 Jan.1	To Balance b/d	45,000	2012 Dec.31	By Depreciation A/c (Note 1)	5,500
July 1	To Bank A/c (addition)	10,000	"	By Balance c/d	49,500
		55,000			55,000
2013 Jan.1	To Balance b/d	49,500	2013 Dec.31	By Depreciation A/c (Note 1)	6,480
Apr. 1	To Bank A/c (Addition)	6,400	"	By Balance c/d	49,420
		55,900			55,900
2014 Jan.1	To Balance b/d	49,420	2014 June30	By Bank A/c (Sales)	6,000
June 30	To Profit & Loss A/c (Note 2)	800	"	By Depreciation A/c (1/2 year)	400
			2014 Dec.31	By Depreciation A/c (Note 1)	5,840
			"	By Balance c/d	37,980
		50,220			50,220
2015 Jan.1	To Balance b/d	37,980			

Working Notes : (1) Calculation of Depreciation	₹	₹		₹
For 2011 : On ₹ 50,000 @ 10% p.a. for 1 year		5,000	**(2) Calculation of profit on Sale of Machinery**	
For 2012 : On ₹ 50,000 @ 10% p.a. for 1 year	5,000		Sale Proceeds	6,000
On ₹ 10,000 @ 10% p.a. for 1/2 year	500	5,500	Less: written down value on 30.6.2014	
For 2013 : On ₹ 50,000 @ 10-% p.a. for 1 year	5,000		₹ (8,000 – 2,800)	5,200
On ₹ 10,000 @ 10% p.a. for 1 year	1,000		**Profit on sale**	800
On ₹ 6,400 @ 10% p.a. for 9 months	480	6,480		
For sold out machine : on 8,000 @ 10% p.a. for 6 months		400		
For 2014 : On ₹ 42,000 (50,000 – 8,000) @ 10% p.a. for 1 year	4,200			
On ₹ 10,000 @ 10% p.a. for 1 year	1,000			
On ₹ 6,400 @ 10% p.a. for 1 year	640	5,840		

Illustration 8

X Company Ltd provides depreciation on Plant and Machinery at 20% p.a. on reducing balances. On 1st April, 2014, the balance of the Plant and Machinery Account was ₹ 10,00,000. It was discovered in 2014-15 that :

(i) ₹ 50,000 being repairs to machiney incurred on 30th June, 2012 had been capitalised.

(ii) ₹ 1,00,000 being the cost of a generator purchased on 1st October, 2011 has been written off to Maintenance Account.

The company directors want to rectify the mistakes while finalising the accounts for the year ended 31st March, 2015.

A plant that cost ₹ 80,000 on 30th September, 2014 was scrapped and replaced with a more sophisticated one on 31st December, 2014 by spending ₹ 1,20,000. Scrap realised ₹ 20,000.

Prepare the Plant and Machinery Account as it would appear on 31st March, 2015 after providing depreciation for the year.

Solution

In the books of X Company Ltd.

Dr. Plant Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 April 1	To Balance b/d	10,00,000	2014 Dec. 31	By Depreciation A/c (Note 3)	10,800
	To Profit & Loss Adjustment A/c (Note 1&2)	23,600	"	By Bank A/c (Scrap value)	20,000
Dec. 31	To Bank A/c (Purchases)	1,20,000	"	By Profit & Loss A/c (Note 3)	41,200
			2015 Mar. 31	By Depreciation A/c (Note 4)	1,96,320
			"	By Balance c/d	8,75,280
		11,43,600			11,43,600

Working Notes :

(1) Adjustment for Repairs to Machinery wrongly Capitalised on 30th June, 2012 :

	₹
Repairs capitalised on 30.6.2012	50,000
Less: Depreciation for 9 months	7,500
W.D.V. on 1.4.2013	42,500
Depreciation for 2013-14	8,500
W.D.V. on 1.4.2014	34,000

Adjustment entry will be :

Profit and Loss Adjustment Account	Dr.	34,000	
To Plant and Machinery Account			34,000

(2) Adjustment for Generator wrongly written-off to Maintenance Account :

	₹
Cost of generator on 1st October, 2011	1,00,000
Less: Depreciation for 6 months	10,000
W.D.V. on 1.4.2012	90,000
Less: Depreciation for 2012-13	18,000
W.D.V. on 1.4.2013	72,000
Less: Depreciation for 2013-14	14,400
W.D.V. on 1.4.2014	57,600

Adjustment entry will be :

Plant and Machinery Account	Dr.	57,600	
To Profit and Loss Adjustment Account			57,600

Net Effect :

The value of plant and machinery will be increased by ₹ 23,600 (₹ 57,600 – 34,000). The same amount will be credited to Profit and Loss Adjustment Account.

	₹
(3) Cost of plant on 30.9.2013	80,000
Less: Depreciation for 6 months	8,000
W.D.V. on 1.4.2014	72,000
Less: Depreciation (1.4.2014 to 31.12.2014)	10,800
	61,200
Less: Scrap value	20,000
Loss on Disposal	41,200

(4) Depreciation for 2014-15

Opening balance (1.4.2014)	10,00,000
Add: Rectification (1.4.2014 — Note 2)	23,.600
	10,23,600
Less: W.D.V. of plant scrap (1.4.2014 — Note 3)	72,000
Total plant in use throughout the year	9,51,600

Depreciation

(i) 20% on ₹ 9,51,600 for full year	1,90,320
(ii) 20% on ₹ 1,20,000 for 3 months	6,000
	1,96,320

2. When Provision for Depreciation Account is maintained

If the asset account is maintained at cost price, on disposal, the original cost of such asset is transferred to Asset Disposal Account and Accumulated Depreciation on such asset is also transferred to this account. The entries are as follows :

(a) For transferring to Assets Disposal Account

Assets Disposal Account	Dr. (Original Cost)
To Asset Account	

(b) For transferring accumulated depreciation on disposed asset

Accumulated Depreciation Account	Dr.
To Assets Disposal Account	

(c) For charging current year's depreciation on disposed asset

Depreciation Account	Dr.
To Assets Disposal Account	

(d) For sale proceeds

Bank Account	Dr.
To Assets Disposal Account	

(e) For profit

Assets Disposal Account	Dr.
To Profit & Loss Account	

(f) For loss

Profits and Loss Account	Dr.
To Assets Disposal Account	

Illustration 9

Goutam & Co, whose books are closed on 31.12.2012, purchased a machine for ₹ 1,50,000 on 1st January 2012. Additional machinery was acquired for ₹ 50,000 on 1st July 2012.

Certain machinery, which was purchased for ₹ 50,000 on 1st July, 2012 was sold for ₹ 30,000 on 30th June 2014.

Prepare Machinery Account and Accumulated Depreciation Account for all the years upto the year ending 31st December, 2014 taking into account depreciation @ 10% p.a. on straight line method.

And also show Machinery Disposal Account.

Solution

In the Books of Goutam & Co

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2012 Jan 1	To Bank A/c (Purchase)	1,50,000	2012 Dec.31	By Balance c/d	2,00,000
July 1	To Bank A/c (Purchase)	50,000			
		2,00,000			2,00,000
2013 Jan.1	To Balance b/d	2,00,000	2013 Dec.31	By Balance c/d	2,00,000
2014 Jan.1	To Balance b/d	2,00,000	2014 June 30	By Machinery Disposal A/c (original cost)	50,000
			Dec.31	By Balance c/d	1,50,000
		2,00,000			2,00,000
2015 Jan.1	To Balance b/d	1,50,000			

Dr. Accumulated Depreciation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2012 Dec.31	To Balance c/d	17,500	2012 Dec.31	By Depreciation A/c	17,500
2013 Dec.31	To Balance c/d	37,500	2013 Jan.1	By Balance b/d	17,500
			Dec.31	By Depreciation A/c	20,000
		37,500			37,500
2014 Jun.30	To Machinery Disposal A/c	7,500	2014 Jan 1	By Balance b/d	37,500
Dec.31	To Balance c/d	45,000	Dec 31	By Depreciation A/c (Note 1)	15,000
		52,500			52,500

Dr. Machinery Disposal Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 June 30	To Machinery A/c (original cost)	50,000	2014 June 30	By Accumulated Depreciation A/c	7,500
			"	By Depreciation A/c (Note 2)	2,500
			"	By Bank A/c (Sale)	30,000
			"	By Profit & Loss A/c (Loss)	10,000
		50,000			50,000

Working Note : (1) Calculation of Depreciation	1st	2nd
Acquisition cost	1,50,000	50,000
Date of acquisition	1.1.2012	1.7.2012
Depreciation for 2012 @ 10% p.a.	15,000	2,500*
Depreciation for 2013 @ 10% p.a.	15,000	5,000
Accumulated Depreciation upto 31.12.2013	30,000	7,500
Depreciation for 2014 @ 10% p.a.	15,000	2,500*

* 1/2 year

Illustration 10

At the beginning of the financial year on 1st April, 2014, X Co. Ltd. had a balance on Plant Account of ₹ 18,60,000 and on Provision for Depreciation on Plant Account of ₹ 10,27,000.

On 1st September, 2014 the company sold for ₹ 68,500 some plant which it had acquired on 31st October, 2013 at a cost of ₹ 1,80,000. Additionally, installation costs totalled ₹ 20,000. During 2015 major repairs costing ₹ 31,500 had been carried out on this plant and, in order to increase the capacity of the plant, a new motor had been fitted in December 2015 at a cost of ₹ 22,000. A further overhauling cost of ₹ 13,500 had been carried out during 2013.

The company acquired new replacement plant on 30th November, 2014 at a cost of ₹ 4,80,000, inclusive of installation charges of ₹ 35,000. The company's policy is to provide depreciation using the reducing balance method applied to fixed assets held at the end of the financial year at the rate of 20% p.a.

You are required to show : (i) the balance of plant at cost at 31st March, 2015; (ii) the provision for depreciation of plant at 31st March, 2015; and, (iii) Plant Disposal Account.

Solution

In the books of X Co. Ltd.

Dr. Plant Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 April 1	To Balance b/d	18,60,000	2014 Sept. 1	By Plant Disposal A/c (Note 1)	2,22,000
Nov. 30	To Bank A/c	4,80,000	2015 Mar 31	By Balance c/d	21,18,000
		23,40,000			23,40,000

Dr. Provision for Depreciation of Plant Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Sept.1	To Plant Disposal A/c (Note 2)	1,26,000	2014 April. 1	By Balance b/d	10,27,000
2015 Mar 31	To Balance c/d	11,44,400	2015 Mar 31	By Depreciation A/c (Note 3)	2,43,400
		12,70,400			12,70,400

Dr. Plant Disposal Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Sept.1	To Plant A/c (Note 1)	2,22,000	2014 Sept.1	By Provision for Depreciation of Plant A/c	1,26,000
			"	By Bank A/c	68,500
			"	By Loss on Disposal A/c	27,500
		2,22,000			2,22,000

Working Notes :

(1) Original Cost of Plant Sold	₹	**(2) Depreciation on Disposal**	₹	₹
Cost	1,80,000	Cost as on 31.10.2010	1,80,000	
Installation	20,000	Installation on 31.10.2010	20,000	
Upgrade	22,000		2,00,000	
	2,22,000	Less: Depreciation for 2010-01 @ 20%	40,000	40,000
(3) Depreciation for 2014-15	₹		1,60,000	
Original cost of total plant	23,40,000	Less: Depreciation for 2011-2012 @ 20%	32,000	32,000
Less: Original cost plant sold	2,22,000		1,28,000	
Original cost of asset in use	21,18,000	Add: Increase in Capacity (December)	22,000	

Less: Accumulated Depreciation of plant in use			1,50,000	
(₹ 10,27,000 – 1,26,000)	9,01,000	Less: Depreciation for 2012-13 @ 20%	30,000	30,000
W.D.V. of plant in use on 31.3.2015	12,17,000		1,20,000	
Depreciation @ 20%	2,43,400	Less: Depreciation for 2013-14 @ 20%	24,000	24,000
			96,000	1,26,000

Tutorial Note : Major repairs costing ₹ 31,500 in 2012 do not form a part of the cost of this plant and, therefore, it should be charged to the Profit and Loss Account of that period. The overhauling cost in 2013 is also a revenue expense. However, new motor fitted in 2012 will be treated as capital expenditure as it will increase the capacity of the plant.

Change in the Method of Depreciation

In connection with this, AS—6 para 21 states that the depreciation method selected should be applied consistently from period to period. A change from one method of providing depreciation to another should be made only if the adoption of the new method is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements of the enterprise. When such a change in the method of depreciation is made, depreciation should be ***recalculated in accordance with the new method from the date of the asset coming into use***. The deficiency or surplus arising from ***retrospective recomputation*** of depreciation in accordance with the new method should be adjusted in the accounts in the year in which the method of depreciation is changed. In case the change in the method results in deficiency in depreciation in respect of past years, the deficiency should be charged in the statement of profit and loss. In case the change in the method results in surplus, the surplus should be credited to the statement of profit and loss. Such a change should be treated as a change in accounting policy and its effect should be quantified and disclosed.

The following points are important :

1. ***The change in the method of depreciation must be with retrospective effect.***
2. ***The deficiency or surplus arising from retrospective recomputation of depreciation in accordance with the new method should be adjusted in the accounts in the year in which the method of depreciation is changed.***
3. ***The deficiency or surplus of depreciation in respect of past years, should be debited or credited to the Profit and Loss Account of the year of change in the method of depreciation.***

Change in the method of Depreciation with Restrospective Effect

In this case depreciation already recorded in prior years will be adjusted. The W.D.V. on the date of change is to be adjusted for under-depreciation or over-depreciation. The following steps should be taken for such adjustment:

Step 1 Calculate total depreciation from the date of retrospective effect to the date of change by adopting the ***new method*** of depreciation.

Step 2 Ascertain total depreciation under the existing method upto the date of change.

Step 3 Pass the following entry:

(a) if total depreciation of Step 1 is greater than that of Step 2

Profit and Loss Account Dr. [Difference]
To Asset Account

(b) If the total depreciation of step 1 is less than that of step 2

Asset Account Dr. [Difference]
To Profit and Loss Acount

Step 4 Charge depreciation from the date of change by adopting the new method.

Illustration 11

X Co. Ltd. charged depreciation on its assets on SLM basis. For the year ended 31.3.2015, it changed to WDV basis. The impact of the change when computed from the date of the asset coming to use amounts to ₹ 20 lakhs being additional charge. Decide how it must be disclosed in Profit and Loss Account. Also discuss, when such change in method of depreciation can be adopted by an enterprise as per AS—6.

Solution

Para 21 of AS—6 states that in case the change in the method results in deficiency in depreciation in respect of past years, the deficiency should be charged to the statement of Profit and Loss.

Here, ₹ 20 lakhs should be charged to the Profit and Loss Account for the year ended on 31st March, 2015.

An enterprise may change the method of depreciation only under the following conditions :

(a) the change is required by a statute or an Accounting Standard;

(b) the change would produce a more appropriate presentation.

Illustration 12

Ram Co. (P) Ltd. furnishes you the following information for the year ended 31.3.2015 :

		(₹ in lakhs)
(i)	Depreciation for the year ended 31.3.2015 (under SLM)	100
(ii)	Depreciation for the year ended 31.3.2015 (under WDV)	200
(iii)	Excess of depreciation for the earlier years calculated under WDV over SLM	500

The company wants to change its method of claiming depreciation from straight line method to written down value method.

Decide how the depreciation should be disclosed in the financial statement for the year ended 31.3.2015.

Solution

Para 21 of AS—6 states that

"When such a change in the method of depreciation is made, depreciation should be recalculated in accordance with the new method from the date of the asset coming into use. The deficiency or surplus arising from retrospective recomputation of depreciation in accordance with the new method should be adjusted in the accounts in the year in which the method of depreciation is changed. In case the change in the method results in deficiency in depreciation in respect of past years, the deficiency should be charged in the statement of profit and loss. In case the change in the method results in surplus, the surplus should be credited to the statement of profit and loss. Such a change should be treated as a change in accounting policy and its effect should be quantified and disclosed."

In this case, the deficiency of ₹ 500 lakhs would be charged to the Profit and Loss Account for the year ending on 31st March, 2015. In the notes to account the reasons for change in the method of depreciation is to be elaborated. The effect of ₹ 500 lakhs is also to be disclosed. Current year's depreciation of ₹ 200 lakhs is to be charged to Profit and Loss Account for the year ended 31st March, 2015.

Illustration 13

A plant was depreciated under two different methods as under :

Year	SLM (₹ in Lakhs)	WDV (₹ in Lakhs)
1	7.80	21.38
2	7.80	15.80
3	7.80	11.68
4	7.80	8.64
	31.20	57.50
5	7.80	6.38

What should be the amount of resultant surplus / deficiency, if the company decides to switch over from W.D.V. method to S.L.M. method for first four years ? Also state, how will you treat the same in accounts.

Solution

Here, in this case, there is a surplus of ₹ 26.30 lakhs (57.50 – 31.20) on account of change in the method of depreciation.

As per para 21 of AS—6, when a change in the method of depreciation is made, depreciation should be recalculated in accordance with the new method from the date of the asset coming into use. The surplus arising from retrospective recomputation of depreciation in accordance with the new method should be credited to the statement of profit and loss. Such a change should be treated as a change in accounting policy and its effect should be quantified and disclosed.

Therefore, the surplus of ₹ 26.30 lakhs will be ***credited*** to Profit and Loss Account.

Illustration 14

A company purchased machinery for ₹ 20,000 on 1st January, 2011 and followed the diminishing balance method of depreciating the value @ 15%. At the end of 2012, it was decided to follow the fixed instalment system of depreciating the machine at ₹ 3,000 per year from the very beginning and the necessary amount of unabsorbed depreciation of 2011 to 2013 to be adjusted in 2014. Show the Machinery Account for the period 2011 to 2014.

Solution

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2011 Jan. 1	To Bank A/c	20,000	2011 Dec. 31	By Depreciation A/c	3,000
			"	By Balance c/d	17,000
		20,000			20,000
2012 Jan. 1	To Balance b/d	17,000	2012 Dec. 31	By Depreciation A/c	2,550
			"	By Balance c/d	14,450
		17,000			17,000
2013 Jan. 1	To Balance b/d	14,450	2013 Dec. 31	By Depreciation A/c	2,168
			"	By Balance c/d	12,282
		14,450			14,450
2014 Jan. 1	To Balance b/d	12,282	2014 Dec. 31	By Profit & Loss A/c (Note 1)	1,282
			"	By Depreciation A/c	3,000
			"	By Balance c/d	8,000
		12,282			12,282
2015 Jan. 1	To Balance b/d	8,000			

Working Note: (1) :

Total depreciation from 1.1.2011 to 31.12.2013 under ***Old Method*** = ₹ (3,000 + 2,550 + 2,168) = ₹ 7,718

Total depreciation from 1.1.2011 to 31.12.2013 under ***New Method*** = (3 x ₹ 3,000) = ₹ 9,000

Additional depreciation to be adjusted in 2014 ₹ 1,282

Journal Entry: Profit & Loss Account Dr. ₹ 1,282

To Machinery Account ₹ 1,282

Illustration 15

Messrs Mill and Wright commenced business on 1st January, 2011, when they purchased plant and equipment for ₹ 7,00,000. They adopted a policy: (i) Charging depreciation at 15% per annum on diminishing balance basis; and (ii) charging full years depreciation on additions. Over the years, their purchases of plant have been ₹

1.8.2012 1,50,000

30.9.2015 2,00,000

On 1.1.2015 it was decided to change the method and rate of depreciation to 10% on straight line basis with retrospective effect from 1.1.2011, the adjustment being made in the accounts for the year ending 31st December, 2015. Calculate the difference in depreciation to be adjusted in the Plant and Equipment. Account on 1.1.2015 and show the Ledger Account for the year 2015.

Solution **Calculation of Depreciation under Straight Line Basis**

Date of Acquisition	1.1.2011	1.8.2012	Total
No. of years for which depreciation is to be charged	4	3	
Annual Depreciation @ 10% on original cost	70,000	15,000	
Total Depreciation	2,80,000	45,000	3,25,000

Calculation of Depreciation under Diminishing Balance Basis

Date of Acquisition	1.1.2011	1.8.2012	Total
Cost	7,00,000		
Less: Depreciation for 2011	1,05,000		1,05,000
Balance on 1.1.2012 (W.D.V.)	5,95,000		
Cost		1,50,000	
Less: Depreciation for 2012	89,250	22,500	1,11,750
Balance on 1.1.2013 (W.D.V.)	5,05,750	1,27,500	
Less: Depreciation for 2013	75,863	19,125	94,988
Balance on 1.1.2014 (W.D.V.)	4,29,887	1,08,375	
Less: Depreciation for 2014	64,483	16,256	80,739
Balance on 1.1.2015	3,65,404	92,119	3,92,477

Depreciation overcharged = ₹ 67,477 (3,25,000 – 3,92,477)

Total Depreciation from 1.1.2014 to 1.1.2015 under new method ₹ 3,25,000

Total Depreciation from 1.1.2014 to 1.1.2015 under old method ₹ 3,92,477

Journal Entry : Plant & Equipment Account Dr. 67,477

To Profit and Loss Account 67, 477

(Being the adjustment for over-depreciation)

Dr. **Plant and Equipment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/d (₹ 3,65,404 + 92,119)	4,57,523	31.12.2015	By Depreciation A/c	1,05,000
"	To Profit & Loss A/c	67,477	"	By Balance c/d	6,20,000
30.9.2015	To Bank A/c	2,00,000			
		7,25,000			7,25,000

Illustration 16

Better and Best Enterprises depreciates its machinery @ 10% p.a. on reducing balance. On 1.1.2014, the balance in Machinery Account was ₹ 97,200.

During the year 2014, a machine purchased on 1.1.2012 for ₹ 8,000 was sold for ₹ 4,500 on 1.7.2014. A new machine was bought on the same date for ₹ 15,800. On 1st January, 2014, the concern changed the method of depreciation from reducing balance method to straight line method with retrospective effect from 2012 with no change in the rate.

Show the Machinery Account for the year ending 31st December, 2014, and also the Machinery Disposal Account. Working should form part of your answer.

Solution

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

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance b/d	97,200	2014 July 1	By Machinery Disposal A/c (Note 1)	6,480
July 1	To Bank A/c (new purchase)	15,800	Dec. 31	By Profit & Loss A/c (Note 2)	1,120
			"	By Depreciation A/c (Note 4)	11,990
			"	By Balance c/d	93,410
		1,13,000			1,13,000

Dr. **Machinery Disposal Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 July 1	To Machinery A/c	6,480	2014 July 1	By Depreciation A/c (Note 1)	324
			"	By Bank A/c	4,500
			Dec. 31	By Profit & Loss A/c (loss)	1,656
		6,480			6,480

Working Notes:

(1) Calculation of Loss on Sale	₹	(2) Extra Depreciation to be charged	₹
Original Cost on 1.1.2012	8,000	Total Depreciation charged under Reducing Balance Method	
Less: Depreciation of 2012 @ 10%	800	2012 — 10% of ₹ 1,12,000 (Note 3)	11,200
Balance on 1.1.2013 (W.D.V.)	7,200	2013 — 10% of ₹ (1,12,000 – 11,200)	10,080
Less: Depreciation of 2013 @ 10%	720		21,280
Balance on 1.1.2014 (W.D.V.)	6,480	Depreciation for 2012 and 2013 under Straight Line Method will	
Less: Depreciation for 6 months	324	be 10% of ₹ 1,12,000 for two years = ₹ 22,400.	
	6,156	Therefore, extra depreciation is to be charged =	
Less: Sale value	4,500	₹ 22,400 – ₹ 21,280 = ₹ **1,120**	
Loss	1,656		

(3) Original cost of Machinery still in use

Balance on 1.1.2014 (W.D.V.)	97,200	Original cost of machine still in use will be:
Less: W.D.V. of Machine sold	6,480	₹ 100 / 81 x ₹ 90,720 = ₹ 1,12,000
W.D.V. of Machine in use (after depreciation for 1994 & 1995)	90,720	

(4) Depreciation for 2014 = ₹ 11,200 + ₹ 790 (6 months) = ₹ 11,990.

Illustration 17

On 1.1.2012, a new plant was purchased by Mrs Kalyani Basu for ₹ 1,00,000 and a further sum of ₹ 5,000 was spent on its installation. On 1.6.2013, another plant was acquired for ₹ 65,000.

On 2.10.2014, the first plant was totally destroyed and the amount of ₹ 2,500 only was realised by selling the scrap. It was not insured. On 20.10.2014, a second hand plant was purchased for ₹ 75,000 and a further sum of ₹ 7,500 was spent on repairs and ₹ 2,500 on its erection. It came into use on 15.11.2014. Depreciation has been provided at 10% on the original cost annually on 31st December. It was the practice to provide depreciation for full year on all acquisitions made at any time during any year and to ignore depreciation on any item sold during the year. The accounts are closed annually on 31st December. In December 2014, it was decided to change the method of depreciation and to follow the rate of 15% on diminishing balance method with retrospective effect in respect of the existing items of plant and to make necessary adjustments on 31.12.2014. Show Plant Account, Plant Disposal Account and Provision for Depreciation Account for 3 years.

Solution

In the books of Mrs Kalyani Basu

Plant Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2012 Jan. 1	To Bank A/c (₹ 1,00,000 + 5,000)	1,05,000	2012 Dec.31	By Balance c/d	1,05,000
2013 Jan. 1	To Balance b/d	1,05,000	2013 Dec. 31	By Balance c/d	1,70,000
June 1	To Bank A/c	65,000			
		1,70,000			1,70,000
2014 Jan. 1	To Balance b/d	1,70,000	2014 Oct. 2	By Plant Disposal A/c	1,05,000
Oct. 20	To Bank A/c	75,000	Dec. 31	By Balance c/d	1,50,000
"	To Bank A/c (₹ 7,500 + 2,500)	10,000			
		2,55,000			2,55,000
2015 Jan. 1	To Balance b/d	1,50,000			

Provision for Depreciation Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2012 Dec. 31	To Balance c/d	10,500	2012 Dec.31	By Depreciation A/c	10,500
2013 Dec. 31	To Balance c/d	27,500	2013 Jan. 1	By Balance b/d	10,500
			Dec. 31	By Depreciation A/c	17,000
		27,500			27,500
2014 Oct. 2	To Plant Disposal A/c	21,000	2014 Dec. 31	By Balance b/d	27,500
Dec. 31	To Balance c/d	30,788	"	By Profit & Loss A/c (Note 1)	3,250
			"	By Depreciation A/c (Note 2)	21,038
		51,788			51,788
			2015 Jan. 1	By Balance b/d	30,788

Plant Disposal Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Oct. 2	To Plant A/c	1,05,000	2014 Oct. 2	By Provision for Depreciation A/c	21,000
			"	By Bank A/c	2,500
			Dec. 31	By Profit & Loss A/c (Loss)	81,500
		1,05,000			1,05,000

Working Note : (1)	₹	**(2)**	₹
Depreciation for 2013 — New Method (@ 15% on ₹ 65,000)	9,750	Depreciation for 2014 : (i) 15% of ₹ (65,000 – 9,750)	8,288
Depreciation for 2013 — Old Method (@ 10% on ₹ 65,000)	6,500	(ii) 15% of ₹ 85,000	12,750
	3,250		21,038

Tutorial Note. Plant purchased on June 1, 2013 is in use at present. Therefore, effect of change in the method of depreciation is to be calculated for that plant of ₹ 65,000 only for the year 2013.

3. Sinking Fund Method or Depreciation Fund Method

A Sinking Fund is a fund created by the regular investment of a fixed amount to accumulate the amount of money required to replace an asset at a set date in the future. This method is based on concept of present values.

The previous two methods made no attempt to generate fund for replacement of asset at the end of its useful life. The sinking fund method not only takes depreciation into account but also makes provision for replacement of the asset. Under this method, a fund is created by debiting Depreciation Account and crediting Sinking Fund Account.

Depreciation Account is ultimately transferred to Profit and Loss Account. An amount equivalent to depreciation charged is invested outside the business in gilt-edged or other securities and are allowed to accumulate at compound interest so as to produce the required amount to replace the asset after a specified period of time. The main advantage of this method is that it avoids strain on working capital, if substantial sums are withdrawn from the business to replace the asset at the end of its life. However, during inflation, the depreciable cost of an asset is likely to be less than the replacement cost of the asset.

The asset is shown in the Balance Sheet, every year, at its original value. Sinking fund is shown on the liabilities side and sinking fund investment is shown on the assets side of the Balance Sheet.

At the end of the useful life of the asset, all investments are sold away. The proceeds are utilised for purchasing the new asset. The Asset Account is closed by setting it off against the Sinking Fund Account. It should be noted that profit or loss on sale of investment is also transferred to the Sinking Fund Account.

The equal amount of cash to be invested each year is ascertained from the sinking fund table.

Journal Entries

A. ***At the end of the first year***

(i) For setting aside the required amount

Depreciation Account Dr.
To Sinking Fund Account

(ii) For transferring depreciation to Profit and Loss Account

Profit and Loss Account Dr.
To Depreciation Account

(iii) For investing the amount

Sinking Fund Investment Account Dr.
To Bank Account

B. ***Second and subsequent years***

(i) For interest on investment

(a) Bank Account Dr.
To Interest on Sinking Fund Investment Account
(b) Interest on Sinking fund Investment Account Dr.
To Sinking Fund Account

(ii) For setting aside the amount

Depreciation Account Dr.
To Sinking Fund Account

(iii) For transferring depreciation to Profit and Loss Account

Profit and Loss Account Dr.
To Depreciation Account

(iv) For investing (amount of depreciation plus interest)

Sinking Fund Investment Account Dr.
To Bank Account

C. ***Last Year***

(i) For interest on investment

(a) Bank Account Dr.
To Interest on Sinking Fund Investment Account
(b) Interest on Sinking fund Investment Account Dr.
To Sinking Fund Account

(ii) For setting aside the amount

Depreciation Account Dr.
To Sinking Fund Account

In the last year, the amount of depreciation and interest are not re-invested. Instead, all investments are sold.

(iii) For sale of investment

Bank Account Dr.
To Sinking Fund Investment Account

(iv) For transferring profit or loss on sale of investment

(a) For Profit

Sinking Fund Investment Account Dr.

To Sinking Fund Account

(b) For Loss

Sinking Fund Account Dr.

To Sinking Fund Investment Account

(v) For sale of scrap

Bank Account Dr.

To Asset Account

(vi) For closing Sinking Fund Account

Sinking Fund Account Dr.

To Asset Account

(vii) For closing Asset Account

If there is any balance in the asset account, it is transferred to Profit & Loss Account.

Illustration 18

On 1st July, 2011, Wise Ltd purchased a machine for ₹ 1,10,000 and spent ₹ 6,000 on its installation. The expected life of the machine is 4 years at the end of which the estimated scrap value will be ₹ 16,000. Desiring to replace the machine on the expiry of its life, the company establishes a sinking fund. Investments are expected to realize 5% interest. On 30th June, 2015, the machine was sold off as scrap for ₹ 18,000 and the investments were realized at 5% less than the book value. On 1st July, 2015, a new machine is installed at a cost of ₹ 1,25,000. Sinking Fund tables show that ₹ 0.2320 invested each year will produce ₹ 1 at the end of 4 years at 5%.

Show the necessary Ledger Accounts in the books of Wise Ltd for all the years.

Solution

Amount required = ₹ 1,10,000 + 6,000 – 16,000 = ₹ 1,00,000; Therefore, Annual Contribution = ₹ 1,00,000 x 0.232 = ₹ 23,200.

In the Books of Wise Ltd

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.7.2011	To Bank A/c (Cost)	1,10,000	30.6.2012	By Balance c/d	1,16,000
	To Bank A/c (Expenses)	6,000			
		1,16,000			1,16,000
1.7.2012	To Balance b/d	1,16,000	30.6.2013	By Balance c/d	1,16,000
1.7.2013	To Balance b/d	1,16,000	30.6.2014	By Balance c/d	1,16,000
1.7.2014	To Balance b/d	1,16,000	30.6.2015	By Bank A/c (Scrap sold)	18,000
			"	By Sinking Fund A/c	96,343
			"	By Profit & Loss A/c	1,657
		1,16,000			1,16,000
1.7.2015	To Bank A/c (New)	1,25,000			

Dr. Sinking Fund Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.6.2012	To Balance c/d	23,200	30.6.2012	By Depreciation A/c	23,200
30.6.2013	To Balance c/d	47,560	1.7.2012	By Balance b/d	23,200
			30.6.2013	By Interest on Investment A/c	1,160
			"	By Depreciation A/c	23,200
		47,560			47,560
30.6.2014	To Balance c/d	73,138	1.7.2013	By Balance b/d	47,560
			30.6.2014	By Interest on Investment A/c	2,378
			"	By Depreciation A/c	23,200
		73,138			73,138
30.6.2015	To Sinking Fund Investment A/c	3,657	1.7.2014	By Balance b/d	73,138
	To Machinery A/c	96,343	30.6.2015	By Interest on Investment A/c	3,657
			"	By Depreciation A/c*	23,205
		1,00,000			1,00,000

* An adjustment has been made in the depreciation charged in 2014-15.

Dr. **Sinking Fund Investment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
30.6.2012	To Bank A/c	23,200	30.6.2012	By Balance c/d	23,200
1.7.2012	To Balance b/d	23,200	30.6.2013	By Balance c/d	47,560
30.6.2013	To Bank A/c (23,200 + 1,160)	24,360			
		47,560			47,560
1.7.2013	To Balance b/d	47,560	30.6.2014	By Balance c/d	73,138
30.6.2014	To Bank A/c (23,200 + 2,378)	25,578			
		73,138			73,138
1.7.2014	To Balance b/d	73,138	30.6.2015	By Bank A/c (Sales)	69,481
			"	By Sinking Fund A/c (Loss on sale)	3,657
		73,138			73,138

Illustration 19

On 1 January, 2012 a company purchased a machine at a cost of ₹ 80,000. In order to provide sufficient fund for replacement of the machine at the end of its working life it decided to create a Sinking fund and to invest the amount in Government Securities bearing interest @ 5% per annum. The working life of the machine was 4 years and estimated scrap value was ₹ 16,000.

The machine became obsolete and was sold at ₹ 30,000 on 31 December, 2014. The Government Securities were sold at a profit of ₹ 3,000. A new machine was purchased on 1 January, 2012 at ₹ 1,20,000. Sinking Fund Table shows that ₹ 0.2320 invested each year will produce ₹ 1 at tne end of 4 years at 5% annual interest.

Prepare Machinery Account, Sinking Fund Account and Sinking Fund Investment Account.

Solution

Amount required = ₹ 80,000 – ₹ 16,000 = ₹ 64.000.

Annual contribution = ₹ 64,000 × 0.232 = ₹ 14,848.

In the Books of ...

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

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Bank A/c	80,000	30.12.2012	By Balance c/d	80,000
1.1.2013	To Balance b/d	80,000	30.12.2013	By Balance c/d	80,000
1.1.2014	To Balance b/d	80,000	30.12.2014	By Bank A/c	30,000
			"	By Sinking Fund A/c	49,808
			"	By Profit & Loss A/c (Loss on sale)	192
		80,000			80,000

Dr. **Sinking Fund Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Balance c/d	14,848	31.12.2012	By Depreciation A/c	14,848
31.12.2013	To Balance c/d	30,438	1.1.2013	By Balance b/d	14,848
				By Interest on Investment A/c	742
			31.12.2014	By Depreciation A/c	14,848
		30,438			30,438
31.12.2014	To Machinery A/c	49,808	1.1.2014	By Balance b/d	30,438
			31.12.2014	By Interest on Investment A/c	1,572
			"	By Depreciation A/c	14,848
			"	BySinking Fund Investment A/c (Profit)	3,000
		49,808			49,808

Dr. **Sinking Fund Investment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Bank A/c	14,848	31.12.2012	By Balance c/d	14,848
1.1.2013	To Balance b/d	14,848	31.12.2013	By Balance c/d	30,438
31.12.2013	To Bank A/c (742 + 14,838)	15,590			
		30,438			30,438
1.1.2014	To Balance b/d	30,438	31.12.2014	By Bank A/c (Sales)	33,438
31.12.2014	To Sinking Fund A/c (Profit)	3,000			
		33,438			33,438

4. Insurance Policy Method

This is similar to the sinking fund method but, instead of investing the money in securities, the amount is used in paying premium on a policy taken out with an insurance company. The policy should mature immediately after the expiry of the useful life of the asset. The money that is received from the insurance company is used to replace the asset. Though the interest received is lower than could be obtained by investing in securities, the risk of loss on realisation of securities is avoided. To be more conservative, some accountants are of the opinion that the policy account should be adjusted, at the year end, at its surrender value so as to maintain the policy in the Balance Sheet at its net realisable value. Others argue that there is no need to write down the policy to its surrender value, because the policy is for a fixed sum and there is no intention of surrendering it.

Journal Entries:

(a) For yearly depreciation

Depreciation Account Dr. [Insurance premium]
    To Depreciation Reserve Fund Account

(b) For transferring depreciation to Profit and Loss Account

Profit and Loss Account Dr.
    To Depreciation Account

(c) For payment of yearly premium

Depreciation Insurance Policy Account Dr.
    To Bank Account

[No entry will be passed in respect of interest which will be earned]

(d) For realisation of Insurance Policy

Bank Account Dr.
    To Depreciation Insurance Policy Account

(e) If there is any balance in the Depreciation Insurance Policy Account, it should be transferred to Depreciation Reserve Account. Assuming that the realised amount of policy is greater than the total premia paid, the following entry will be passed:

Depreciation Insurance Policy Account Dr.
    To Depreciation Reserve Fund Account

(f) For sale of asset (When the asset becomes worthless)

(i) Bank Account Dr.
    To Asset Account
(ii) Depreciation Reserve Fund Account Dr.
    To Asset Account

(g) If there is any balance lying in the Asset Account, it should be transferred to Profit and Loss Account to close the Asset Account.

Illustration 20

A company purchased a machinery for ₹ 50,000 on 1.1.2011 and incurred ₹ 10,000 towards freight, insurance, carriage inwards and installation charges. It was estimated that the machinery will have a scrap value of ₹ 5,000 at the end of its useful life of 4 years.

It was decided to take out an insurance policy to provide necessary funds for the replacement of asset at the end of its useful life. The annual insurance premium for the policy on 1st April every year was ₹ 13,000. The scrap value at the end of the 4th year realised ₹ 5,200.

Prepare Depreciation Reserve Fund Account, Depreciation Insurance Policy Account.

Solution

Dr. Depreciation Reserve Fund Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2011 Dec. 31	To Balance c/d	13,000	2011 Dec. 31	By Depreciation A/c	13,000
2012 Dec. 31	To Balance c/d	26,000	2012 Jan. 1	By Balance b/d	13,000
			Dec. 31	By Depreciation A/c	13,000
		26,000			26,000
2013 Dec. 31	To Balance c/d	39,000	2013 Jan. 1	By Balance b/d	26,000
			Dec. 31	By Depreciation A/c	13,000
		39,000			39,000
2014 Dec. 31	To Machinery A/c	55,000	2014 Jan. 1	By Balance b/d	39,000
			Dec. 31	By Depreciation A/c	13,000
			"	By Depreciation Insurance Policy A/c (Profit)	3,000
		55,000			55,000

Dr. Depreciation Insurance Policy Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2011 Apr. 31	To Bank A/c	13,000	2011 Dec. 31	By Balance c/d	13,000
2012 Jan. 1	To Balance b/d	13,000	2012 Dec. 31	By Balance c/d	26,000
April 1	To Bank A/c	13,000			
		26,000			26,000
2013 Dec. 31	To Balance b/d	26,000	2013 Dec. 31	By Balance c/d	39,000
April 1	To Bank A/c	13,000			
		39,000			39,000
2014 Jan. 1	To Balance b/d	39,000	2014 Dec. 31	By Bank A/c (Note 1)	55,000
April 1	To Bank A/c	13,000			
	To Depreciation Reserve Fund A/c (Profit)	3,000			
		55,000			55,000

Working Note (1) : Amount of insurance policy required = ₹ 50,000 + ₹ 10,000 – ₹ 5,000 = ₹ 55,000.

5. Sum-of-the-Years' Digits Method

This method assumes that the depreciation charge should be more in the early years of the life of the asset. It allocates approximately two-third of the cost in the first half of the asset's estimated economic life.

Under this method, the depreciation expense is calculated by multiplying the cost by a fraction based on the sum of the number of periods of the useful economic life. The depreciation expense for each year is computed as follows:

(1) To compute the sum of the digits from one through the number of years of the asset's economic life. If n is the estimated years of useful life, the numbers 1,2,3..... n are added. If the estimated useful life of an asset is 5 years, the sum of the years' digit is 1 + 2 + 3 + 4 + 5 = 15.
Taking n as the estimated useful life, the above sum can be computed by the following formula:

$$\text{Sum of years' digits} = \frac{n\ (n + 1)}{2} = \frac{5\ (5 + 1)}{2} = 15.$$

(2) For each year, the depreciation rate is expressed as a fraction in which the denominator is the sum of the digits n (as calculated above) and the numerator of the fraction for each year is determined by taking the digits in increasing order. Therefore, the numerator for the first year is 'n', for the second year it is 'n-1', for the third year it is 'n-2' and so on. Taking the above example, the denominator is 15 and the numerator of the fraction for the first year is 5, for the second year is 4, for the third year is 3 and so on. The asset will be depreciated 5/15 in the first year, 4/15 in the second year and so on. Therefore, the formula for ascertaining depreciation:

$$\text{Depreciation} = \frac{\textit{Number of years life remaining}}{\textit{Sum of years' digits}} \times (\text{Cost} - \text{Salvage Value})$$

Example : If the cost of a machine is ₹ 5,000 and scrap value after 5 years is ₹ 100, the amount of depreciation to be charged in different years will be as under:

		₹
1st year	5/15 of ₹ 4,900	1,633
2nd year	4/15 of ₹ 4,900	1,307
3rd year	3/15 of ₹ 4,900	980
4th year	2/15 of ₹ 4,900	653
5th year	1/15 of ₹ 4,900	327
		4,900

This method is well known as 'Rule of 78', because it is based on the sum of the digits 1 to 12. If the method is used on the monthly intervals and if the digit 1 is assigned to January, and 2 to February, 3 to March and so on up to 12 to December, the sum of the digits for the year becomes: (1+2+3 ... + 12) = 78.

To compute depreciation for a part of the year, the annual depreciation for different years is computed first. When an asset is purchased during the year, the depreciation for one full year will fall in two accounting periods. The depreciation for the first year will be the annual depreciation multiplied by the appropriate fraction representing the portion of the year being considered. For the second and subsequent years, the depreciation will be calculated as: unallocated portion of the previous year's depreciation will be added to the remaining portion of the current year's depreciation.

To illustrate, we consider the above example. If the asset is purchased on 1.7.2014 and the accounting year ends on 31st December, each year, the first year of the asset's life is 1.7.2014 to 30.6.2015. Therefore, depreciation for the first year will be 1/2 of ₹ 1,633 = ₹ 816.50. The depreciation expense for the second year will be half of the first year's depreciation and half of the second year's depreciation, i.e. 1/2 of ₹ 1,633 plus 1/2 of ₹ 1,307 = ₹ 816.50 + ₹ 653.50 = ₹ 1,470.

This method can best be applied to assets that provide more service benefits in the earlier years as compared to the later years, e.g. Copying machines and Computers. It is also used in allocating interest charges in hire-purchase, leasing and instalment sale accounting, and for writing off discount on issue of debentures.

6. Annuity Method

The basis of this method is to consider the time value of money and opportunity cost of capital locked up in the asset. When an amount is invested in acquiring an asset, the business has to forego some amount of interest, which could have been earned if the money was instead employed in the purchase of an income producing asset, like securities. Under this method, the total amount of depreciation written off during the life of the asset equals the net cost of the asset plus interest calculated on the reducing balance. The rate of interest (calculated at a fixed rate per cent) is applied to the cost value of the asset and the amount of interest produced added to the asset. Therefore, interest is debited to the asset (on the reducing balance) and credited to the Interest Account. Here, the asset is regarded as providing an annuity (a series of equal periodic payments occuring at equal intervals of time) and the equal amount of depreciation charged in each year is the value of the annuity. Under this system, the annual amount of depreciation is calculated from the annuity table.

This method for deprecaition can only be applied to an asset the life of which will extend to a known period, e.g. a lease. Since the depreciation charge is same and the interest charges decrease each year (because interest is calculated on reducing balance), the net charge for depreciation (depreciation less interest) gradually decreases.

Journal Entries :

1. Asset Account	Dr.
To Interest Account	
2. Depreciation Account	Dr.
To Asset Account	

Illustration 21

P. Ltd took a lease on 1st January, 2010, costing ₹ 1,00,000 for a period of 5 years. The company decided to amortise the lease by the annuity method, interest at the rate of 5% p.a. being charged. If annuity of ₹ 1 for 5 years at 5% is 0.230975, show Lease Account for the whole period.

Solution Annual instalment = ₹ 1,00,000 x 0.230975 = ₹ 23,097.50.

In the Books of P Ltd

Dr. **Lease Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2010	To Cash A/c	1,00,000.00	31.12.2010	By Depreciation A/c	23,097.50
31.12.2010	To Interest A/c	5,000.00		By Balance c/d	81,902.50
		1,05,000.00			1,05,000.00
1.1.2011	To Balance b/d	81,902.50	31.12.2011	By Depreciation A/c	23,097.50
31.12.2011	To Interest A/c	4,095.13	"	By Balance c/d	62,900.13
		85,997.63			85,997.63
1.1.2012	To Balance b/d	62,900.13	31.12.2012	By Depreciation A/c	23,097.50
31.12.2012	To Interest A/c	3,145.00	"	By Balance c/d	42,947.63
		66,045.13			66,045.13
1.1.2013	To Balance b/d	42,947.63	31.12.2013	By Depreciation A/c	23,097.50
31.12.2013	To Interest A/c	2,147.38	"	By Balance c/d	21.997.51
		45,095.01			45,095.01
1.1.2014	To Balance b/d	21,997.51	31.12.2014	By Depreciation A/c*	23,097.38
31.12.2014	To Interest A/c	1,099.87			
		23,097.38			23,097.38

(* Note: An adjustment of 12 paise has been made in Depreciation charged on 31.12.2014)

We give below a table showing the amounts of interest and depreciation charged each year and net debit to Profit and Loss Account:

Year	Depreciation (Debited to P/L)	Interest (Credited to P/L)	Net (Debited to P/L)	Remarks
2010	23,097.50	5,000	18,097.50	Note that : Cost of lease and interest is equal to the total depreciation.
2011	23,097.50	4,095.13	19,002.37	
2012	23,097.50	3,145.00	19,952.50	
2013	23,097.50	2,147.38	20,950.12	
2014	23,097.38	1,099.87	21,997.51	
TOTAL	1,15,487.38	15,487.38	1,00,000.00	

7. Revaluation Method

This method is applied for the writing off of a fixed asset to its current market value. To ascertain the real profit for an accounting period, it is necessary to value the assets each year at the end of the period and any decrease in the value as compared with the book value should be charged against profit as depreciation. Since there are many practical difficulties in ascertaining the real value of an asset at any point of time, for obvious reasons, a depreciation method never concerns itself with measuring the value of an asset. It remains as a process of allocation only.

The revaluation method can only be used in the case of assets such as loose, tools, livestock, and the like. Here, the assets are valued at their current market values and the depreciation is calculated by finding out the difference between the written down value and the revaluation figure. We consider the following example:

Opening value of loose tools	₹ 10,000
Manufactured / Purchases of loose tools during the peirod	₹ 3,000
Value of the loose tools at the end of the period	₹ 11,000

Therefore, depreciation for the loose tools is : ₹ 10,000 + ₹ 3,000 – ₹ 11,000 = ₹ 2,000.

If any profit is arising out of revaluation of assets, it should be credited to Revaluation Reserve Account, where it will find a place on the liability side of the Balance Sheet. The revaluation method is a departure from historical cost accounting with regard to the valuation of assets.

The point to note is that, under this method, there is no formal recording of individual asset values. In effect, it is not possible to calculate profit or loss arising on sale of an individual asset.

Illustration 22

A company manufacturers loose tools for its own use. At the end of each year, depreciation is charged on revaluation method. From the following particulars, show the Loose Tools Account :

Year ended 31.12.2011 : Loose tools manufacture ₹ 5,000 (revalued on 31.12.2011 ₹ 4,100)
Year ended 31.12.2012 : Loose tools manufacture ₹ 2,700 (revalued on 31.12.2012 ₹ 5,700)
Year ended 31.12.2013 : Loose tools manufacture ₹ 1,000 (revalued on 31.12.2013 ₹ 6,000)
Year ended 31.12.2014 : Loose tools manufacture ₹ 1,500 (revalued on 31.12.2014 ₹ 5,100)

The value as on 31.12.2014 after considering the sale of old tools at the book value of ₹ 1,200 (as on 31.12.2014) for ₹ 950.

Solution

Dr. **Loose Tools Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2011 Dec. 31	To Manufacturing A/c	5,000	2011 Dec. 31	By Depreciation A/c	900
			2011 Dec. 31	By Balance c/d	4,100
		5,000			5,000
2012 Jan. 1	To Balance b/d	4,100	2012 Dec. 31	By Depreciation A/c	1,100
Dec. 31	To Manufacturing A/c	2,700	2012 Dec. 31	By Balance c/d	5,700
		6,800			6,800
2013 Jan. 1	To Balance b/d	5,700	2013 Dec. 31	By Depreciation A/c	700
Dec. 31	To Manufacturing A/c	1,000		By Balance c/d	6,000
		6,700			6,7000
2014 Jan. 1	To Balance b/d	6,000	2014 Dec. 31	By Bank A/c	950
Dec. 31	To Manufacturing A/c	1,500	"	By Profit & Loss A/c	250
			"	By Depreciation A/c	1,200
			"	By Balance c/d	5,100
		7,500			7,500

8. Depletion Method

This method is an accounting for natural resources rather than accounting for depreciation. Wasting assets, such as mines, quarries, and the like are examples of such natural resources. The distinguishing feature of these types of assets is that they cannot be depreciated but can gradually be *depleted*. This is because these assets can be physically consumed and converted into inventory. For example, a coal mine can be considered as an underground inventory of coal. But such inventory cannot be considered as one of the current assets.

Therefore, this method is applied to wasting assets such as mines, quarries, and the like where the output for each year depends on the quantity extracted. Here, depreciation is calculated first by making an estimate in advance of the total quantity to be extracted over its life and then the cost of the asset is apportioned over the periods of the asset in proportion to the rate of extraction.

For example, suppose a mine is acquired for ₹ 10,00,000 and it is estimated that 2,50,000 tonnes of coal can be extracted over its life. Therefore, the rate of depreciation per tonne of coal is ₹ 10,00,000/2,50,000 = ₹ 4. If 50,000 tonnes are extracted in a year, then the depreciation for that year will be 50,000 x ₹ 4 = ₹ 2,00,000.

Illustration 23

Bharat Collieries Ltd. acquired a lease right for 25 years of a mine on January 1st, 2009 on a lumpsum payment of ₹ 5,00,000. Estimated coal deposit was 25,00,000 tonnes, 80% of which, it is expected, could be raised within the lease period. The company decided to depreciate the lease under the depletion method. The annual raising were: 2009—40,000 tonnes; 2010—60,000 tonnes; 2011—1,00,000 tonnes; 2012 to 2013—2,00,000 tonnes each year.

Show Lease Account from 1st January 2009 to 31st December, 2014.

Solution

In the Books of Bharat Collieries Ltd.

Dr. **Lease Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2009	To Bank A/c	5,00,000	31.12.2009	By Depreciation A/c	10,000
			"	By Balance c/d	4,90,000
		5,00,000			5,00,000
1.1.2010	To Balance b/d	4,90,000	31.12.2010	By Depreciation A/c	15,000
			"	By Balance c/d	4,75,000
		4,90,000			4,90,000

1.1.2011	To Balance b/d	4,75,000	31.12.2011	By Depreciation A/c	25,000
			"	By Balance c/d	4,50,000
		4,75,000			4,75,000
1.1.2012	To Balance b/d	4,50,000	31.12.2012	By Depreciation A/c	50,000
			"	By Balance c/d	4,00,000
		4,50,000			4,50,000
1.1.2013	To Balance b/d	4,00,000	31.12.2013	By Depreciation A/c	50,000
			"	By Balance c/d	3,50,000
		4,00,000			4,00,000
1.1.2014	To Balance b/d	3,50,000	31.12.2014	By Depreciation A/c	50,000
			"	By Balance c/d	3,00,000
		3,50,000			3,50,000
1.1.2015	To Balance b/d	3,00,000			

Depreciation per tonne of coal = ₹ 5,00,000 / 20,00,000 (being 80% of 25,00,000) = ₹ 0.25. Therefore, depreciation for 2012 = 40,000 x 0.25 = ₹ 10,000; similarly for 2013 = ₹ 15,000 and so on.

9. Machine Hour Rate Method

This is a method of providing depreciation on annual machine hours in use compared with total anticipated machine hours over the life of the machine. Here, it is necessary to estimate the total effective working hours (estimated hours less idle time) during the whole life of the machine and to divide this total into the net cost of the machine and thus arriving at an hourly rate of depreciation. For example, a machine costs ₹ 50,000 with an estimated residual value of ₹ 10,000. The expected effective hours during its life is 20,000. The depreciation charge per machine hour would be :

$$\textit{Machine Hour Rate} = \frac{\textit{Cost of the Machine} - \textit{Scrap Value}}{\textit{Effective Working Hours}}$$

Therefore, depreciation rate per machine hour is $= \dfrac{50{,}000 - 10{,}000}{20{,}000} =$ ₹ 2.

Under this method, each period is charged with depreciation to the extent of the use of machine. But this method misses a vital point, i.e. depreciation also takes place even when a machine is not in use.

Illustration 24

Computer 'Meteor-500' is estimated to have effective life of 20,000 hours. The cost of the computer is ₹ 60,000. If the computer has worked for 2,000 hours in 2013 and 3,000 hours in 2014, what will be the depreciation at the end of each year? You are required to show the Computer Account for 2013 and 2014.

Solution

Depreciation per hour = $\dfrac{60{,}000}{20{,}000}$ = ₹ 3; Depreciation for 2013 = ₹ 3 x 2,000 = ₹ 6,000;

Depreciation for 2014 = ₹ 3 x 3,000 = ₹ 9,000

Dr. **Computer Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013 Jan. 1	To Bank A/c	60,000	2013 Dec. 31	By Depreciation A/c	6,000
			"	By Balance c/d	54,000
		60,000			60,000
2014 Jan. 1	To Balance b/d	54,000	2014 Dec. 31	By Depreciation A/c	9,000
			"	By Balance c/d	45,000
		54,000			54,000
2015 Jan. 1	To Balance b/d	45,000			

10. Depreciation and Repairs Fund Method

Under this method, total maintenance costs are estimated for the entire life of the asset, and added to its capital cost (less residual value) to get a composite figure, which is divided by the number of years the asset is expected to last. The resultant amount is debited to the Profit and Loss Account and credited to Depreciation and Repairs Fund Account.

The repairs and renewals (etc), incurred are debited to this fund, instead of Profit and Loss account. Practically, it is the best method of equalising the burden on Profit and Loss Account in respect of depreciation and repairs (etc).

The Depreciation and Repairs Fund will be closed at the end of the useful life of the asset, by transferring it to the Asset Account. If there is any balance in the Asset Account, it is transferred to the Profit and Loss Account.

Journal Entries

(a) For setting aside the required sum

Profit and Loss Account Dr.
To Depreciation and Repairs Fund Account

(b) For actual repairs and renewals

Repairs and Renewals Account Dr.
To Cash Account

(c) For closing the Repairing and Renewal Account

Depreciation and Repairs Fund Account Dr.
To Repairing and Renewals Account

(d) For closing Depreciation and Repairs Fund Account (at the end of the life of the asset)

Depreciation and Repairs Fund Account Dr.
To Asset Account

(e) For closing Asset Account

Any balance of the Asset Account will be transferred to Profit and Loss Account and it will close this account.

Illustration 25

A combined provision for depreciation and repairs and renewals was made every year at 15% of the original cost of a machine purchased at ₹ 50,000. The 'Provision for Depreciation and Maintenance Account' that was opened for the purpose was, therefore, debited with the actual costs of repairs and renewals which were as stated below :
1st Year—₹ 1,500; 2nd Year—₹ 1,600; 3rd Year—₹ 2,100; 4th Year—₹ 3,000; 5th Year—₹ 4,200

At the end of the fifth year, the machine was sold out at ₹ 20,000 after utilizing a few of its minor parts valued at ₹ 4,000, in installing in its place a new machine purchased at ₹ 75,000. The resulting loss in the disposal of the old machine was debited to revenue. Write up 'Provision for Depreciation and Maintenance Account' for the five years and the Old and the New Machine Accounts at the end.

Solution

Dr. Provision for Depreciation and Maintenance Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1st Year	To Repairs & Renewals A/c	1,500	1st Year	By Profit & Loss A/c	7,500
	To Balance c/d	6,000			
		7,500			7,500
2nd Year	To Repairs & Renewals A/c	1,600	2nd Year	By Balance b/d	6,000
	To Balance c/d	11,900		By Profit & Loss A/c	7,500
		13,500			13,500
3rd Year	To Repairs & Renewals A/c	2,100	3rd Year	By Balance b/d	11,900
	To Balance c/d	17,300		By Profit & Loss A/c	7,500
		19,400			19,400
4th Year	To Repairs & Renewals A/c	3,000	4th Year	By Balance b/d	17,300
	To Balance c/d	21,800		By Profit & Loss A/c	7,500
		24,800			24,800
5th Year	To Repairs & Renewals A/c	4,200	5th Year	By Balance b/d	21,800
	To Old Machinery A/c (Transfer)	25,100		By Profit & Loss A/c	7,500
		29,300			29,300

Dr. Old Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
5th Year	To Balance b/d	50,000	5th Year	By New Machinery A/c	4,000
				By Bank A/c	20,000
				By Provision for Depreciation & Maintenance A/c	25,100
				By Profit & Loss A/c (loss)	900
		50,000			50,000

Dr. **New Machinery Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
5th Year	To Old Machinery A/c To Bank A/c	4,000 75,000	5th Year	By Balance c/d	79,000
		79,000			79,000
6th Year	To Balance b/d	79,000			

Revision of the Estimated Useful Life

The useful lives of major depreciable assets or classes of depreciable assets may be reviewed periodically. Where there is a revision of the estimated useful life of an asset, the ***unamortised depreciable amount*** should be charged over the ***revised remaining useful life***.

Illustration 26

On 1.4.2010, ABC Limited purchased plant and machinery worth ₹ 20,00,000, useful life being 8 years. Till the year ended 31.3.2013, the amount of accumulated depreciation on this plant and machinery was ₹ 8,00,000. The remaining useful life of the plant and machinery was reviewed during 2013-14, which was estimated at 2 years due to wear and tear. Calculate the amount of depreciation to be charged from the year 2013-14 onwards.

Solution

Here, in this case, the unamortised depreciable amount is ₹ (20,00,000 – 8,00,000) = ₹ 12,00,000 and the revised remaining useful life is 2 years.

Therefore, the amount of depreciation to be charged from the year 2013-14 onwards is ₹ 12,00,000 / 2 = ₹ 6,00,000 p.a.

Depreciation on Addition or Extention of the Asset

Any addition or extension which becomes an integral part of the existing asset should be depreciated over the remaining useful life of that asset. The depreciation on such addition or extension may also be provided at the rate applied to the existing asset. Where an addition or extension retains a separate identity and is capable of being used after the existing asset is disposed of, depreciation should be provided independently on the basis of an estimate of its own useful life.

Example : ACC Ltd. has installed a conveyor belt system for material handling at its 25 years old cement plant. The cost of the entire conveyor belt unit is ₹ 20,00,000 and its useful life is 10 years without any residual value. However, the remaining life of the principal plant is 5 years.
The conveyor belt unit should be recognised as an item of fixed asset separate from principal plant. It will be depreciated over its useful life, i.e., 10 years. However, if the 'conveyor belt' cannot be used separately, its useful life will terminate with the life of the principal plant, i.e., 5 years. The entire amount of ₹ 20,00,000 is to be depreciated in 5 years.

Illustration 27

On 1.4.2012, the value of X Limited's plant and machinery was ₹ 1,000 lakhs. The company provided depreciation @ 15% p.a. under Reducing Balance Method. It was found that about ₹ 150 lakhs of imported asset, which is the component of plant and machinery acquired on 1.4.2012, would be obsolete in 3 years. Accordingly, X Limited wants to write off this asset over 3 years. Can the company do so as per AS–6?

Solution

As per para 24 of AS–6, any addition or extention which becomes an integral part of the existing asset should be depreciated **over the remaining useful life of that asset**. The depreciation on such addition or extention may also be provided at the rate applied to the existing asset. Where an addition or extention retains a separate identity and is **capable of being used after the existing asset is disposed of**, depreciation should be provided **independently** on the basis of an estimate of its own useful life.

Therefore, in this case, the company can write off the asset in 3 years, since the asset has independent useful life.

Change in the Historical Cost

Where the historical cost of a depreciable asset has undergone a change due to increase or decrease in long term liability on account of ***exchange fluctuations, price adjustments, changes in duties*** or ***similar factors***, the depreciation on the revised unamortised depreciable amount should be provided ***prospectively*** over the residual useful life of the asset.

Illustration 28

ABC Ltd. purchased an imported Printing Machinery from Germany for ₹ 20,00,000 on 1.4.2008. The life of the machine is 10 years without any residual value. The company followed straight line method of depreciation. During 2012-13 due to change in foreign exchange rate the amount of unpaid liability increased by ₹ 3,00,000.

Calculate amount of depreciation to be charged for the year 2012-13 and onwards.

Solution

		₹
Cost of the printing machinery		20,00,000
Less: Depreciation under SLM :		
2008-09	2,00,000	
2009-10	2,00,000	
2010-11	2,00,000	
2011-12	2,00,000	8,00,000
Unamortised depreciable amount on 1.4.2012		12,00,000
Add: Increase in liability for change in foreign exchange		3,00,000
Revised depreciable amount		15,00,000

Depreciation for the year 2012-13 and onwards :

$$\text{Depreciation p.a.} - \frac{15,00,000}{(10 - 4)} = ₹\ 2,50,000.$$

Depreciation of Revalued Assets

Where the depreciable assets are revalued, the provision for depreciation should be based on the revalued amount and on the estimate of the remaining useful lives of such assets. In case the revaluation has a material effect on the amount of depreciation, the same should be disclosed separately in the year in which revaluation is carried out.

Illustration 29

A Ltd acquired a building on 1st January, 1995 at a cost of ₹ 6,40,000. The useful life of the building was estimated as 50 years and depreciation is provided on a straight line basis. The building was revalued on 30th June 2012 for ₹ 16,80,000 and the revaluation incorporated in the accounts. Assuming no change made to the remaining useful life. You are required to calculate : (i) the surplus on revaluation; (ii) depreciation to be charged in the Statement of Profit and Loss of 2012.

Solution

(i) Surplus on Revaluation	₹
Revaluation at 30th June, 2012	16,80,000
Net book value at 30th June, 2012 (Note 1)	4,16,000
Surplus	12,64,000

This surplus of ₹ 12,64,000 should be credited directly to owners' interests under the heading of Revaluation Reserve as per the requirement of AS—10 Para 30.

(ii) Depreciation Charged in the Profit and Loss Account of 2012

Here, it should be noted that upto 30.6.2012 depreciation will be calculated on original value and from 1.7.2015 it is to be calculated on revalued value.

		₹
(a) On historical cost (upto 30.6.2012) — $\frac{6,40,000}{50} \times \frac{1}{2}$		6,400
(b) On revalued amount (1.7.2012 to 31.12.2012) — $\frac{16,80,000}{32\frac{1}{2}} \times \frac{1}{2}$		25,846
	Total	32,246

Working Note :

(1) Net Book Value on 30th June, 2012	₹
Original cost on 1.1.1995	6,40,000
Less: Depreciation for 17.5 years (₹ 6,40,000 / 50 × 17.5)	2,24,000
	4,16,000

Disclosure

1. If any depreciable asset is disposed of, discarded or destroyed, the net surplus or deficiency, if material, should be disclosed separately.
2. The following information should be disclosed in the financial statements:
   (i) the historical cost or other amount substituted for historical cost of each class of depreciable assets;
   (ii) total depreciation for the period for each class of assets; and
   (iii) the related accumulated depreciation.

3. The following information should also be disclosed in the financial statements alongwith the disclosure of other accounting policies:
   (i) depreciation methods used; and
   (ii) depreciation rates or the useful lives of the assets, if they are different from the principal rates specified in the statute governing the enterprise.

Is Depreciation a Source of Fund?

A popular misconception, which does create confusion, that depreciation is a source of fund. ***Under no circumstances is depreciation a source of fund***. The accounting for depreciation is an internal transaction (an adjusting entry without involving second parties) to write off the cost of an asset, i.e. a cost already incurred is charged to expense. Generally, a fund requires a connection with an outside agency. Since depreciation is simply a book entry, (a contra asset account) it has no outside connection. Just by passing some book entry, it is not possible for a business to generate a fund. When depreciation is provided, it does not depend upon a cash payment. For this reason, depreciation is regarded as a non-cash expense. As has already been stated, *when an asset is purchased, the payment of many years' depreciation is made in advance.* When the useful life of an asset ends, an even larger cash payment may be required to replace it.

Though depreciation charges neither recover nor create funds, it may affect fund in the following two ways:

First, depreciation charges affect periodic income and, hence may affect managerial decisions in regard to dividend, product pricing or the selection of a new product or machinery.

Second, depreciation charges affect taxable income and, hence affect directly the amount of income tax payable.

Key Points

- ***Depreciation*** is the process of allocating the cost of a fixed asset (less any residual value) over its estimated useful life in a rational and systematic manner.
- The amount of depreciation to be charged for a particular fixed asset will depend upon the following ***three*** factors:
  (i) Cost of the asset
  (ii) Useful life of the asset
  (iii) Residual value of the asset
- The useful life of an asset is its ***service life*** which can be defined as the number of accounting periods during which it will be useful to the business.
- Residual value of asset is the estimated value of a fixed asset at the end of its ***economic life***.
- The change in the method of depreciation must be with retrospective effect.
- The deficiency or surplus of depreciation in respect of past years, should be debited or credited to the Profit and Loss Account of the year of change in the method of depreciation.
- A ***Sinking Fund*** is a fund created by the regular investment of a fixed amount to accumulate the amount of money required to replace an asset at a set date in the future.
- Any addition or extension which becomes an integral part of the existing asset should be depreciated over the remaining useful life of that asset.

THEORETICAL QUESTIONS

1. What is depreciation? What are the various methods of calculating depreciation ? Describe one of them fully.
2. What do you understand by the Annuity System of providing depreciation ? State the circumstances in which you will employ this system.
3. (a) Briefly discuss two methods of calculating depreciation. (b) Which method of charging depreciation would you recommend for the following : Freehold building; Long-term lease?
4. Explain the Sinking Fund Method of charging depreciation. For what particular types of assets is this method most suitable?
5. What are the factors to be taken into consideration in selecting a depreciation method ?
6. Is depreciation a source of fund ?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below.

1. AS—6 deals with depreciation accounting and applies to all depreciable assets, except :
   A assets used for administrative purposes
   B assets used for sales and service
   C wasting assets
2. Depreciable assets are assets which
   A have unlimited useful life, e.g., land
   B have a limited useful life, e.g., furniture
   C are expected to be used not for more than one year
3. Residual value is specifically
   A scrap value
   B the estimated value of a fixed asset at the end of its economic life
   C the estimated value of a fixed asset at the end of its physical life
4. The useful life of an asset is :
   A its service life
   B its physical life
   C none of the above
5. Which of the following statement is **not** correct ?
   A depreciation will vary directly with the useful life of the asset
   B the higher the residual value, the lower will be the depreciation charge
   C the higher the residual value, the higher will be the depreciation
6. Repairs and maintenance costs are :
   A normally capitalised
   B expensed in the profit and loss account as incurred
   C recorded as deferred expenses
7. Which of the following statement is correct in relation to AS—6 ?
   A only straight line method can be adopted for calculation of depreciation
   B only reducing balance method can be adopted for calculation of depreciation
   C no particular method has been specified for calculation of depreciation
8. Which of the following statement is correct in relation to AS—6 ?
   A the change in the method of depreciation should be treated as a change in estimate
   B the change in the method to depreciation should be treated as change in accounting policy but the depreciation should be computed in accordance with the new method from the date of change in the method of depreciation
   C the change in the method of depreciation should be treated as change in accounting policy but the depreciation should be recomputed in accordance with the new method from the date of first use of the asset
9. The cost of a fixed asset should comprise :
   (i) its purchase price
   (ii) any attributable cost of bringing the asset to its working condition for intended use
   (iii) overhead of purchase department relating to the purchase of asset
   Which of the following is correct ?
   A (i) only
   B (i) and (ii) only
   C (i), (ii) and (iii)
10. Depreciation charges for a period are recorded
    A only in the Profit and Loss Account
    B only in the Balance Sheet
    C in the Profit and Loss Account or as part of the Cost of another asset (such as inventory).
11. What is the purpose of charging depreciation in accounts ?
    A to allocate the cost less residual value of a fixed asset over the accounting periods expected to benefit from its use
    B to ensure that funds are available for eventual replacement of the asset
    C to comply with prudence concept

PRACTICAL QUESTIONS

Straight Line / Fixed Instalment Method

1. On 1.1.2013 B purchased a machine for ₹ 1,00,000. Assuming its life to be 10 years and its scrap value for ₹ 20,000 charge depreciation according to Straight Line Method. Show the Machine Account in the ledger upto 31.12.2014.
2. A machine was bought at ₹ 20,000. The scrap value of the machine was estimated to be ₹ 5,000 after 10 years. Show the Machinery Account and the Balance sheet for the first three years charging 10% depreciation.
3. On 1.1.2012 a company purchased a machine for ₹ 1,00,000. It was decided to write off 10% depreciation under Straight Line Method, estimating the life of the machine at 10 years and scrap value at ₹ 10,000. You are required to prepare Machinery Account upto 31.12.2014 and also show the Provision for Depreciation Account for the same period.
4. A firm purchased a machine at a cost of ₹ 2,00,000 and paid import duty of ₹ 80,000. The machine was installed on 1st April, 2012 and installation charges of ₹ 20,000 was paid. The scrap value was estimated at 10% of the cost of machine and estimated life of the machine was fixed at 10 years. They decided to charge depreciation under Straight Line Method. Show Machinery Account and Provision for Depreciation Account for 2012, 2013 and 2014. The firm closes its books on 31st December each year.

Reducing Balance / Diminishing Balance Method

5. A machine was purchased on 1.1.2013 for ₹ 5,00,000. On 1.7.2013 another machine was purchased for ₹ 3,00,000. Depreciation is to be provided @ 10% p.a. under Reducing Balance Method.
   You are required to show : (i) Machinery Account for 2013 and 2014; (ii) Provision for Depreciation Account for 2013 and 2014; (iii) How did the Machinery Account appear in the Balance Sheet at the end of 2014. [Assume that no Provision for Depreciation Account is maintained]
6. A plant is purchased for ₹ 6,00,000 on 1st April, 2011. Some additions to the plant are made on 1st July, 2011 for ₹ 1,00,000. Depreciation on the diminishing Balance Method is to be written off at 10% p.a. in 2011, at 15% p.a. in 2012 and 20% in 2013 and 2014. The books are closed on 31st December each year.
   You are required to show Machinery Account for 2011, 2012, 2013 and 2014.
7. A company maintains its fixed assets at cost. Depreciation provision accounts, one for each type of asset are in use. Machinery is to be depreciated @ 12.5% p.a., and fixtures @ 10% p.a., using the reducing balance method. Depreciation is to be calculated on assets in existence at the end of each year, giving a full year's depreciation even though the asset was bought part of the way through the year.
   The following assets were acquired : 1.1.2013 : Machinery ₹ 64,000; Fixture : ₹ 10,000; 1.7.2013 : Fixtures : ₹ 20,000; 1.10.2014 : Machinery : ₹ 72,000; Fixtures : ₹ 5,000.
   The financial year of the business is ending on 31st December. You are to show : (a) Machine Account; (b) Fixtures Account; (c) Two separate Provision for Depreciation Accounts; (d) Fixed assets section of the Balance Sheet at the end each year for the years ended 31.12.2013 and 31.12.2014.

Addition to and Disposal of Assets

8. On 1.1.2014, balance of Machinery Account was ₹ 48,600. On 1.7.2014, a new machine was purchased for ₹ 24,000, installation cost ₹ 1,000. On 1.9.2014, machinery was sold for ₹ 6,000. The original cost of the machine sold was ₹ 10,000 on 1.1.2012. Machinery is depreciated at 10% p.a. under the diminishing balance method. Show Machinery Account for the year 2014. The books are closed on 31st December every year.
9. A manufacturing concern, whose books are closed on 31st March, purchased a machine for ₹ 1,50,000 on 1st April, 2011. Additional machinery was acquired for ₹ 40,000 on 30th September, 2012 and for ₹ 25,000 on 1st April, 2014. Certain machinery, which was purchased for ₹ 40,000 on 30th September, 2012 was sold for ₹ 34,000 on 30th September, 2014.
   Give the Machinery Account for the year ending 31st March, 2015 taking into account depreciation at 10% per annum on the written down value.
10. The following relate to the business of a manufacturer for the year ended 31.12.2014 :
    (a) The debit balance of the Plant and Machinery Account as on 1.1.2014 was ₹ 2,68,400.
    (b) During the year three machines standing in the books at ₹ 12,860 were sold for ₹ 6,000.
    (c) On 1.4.2014, new machines costing ₹ 58,800 were purchased and were installed by the manufacturer's workmen at an expenditure of ₹ 2,160 (i.e. wages ₹ 1,740 and materials ₹ 420).
    (d) It is the practice of the business to write off 15% depreciation on all additions to plant and 20% on all old plants.
    Prepare Plant and Machinery Account as it would appear on 31.12.2014.

11. A firm, writes off 95% of the cost of machinery acquired over a period of 10 years by the straight line method. Full depreciation is written off even if the machinery is in use for part of a year. On 31.12.2013, the original cost of machinery in use was as : Purchased in 2004 or earlier ₹ 57,000; Purchased in 2006 ₹ 1,30,000; Purchased in 2009 ₹ 40,000. On 30.6.2014, a machine which had cost ₹ 10,000 in 2003 was disposed off for ₹ 900 and on 30.9.2014 a machine installed in 2012 at a cost of ₹ 20,000 was destroyed in an accident and ₹ 11,800 was received from the insurance company in settlement of the claim. On the same date, a new machine costing ₹ 25,000 was installed. Show the Machinery Account for the year 2014.
12. The following balances appear in the books of a firm :
    January 1, 2014—Machinery Account ₹ 1,00,000; Provision for Depreciation—₹ 45,000.
    The depreciation is charged at 10% on straight line method and in terms of firm's accounting policy, acquisitions during the year are depreciated for a full year irrespective of the date of purchase and no depreciation is charged on assets in the year of their disposal.
    On June 30, 2014, the following transactions took place :
    (a) Sold machinery for ₹ 43,500 which was purchased for ₹ 80,000 on January 1, 2010.
    (b) Acquired plant costing ₹ 40,000.
    You are required to prepare on December 31, 2014 :
    (i) Machinery Account; (ii) Provision for Depreciation Account; and, (iii) Machinery Disposal Account.
13. The Machinery Account of a big rubber factory showed balance of ₹ 1,90,000 on 1st January 2014 : Its accounts were made up on 31st December each year and depreciation is written at 10% p.a. under the Diminishing Balance Method. On 1st June 2014, new machinery was acquired at a cost of ₹ 28,000 and installation charges incurred in erecting the machine worked out to ₹ 892 on the same date. On 1st June 2014 a machine which had cost ₹ 6,000 on 1st January 2012 was sold for ₹ 750, another machine which had cost ₹ 600 on 1st January 2013, was scrapped on the same date and it realised nothing. Write up Plant and Machinery Account for the year 2014, allowing the same rate of Depreciation as in the past calculating depreciation to the nearest multiple of a Rupee.
14. On July 1, 2012, Gopal Ltd. purchased second-hand machinery for ₹ 20,000 and spent ₹ 3,000 on reconditioning and installing it. On January 1, 2013 the firm purchased new machinery worth ₹ 12,000. On June 30, 2014 the machinery purchased on January 1, 2013 was sold for ₹ 8,000. On July 1, 2014, fresh machinery was purchased on instalment basis, payment for this machinery was to be made as follows :
    July 1, 2014—₹ 5,000; June 30, 2015—₹ 6,000; June 30, 2016—₹ 5,500.
    Payments in 2015 and 2016 include interest ₹ 1,000 and ₹ 500 respectively. The company writes off depreciation @ 10% p.a. on original cost. The accounts are closed every year on 31st March. Show the Machinery Account for three years ending 31st March, 2015.
15. The following details regarding machinery are available from the books of Simco Engineers Limited:
    (a) Balance as on 1.4.2014 ₹ 1,00,000 on Machinery Accoiunt.
    (b) The opening balance [item (a)] includes ₹ 70,000 worth of machinery bought on 31.3.2014.
    (c) Bought new machinery on 1.10.2014 for ₹ 40,000.
    (d) Incurred expenses on installation (to be capitalised) ₹ 8,000 on item (c)..
    (e) Sold machinery on 1.1.2015 for ₹ 32,000 (its original cost was ₹ 40,000 on 1.10.2011).
    (f) Mode of depreciation is Fixed Instalment System @ 10% per annum, bearing in mind the dates of purchase/ sale.
    Show the Machinery Account for the year from 1st April 2014 to 31st March, 2015.

Change in the Method of Depreciation with Retrospective Effect

16. Ram Ltd. which depreciates its machinery at 10% p.a. on Diminishing Balance Method had on 1.1.2014, ₹ 9,72,000 on the debit side of Machinery Account. During the year 2014, Machinery purchased on 1.1.2012 for ₹ 80,000 was sold for ₹ 45,000 on 1.7.2014 and a new machinery at a cost of ₹ 1,50,000 was purchased and installed on the same date, installation charges being ₹ 8,000. The company wanted to change the method of depreciation from Diminishing Balance Method to Straight Line Method, w.e.f., 1.1.2012. Difference of depreciation upto 31.12.2014 to be adjusted. The rate of depreciation remains the same as before.
    Show Machinery Account.
17. A firm charges depreciation on its plant a machinery on the Straight Line Method at 10%. On 1.1.2014, it was decided that the Reducing Balance Method of charging depreciation on plant and machinery should be adopted w.e.f. 1.1.2011, the rate of depreciation remaining at 10%. The Plant and Machinery Account stood in the books at ₹ 1,34,000 on 1.1.2014. The following are the particulars regarding purchase and sale of plant during the 3 year period :
    2011 : Total depreciation charged ₹ 16,000

April 1 : Sale of machinery ₹ 24,000 (bought on 1.7.2008) for	₹ 36,000
June 1 : Acquired a new machine at a cost of	₹ 42,000

2012 : Total depreciation charged ₹ 12,000
Feb 10 : Sale of machinery scrap ₹ 1,200 (bought on 1.1.2002) at a cost of ₹ 55,000
2013 : Total depreciation charged ₹ 14,000
Dec. 31 : Depreciation written off for 3 months on new machinery acquired ₹ 1,000
You are required to recast the Plant and Machinery Account and also to show the relevant figures in the Profit and Loss Account for the year ended 31.12.2014.

18. H Ltd. charged depreciation at 10% p.a. on diminishing balances. On 1.1.2013 there was a balance of ₹ 2,43,000 in Machinery Account.
On 1.7.2013 new machine costing ₹ 72,000 was installed. Installation charge amounted to ₹ 3,000.
On 1.7.2013 a machine was sold for ₹ 43,000 the cost of which was ₹ 60,000 as on 1.1.2011. It was decided in 2013 to change the depreciation method from diminishing balance to straight line with effect from 1.1.2011, keeping the rate of depreciation same as before.
Show the Machinery Account in the books of the company for 2013.

19.. The machinery account (at cost) of a firm for the three years ended 31.12.2013 appeared as follows :

Date	Particulars	₹	Date	Particulars	₹
2011 Jan.1	To Cash A/c (No. 1)	50,000	2011 Dec. 31	By Balance c/d	50,000
2012 Jan. 1	To Balance b/d	50,000	2012 Dec. 31	By Balance c/d	70,000
July 1	To Cash A/c (No. 2)	20,000			
		70,000			70,000
2013 Jan. 1	To Balance b/d	70,000	2013 Dec. 31	By Balance c/d	85,000
July 1	To Cash A/c (No. 3)	15,000			
		85,000			85,000

Depreciation @ 20% on the diminishing balance method was accumulated in Provision for Depreciation Account. On 1.10.2014, machine No. 2 was damaged and had to be replaced by a new machine costing ₹ 25,000. The machine was insured and insurance claim of ₹ 12,400 was admitted by the insurers.
Show the Machinery Account, Provision for Depreciation Account and Machinery Disposal Account for the year 2014. Depreciation during the year is provided for the period for which each machine is in use.

20. A factory possessing different plant and machinery, depreciation on which is provided under 'straight line' method at the rate of 10% p.a. A full year's depreciation is provided at the end of each year on all plant not already completely written off or sold, including any plant purchased during the year. Any profit or loss which may result from sales is transferred to Profit and Loss Account at the end of the year. Accounts are prepared annually to 31st December. The balance standing on the Plant and Machinery Account at 31st December, 2012 after writing off depreciation for that year was ₹ 19,515 and subsidiary records showed that the cost of plant then on hand was made-up as follows: **Items bought** : in 2002 (or earlier) ₹ 5,800; in 2003 ₹ 3,100; in 2004 ₹ 1,700; and in 2005 (or later) ₹ 25,200.
During 2013 a new plant was bought at a cost of ₹ 2,950 and one machine which had cost ₹ 550 in 2001 was sold as scrap for ₹ 35. During 2014 there were additions, costing ₹ 1,800 and a machine which had cost ₹ 700 in 2006 was sold for ₹ 350. You are required to write-up Plant and Machinery Account and Plant Disposal Account for 2013 and 2014.

21. A client of the firm of chartered accountants by which you are employed is interested in buying a road transport business from the widow of its deceased owner.
The senior partner of the practice is investigating various aspects of the business and has delegated to you the task of discovering the amount of investment in vehicles at the end of the each financial year ending 30th September 2011 to 2014 inclusive. The business commenced operations on 1st October, 2010. The only information available to you is the fact that the owner calculated deprecaition @ 20% p.a. using the reducing balance method, based on the balance at 30th September each year, and copies of certain Ledger Accounts which are reproduced below :

Dr. Provision for Depreciation of Vehicles Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2012 Sept.30	To Balance c/d	57,600	2011 Oct 1	By Balance b/d	32,000
			2012 Sept. 30	By Profit & Loss A/c	25,600
		57,600			57,600
2013 ?	To Vehicles Disposal A/c	10,800	2012 Oct 1	By Balance b/d	57,600
Sept.30	To Balance c/d	73,440	2013 Sept.30	By Profit & Loss A/c (includes ₹ 10,000 depreciation on 2008 acquisitions)	26,640
		84,240			84,240
2014 Sept.30	To Vehicles Disposal A/c	29,280	2013 Oct 1	By Balance b/d	73,440
"	To Balance c/d	79,328	2014 Sept. 30	By Profit & Loss A/c (includes ₹ 20,000 Depreciation on 2009 acquisitions)	35,168
		1,08,608			1,08,608

Dr. Vehicles Disposal Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 Sept.30	To Vehicles A/c (Vehicles originally acquired on 1st October, 2003)	30,000	2013 Sept.30	By Prov. for Depreciation of Vehicles A/c	10,800
			"	By Bank A/c	16,000
			"	By Profit & Loss A/c	3,200
		30,000			30,000
2014 Sept.30	To Vehicles A/c (Vehicles originally acquired on 1st October 2003)	60,000	2014 Sept.30	By Prov. for Depreciation of Vehicles A/c	29,280
			"	By Bank A/c	42,000
"	To Profit & Loss A/c	11,280			
		71,280			71,280

You are required to:

(a) calculate the cost of the asset, vehicles, held by the business at 30th September in each of the years 2011 to 2014 inclusive and show Vehicles Account for 2011 to 2014.

(b) show the detailed composition of the charge for depreciation of the vehicles to Profit and Loss Account at 30th September 2012, 2013 and 2014.

Guide to Answers

Multiple Choice

1. C; 2. B; 3. B; 4. A; 5. C; 6. B; 7. C; 8. C; 9. B; 10. C; 11. A.

Practical Questions

1. **Depreciation p.a. ₹ 8,000; Net book value on 31.12.2014 ₹ 60,000.**
2. **Depreciation p.a. ₹ 1,500.**
3. **Depreciation p.a. ₹ 9,000; Net book value as on 31.12.2014 ₹ 73,000.**
4. **Depreciation p.a. ₹ 27,000; Net book value ₹ 2,19,000.**
5. **Depreciation for 2013—₹ 65,000; 2014 ₹ 73,500. Accumulated depreciation ₹ 1,38,500.**
6. **Depreciation (total) : 2011 ₹ 50,000; 2012 ₹ 97,500; 2013 ₹ 1,10,500; 2014 ₹ 88,400; Balance of Machinery Account on 31.12.2014 ₹ 3,53,600.**
7. **Machinery : Depreciation for 2013—₹ 8,000; 2014—₹ 16,000; Accumulated depreciation at the end of 2014—₹ 24,000; Net book value—₹ 1,12,000.**
   Fixtures : Depreciation for 2012—₹ 3,000; 2013—₹ 3,200; Accumulated depreciation at the end of 2013—₹ 6,200; Net book value—₹ 28,800.
8. **Depreciation for 2014—₹ 5,300; W.D.V. — ₹ 60,200; Depreciation on disposed asset — ₹ 540 (for 8 months); Loss on disposal—₹ 1,560.**
   Profit on disposal of asset ₹ 1,510; depreciation on disposed asset ₹ 1,710; Net book value on 31.3.2014 ₹ 1,20,915.
10. **Loss on disposal of asset — ₹ 6,860; depreciation for the year ended on 31st December, 2014 ₹ 60,252 (20% on ₹ 2,55,540 and 15% on ₹ 60,960); Net book value ₹ 2,56,248.**
11. **Book value as on 1.1.2014 ₹ 55,050; Depreciation for the year ₹ 18,525 (₹ 12,350 + 3,800 + 2,375). Profit on disposal of asset on 30.6.2014 — ₹ 400. Profit on machine destroyed in an accident ₹ 3,200. Book value as on 31.12.2014 ₹ 52,425.**
12. **Balance of Machinery Account on 31.12.2014 ₹ 60,000. Accumulated depreciation as on that date ₹ 19,000. Loss on sale of machinery ₹ 4,500.**
13. **Loss on sale of machinery ₹ 2,645; Loss on machinery scrapped ₹ 377. Book value of machinery on 31.12.2014 ₹ 1,94,665.**
14. **Loss on sale of machinery ₹ 3,400; Net book value on 31.3.2015 ₹ 30,550.**
15. **Profit on sale of machinery ₹ 5,000. On 31.3.2015, written down value ₹ 1,08,600.**
16. **Loss on sale of machinery ₹ 16,560; additional depreciation to be charged ₹ 11,200 (₹ 2,24,000 – ₹ 2,12,800). Net book value on 31.12.2014 ₹ 9,34,100.**
17. **Depreciation written back ₹ 896 (₹ 35,600 – 34,704); Net book value on 31.12.2014 ₹ 1,21,406. Depreciation for the year ended on 31.12.2014 ₹ 13,490.**
18. **Loss on sale of machinery ₹ 3,170. Undercharge of depreciation ₹ 2,400. Balance of Machinery Account as on 31.12.2013 ₹ 2,39,250.**
19. **Depreciation for 2014 on disposal of machinery — ₹ 2,160. Total depreciation on remaining machineries — ₹ 9,070 (₹ 5,120 + ₹ 2,700 + ₹ 1,250).**
20. **Loss on plat disposal — ₹ 70. Book value of plant sold — ₹ 420. Depreciation for 2013 — ₹ 2,985; 2014 — ₹ 2,925.**
21. **Cost of the assets as on 30.09.2012 — ₹ 1,60,000; 30.09.2013 — 1,80,000; 30.09.2014 — ₹ 2,20,000.**
    Depreciation : 2012 — ₹ 25,600; 2013 — ₹ 26,640; 2014 — ₹ 35,168.

11

Reserves and Provisions

Section 1 : Reserves

Meaning of Reserve

A reserve is an amount of profit set aside until it is needed for some particular purpose. Usually, a reserve account is specifically named to indicate its purpose. The creation of a reserve is the result of an accounting entry and does not set aside cash or other assets of the business. It is merely a part of the net worth. A reserve generally arises from the following :

1. Retention of profits—It is an appropriation of profit, that is an amount set aside from distributable profits.
2. Capital receipts—Profit on sale of a fixed asset or issue of shares at a premium.
3. Upward revaluation of assets—It is the bringing up of assets from historical costs to their current values.

All reserves appear on the liabilities side of the Balance Sheet.

Types of Reserves

Reserves are generally classified into: (a) Capital Reserves and (b) Revenue Reserves.

(a) Capital reserves are those which are not generally distributed as profits. They arise mainly out of the following :

1. Capital receipts, e.g. issue of shares or debentures at a premium.
2. Non-trading incomes during the period prior to incorporation.

Capital reserves may or may not involve any receipts of cash.

(b) Revenue reserves are created by retaining profits. They are usually available for distribution as profits in the future. Examples of revenue reserves are credit balance of the Profit and Loss Account, General Reserve etc. Revenue reserves can further be classified into: (i) General Reserves and (ii) Specific Reserves.

1. *General reserves:* These reserves are not created for any particular purpose. They are created for safeguarding the business against unforeseen losses in the future or with a view to planning for further development of the business.

2. *Specific reserves:* These reserves are created for some specific purpose and are utilised for these purposes only. These reserves are generally earmarked against some particular asset and are expressed as 'reserve fund'. An amount of the reserve created is invested outside the business in securities for a specified period. At the end of that specified period, all investments are sold. The proceeds are utilised for meeting that particular purpose for which the reserve was created.

Meaning of Reserve Fund

Funds are cash or its equivalent. In accounting, the term 'fund' means money invested in assets which can produce income, e.g. securities. It should have a ready market and can easily be converted into cash. Funds also refer to assets for specific purposes, which are not generally available for normal business activities. In fact, a fund sets aside cash or other assets to achieve specific objectives.

Reserves are not usually represented by earmarking assets. If they are, they are expressed as 'reserve fund'. A reserve represented by an earmarked asset is usually cash or marketable securities. For example, if an organisation sets aside profits for building construction, the reserve so created is known as '***Building Funds***'. When an amount equal to the reserve created is invested outside the business in securities, it is known as '***Building Fund Investment***'. A reserve fund is usually created either to replace a fixed asset at the end of its useful life or to repay a liability in the future, e.g. redemption of debentures.

Distinction between Provisions and Reserves

	Provisions		Reserves
1.	A provision is a charge against profit (a debit in the Profit and Loss Account)	1.	A reserve is an appropriation of profit (a debit in the Profit and Loss Appropriation Account).
2.	The creation of provisions has nothing to do with the amount of net profit. In fact,provisions are created in order to assist in the calculation of a correct profit.	2.	The creation of a revenue reserve depends on the amount of profits earned by the business.
3.	Provisions are created for future liabilities and charges or for valuation adjustments of assets.	3.	Reserves are created for safeguarding the business against unforeseen losses or with a view to planning for further development of the business.
4.	Provisions are created for some specific purpose and are utilised for that particular purpose.	4.	Reserves that are created are mostly general,and/or in a few cases, particular (reserve fund).
5.	Provisions cannot be distributed as profits except in cases where the actual liabilities or charges fall short of the amount provided for.	5.	Reserves,other than capital reserves,can be distributed as profits.
6.	Provisions are adjustment entries—they are internal transactions and cause a reduction in the net profit.	6.	Capital reserves may be internal or external transactions—they may reduce the net divisible profits or can cause an increase in that or may not bear any relation with net profit.
7.	Provisions may appear in the liabilities side or in the assets side of the Balance Sheet.	7.	Reserves compulsorily appear in the liabilities side of the Balance Sheet alone.
8.	Provisions are not earmarked against any particular asset.	8.	Reserves may be earmarked against a particular asset (reserve fund).

Distinction Between Capital Reserve and Revenue Reserve

	Capital Reserve		Revenue Reserve
1.	The transaction for a capital reserve may be internal or external.	1.	It is always an internal transaction.
2.	It is always specific.	2.	It can be general or specific.
3.	It is not generally distributed as profits.	3.	It may be distributed as profits.

4.	It may or may not involve any receipts of cash.	4.	It may or may not involve any payment of cash.
5.	It may arise during the period prior to incorporation.	5.	It cannot arise during the period prior to incorporation.
6.	It is not created by retaining profits.	6.	It is created by retaining profits.

Sinking Funds

A sinking fund is a fund created by the regular investment of a fixed amount to accumulate the amount of money required to pay off a debt or for the replacement of an asset at a set date in the future. An amount equivalent to reserve created as sinking fund is invested outside the business in gilt-edged or other securities and are allowed to accumulate at compound interest so as to produce the required amount to repay the liability or to replace the asset after a specified period of time. The main advantage of creating such a fund is that it does away with the strain on working capital, if substantial sums are withdrawn from the business to replace an asset at the end of its life or to repay a liability.

Difference between a sinking fund to replace an asset and sinking fund to repay a liability

The following are the differences between the above two:

(a) In the first case, a sinking fund is created by debiting Depreciation Account and crediting Sinking Fund Account. Depreciation Account is ultimately transferred to the Profit and Loss Account as an expense to be charged against profits. Therefore, the fund that is created is the actual amount of depreciation provided. But under the seconed case, it is an appropriation of profit and is created by debiting Profit and Loss Appropriation Account and crediting Sinking Fund Account.

(b) In the first case, at the end of the useful life of the asset, all investments are sold away and the proceeds are utilised for purchasing the new asset and writing-off the old asset. The profit or loss on sale of investments is transferred to the Sinking Fund Account. But in the second case, sinking fund investments are realised to repay the liabilities and the profit or loss on sinking fund investment is transferred to Reserve Account.

(c) In the first case, creation of sinking fund does not enhance the capital of the business unit, since it is a charge against profits. But in the second case, it is an appropriation of profits and it increases the capital of the business to the extent the liabilities are discharged.

Section 2 : Provisions

Meaning of Provision

A provision is a charge against profit for the purpose of providing for any liability or loss. The anticipated liability or loss is likely or certain to be incurred, but the amount or the date on which they will arise may or may not be ascertained with reasonable accuracy. Therefore, a provision is debited in the Profit and Loss Account to ascertain the ***correct profit***. It is an internal transaction and, therefore, does not involve any payment of cash. If the amount of a known liability or loss can be ascertained with substantial accuracy, it should be treated as a liability and not a provision. A Provision can be created for the following purposes :

1. For liabilities and charges (e.g., provision for taxation, provision for sales tax etc.);
2. Valuation adjustment for fixed assets (e.g., provision for depreciation);
3. Valuation adjustment for current assets (e.g., provision for doubtful debts).

A provision can be ***specific***, e.g. provision against a particular debtor; or ***general,*** e.g. provision expressed as a percentage of total debtors; or a combination of specific and general provisions.

Provisions for liabilities and charges are shown on the liabilities side of the Balance Sheet. But, provisions for valuation adjustment appear on the assets side of the Balance Sheet as a deduction from the assets concerned (e.g. provision for doubtful debts are deducted from sundry debtors or provisions for depreciation are deducted from the asset accounts).

Illustration 1

Which of the following should be 'charged' against profit and which should be 'appropriation' of profit ?

(i) Provision for Doubtful Debts; (ii) Provision for Depreciation; and (iii) General Reserves.

Solution

(i) Provision for Doubtful Debts is a charge against profit.
(ii) Provision for Depreciation is a charge against profit.
(iii) General Reserve is an appropriation of profit.

Illustration 2

Crimson Limited's Profit and Loss Account for the year ended 31.12.2014 includes the following information:

(i) Depreciation ₹ 57,500; (ii) Bad debts written off ₹ 21,300; (iii) Increase in doubtful debts ₹ 18,400; (iv) Proposed dividend ₹ 20,000; (v) Retained profit for the year ₹ 30,800; and (vi) Liability for tax ₹ 5,000.

State which one of the items (i) - (vi) above are —

(i) transfer to provisions; (ii) transfer to reserves; and (iii) neither related to provisions nor reserves.

Solution

(i) Transfer to provision.
(ii) Neither related to provisions nor reserves.
(iii) Transfer to provision.
(iv) Neither related to provisions nor reserves.
(v) Transfer to reserve.
(vi) Transfer to provision.

Accounting for Provision for Bad Debts

At the end of each accounting period, the firm knows that it will suffer a loss due to bad debts in future. An accurate estimate of the apprehended bad debts losses can nevertheless be made, because the firm does not know which debtor will fail to make payment in future. Therefore, the book value of the sundry debtors may not be the actual realizable value. Towards the endeavour of ascertaining the true (or fair) trading profit, a portion of the profit is set aside in a special account called 'Provision for Bad and Doubtful Debts Account,' to adjust the loss of future bad debts which is based on approximations. But, we cannot write off the accounts of the doubtful debtors at once, the value of the sundry debtors cannot be reduced directly. This is so because there may still be a chance of recovery (partly or fully) of the debt. The estimate of doubtful debts (Provision for Bad and Doubtful Debts Account) is shown as a separate figure in the Balance Sheet. The value of the sundry debtors are retained at the *sum due*, but are shown in the Balance Sheet at the *estimated realizable value*.

The following entry is passed for the provision against bad debts:

Profit and Loss Account Dr.

To Provision for Bad and Doubtful Debts Account

Dr. Provision for Bad and Doubtful Debts Account Cr.

To Balance c/d		By Profit & Loss A/c	

Though Provision for Bad and Doubtful Debts Account is a credit balance, and should find a place on the liabilities side of the Balance Sheet, it is shown as a deduction from sundry debtors in the assets side (to reflect the net realizable amount at a glance). In the Balance Sheet, the Provision for Bad and Doubtful Debts will appear as follows:

Balance Sheet as at ...

		Sundry Debtors	...	
		Less: Bad Debts*	...	
			...	
		Less : Provision for Bad and Doubtful Debts	...	

***Bad debt occurred after preparation of Trial Balance.**

There are two methods of recording for bad and doubtful debts. Also, the treatment in the first year (when a provision is created for the first time), is different from the treatments of the subsequent years.

First Method

Under this method, a Bad Debts Account is opened and all bad debts are written off to it. A Provision for Doubtful Debts Account is also opened in the very first year. All bad debts are adjusted against this Provision for Doubtful Debts Account in the subsequent years. However, the first year's bad debts is charged to Profit and Loss Account directly.

Journal Entries in the First Year

1. When a provision is created for the first time.

Profit and Loss Account Dr.
To Provision for Bad and Doubtful Debts Account

2. For bad debts after Trial Balance :

Bad Debts Account Dr.
To Sundry Debtors Account

3. For writing off bad debts in the Profit and Loss Account

Profit and Loss Account Dr.
To Bad Debts Account (Trial Balance figure and bad debts after Trial Balance)

Journal entries in the Second and Subsequent Years

1. For bad debts after Trial Balance

Bad Debts Account Dr.
To Sundry Debtors Account

2. For writing off bad debts against provision account

Provision for Bad and Doubtful Debts Account Dr.
To Bad Debts Account (Bad debt during the year and after the Trial Balance)

3. For creating necessary provision at the year end

Profit and Loss Account Dr.
To Provision for Bad and Doubtful Debts Account

In the second and any subsequent year, we may consider our provision to be too large or too small. the above entry is passed to increase the provision. Conversely, to reduce the provision, we must reserve the entry.

The amount of provision to be created is calculated as under

Closing Provision required*	***
Add: Bad debts written off (total)	***
	***
Less: Provision for bad and doubtful debts at the beginning	***
Amount to be charged to Profit and Loss Account	***

* Provision is to be calculated on the balance of sundry debtors after adjusting bad debts (after Trial Balance).

Under this method, (excepting in the first year), bad debt account cannot find a place in the Profit and Loss Account, since it is written off against Provision for Bad and Doubtful Debts Account. First we calculate the amount to be provided against doubtful debts and then we ascertain the amount to be charged in the Profit and Loss Account as an expense. Therefore, Profit and Loss Account is debited with the Provision for Bad and Doubtful Debts Account only (instead of Bad Debt Account).

Illustration 3

The outstanding debtors of X at the end of his first year's trading on 31.12.2014 amounted to ₹ 76,800. A review of the debtors list on the same date revealed that there was a long over due of ₹ 1,500 from a debtor, the collection of which was considered doubtful.

You are required to show the relevant journal entries and ledger accounts in the books of X in the following circumstances : (i) if he decides to write off the balance due from the debtor as a bad debt; and (ii) if he decides to make a provision of ₹ 1,500 for the debt.

Solution

In the books of X

(i) Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2014 Dec. 31	Bad Debt A/c	Dr.		1,500	
	To Sundry Debtors A/c				1,500
	(Being bad debts written off)				
	Profit & Loss A/c	Dr.		1,500	
	To Bad Debt A/c				1,500
	(Being bad debts charged to Profit and Loss Account)				

Dr. Bad Debt Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Sundry Debtors A/c	1,500	2014 Dec. 31	By Profit and Loss A/c	1,500

(ii) Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2014 Dec. 31	Profit & Loss A/c	Dr.		1,500	
	To Provision for Bad Debts A/c				1,500
	(Being the creation of necessary provision)				

Dr. Provision for Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Balance c/d	1,500	2014 Dec. 31	By Profit and Loss A/c	1,500

Illustration 4

Following are the balances taken from the Trial Balance of a trader as on 31.12.2014 : Provision for bad debts—₹ 5,000; Sundry Debtors—₹ 90,000; Bad Debts—₹ 5,000. You are required to prepare Provision for Bad Debts Account after considering the following : (i) further bad debts to be written off ₹ 10,000; and (ii) a provision for doubtful debts to be created @ 10% on closing debtors.

Solution

In the books of the Trader

Dr. Provision for Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Bad Debts A/c (₹ 5,000 + 10,000)	15,000	2014 Jan. 1	By Balance b/d	5,000
"	To Balance c/d [10% on ₹ (90,000 – 10,000]	8,000	Dec. 31	By Profit and Loss A/c (Balancing figure)	18,000
		23,000			23,000

Tutorial Notes :

(1) Provision for bad debts appearing in the Trial Balance represents opening provisions.

(2) Bad debts are increased by ₹ 10,000 and sundry debtors are decreased by the same amount. Following is the Journal Entry :

Bad Debts Account Dr. ₹ 10,000
  To Sundry Debtors Account ₹ 10,000

(3) Bad debts of ₹ 5,000 appearing in the Trial Balance represents bad debts already written off by passing the above Journal Entry for ₹ 5,000. Therefore, closing balance of sundry debtors is ₹ 80,000 (₹ 90,000-10,000).

(4) Assumed accounting year begins on 1st January every year.

Illustration 5

Mr. X, a trader, had incurred a loss of ₹ 3,000 as bad debt during the year 2013, and then decided to create a Provision for Bad and Doubtful Debts at 5% on good debtors amounting to ₹ 50,000 on 31st December, 2013. During the year ended 31st December, 2014, the bad debts loss was ₹ 2014. On 31st December, 2014, his good debtors amounted to ₹ 65,000 and decided to maintain the Provision for Bad and Doubtful Debts at 4%. Pass the necessary Journal entries in the books of Mr. X for the year 2013 and 2014.

Solution

In the books of X

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2013 ?	Bad Debt A/c	Dr.		3,000	
	To Sundry Debtors A/c				3,000
	(Being bad debt written off)				
Dec. 31	Profit & Loss A/c	Dr.		3,000	
	To Bad Debt A/c				3,000
	(Being bad debt transferred to Profit and Loss Account)				

Dec. 31	Profit & Loss A/c Dr.		2,500	
	To Provision for Bad & Doubtful Debts A/c			2,500
	(Being the creation of necessary provision @ 5% on ₹ 50,000)			
2014	Bad Debt A/c Dr.		2,000	
?	To Sundry Debtors A/c			2,000
	(Being bad debt written off)			
Dec. 31	Provision for Bad & Doubtful Debts A/c Dr.		2,000	
	To Bad Debt A/c			2,000
	(Being bad debt of the period adjusted against the provision for bad & doubtful debts)			
Dec. 31	Profit & Loss A/c Dr.		2,100	
	To Provision for Bad & Doubtful Debts A/c			2,100
	(Being creation of necessary provision)			

Closing provision required (4% of ₹ 65,000)	₹ 2,600
Add: Bad Debt	₹ 2,000
	₹ 4,600
Less: Opening balance of provision	₹ 2,500
	₹ 2,100

Illustration 6

The Balance Sheet of A as on 31.12.2014 included the following items :

Sundry Debtors	₹ 98,000	
Less: Provision for bad debts	₹ 2,450	₹ 95,550

At the end of the following financial years, the gross amount of Debtors (before deducting a provision) were as under: As on 31.12.2013—₹ 94,000; As on 31.12.2014—₹ 1,02,000.

On each of these years there was a provision for bad debts calculated on the same percentage basis as on 31.12.2013.

The actual amount of bad debts written off from Debtors Accounts over those periods were :

For the year ended 31.12.2013—₹ 2,600; For the year ended 31.12.2014—₹ 2,300.

You are required to prepare Bad Debts Account and Provision for Bad Debts Account for the years 2013 and 2014.

Solution

In the books of A

Dr. Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 Dec. 31	To Sundry Debtors A/c	2,600	2013 Dec. 31	By Provision for Bad Debts A/c	2,600
2014 Dec. 31	To Sundry Debtors A/c	2,300	2014 Dec. 31	By Provision for Bad Debts A/c	2,300

Dr. Provision for Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 Dec. 31	To Bad Debts A/c	2,600	2013 Jan. 1	By Balance b/d	2,450
"	To Balance c/d (2.5% on ₹ 94,000)	2,350	Dec. 31	By Profit and Loss A/c	2,500
		4,950			4,950
2014 Dec. 31	To Bad Debts A/c	2,300	2014 Jan. 1	By Balance b/d	2,350
"	To Balance c/d (2.5% on ₹ 1,02,000)	2,550	Dec. 31	By Profit and Loss A/c (Balancing figure)	2,500
		4,850			4,850
			2013 Jan. 1	By Balance b/d	2,550

Percentage of provision to be created = $\left(\frac{2,450}{98,000} \times 100\right) = 2.5\%$.

Illustration 7

The Trial Balance as on 31.12.2014 of Mr. X contains the following items :

(a) Provision for Bad Debts—₹ 12,000; (b) Sundry Debtors—₹ 1,00,000; (c) Bad Debts—₹ 8,000.

On enquiry, it was ascertained that sundry debtors include the following :

(i) ₹ 10,000 due from A (creditors include ₹ 15,000 due to the same party);

(ii) ₹ 5,000 due on account of sale of furniture; and,

(iii) Bad debts ₹ 5,000.

You are required to show Bad Debts Account and Provision for Bad Debts Account. A provision for bad debts @ 2% is to be created on closing debtors.

Solution

In the books of X

Dr. Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Balance b/d	8,000	2014 Dec. 31	By Provision for Bad Debts A/c	13,000
"	To Sundry Debtors A/c	5,000			
		13,000			13,000

Dr. Provision for Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Bad Debts A/c ₹ (8,000 + 5,000)	13,000	2014 Jan. 1	By Balance b/d	12,000
	To Balance c/d [2% on ₹ 80,000)*	1,600	Dec. 31	By Profit and Loss A/c (Balancing figure)	2,600
		14,600			14,600

* ₹ 1,00,000 – ₹ 10,000 – ₹ 5,000 – ₹ 5,000 = ₹ 80,000.

Illustration 8

Mr. X started business on 1.1.2012. Following is the information provided for the year ended 31st December:

Year	2012	2013	2014
Credit Sales	50,000	70,000	1,00,000
Received from Debtors	30,000	50,000	50,000
Discount allowed	5,000	7,000	6,000
Returns inward	3,000	2,000	23,000
Bad debts	2,000	6,000	1,000

Provision is to be created for doubtful debts @ 10% on closing debtors. You are required to prepare Sundry Debtors Account, Bad Debts Account and Provision for Bad Debts Account for the years 2012 to 2014.

Solution

In the books of X

Dr. Sundry Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2012 Dec. 31	To Sales A/c	50,000	2012 Dec. 31	By Bank A/c	30,000
				By Discount Allowed A/c	5,000
				By Returns Inward A/c	3,000
				By Bad Debts A/c	2,000
				By Balance c/d	10,000
		50,000			50,000
2013 Jan. 1	To Balance b/d	10,000	2013 Dec. 31	By Bank A/c	50,000
Dec. 31	To Sales A/c	70,000		By Discount Allowed A/c	7,000
				By Returns Inward A/c	2,000
				By Bad Debts A/c	6,000
				By Balance c/d	15,000
		80,000			80,000
2014 Jan. 1	To Balance b/d	15,000	2014 Dec. 31	By Bank A/c	50,000
Dec. 31	To Sales A/c	1,00,000		By Discount Allowed A/c	6,000
				By Returns Inward A/c	23,000
				By Bad Debts A/c	1,000
				By Balance c/d	35,000
		1,15,000			1,15,000

Dr. Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2012 Dec. 31	To Sundry Debtors A/c	2,000	2012 Dec. 31	By Profit and Loss A/c	2,000
2013 Dec. 31	To Sundry Debtors A/c	6,000	2013 Dec. 31	By Provision for Bad Debts A/c	6,000
2014 Dec. 31	To Sundry Debtors A/c	1,000	2014 Dec. 31	By Provision for Bad Debts A/c	1,000

Dr. Provision for Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2012 Dec. 31	To Balance c/d (10% of ₹ 10,000)	1,000	2012 Dec. 31	By Profit and Loss A/c	1,000
2013 Dec. 31	To Bad Debts A/c	6,000	2013 Jan. 1	By Balance b/d	1,000
2013 Dec. 31	To Balance c/d (10% on ₹ 15,000)	1,500	2013 Dec.31	By Profit and Loss A/c (Balancing figure)	6,500
		7,500			7,500

2014 Dec. 31	To Bad Debts A/c	1,000	2014 Jan. 1	By Balance b/d	1,500
2014 Dec. 31	To Balance c/d (10% on ₹ 35,000)	3,500	2014 Dec. 31	By Profit and Loss A/c (Balancing figure)	3,000
		4,500			4,500

Illustration 9

Banik & Co is in business as a distributor of household goods on credit terms to a wide range of customers. The following balances were extracted from their ledger at 31st March, 2014 (all figures in rupees) :

Sales	9,42,520	Returns inwards	30,510
Debtors – Balance at 31.3.2013	98,412	Carriage outwards	5,760
Discount allowed	8,324	Provision for Doubtful debts as at 31.3.2013	6,876
Cash received from debtors	8,76,940		

Subsequent enquiries revealed the following information :

A cheque for ₹ 3,528 from Samar, a customer, had been returned by the bank marked "refer to drawer". Bad debts totalling ₹ 8,536 are to be written-off, and the provision for doubtful debts is to be raised to 10% of debtors balance at 31st March, 2014.

On the last day of the year a cheque is received for ₹ 1,400 from the receiver of Naresh. This customer ceased to trade in January, 2012 when he owed Banik & Co ₹ 7,000 and the debt had been written-off as bad in the year ended 31st March, 2012. No entry in respect of this cheque has yet been made in the books.

Write-up the following accounts for the year ended 31st March, 2014 :

(a) Sundry Debtors Account; (b) Provision for Doubtful Debts Account.

Solution **In the books of Banik & Co**

Dr. **Sundry Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013			2014		
Apr. 1	To Balance b/d	98,412	?	By Discount Allowed A/c	8,324
2014			?	By Bank A/c	8,76,940
?	To Sales A/c	9,42,520	?	By Returns Inwards A/c	30,510
Mar. 31	To Bank A/c (Cheque dishonoured)	3,528	?	By Bad Debts A/c	8,536
			Mar. 31	By Balance c/d	1,20,150
		10,44,460			10,44,460

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

Date	Particulars	₹	Date	Particulars	₹
.2014			2013		
Mar. 31	To Bad Debts A/c	8,536	Apr. 1	By Balance b/d	6,876
	To Balance c/d (10% on ₹ 1,20,150)	12,015	2014		
			Mar. 31	By Profit and Loss A/c (Balancing figure)	13,675
		20,551			20,551

Tutorial Notes :

(1) Cheque received from the receiver of Naresh will be credited to Bad Debt Recovery Account. This account will be closed by transferring to Profit and Loss Account.

(2) Carriage outward has nothing to do with Sundry Debtors Account.

Illustration 10

Because of their doubtful nature, Sri A K Sinha instructed his accountants to make a specific provision in the accounts for the year ended 31st December, 2013 against the following debts :

Roy — ₹ 280; Das — ₹ 60; Ghosh — ₹ 240; Saha — ₹ 2,040.

He also instructed that a general provision of 5% for doubtful debts should be created on the other debtors, which at 31st December, 2013 amounted to ₹ 80,000.

No further business transactions were entered into with any of these debtors during the year ended 31st December, 2014 but an amount of ₹ 90 was received from Roy's trustee in bankruptcy by way of a first dividend; a first and final dividend of ₹ 700 was received from the liquidator of Saha and Ghosh paid his debt in full. A further debt of ₹ 950 due from Sarkar proved to be bad.

On 31st December, 2014 Sri A K Sinha instructured his accountants to maintain the provision existing against Das's debt and to provide for the balance due from Roy, and to make further provision for doubtful debts due from Bose ₹ 190 and Ganguli ₹ 150. The other debtors amounted to ₹ 75,000 and the accountants were instructed to make the provision for doubtful debts equal to 5% of these debts.

Prepare Bad Debts Account and Provision for Doubtful Debts Account.

Solution **In the books of Sri A K Sinha**

Dr. **Bad Debts Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Dec. 31	To Debtors A/c (Note 1)	2,290	Dec. 31	By Provision for Doubtful Debts A/c	2,290
		2,290			2,290

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

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Dec. 31	To Bad Debts A/c	2,290	Jan. 1	By Balance b/d (Note 2)	6,620
"	To Profit and Loss A/c (Balancing figure)	10			
"	To Balance c/d (Note 3)	4,320			
		6,620			6,620

Working Notes :

(1) Bad Debts

	₹
Saha (₹ 2,040 – 700)	1,340
Sarkar	950
	2,290

Illustration 11

Dinesh Goel has an accounting year ending on 31st December. At 31.12.2013, the ledger contained the following balances:

Sundry Debtors ₹ 10,760; Provision for Doubtful Debts ₹ 1,260.

The provision for doubtful debts consists of a general provision of ₹ 500 and specific provision comprising :

A ₹ 320; B ₹ 180; and C ₹ 260.

The following transactions occurred during 2013 :

30th April A was declared bankrupt and a first dividend of ₹ 70 was received from the trustee.

15th June A debt of ₹ 210 due from D that is included in the debtors at 31.12.2013 was found to be bad.

3rd August B paid his debt in full.

7th October C was declared bankrupt and a first and final dividend of ₹ 110 was received from the estate.

The sundry debtors at 31.12.2014 were ₹ 12,610. This figure is after recording all money received but does not take into account any of the above bad debts.

The relevant specific provisions and a general provision for doubtful debts should be maintained at 31.12.2014.

You are required to prepare Bad Debts Account and Provision for Doubtful Debts Account.

Solution **In the books of Dinesh Goel**

Dr. **Bad Debts Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Jan. 15	To Sundry Debtors A/c (D)	210	Dec. 31	By Provision for Doubtful Debts A/c	360
Oct. 7	To Sundry Debtors (C — ₹ 260 – 110)	150			
		360			360

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

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Dec. 31	To Bad Debts A/c	360	Jan. 1	By Balance b/d	1,260
"	To Profit and Loss A/c (Balancing figure)	50			
?	To Balance c/d (Note 1)	850			
		1,260			1,260

Working Notes :

(1) Closing Provision

	₹
A (₹ 320 – 70)	250
General [5% of ₹ 12,000 (Note 3)]	600
	850

(2) Percentage of General Opening Provision

$$\frac{500}{10,760 - (320 + 180 + 260)} \times 100 = 5\%$$

(3) General Provision required on Debtors

	₹
Closing balance of Sundry Debtors	12,610
Less: Bad Debts (₹ 210 + ₹ 150)	360
	12,250
Less: Specific Provision for A (₹ 320 – ₹ 70)	250
	12,000

Illustration 12

A trader had incurred a loss of ₹ 2,500 as bad debt during the year 2012 and then decided to create a provision for bad and doubtful debts at 5% on the good debtors amounting to ₹ 75,000 on 31st December, 2012.

During the year ended 31st December, 2013, his debtors worth ₹ 1,500 failed to pay their dues. On 31st December, 2013, his good debtors amounted to ₹ 40,000 and he decided to maintain the provision for bad and doubtful debts at 4% on Debtors. During 2014 his bad debts amounted to ₹ 3,000. He decided to increase the Provision for Bad and Doubtful Debts to 5% on good debtors, which amounted to ₹ 80,000 on 31st December, 2014.

Pass necessary Journal entries and show the Bad Debt Account Provision for Bad and Doubtful Debts Account and also appropriate entries in the Profit and Loss Account and Balance Sheet of 2012, 2013 and 2014.

Solution

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

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2012	Bad Debt A/c	Dr.		2,500	
?	To Sundry Debtors A/c				2,500
	(Being bad debt written off)				
Dec. 31	Profit & Loss A/c	Dr.		2,500	
	To Bad Debt A/c				2,500
	(Being bad debt charged to P & L Account)				
Dec. 31	Profit & Loss A/c	Dr.		3,750	
	To Provision for Bad & Doubtfuls Debts A/c				3,750
	(Being the creation of provision for bad & doubtful debts @ 5% on ₹ 75,000)				
2013	Bad Debt A/c	Dr.		1,500	
?	To Sundry Debtors A/c				1,500
	(Being bad debt written off)				
Dec. 31	Provision for Bad & Doubtful Debts A/c	Dr.		1,500	
	To Bad Debt A/c				1,500
	(Being bad debt loss transferred to provision for bad & doubtful debts account)				
Dec. 31	Provision for Bad & Doubtful Debts A/c	Dr.		650	
	To Profit & Loss A/c				650
	(Being the excess provision credited to Profit and Loss Account)				
2014	Bad Debt A/c	Dr.		3,000	
?	To Sundry Debtors A/c				3,000
	(Being bad debt written off)				
Dec. 31	Provision for Bad & Doubtful Debts A/c	Dr.		3,000	
	To Bad Debt A/c				3,000
	(Being bad debt loss transferred to Provision for Bad & Doubtful Debts Account)				
Dec. 31	Profit & Loss A/c	Dr.		5,400	
	To Provision for Bad & Doubtful debts A/c				5,400
	(Being the creation of necessary provision for doubtful debts)				

Dr. **Bad Debt Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2012 ?	To Sundry Debtors A/c	2,500	2012 Dec. 31	By P&L A/c	2,500
2013 ?	To Sundry Debtors A/c	1,500	2013 Dec. 31	By Provision for Bad & Doubtful Debts A/c	1,500
2014 ?	To Sundry Debtors A/c	3,000	2014 Dec. 31	By Provision for Bad & Doubtful Debts A/c	3,000

Dr. Provision for Bad & Doubtful Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2012 Dec.31	To Balance c/d	3,750	2012 Dec.31	By P & L A/c	3,750
2013 Dec.31	To Bad Debt A/c	1,500	2013 Jan.1	By Balance b/d	3,750
"	To P & L A/c	650			
"	To Balance c/d	1,600			
		3,750			3,750
2014 Dec.31	To Bad Debt A/c	3,000	2014 Jan.1	By Balance b/d	1,600
"	To Balance c/d	4,000	2014 Dec.31	By P & L A/c	5,400
		7,000			7,000
			2015 Jan. 1	By Balance c/d	4,000

Dr. P & L Account for the year ended on 31st December, 2012 (includes) Cr.

To Bad Debt A/c	2,500		
To Provision for Bad & Doubtful Debts A/c	3,750		

Dr. P & L Account for the year ended on 31st December, 2013 (includes) Cr.

		By Provision for Bad & Doubtful Debts A/c	650

Dr. P & L Account for the year ended on 31st December, 2014 (includes) Cr.

To Provision for Bad & Doubtful Debts A/c	5,400		

Balance Sheet as at 31st December, 2012 (includes)

		Sundry Debtors	₹ 75,000	
		Less: Prov. for Bad & Doubtful Debts @ 5%	₹ 3,750	71,250

Balance Sheet as at 31st December, 2013 (includes)

		Sundry Debtors	₹ 40,000	
		Less: Prov. for Bad & Doubtful Debts @ 4%	₹ 1,600	38,400

Balance Sheet as at 31st December, 2014 (includes)

		Sundry Debtors	₹ 80,000	
		Less: Prov. for Bad & Doubtful Debts @ 5%	₹ 4,000	76,000

Second Method

Under this method, a Bad Debts Account is opened and all bad debts are written off to it. At the end of each year, Bad Debts Account is closed by transferring to Profit and Loss Account. In the first year, a provision is created by debiting the Profit and Loss Account and it is carried to the next period. The amount of provision needed at the end of each subsequent year is established and necessary adjustment made to the balance on the Provision Account.

Journal Entries in the First Year

1. For the bad debts of the period for which no entry has been made

Bad Debts Account Dr.
To Sundry Debtors Account

2. For writing off bad debts in the Profit and Loss Account

Profit and Loss Account Dr.
To Bad Debts Account

3. When provision is created for the first time

Profit and Loss Account Dr.
To Provision for Bad and Doubtful Debts Account

The total charge to the Profit and Loss Account for the first year is thus the sum of the bad debts written off and the amount transferred to the Provision for Bad and Doubtful Debts Account.

Journal Entries in the Second and Subsequent Years

1. For the bad debts of the period for which no entry has been made

Bad Debts Account Dr.
  To Sundry Debtors Account

2. For writing off bad debts in the Profit and Loss Account

Profit and Loss Account Dr.
  To Bad Debts Account

3. For creating provision at the year end

(a) (Closing provision > Opening provision)

Profit and Loss Account Dr.
  To Provision for Bad and Doubtful Debts Account

(b) (Closing provision < Opening Balance)

Provision for Bad and Doubtful Debts Account Dr.
  To Profit and Loss Account

Unlike the first, this method shows the bad debts as well as provision for bad and doubtful debts in the Profit and Loss Account since the bad debts are not adjusted against the Provision for Bad and Doubtful Debts Account.

The Provision for Bad and Doubtful Debts Account is often labelled as Reserve for Bad and Doubtful Debts Account . This is wrong and causes confusion. The reserve is an appropriation of profit, a sum of money set aside from distributable profits after the profits have been calculated whereas a provision is a charge against profit (appears with Profit and Loss Account to assist in the calculation of a correct profit). The Provision for Bad and Doubtful Debts Account is purely in the nature of a suspended credit against doubtful customers.

Illustration 13

The figure of sundry debtors in a Trial Balance is ₹ 90,000. You are asked to write off ₹ 5,000 as bad debts and make a provision for doubtful debts @ 5% on sundry debtors. Pass the necessary Journal Entries and prepare the Ledger Accounts.

Solution

In the books of ...

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

Date	Particulars		L.F.	₹	₹
?	Bad Debt A/c	Dr.		5,000	
	To Sundry Debtors A/c				5,000
	(Being bad debt written off)				
?	Profit & Loss A/c	Dr.		5,000	
	To Bad Debt A/c				5,000
	(Being bad debt transferred to P & L Account)				
?	Profit & Loss A/c	Dr.		4,250	
	To Provision for Bad & Doubtful Debts A/c (Note 1)				4,250
	(Being the creation of necessary provision)				

Dr. **Bad Debts Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Sundry Debtors A/c	5,000	?	By Profit and Loss A/c	5,000

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

Date	Particulars	₹	Date	Particulars	₹
?	To Balance c/d	4,250	?	By Profit and Loss A/c	4,250

Working Note : (1) Provision for bad debts is to be calculated after writing off bad debts of ₹ 5,000 for sundry debtors of ₹ 90,000. Therefore, the amount of provision will be 5% of (₹ 90,000 – ₹ 5,000) = ₹ 4,250.

Illustration 14

Mr. X, a trader, had incurred a loss of ₹ 3,000 as bad debt during the year 2013, and then decided to create a Provision for Bad and Doubtful Debts at 5% on good debtors amounting to ₹ 50,000 on 31st December, 2013. During the year ended

31st December, 2014, the bad debts loss was ₹ 2014. On 31st December 2014 his good debtors amounted to ₹ 65,000 and decided to maintain the Provision for Bad and Doubtful Debts at 4%.

Pass the necessary Journal entries in the books of Mr. X for the year 2013 and 2014.

Solution

In the books of X

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2013	Bad Debt A/c	Dr.		3,000	
?	To Sundry Debtors A/c				3,000
	(Being bad debt written off)				
Dec. 31	Profit & Loss A/c	Dr.		3,000	
	To Bad Debt A/c				3,000
	(Being bad debt transferred to P & L Account)				
Dec. 31	Profit & Loss A/c	Dr.		2,500	
	To Provision for Bad & Doubtful Debts A/c				2,500
	(Being the necessary provision created)				
2014	Bad Debt A/c	Dr.		2,000	
?	To Sundry Debtors A/c				
	(Being bad debt written off)				2,000
Dec. 31	Profit & Loss A/c	Dr.		2,000	
	To Bad Debt A/c				2,000
	(Being the bad debt transferred to P & L Account)				
Dec. 31	Profit & Loss A/c	Dr.		100	
	To Provision for Bad & Doubtful Debts A/c				100
	(Being necessary provision created - ₹ 2,600 – 2,500)				

Illustration 15

You are given the following balances on 1st January, 2013 : Debtors—₹ 10,000; Provision for doubtful debts ₹ 400. You ascertain the following information :

Sales for the year 2013 (all on credit) : ₹ 1,00,000; Sales returns for the year 2013—₹ 1,000; Collection from debtors during 2013—₹ 90,000; Bad debt written off during 2013—₹ 500; Discount allowed during 2013—₹ 400.

At the end of 2013 the provision for doubtful debts is required to be 5% of debtors, after making a specific provision for a debt of ₹ 200 from a customer who has been declared bankrupt.

Sales for the year 2014 (90% on credit)—₹ 1,00,000; Sales returns for the year 2014 (90% relating to credit customers) —₹ 2,000; Collection from debtors during 2014—₹ 95,000; Debtors balances settled by contra against creditors balances during 2014—₹ 3,000; Bad debts written off during 2014 (including 50% of the debt due from the customer who had gone bankrupt), other 50% having been received in cash during 2014—₹ 1,500; Discount allowed during 2014—₹ 500. At the end of 2014, the provision for doubtful debts is still required to be 5% of debtors. You are required to write up the Sundry Debtors Account and the Provision for Doubtful Debts Account for the year 2013 and 2014.

Solution

Dr. Sundry Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 Jan.1	To Balance b/d	10,000	2013 ?	By Returns Inward A/c	1,000
Dec. 31	To Sales A/c	1,00,000	?	By Cash A/c	90,000
			?	By Bad Debts A/c	500
			?	By Discount Allowed A/c	400
			Dec. 31	By Balance c/d	18,100
		1,10,000			1,10,000
2014 Jan. 1	To Balance b/d	18,100	2014 ?	By Returns Inward A/c	1,800
Dec. 31	To Sales A/c	90,000	?	By Cash A/c	95,000
			?	By Sundry Creditors A/c	3,000
			?	By Bad Debts A/c	1,500
			?	By Discount Allowed A/c	500
			Dec. 31	By Balance c/d	6,300
		1,08,100			1,08,100

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

Date	Particulars	₹	Date	Particulars	₹
2013 Dec. 31	To Balance c/d (Note 1)	1,095	2013 Jan.1	By Balance b/d	400
			Dec. 31	By Profit and Loss A/c	695
		1,095			1,095
2014 Dec. 31	To Profit and Loss A/c	780	2014 Jan. 1	By Balance b/d	1,095
"	To Balance c/d (Note 2)	315			
		1,095			1,095

Working Notes :

(1) On 31st December 2013, the balance of Sundry Debtors is ₹ 18,100. This amount includes ₹ 200 due from a debtor who has been declared bankrupt. Therefore, provision for doubtful debts is to be created 100% on ₹ 200 and 5% on ₹ (18,100 – 200). Total provision on 31st December 2013 = ₹ 200 + ₹ 895 = ₹ 1,095.

(2) On 31st December 2014, the balance of Sundry Debtor is ₹ 6,300. It does not include any balance due from bankrupt debtor. Therefore, provision is to be created @ 5% on ₹ 6,300, which is equal to ₹ 315.

Provision for Discount on Debtors

In a sales transaction, payment is made either at the point of sale or after a specified period of time. Since many sellers offer a cash discount (sales discount), if payment is made within a specified period of time, cash discounts allowed are conveniently treated as an expense of the period. The book value of the debtors may not be the net realizable value. Like Provision for Bad and Doubtful Debts, it is desirable to reduce the debtors figure by the amount of probable cash discount to be allowed. This is because, customers are always debited with the full amount invoiced at the time of sale, but credited with the discount when they earn it.

The difficulties, however, are that nobody knows how many debtors will take the opportunity of cash discount and, hence, discounts allowed to debtors are less predictive. (Here, we must mention that if the cash discount is not more than or equal to the opportunity cost of liquid fund, a majority of the debtors may not avail cash discount.) Therefore, all that is possible is to make a rough estimate based on a percentage of outstanding debtors. A separate 'Provision for Discount on Debtors Account' is opened, which is very similar to Provision for Bad and Doubtful Debts Account. The only difference is that provision for discount is calculated on the debtors' balance after deducting the Provision for Bad and Doubtful Debts. Like Provision for Bad and Doubtful Debts it is also shown in the Balance Sheet as a deduction from Sundry Debtors. Like the treatment of Bad Debts, the accounting treatment of Provision for Discount on Debtors allowed in the first year is different from the treatment in the 2nd and subsequent years.

Accounting Entries in the First Year

1. *When discount is allowed to debtors*

Discount Allowed Account Dr.
To Sundry Debtors Account

2. *For closing the discount allowed account against Profit and Loss Account*

Profit and Loss Account Dr.
To Discount Allowed Account

3. *When Provision is created for the first time*

Profit and Loss Account Dr.
To Provision for Discount on Debtors Account*

This figure will be calculated by applying a percentage on Sundry Debtors after adjusting bad debts (after Trial Balance) and Provision for Bad and Doubtful Debts (new).

Accounting Entries in the Second and Subsequent Years

1. *When discount is allowed*

Discount Allowed Account Dr.
To Sundry Debtors Account

2. *At the end of the accounting year the discount account is closed by passing the following entry:*

Provision for Discount on Debtors Account Dr.
To Discount Allowed Account

3. The balance left in the Provision for Discount on Debtors Account at the end of a period is adjusted with the provision required to be made for next financial year and accounting entry to be passed according to situation.

(i) If the required provision is more than the balance left:

Profit and Loss Account Dr.

To Provision for Discount on Debtors Account*

(ii) If the required provision is less than the balance left:

Provision for Discount on Debtors Account Dr.

To Profit and Loss Account

*This figure will be calculated as follows:

Closing Provision required	***
Add: Discount allowed during the period	***
	***
Less: Opening Provision	***
Amount to be provided	***

The Bad Debts (after Trial Balance), Provision for Bad and Doubtful Debts and Provision for Discount on Debtors together will appear in the Balance Sheet as follows:

Balance Sheet As At ...

		Sundry Debtors	. . .	
		Less: Bad Debts	. . .	
		Less: Provision for Bad & Doubtful Debts	. . .	
		Less : Provision for Discount on Debtors	. . .	....

Illustration 16

The Sundry Debtors at 31.12.2014 were ₹ 10,000. A provision for bad debts @ 4% was made and also a provision for discount on debtors @ 5% was required. The discount allowed during the year amounted to ₹ 400. The business was commenced on 1.1.2014. Pass Journal Entries; and prepare Discount Allowed Account, Provision for Bad Debts Account and Provision for Discount on Debtors Account. Also, show how they appear in the Profit and Loss Account and in the Balance Sheet.

Solution

In the books of ...

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2014 Dec. 31	Discount Allowed A/c Dr.		400	
	To Sundry Debtors A/c			400
	(Being discount allowed on debtors)			
?	Profit and Loss A/c Dr.		400	
	To Discount Allowed A/c			400
	(Being the discount allowed transferred to Profit and Loss Account)			
?	Profit and Loss A/c Dr.		400	
	To Provision for Bad Debts A/c			400
	(Being the provision for bad debts @ 4% on ₹ 10,000)			
?	Profit and Loss A/c Dr.		480	
	To Provision for Discount on Debtors A/c			480
	(Being the provision for discount on debtors created @ 5% on ₹ 9,600)			

Dr. Discount Allowed Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Sundry Debtors A/c	400	2014 Dec.31	By Profit and Loss A/c	400

Dr. Provision for Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Balance c/d	400	2014 Dec.31	By Profit and Loss A/c	400

Dr. Provision for Discount on Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Balance c/d	480	2014 Dec.31	By Profit and Loss A/c	480

Dr. Profit and Loss Account for the year ended 31st December, 2014 (includes) Cr.

Particulars	₹	Particulars	₹
To Discount Allowed A/c	400		
To Provision for Bad Debts A/c	400		
To Provision for Discount on Debtors A/c	480		

Balance Sheet as at 31st December, 2014 (includes)

Liabilities	₹	Assets		₹
		Sundry Debtors	10,000	
		Less: Provision for Bad Debts	400	
			9,600	
		Less: Provision for Discount on Debtors	480	9,120

Illustration 17

Following are the balances taken from the Trial Balance of a trader as on 31.12.2014.

	Dr. (₹)	Cr. (₹)
Sundry Debtors	1,00,000	
Bad debts	7,000	
Discount allowed	3,000	
Provision for Bad debts		12,000
Provision for discount on Debtors		6,000

You are required to prepare Bad Debts Account, Discount Allowed Account, Provision for Bad Debts Account and Provision for Discount on Debtors Account. Also, show how they appear in the Profit and Loss Account and in the Balance Sheet, after considering the following :

1. Further bad debts and discount allowed are ₹ 3,000 and ₹ 2,000 respectively;
2. Provision for bad debts and provision for discount on Debtors to be created @ 10% and @ 5% respectively.

Solution

In the books of the Trader

Dr. Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 ?	To Sundry Debtors A/c	7,000	2014	By Provision for Bad Debts A/c	10,000
Dec. 31	To Sundry Debtors A/c	3,000	Dec. 31		
		10,000			10,000

Dr. Discount Allowed Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 ?	To Sundry Debtors A/c	3,000	2014	By Provision for Discount on Debtors A/c	5,000
Dec. 31	To Sundry Debtors A/c	2,000	Dec. 31		
		5,000			5,000

Dr. Provision for Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014	To Bad Debts A/c	10,000	2014 Jan. 1	By Balance b/d	12,000
Dec. 31	To Balance c/d (10% on ₹ 95,000)	9,500	Dec. 31	By Profit and Loss A/c (Balancing figure)	7,500
		19,500			19,500

Dr. Provision for Discount on Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014	To Discount Allowed A/c ₹ (3,000 + 2,000)	5,000	2014 Jan. 1	By Balance b/d	6,000
Dec. 31	To Balance c/d (5% on ₹ 85,500)	4,275	Dec.31	By Profit and Loss A/c (Balancing figure)	3,275
		9,275			9,275

Dr. Profit and Loss Account for the year ended 31st December, 2014 (includes) Cr.

Particulars	₹	Particulars	₹
To Provision for Bad Debts A/c	7,500		
To Provision for Discount on Debtors A/c	3,275		

Balance Sheet as at 31st December, 2014 (includes)

Liabilities	₹	Assets		₹
		Sundry Debtors (Note 3)	95,000	
		Less: Provision for Bad Debts	9,500	
			85,500	
		Less: Provision for Discount on Debtors	4,275	81,225

Working Notes :

(1) Provision for bad debts and provision for discount on debtors appearing in the Trial Balance represent opening provisions.

(2) Bad debts are increased to ₹ 10,000 (₹ 7,000 + ₹ 3,000) and discount allowed to ₹ 5,000 (₹ 3,000 + ₹ 2,000).
Following are the required Journal Entries.

Bad Debts Account	Dr.	₹ 3,000	
To Sundry Debtors Account			₹ 3,000
Discount Allowed Account	Dr.	₹ 2,000	
To Sundry Sundry Debtors Account			₹ 2,000

(3) The closing balance of sundry debtors becomes ₹ 95,000 [₹ (1,00,000 – 3,000 – 2,000)].

(4) Assumed accounting year begins on 1st January every year.

(5) Provision for discount on debtors is to be created @ 5% on (₹ 95,000 – ₹ 9,500) = ₹ 85,500.

Reserve for Discount on Creditors

If the firm is to allow cash discount to customers for early payments, it is quite possible that the firm may receive discount by making early payment which can be treated as income in the Profit and Loss Account. Such discount will be received in the next year but should be taken into account in current year's account because it relates to creditors of current year. Generally accepted accounting principles (also the concept of conservatism), state that we should provide a loss only when we apprehend that, but should never take a profit until it is actually made. ***It is seldom found in actual practice that a reserve has been created for discount to be received by making prompt payment to creditors (except in examination problems)***.

Journal Entries for Reserve for Discount on Creditors in the First Year

1. *When discount is received from the creditors*
   Sundry Creditors Account Dr.
   To Discount Received Account

2. *For closing the discount received to Profit and Loss Account*
   Discount Received Account Dr.
   To Profit and Loss Account

3. *When a Reserve is created for the first time*
   Reserve for Discount on Creditors Account Dr.
   To Profit and Loss Account

Journal Entries in the Second Year and Subsequent Years

1. *When discount is received from the creditors*
   Sundry Creditors Account Dr.
   To Discount Received Account

2. *At the end of the accounting year, the discount received account is closed by transferring it to the Reserve for Discount on Creditors Account as under:*
   Discount Received Account Dr.
   To Reserve for Discount on Creditors Account

3. *For creating a Reserve for the next year*
   Reserve for Discount on Creditors Account Dr.
   To Profit & Loss Account*

*This is calculated as under:

Closing Reserve required	***
Add: Discount received during the year	***
	***
Less: Opening Balance of Reserve	***
Amount to be credited to P & L A/c	***

In the Balance Sheet, the Reserve for Discount on Creditors is shown by way of deduction from Sundry Creditors.

Balance Sheet As At ...

Sundry Creditors	...			
Less: Reserve for Discount on Creditors	...	...		

In regard to the provision for discount on debtors and reserve for discount on creditors, the following points are worth noting:

1. ***The basic source of accounting, the total of discount allowed and discount received are the two discount columns of the Cash Book.***
2. ***Like bad debts, the profit on a credit sale may be taken in one year but the discount allowed as expenses may be a charge against profit of the subsequent year. Similarly, the cost of total purchase may be charged against the profit in one period, but the gain arising out of discount received may be taken to credit in another accounting period.***

Recovery of Bad Debts

We have already mentioned that when the seller apprehends any loss due to bad debt, he immediately writes it off by debiting Bad Debt Account and crediting the Sundry Debtors Account. In case of bad debt, the seller takes the initiative for closing the account of the customer and he does it immediately. After writing off any bad debt, if any amount is received from that customer in respect of that old debt, it is called recovery of bad debt. Occasionally, sundry debtors that have been charged off as bad debts, are unexpectedly collected (generally in a subsequent accounting period). When any bad debt is recovered, the accounting entries are as follows:

1. *When the bad debt is recovered*

Bank Account Dr.
To Bad Debt Recovery Account

2. *For closing bad debt recovery*

(a) If the seller is maintaining a Provision for Bad and Doubtful Debts Account and adjusting the bad debt against such provision, the bad debt recovery should be closed by transferring it to the Provision for Bad Debt Account.

Bad Debt Recovery Account Dr.
To Provision for Bad and Doubtful Debts Account

(b) In all other cases, it should be transferred to Profit and Loss Account

Bad Debt Recovery Account Dr.
To Profit and Loss Account

Treatment of Bad Debt Recovery in the Books of the Buyer

1. If the account of the seller (in the buyer's book) has not been closed

Seller Account Dr.
To Bank Account

2. If the Seller's Account has been closed

Goodwill Account* Dr.
To Bank Account

*The amount is paid for maintaining the goodwill of the business.

Illustration 18

Coalman Ltd. had:

(a) Sundry Debtors worth ₹ 68,000, ₹ 48,000 and ₹ 92,000; and

(b) Sundry Creditors worth ₹ 38,000; ₹ 45,000 and ₹ 55,000 as on 31st December, 2012, 2013 and 2014 respectively.

Show from the following data the Provision for Bad and Doubtful Debts Account, Provision for Discount on Debtors Account and Reserve for Discount on Creditors Account at 5%, 2% and 2% respectively, for the years 2012, 2013 and 2014 :

During the year	Bad Debts written off	Discount Allowed	Discount Received
2012	3,000	1,000	700
2013	1,800	500	980
2014	2,900	1,200	620

All the provisions / reserves were created for the first time on 31.12.2014 and maintained accordingly in the following years.

Solution

In the books of Coalman Ltd.

Dr. Provision for Bad and Doubtful Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2012 Dec. 31	To Balance c/d	3,400	2012 Dec. 31	By Profit and Loss A/c (5% on ₹ 68,000)	3,400
2013 Dec. 31	To Bad Debts A/c	1,800	2013 Jan. 1	By Balance b/d	3,400
	To Balance c/d (5% on ₹ 48,000)	2,400		By Profit and Loss A/c (Balancing figure)	800
		4,200			4,200
2014 Dec. 31	To Bad Debts A/c	2,900	2014 Jan. 1	By Balance b/d	2,400
2014 Dec. 31	To Balance c/d (5% on ₹ 92,000)	4,600	2014 Dec.31	By Profit and Loss A/c (Balancing figure)	5,100
		7,500			7,500

Dr. Provision for Discount on Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2012 Dec. 31	To Balance c/d (2% on ₹ 68,000 – 3,400)	1,292	2012 Dec. 31	By Profit and Loss A/c	1,292
2013 Dec. 31	To Discount Allowed A/c	500	2013 Jan. 1	By Balance b/d	1,292
2013 Dec. 31	To Balance c/d (2% on ₹ 48,000 – 2,400)	912	2013 Dec.31	By Profit and Loss A/c (Balancing figure)	120
		1,412			1,412
2014 Dec. 31	To Discount Allowed A/c	1,200	2014 Jan. 1	By Balance b/d	912
2014 Dec. 31	To Balance c/d (2% on ₹ 92,000 – 4,600)	1,748	2014 Dec.31	By Profit and Loss A/c (Balancing figure)	2,036
		2,948			2,948

Dr. Reserve for Discount on Creditors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2012 Dec. 31	To Profit and Loss A/c (2% on ₹ 38,000)	760	2012 Dec. 31	By Balance c/d	760
2013 Jan. 1	To Balance b/d	760	2013 Dec.31	By Discount Received A/c	980
2013 Dec. 31	To Profit and Loss A/c (Balancing figure)	1,120	2013 Dec.31	By Balance c/d (2% on ₹ 45,000)	900
		1,880			1,880
2014 Jan. 1	To Balance b/d	900	2014 Dec.31	By Discount Received A/c	620
2014 Dec. 31	To Profit and Loss A/c (Balancing figure)	820	2014 Dec.31	By Balance c/d (2% on ₹ 55,000)	1,100
		1,720			1,720

Note : In 2012, Bad debts, Discount allowed and Discount received will be transferred to Profit and Loss Account directly.

Illustration 19

The following balances on accounts appeared in a company's Ledger at 30th September, 2012: (all figures in ₹)

Sundry Debtors Account—63,158; Sundry Creditors Account—32,000 Provision for bad debts—3,158; Reserve for discount receivable—800; Provision for discount allowable—1,500.

During the year to 30th September, 2013 the following summarized transactions occurred (all figures in ₹):

Sales on credit	5,50,000	Discount allowed to customers	12,790
Purchases on credit	2,76,000	Bad Debts written off against the provision	4,100
Sales returns	6,000	Amount recovered from debtor whose debt had been written off as bad in previous years	542
Purchases returns	4,000	Debtor and creditor accounts settled by setting off one against the other	4,000
Cash received from customers (excluding bad debt recovered)	5,14,268		
Cash paid to suppliers	2,58,100	Discount received from suppliers	5,900

The company's policy is to pass all transactions for bad debts written off and recovered through the provision for bad debts account, and to make the provision at the year-end equal to 5% of the debtors. The company also makes provisions for discounts allowable equal to 2.5% of the year-end debtors minus the provision for bad debts, and for discount receivable equal to 2.5% of the year-end creditors.

You are required to enter the above information in the following Ledger Accounts, to carry down the balances at 30th September, 2013, and in the case of (c), (d) and (e), show the amount transferred to Profit and Loss Account:

(i) Sundry Debtors Account;

(ii) Sundry Creditors Account;

(iii) Provisions for Bad Debts Account;

(iv) Reserve for Discount Receivable Account; and

(v) Provision for Discount Allowable Account.

Solution

Dr. Sundry Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2012 1st Oct.	To Balance b/d	63,158	2012 Oct.	By Sales Returns A/c	6,000
?	To Sales A/c	5,50,000	?	By Cash A/c	5,14,268
			?	By Discount Allowed A/c	12,790
			?	By Bad Debts A/c	4,100
			?	By Sundry Creditors A/c	4,000
			2013 Sept.30	By Balance c/d	72,000
		6,13,158			6,13,158

Dr. Sundry Creditors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2012	To Purchases Returns A/c	4,000	2012 1st Oct.	By Balance b/f	32,000
?	To Cash A/c	2,58,100	?	By Purchases A/c	2,76,000
?	To Discount Received A/c	5,900			
?	To Sundry Debtors A/c	4,000			
2013 Sept.30	To Balance c/d	36,000			
		3,08,000			3,08,000

Dr. Provision for Bad Debts Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2012 ?	To Bad Debt A/c	4,100	2012 Oct. 1	By Balance b/f	3,158
2013 Sept.30	To Balance c/d (5% on ₹ 72,000)	3,600	?	By Bad Debt Recovered A/c	542
			2013 Sept.30	By P & L A/c	4,000
		7,700			7,700

Dr. Reserve for Discount Receivable Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2012 Oct. 1	To Balance b/f	800	2012 ?	By Discount Received A/c	5,900
2013 Sept.30	To P & L A/c	6,000	2013 Sept.30	By Balance c/d (2.5% of ₹ 36,000)	900
		6,800			6,800

Dr. Provision for Discount Allowable Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Discount Allowed A/c	12,790	2012 Oct.1	By Balance b/f	1,500
2013 Sept.30	To Balance c/d (2.5% of ₹ 68,400)	1,710	2013 Sept.30	By P & L A/c	13,000
		14,500			14,500

Illustration 20

A. Ltd. makes provision for doubtful debts at the end of each year against specific debtors.

On 31st December, 2013 the following debtors' balances were considered doubtful and provided for B—₹ 1,500; C—₹ 400; D—₹ 250.

Following are the particulars for the year ended 31st December, 2014:

(a) Bad Debts written off: B—₹ 1,200; E- ₹ 300; P—₹ 200.

(b) Bad Debts recovered: R—₹ 700; S - ₹ 600; N—₹ 500.

(c) Bad Debts considered doubtful at the end of the year: G—₹ 800; H—₹ 900; K—₹ 1,000

Debts considered doubtful at the commencement of the year 2014 were either realized or written off as bad debt.

Write up the Bad Debts Account and Provision for Doubtful Debts Account for the year ended 31.12.2014.

Solution

Dr. **Bad Debt Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 ?	To Sundry Debtors A/c (₹ 1200+300+200)	1,700	2014 Dec. 31	By Provision for Doubtful Debts	1,700

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

Date	Particulars	₹	Date	Particulars	₹
2014 Dec.31	To Bad Debt A/c	1,700	2014 Jan 1	By Balance b/f (₹ 1,500 + 400 + 250)	2,150
	To Balance c/d (₹ 800 + 900 + 1,000)	2,700	Dec.31	By Bad Debt Recovery A/c	1,800
				By Profit & Loss A/c	450
		4,400			4,400

Note: Amount realised from past bad debts should be credited to Provision for Bad and Doubtful Debts Account. Alternatively, it can be credited to Profit and Loss Account.

Illustration 21

On January 1, 2014 the Provision for Bad and Doubtful Debts Account of a concern showed a balance of ₹ 60,000 and the Debtors amounted to ₹ 15,00,000. Out of these, during 2014, Debtors amounting to ₹ 10,75,000 paid in full, but the following debts proved bad or doubtful: A (₹ 20,000)—bad to the full extent; B (₹ 40,000)—insolvent, estate expected to pay 50 paise in the rupee; C (₹ 12,000)—realised 33.1/3 % in full settlement.

The remaining debts were considered somewhat doubtful on December 31. The following further debts became due during 2014 but outstanding on December 31:

D (₹ 20,000)—expected to prove totally bad; E (₹ 80,000)—expected to prove 5% bad; F (₹ 6,40,000)—expected to prove 4% bad; G (₹ 4,00,000)—expected to prove bad to some extent; H (₹ 12,60,000)—expected to prove wholly good.

It was decided to write off actual debts and to make reserve of 5% on debts of unknown doubtful nature. Draw up the Provision for Bad and Doubtful Debts Account and show the balance of the account as at December, 31,2014.

Solution

Calculation of Actual Bad Debts

Amount due from A (fully bad)	₹ 20,000
Amount due from C (2/3 bad)	8,000
	28,000

Creation of Provision

50% amount due from B	20,000
Full amount due from D	20,000
5% amount due from E	4,000
4% amount due from F	25,600
5% amount due from others*	37,650
	1,07,250

Calculation of Other Debtors*

Debtor at the beginning	15,00,000
Less: Paid during the year	10,75,000
	4,25,000
Less: Amount due from A, B and C	72,000
	3,53,000
Add: Amount due from G	4,00,000
	7,53,000

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

Date	Particulars	₹	Date	Particulars	₹
2014 Dec.31	To Bad Debt A/c	28,000	2014 Jan.1	To Balance b/f	60,000
"	To Balance c/d	1,07,250	2014 Dec.31	To P & L A/c (balancing figure)	75,250
		1,35,250			1,35,250
			2015 Jan.1	By Balance b/f	1,07,250

Illustration 22

On 31.12.2013, the Trial Balance of G. Gupta contained the following Ledger Balances:

Provision for Bad and Doubtful Account (1.1.2013) was ₹ 1,000. Provision for Discount on Debtors Account (1.1.2013) was ₹ 4,750. Sundry Debtors Account was ₹ 40,400 (of the Debtors, ₹ 400 are bad and should be written off).

On 31.12.2014, the Sundry Debtors Account was ₹ 20,500 (of which ₹ 500 are bad and should be written off). It is desired to maintain the Provision for Bad and Doubtful Debts Account at 5% on Sundry Debtors and the Provision for Discount on Debtors at 2.5%. Show by means of Ledger Accounts how the Provision for Bad and Doubtful Debts Account and the Provision for Discount on Debtors Account will appear in the books of G. Gupta for the year 2013 and 2014 and bring down the balance on 1.1.2013.

Solution

In the Books of G. Gupta

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

Date	Particulars	₹	Date	Particulars	₹
2013 Dec.31	To Bad Debts A/c	400	2013 Jan.1	By Balance b/f	1,000
"	To Balance c/d (5% of ₹ 40,000)	2,000	"	By Profit & Loss A/c	1,400
		2,400			2,400

2014 Dec.31	To Bad Debts A/c	500	2014 Jan.1	By Balance b/d	2,000
"	To Profit & Loss A/c	500			
"	To Balance c/d (5% of ₹ 20,000)	1,000			
		2,000			2,000
			2005 Jan.1	By Balance b/d	1,000

Dr. **Provision for Discount on Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013 Dec.31	To Profit & Loss A/c	3,800	2013 Jan.1	By Balance b/f	4,750
"	To Balance c/d (2.5% of ₹ 38,000)	950			
		4,750			4,750
2014 Dec.31	To Profit & Loss A/c	475	2014 Jan.1	By Balance b/d	950
"	To Balance c/d (2.5% of ₹ 19,000)	475			
		950			950
			2015 Jan.1	By Balance b/d	475

Key Points

- A ***reserve*** is an amount of profit set aside until it is needed for some particular purpose.
- ***Reserves*** are generally classified into: (a) Capital Reserves and (b) Revenue Reserves.
- A ***provision*** is a charge against profit for the purpose of providing for any liability or loss.

THEORETICAL QUESTIONS

1. Define the following:
   (a) Reserve; (b) Reserve Fund; (c) Capital Reserve; (d) Specific Reserve; (e) General Reserve; and (f) Secret Reserve.
2. Distinguish between the following:
   (a) Reserves and Provisions; (b) Capital Reserves and Revenue Reserves; (c) General Reserves and Specific Reserves; (d) Reserve and Reserve Fund.
3. Is reserve a charge against profit or an appropriation of profits? Discuss.
4. What do you mean by Provision for Bad and Doubtful Debts? Justify its creation.
5. What are Bad Debts and how are they treated? In this context, explain the way in which provisions are created for such a contingency.
6. Why should provisions for discounts be provided for? Explain fully its working.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below.

1. The term 'provision' is generally used to indicate known :
   A depreciation
   B losses
   C none of these
2. Reserves are the items of :
   A current liabilities
   B owners' equity
   C none of these
3. Reserves arise from capital receipts are known as :
   A capital reserve
   B reserve fund
   C none of these
4. Provisions are :
   A external transactions
   B internal transactions
   C none of these.

5. Reserves that are created are mostly :
   A general
   B specific
   C none of these.
6. Goods are sold on credit to —
   A known customers
   B unknown customers
   C employees.

PRACTICAL QUESTIONS

1. On 1.1.2012 M/s A & Co had a provision for bad debts of ₹ 10,880. The bad debts during the year 2012 amounted to ₹ 9,040. The debtors as at 31.12.2012 were ₹ 2,24,000. Provision for bad debts @ 5% is maintained by the business. Bad debts during 2013 and 2014 were ₹ 11,680 and ₹ 4,160 respectively. The sundry debtors as at 31.12.2013 and 31.12.2014 were ₹ 2,88,000 and ₹ 1,36,000 respectively.

   Prepare necessary Ledger Accounts in the books of M/s A & Co. Also show how these would appear in the Profit and Loss Account and Balance Sheet for the year 2012 to 2014.
2. A provision for bad and doubtful debts, equal to five per cent of debtors, is created every year-end by a business concern. From the particulars given below, write up the Provision for Bad and Doubtful Debts Accounts for five consecutive years, assuming that accumulated bad debts are, for their necessary adjustment, transferred to the said provision account each year before the new provision is made for the next year: Balance extracted from the Trial Balance:

Years	1st	2nd	3rd	4th	5th
Sundry Debtors (₹)	45,000	48,500	56,800	62,000	58,400
Bad Debts written off (₹)	1,800	2,000	4,000	2,700	2,800
Past Bad Debts recovered (₹)	—	—	—	520	—
Closing Adjustments : Bad Debts written off (₹)	200	140	420	260	300

   Balance of the Provision for Bad and Doubtful Debts Account at the beginning of the 1st year was ₹ 2,500.
3. Docks Limited, a window replacement company, offers fairly generous credit terms to its high risk customers. Provision is made for bad debts at a varying percentage based on the level of outstanding trade debtors, and an assessment of general economic circumstances, resulting in the following data for the last three accounting periods:

Year to 31st March	2012	2013	2014
Trade Debtors at the year end (before allowing for any bad debts) (₹)	1,86,680	1,41,200	2,06,200
Estimated Bad Debts (companies in liquidation) (₹)	1,680	1,200	6,200
Provision for Bad Debts	10%	12.5%	15%

   The provision for Bad Debts at 1st April, 2011 amounted to ₹ 13,000.

   Required:

   (a) Prepare the Provision for Bad Debts Account for each of the three years to 31st March 2012, 2013 and 2014 respectively, showing how the balances would appear on the Balance Sheets at these dates.

   (b) Assuming that a debt of ₹ 1,000 written off as bad in 2012 was subsequently recovered in cash in 2013, state briefly how this would have affected the profit for the year to 31st March, 2012, and also how it would be treated in the accounts for the year to 31st March, 2013.
4. Certain Balances in a company's ledger at 30th June, 2014 were: (all figures in rupees)

   Debtors—20,000; Provision for bad debts—1,000; Stock of coke—630; Electricity accrued—920.

During the year to 30th June, 2015 the following transaction occurred:	₹
Sales on credit	2,00,000
Cash received from Debtors	1,93,000
Certain debtors became bankrupt, and their debts were written off against the provision	3,000
Certain debts which had been written off as bad in previous years were recovered in cash and transferred to the provision	1,000
Purchases of coke	8,000
Payments for electricity for the year ended 30th April, 2015	6,000

   At 30th June, 2015, the stock of coke was valued at ₹ 750, and the provision for bad debts was adjusted to be equal to 5% of the Debtors. On 6th August, 2015, the Company paid its electricity account of ₹ 1,010 for the quarter ended 31st July, 2015.

   You are required to show the debtors and provision for bad debts accounts in the company's Ledger for the year ended 30th June, 2015.

5. Theta Ltd. in a business which acts as a distributor of washing machines entirely on credit term to a wide range of customers. The following balances were extracted from its ledgers at 30th June, 2015: (all figures in ₹)

Sales	7,23,869	Cash received from debtors	6,88,267
Creditors – Balance at 30th June, 2014	49,781	Cash paid to creditors	3,21,853
Debtors – Balance at 30th June, 2014	84,611	Returns inwards	36,925
Purchases of washing machines	3,42,916	Carriage outwards	5,264
Discounts allowed	8,214	Overdraft interest	12,748
Discounts received	6,978	Provision for Doubtful debts as on 30.6.2014	4,813

Subsequent enquiries reveal the following information:

A cheque for ₹ 1,246 from A. Brown, a customer, has been returned by the bank marked 'refer to drawer'. Bad Debts totalling ₹ 6,854 are to be written off, and the provision for doubtful debts is to be raised to 8% of the debtor balances at 30th June, 2015. On the last day of the year a cheque is received for ₹ 1,000 from the liquidator of J. Smith Ltd. This customer had owed Theta Ltd ₹ 7,500 when it ceased to trade in March 2012, and the debt had been written off as a bad debt in the year ended 30th June, 2014. No entry in respect of this cheque has yet been made in the books.

You are required to write up for the year ended 30th June, 2015: (a) The Sundry Debtors Account; (b) The Provision for Bad and Doubtful Debts Account; and, (c) Show the Balance Sheet entry for debtors as at that date.

6. X Company Ltd maintains provisions for bad debts at 5% and a provision for discounts at 2.5%. The company also maintains a reserve for discounts on creditors at 2%.

From the following particulars, write up the Provision Accounts : (a) Provision for Bad Debts—₹ 10,000; (b) Provision for Discount on Debtors—₹ 5,000; (c) Reserve for Discount on Creditors—₹ 4,000.

Total Debtors as on 31.12.2013 were ₹ 2,40,000 after writing off bad debts ₹ 6,000 and allowing discount ₹ 2,000. On 31.12.2014, the total Debtors were ₹ 2,00,000 after writing off bad debts ₹ 1,000 and allowing discounts ₹ 500.

The creditors as on 31.12.2013 and 31.12.2014 were ₹ 1,00,000 and ₹ 1,50,000 respectively. Discount received during each of the years amounted to ₹ 500, ₹ 3,000 respectively.

7. The following details as to bad and doubtful debts are extracted from the books of the Nellore Co. Ltd:

December 31, 2012 – Bad debts to be written off: Chandu ₹ 60; Ehsan ₹ 95; both being totally irrecoverable. Five per cent is to be provided for bad and doubtful debts on ₹ 1,100 that being the total amount owing by the debtors then outstanding.

December 31, 2013 – Five per cent is to be provided for bad and doubtful debt ₹ 2,500, that being the total amount owing by the debtors then outstanding.

December 31, 2014 – Bad debts to be written off : Ganesh ₹ 60; Lodha ₹ 50; Five per cent is to be provided for bad and doubtful debts on ₹ 1,500 that being the total amount owing by the debtors then outstanding.

You are required to show the Ledger entries involved in the following accounts:
(a) Bad Debts Account; and (b) The Provision for Bad and Doubtful Debts Accounts.

8. The firm had the following balances on January 1, 2013 : (a) Provision for Bad and Doubtful Debts—₹ 2,500; (b) Provision for Discount on Debtors—₹ 1,200; and, (c) Reserve for Discount on Creditors—₹ 1,000

During the year, bad debts amounted to ₹ 2,000, discount allowed were ₹ 100 and discount received were ₹ 200. During 2014 bad debts amounting to ₹ 1,000 were written off while discount allowed and received were ₹ 2,000 and ₹ 500 respectively. Total Debtors on December 31, 2013 were ₹ 48,000 before writing off bad debts but after allowing discounts. On December 31, 2014, the amount was ₹ 19,000 after writing off the bad debts but before allowing discounts. Total creditors of these two dates were ₹ 20,000 and ₹ 25,000 respectively.

It is the firm's policy to maintain a provision of 5% against bad and doubtful debts and 2% for discount on debtors and a reserve for discount on creditors @ 3%. Show : (a) Provision for Bad and Doubtful Debts Account; (b) Provision for Discount on Debtors Account; and (c) Reserve for Discount on Creditors Account.

9. On 1.1.2012 the Provision for Doubtful Debts Account in the books of S. Soman, stood at ₹ 1,200 and the Provision for Discount on Debtors Account at ₹ 150.

On 31.12.2012, the Sundry Debtors were ₹ 20,400 of which ₹ 400 are bad and are to be written off. The discount allowed to Debtors during 2012 were ₹ 300.

On 31.12.2013, the Sundry Debtors were ₹ 10,100 of which ₹ 100 are bad and to be written off. The discount allowed to debtors during 2013, were ₹ 50. On 31.12.2014 the Sundry Debtors were ₹ 36,200 of which ₹ 200 are bad and are to be written off. The discount allowed to Debtors during 2014 was ₹ 50.

It is desired to maintain aprovision for doubtful debts at 5% on Sundry Debtors and a provision for discount on debtors at 2% on Debtors. Show how the Provision for Doubtful Debts Account and the Provision for Discount on Debtors Account would appear in the ledger of S .Soman for the year 2012, 2013 and 2014, bringing down the balance on 1.1.2015.

10. A Company maintains its Provision for Bad Debts @ 5% and Provision for Discount on Debtors @ 2%. You are given the following details:

Year	2013	2014
Bad Debts (₹)	800	1,500
Discount Allowed (₹)	1,200	500
Recovery of Bad Debts written off in earlier years (₹)	500	300

Sundry Debtors (before writing off Bad Debts and Discounts) amounted to ₹ 60,000 on 31st December, 2013, and ₹ 42,000 on 31st December, 2014. On 1st January, 2013, Provision for Bad Debts and Provision for Discount on Debtors had balances of ₹ 4,550 and ₹ 800 respectively. Show the Provision for Bad Debts Account and Provision for Discount on Debtors Account for 2013 and 2014.

11. A trader maintained Provision for Doubtful Debts @ 5%; a Provision for Discount @ 2% on Debtors; and Reserve for Discount @ 2% on Creditors, which on 1st January, 2013 stood at ₹ 1,500, ₹ 500 and ₹ 400 respectively. His balances on 31.12.2013 and on 31.12.2014 were: (all figures in ₹)

	31.12.2013	31.12.2014
Bad Debts written off	1,800	300
Discount allowed	600	200
Sundry Debtors	20,000	6,000
Discount received	300	50
Sundry Creditors	15,000	10,000

Show necessary accounts in the ledger.

Guide to Answers

Multiple Choice

1. A; 2. B; 3. A; 4. B; 5. A; 6. A.

Practical Questions

1. **2012 : Amount charged to Profit and Loss Account—bad debts ₹ 9,040 and provision for bad debts—₹ 320. Net balance of debtors in Balance Sheet—₹ 2,12,800. 2013 : Amount charged to Profit and Loss Account—bad debts ₹ 11,680 and provision for bad debts—₹ 3,200; Net balance of debtors in Balance Sheet—₹ 2,73,600. 2014 : Amount charged to Profit and Loss Account—bad debts ₹ 4,160; Amount credited to Profit and Loss Account in respect of excess provision—₹ 7,600; Net balance of debtors in Balance Sheet—₹ 1,29,200.**
2. **Provision for bad and doubtful debts debited to Profit and Loss Account : 1st year—₹ 1,740; 2nd year—₹ 2,318; 3rd year—₹ 4,821; 4th year—₹ 2,708 (after crediting ₹ 520 for bad debt recovery); 5th year—₹ 2,918.**
3. **(a) (i) Provision for bad debts debited to Profit and Loss Account of: 2012—₹ 7,180; 2013—₹ 200; 2014—₹ 18,700**
   (ii) Balance of Debtors in Balance Sheet : ₹ 1,86,680 less ₹ 1,680 less ₹ 18,500 = ₹ 1,66,500 in 2012; ₹ 1,41,200 less ₹ 1,200 less ₹ 17,500 = ₹ 1,22,500 in 2013; ₹ 2,06,200 less ₹ 6,200 less ₹ 30,000 = ₹ 1,70,000 in 2014. (b) By charging bad debts of ₹ 1,000 in 2012, the profit would have been reduced by ₹ 1,000. It is better to credit the bad debt recovered in 2013 to the provision for Bad Debts Account in 2013, alternatively it can be credited to Profit and Loss Account of 2013 also.
4. **Balance of Sundry Debtors on 30th June 2014 ₹ 24,000; provision for bad debts debited to Profit and Loss Account ₹ 2,200 (after adjusting ₹ 1,000 bad debts recovery).**
5. **Balance of Sundry Debtor on 30th June 2014: ₹ 69,466; Provision for Doubtful Debts debited to Profit and Loss Account ₹ 6,598 (after adjusting ₹ 1,000 bad debts recovery).**
6. **In 2013: Profit and Loss Account is debited by ₹ 8,000 for provision for bad debts; by 2,700 for provision for discount on debtors and by ₹ 1,500 for reserve for discount on creditors; In 2014: Profit and Loss Account is credited by ₹ 1,000 for provision for bad debts; by ₹ 450 for provision for discount on debtors and by ₹ 4,000 for reserve for discount on creditors.**
7. **In 2012: Profit and Loss Account is debited by ₹ 155 for bad debts and by ₹ 55 for provisions for bad debts; In 2013: Profit and Loss Account is debited by ₹ 70 for provision for bad debts only; In 2014: Profit and Loss Account is debited by ₹ 60 for provision for bad debt.**
8. **In 2013: Profit and Loss Account is debited by ₹ 1,800 for provision for bad debts and by ₹ 200 for reserve for discount on creditors. Profit and Loss Account is credited by ₹ 226 for provision for discount on debtors; In 2014: Profit and Loss Account is debited by ₹ 1,449 for Provision for discount on debtors; Profit and Loss Account is credited by ₹ 450 for provision for bad debts and by ₹ 650 for reserve for discount on creditors.**
9. **In 2012 : Profit and Loss Account is debited by ₹ 200 for Provision for Doubtful Debts and by ₹ 530 for Provision for Discount on Debtors. In 2013 : Profit and Loss Account is credited by ₹ 400 for Provision for Doubtful Debts and ₹ 140 for Provision for Discount on Debtors. In 2014 : Profit and Loss Account is debited by ₹ 1,500 for Provision for Doubtful Debts and ₹ 544 for Provision for Discount on Debtors.**
10. **2013 : Provision for bad debts credited to Profit and Loss Account ₹ 850; Bad debts recovery credited to Profit and Loss Account ₹ 500. 2014 : Provision for bad debts debited to Profit and Loss Account ₹ 600; Bad debts recovery debited to Profit and Loss Account ₹ 300.**
11. **2013 : Provision for bad debts debited to Profit and Loss Account ₹ 1,300;**
    2014 : Provision for bad debts credited to Profit and Loss Account ₹ 400.

12

Capital and Revenue

Capital and Revenue — Income and Expenditure

Meaning of Capital Expenditure

Capital expenditure is the money spent on buying fixed assets or adding to their value. These assets are expected to provide benefits to the business for more than one accounting period. Purchase of land or cost of extentions of existing building are examples of capital expenditure.

Capital expenditure is debited to a fixed asset account which appears on the Balance Sheet. Therefore, it is an expenditure on assets which is not written off completely against income in the accounting period in which it is incurred. A capital expenditure has the following characteristics :

(1) The amount involved in such an expenditure is generally large;
(2) The benefit accruing from such an expenditure is available for more than one accounting period;
(3) The expenditure is of non-recurring nature.
(4) It results in an increase in the value of fixed assets already possessed (for example development of property).

Meaning of Revenue Expenditure

Any form of income is called revenue, but, the term 'revenue' refers to either income or expenditure. Revenue income implies profit, whereas revenue expenditure is the money spent on running the business on a day-to-day basis. Salaries paid to the employees and payment for miscellaneous expenses are the examples of revenue expenditure. Therefore, a revenue expenditure is incurred to carry on the normal course of business and maintain the fixed assets in good condition. Since a revenue expenditure is of benefit for the current accounting period only, it is debited to an expense account which is ultimately transferred to the Trading Account or Profit and Loss Account.

A revenue expenditure has the following characteristics :

(1) The amount involved in such an expenditure is relatively small;
(2) The benefit accruing from such an expenditure is available for one accounting period only;
(3) The expenditure is of recurring nature.
(4) It is incurred in pursuance of trading activities.

Necessity for Distinction Between Capital Expenditure and Revenue Expenditure

The distinction between capital expenditure and revenue expenditure is necessary, because of the following :

1. The distinction affects the measurement of profit in a number of accounting periods.
2. The distinction also affects the valuation of assets in the Balance Sheet.
3. Capital expenditure results in the acquisition of fixed assets, whereas revenue expenditure represents the expenses incurred in the business.
4. Accrual basis of accounting requires a clear distinction between capital and revenue expenditure.
5. The accounting treatment of capital expenditure and revenue expenditure is different.
6. Capital expenditures appear in the Balance Sheet as an asset, whereas revenue expenditures appear in the Profit and Loss Account as expenses.
7. Most of the capital expenditures of a business become revenue expenditures (for example, charging of depreciation on fixed assets).
8. Some revenue expenditures eventually become a capital expenditure (for example, heavy advertisement expenses carried forward to next period).
9. Capital expenditure increases the revenue earning capacity of the business. But revenue expenditure maintains that.
10. Capital expenditure may add to the value of an existing asset, while the revenue expenditure can decrease the value of net assets.

Distinction Between Capital Expenditure and Revenue Expenditure

	Capital Expenditure		Revenue Expenditure
1.	It is the outflow of money to acquire fixed assets of a business or adding to their value.	1.	It is the outflow of money to meet running expenses of a business.
2.	It is always an external transaction.	2.	It may be internal (e.g., depreciation) or external transaction.
3.	It is debited to an asset account.	3.	It is debited to an expense account.
4.	It is a real account.	4.	It is a nominal account.
5.	It is incurred for more than one accounting period.	5.	It is incurred for a particular accounting period.
6.	It finds a place in the Balance Sheet.	6.	It finds a place in the Trading Account or Profit and Loss Account.
7.	It is of non-recurring nature.	7.	It is of recurring nature.
8.	All capital expenditures eventually become revenue expenditures.	8.	Revenue expenditures do not generally become capital expenditures.
9.	Capital expenditures are not matched against capital receipts.	9.	All revenue expenditures are matched against revenue receipts.
10.	It does not affect the profit for an accounting period directly.	10.	It directly affects the profit for an accounting period.
11.	It does not affect the net worth of a business.	11.	It directly affects the net worth of a business.
12.	It may be incurred before or after the commencement of the business.	12.	It is always incurred after the commencement of the business.

Rules For Determining Capital Expenditure

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

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

2. When an expenditure is incurred to improve the present condition of an existing fixed asset that enhances its value to the business, e.g., by increasing its capacity, effectiveness or useful life; or putting an old asset into working condition, is recognised as a capital expenditure. The expenditure is capitalised and added to the cost of the asset. Likewise, any expenditure incurred to put an asset into working condition is also a capital expenditure. For example, if one buys a machine for ₹ 5,00,000, and pays ₹ 20,000 as transportation charges and ₹ 40,000 as installation charges, the total cost of the machine comes upto ₹ 5,60,000. Similarly, if a building is purchased for ₹ 1,00,000 and ₹ 5,000 is spent on registration and stamp duty, the capital expenditure on the building stands at ₹ 1,05,000.
3. If an expenditure is incurred, to increase earning capacity of a business, it will be considered as of capital nature. For example, expenditure incurred for shifting the factory for easy supply of raw materials. Here, the cost of such shifting will be a capital expenditure.
4. Wages paid to the firm's own employees engaged on the erection work of a machine or building extention is also capital expenditure and should be debited to the cost of the asset.
5. Preliminary expenses incurred before the commencement of business is considered capital expenditure. For example legal charges paid for drafting the memorandum and articles of association of a company or brokerage paid to brokers, or commission paid to underwriters for raising capital.

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

Examples of Capital Expenditure

(1) Purchase of land, building, machinery or furniture;
(2) Cost of leasehold land and building;
(3) Cost of acquisition of long-term rights and benefits (e.g., patents, copyrights);
(4) Preliminary expenditures;
(5) Cost of additions or extensions to existing assets;
(6) Cost of overhauling second-hand machines;
(7) Expenditure on putting an asset into working condition; and
(8) Cost incurred for increasing the earning capacity of a business.

Rules For Determining Revenue Expenditure

Any expenditure which cannot be recognised as capital expenditure can be termed as revenue expenditure. A revenue expenditure temporarily influences only the profit earning capacity of the business. An expenditure is recognised as revenue when it is incurred for the following purposes:

1. Expenditure for day-to-day conduct of the business, the benefits of which last less than one year. Examples are wages of workmen, interest on borrowed capital, rent, selling expenses, and so on.
2. Expenditure on consumable items, on goods and services for resale either in their original or improved form. Examples are purchases of raw materials, office stationery, and the like. At the end of the year, there may be some revenue items (stock, stationery, etc.) still in hand. These are generally passed over to the next year though they were acquired in the previous year.
3. Expenditures incurred for maintaining fixed assets in working order. For example, repairs, renewals and depreciation.

From the above, we can see that any expenditure which is incurred in the process of earning of the profits is a revenue expenditure. It is incurred to maintain the earning capacity of the business unit including the maintenance of the fixed assets.

It should be noted that revenue expenditure is transferred to the Trading or Profit and Loss Account only to the extent to which goods or services bought have been consumed. For example, the purchase of goods for reale is a revenue expenditure, but only the cost of goods sold is transferred to the Trading Account. Again, the payment of an insurance premium would be revenue expenditure, but only that part of it that had expired would be transferred to the Profit and Loss Account.

Examples of Revenue Expenditure

(1) Salaries and wages paid to the employees;
(2) Rent and rates for the factory or office premises;
(3) Depreciation on plant and machinery;
(4) Consumable stores;
(5) Inventory of raw materials, work-in-progress and finished goods;
(6) Insurance premium; and
(7) Taxes and legal expenses.

Joint Expenditure

Sometimes one item of expenditure will need dividing between capital expenditure and revenue expenditure.

A civil contractor was engaged to tackle some work on building, the total bill being for ₹ 30,000. If two-thirds of this was for improvements and one-third for repair work, ₹ 20,000 should be treated as capital expenditure and, therefore, should be added to the value of the building and shown as such in the Balance Sheet. The balance of ₹ 10,000 should be treated as revenue expenditure and charged to the Profit and Loss Account.

Capitalised Expenditure

To capitalise means to treat expenditure as if it were for the purchase of a fixed asset. Capitalised expenditures represent certain types of revenue expenditures, whose usefulness does not expire in the year of their occurrence. The benefit generally expires in the near future. These types of revenue expenditures are treated as assets on the Balance Sheet. They are written off in future accounting periods by the process of depreciation. If we undertake substantial repairs to the existing building, the deterioration of the premises may be avoided. We may employ our own employees to do that work and pay them at current wage rates, which is of a revenue nature. The benefit of such revenue expenditure will not expire in the current year but it will be enjoyed for a number of accounting years. Therefore, the entire expenditure is added to the asset account and is known as capitalised expenditure. The other examples of capitalised expenditure are wages paid for the installation of machinery, interest paid before the commencement of the business etc.

Capital and Revenue Receipts

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

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

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

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

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

Sl. No.	Capital Receipts	Sl. No.	Revenue Receipts
1.	Capital receipts are not available for distribution as profits.	1.	Revenue receipts are available for distribution as profits only after deducting revenue expenses.
2.	Capital receipts cannot be utilised for creating a reserve fund.	2.	Revenue receipts can be utilised for creating a reserve fund after deducting revenue expenses.

3.	A business can survive without any capital receipts during an accounting period.	3.	The survival of a business mainly depends on the revenue receipts during an accounting period.
4.	Capital receipts are the sources for creating capital reserves.	4.	Revenue receipts are the sources for creating revenue reserves.

Capital and Revenue Profits

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

Generally, capital profits arise out of the sale of assets other than inventory at a price more than its book value or in connection with the raising of capital or at the time of purchasing an existing business. For example, if an asset, whose book value is ₹ 5,000 on the date of sale, is sold for ₹ 6,000—₹ 1,000 will be considered as capital profit. Likewise, issue of shares at a premium is also a capital profit. Revenue profits are distributed to the owners of the business or transferred to General Reserve Account, being shown in the balance sheet as a retained earning. Capital profits are generally capitalised—transferred to a capital reserve account which can only be utilised for setting off capital losses in future. Capital profits of a small amount (arising out of selling of one asset) is taken to the Profit and Loss Account and added with the revenue profit—*applying the concept of materiality.*

Capital and Revenue Losses

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

Illustration 1

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

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

Solution

(i) Carriage of ₹ 7,500 paid for machinery purchased and installed should be treated as a ***Capital Expenditure***.
(ii) Advertising expenses for launching a new product of the company should be treated as a ***Deferred Revenue Expenditure***.
(iii) ₹ 250 paid for servicing and oil change should be treated as a ***Revenue Expenditure***.
(iv) Construction cost of basement should be treated as a ***Capital Expenditure***.

Illustration 2

State whether the following are capital or revenue expenditure.

(i) Paid a bill of ₹ 10,000 of Mr. Kumar, who was engaged as the erection engineer to set up a new automatic machine costing ₹ 20,000 at the new factory site.

(ii) Incurred ₹ 26,000 expenditure on varied advertisement campaigns undertaken yearly, on a regular basis, during the peak festival season.

(iii) In accordance with the long-term plan of providing a well- equipped Labour Welfare Centre, spent ₹ 90,000 being the budgeted allocation for the year 2010.

Solution

(i) Expenses incurred for erecting a new machine should be treated as a ***Capital Expenditure***.
(ii) Advertisement expenses during peak festival season should be treated as a ***Revenue Expenditure***.
(iii) Expenses incurred for Labour Welfare Centre should be treated as a ***Capital Expenditure***.

Illustration 3

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

Solution

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

Illustration 4

For each of the cases numbered (i) to (iv) below, indicate whether the income/expenditure is ***capital*** or ***revenue***.

(i) Payment of wages to one's own employees for building a new office extension.
(ii) Regular hiring of computer time for the preparation of the firm's accounts.
(iii) The purchase of a new computer for use in the business.
(iv) The use of motor vehicle, hired for five years, but paid at every six months.

Solution

(i) Payment of wages for building a new office extension should be treated as a ***Capital Expenditure***.
(ii) Computer hire charges should be treated as a ***Revenue Expenditure***.
(iii) Purchase of computer for use in the business should be treated as a ***Capital Expenditure***.
(iv) Hire charges of motor vehicle should be treated as a ***Revenue Expenditure***.

Illustration 5

State with reasons whether the following are capital or revenue expenditure:

(1) Freight and cartage on the new machine ₹ 150, and erection charges ₹ 500.
(2) Fixtures of the book value of ₹ 2,500 sold off at ₹ 1,600 and new fixtures of the value of ₹ 4,000 were acquired, cartage on purchase ₹ 5.
(3) A sum of ₹ 400 was spent on painting the factory.
(4) ₹ 8,200 spent on repairs before using a second hand car purchased recently, to put it in usable condition.

Solution

(1) Freight and cartage totalling ₹ 650 should be treated as a ***Capital Expenditure*** because it will benefit the business for more than one accounting year.
(2) Loss on sale of fixtures ₹ (2,500 – 1,600) = ₹ 900 should be treated as a ***Capital Loss***. The cost of new fixtures and carriage thereon should be treated as a ***Capital Expenditure*** because the fixture will be used for a long period.
(3) Painting of the factory should be treated as a Revenue Expenditure because it has been incurred to maintain the factory building.
(4) Repairing cost of second hand car should be treated as a ***Capital Expenditure*** because it will benefit the business for more than one accounting year.

Illustration 6

State the nature (capital or revenue) of the following expenditure which were incurred by Harikishore & Co. during the year ending 30th June, 2010:

(i) ₹ 350 was spent on repairing a second hand machine which was purchased on 8th July, 2009 and ₹ 200 was paid on carriage and freight in connection with its acquisition.
(ii) A sum of ₹ 500 was paid as compensation to two employees who were retrenched.
(iii) ₹ 150 was paid in connection with carriage on goods purchased.
(iv) ₹ 20,000 customs duty is paid on import of a machinery for modernisation of the factory production during the current year and ₹ 6,000 is paid on import duty for purchase of raw materials.
(v) ₹ 18,000 interest had accrued during the year on term loan obtained and utilised for the construction of factory building and purchase of machineries; however, the production has not commenced till the last date of the accounting year.

Solution

(i) Repairing and carriage totalling ₹ 550 for second hand machine should be treated as a ***Capital Expenditure***.
(ii) Compensation paid to employees shall be treated as a ***Revenue Expenditure***.
(iii) Carriage paid for goods purchased should be treated as a ***Revenue Expenditure***.
(iv) Customs duty paid on import of a machinery should be treated as a ***Capital Expenditure***. However, import duty paid for raw materials should be treated as a ***Revenue Expenditure***.
(v) Interest paid during pre-construction period should be treated as a ***Capital Expenditure***.

Illustration 7

State with reasons whether the following items relating to Sitalpur Sugar Mill Ltd. are capital or revenue:

1. A truck costing ₹ 1,00,000 and standing in the books at ₹ 60,000 was sold for ₹ 70,000.
2. ₹ 50,000 received from issue of shares including ₹ 10,000 by way of premium.
3. Purchased agricultural land for the mill for ₹ 60,000. ₹ 500 also paid for land revenue.
4. ₹ 5,000 paid as contribution to PWD for improving roads of sugar producing area.
5. ₹ 40,000 paid for exise duty on sugar manufactured.
6. ₹ 70,000 spent for constructing railway siding.

Solution

(i) Profit on sale of truck ₹ 10,000 should be treated as a ***Capital Profit.***
(ii) ₹ 40,000 (₹ 50,000 – ₹ 10,000) received from issue of shares will be treated as a ***Capital Receipt***. The premium of ₹ 10,000 should be treated as a ***Capital Profit.***
(iii) Cost of land ₹ 60,000 will be treated as a ***Capital Expenditure*** and land revenue of ₹ 500 will be treated as a ***Revenue Expenditure.***
(iv) Contribution paid to PWD should be treated as a ***Revenue Expenditure.***
(v) Excise duty of ₹ 40,000 should be treated as a ***Revenue Expenditure.***
(vi) ₹ 70,000 spent for constructing railway siding should be treated as a ***Capital Expenditure.***

Illustration 8

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

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

Solution

(i) ₹ 10,000 incurred in connection with obtaining a licence for starting the factory is a ***Capital Expenditure***. It is incurred for acquiring a right to carry on business for a long period.
(ii) ₹ 1,000 incurred for removal of stock to a new site is treated as a ***Revenue Expenditure*** because it is not enhancing the value of the asset and it is also required for starting the business on the new site.
(iii) ₹ 5,000 incurred for changing Rings and Pistons of an engine is a ***Revenue Expenditure*** because, the change of rings and piston will restore the efficiency of the engine only and it will not add anything to the capacity of the engine.
(iv) ₹ 2,000 incurred for defending the title to the firm's assets is a ***Revenue Expenditure***.
(v) ₹ 10,000 incurred on advertising is to be treated as a ***Deferred Revenue Expenditure*** because the benefit of advertisement is available for 4 years, ₹ 2,500 is to be written off every year.
(vi) Cost of construction of Factory shed of ₹ 1,00,000 is a ***Capital Expenditure***, similarly cost of construction of small huts for storing building materials is also a ***Capital Expenditure***.

Key Points

- **Capital expenditure** is the money spent on buying fixed assets or adding to their value.
- A **revenue expenditure** is incurred to carry on the normal course of business and maintain the fixed assets in good condition.
- A receipt of money is considered as **capital receipt** when a contribution is made by the proprietor towards the capital of the business or a contribution of capital to the business by someone outside the business.
- A receipt of money is considered as **revenue receipt** when it is received from customers for goods supplied, or fees received for services rendered in the ordinary course of business, which is a result of the firm's activity in the current period.

THEORETICAL QUESTIONS

1. Explain the basic principles which would guide you in allocating expenditure as between capital & revenue. Illustrate your answer with example.
2. Define capital expenditure, revenue expenditure and deferred revenue expenditure.
3. Distinguish between capital expenditure and revenue expenditure.
4. Distinguish between capital receipts and revenue receipts.

PRACTICAL QUESTIONS

1. Classify the following between Capital and Revenue giving reasons for the same:
   (a) ₹ 10,000 spent towards additions to the machinery.
   (b) Repairs for ₹ 2,000 necessitated by negligence.
   (c) ₹ 1,500 spent to remove a worn-out part and replace it with a new one.
   (d) ₹ 400 wages paid in connection with the erection of a new machinery.
   (e) Old machinery of book value of ₹ 10,000 wornout, dismantled at a cost of ₹ 2,000 and scraps realised for ₹ 500.
   (f) Second hand motor-car purchased for ₹ 20,000 and spent ₹ 2,000 for repairs immediately.
   (g) Employees' State Insurance premium ₹ 800 paid.
   (h) Insurance claim of ₹ 5,000 received from the Insurance Company for loss of goods by fire of ₹ 6,000.
2. State which of the following items whould be charged to capital and which to revenue:
   (i) A second-hand truck was purchased for ₹ 50,000 and ₹ 12,000 was spent on overhauling and painting it.
   (ii) ₹ 10,000 was spent for whitewashing the factory building.
   (iii) An old machine which stood in the books at ₹ 50,000 was sold for ₹ 30,000.
   (iv) Wages paid to workmen for installation of a new machinery ₹ 10,000.
   (v) Legal expenses ₹ 5,000 incurred for purchasing a land.
3. The Swadeshi Industries removed their works to more suitable premises:
   (a) A sum of ₹ 4,750 was expended on dismantling, removing and reinstalling plant, machinery and fixtures.
   (b) The removal of stock from the old works to the new one costs ₹ 500.
   (c) Plant and machinery which stood in the books at ₹ 75,000 included a machine at a book value of ₹ 1,700. This being obsolete was sold off at ₹ 450 and was replaced by a new machine which cost ₹ 2,400.
   (d) The freight and cartage on the new machine amounted to ₹ 150 and the erection charge cost ₹ 275.
   (e) The fixtures and furniture appeared in the books at ₹ 7,500. Of these, some portion of the book value of ₹ 1,500 was discarded and sold off at ₹ 600 and new furniture of the value of ₹ 1,200 was acquired.
   (f) A sum of ₹ 1,100 was spent on painting the new factory. State which items of expenditure would be charged to Capital and which to Revenue.

Guide to Answers

1. **(a) Capital expenditure; (b) Revenue expenditure; (c) Revenue expenditure; (d) Capital expenditure; (e) ₹ 10,000 capital loss; and ₹ 2,000 – ₹ 500 = ₹ 1,500 should be treated as revenue expenses; (f) Capital expenditure; (g) Revenue receipt.**
2. **(i) Capital expenditure ₹ 50,000 + ₹ 12,000 = ₹ 62,000. (ii) Revenue expenditure. (iii) ₹ 50,000 – ₹ 30,000 = ₹ 20,000 should be treated as capital loss. (iv) Capital expenditure. (v) Capital expenditure.**
3. **(a) Capital Expenditure; (b) Revenue Expenditure; (c) Capital Expenditure; (d) Capital Expenditure; (e) ₹ 900 Capital Loss; ₹ 1,200 Capital Expenditure; (f) Capital Expenditure.**

13

Revenue Recognition

Introduction

Determination of profit is influenced by the revenue recognition policy of the enterprise. In principle, revenue can be recognised at the point of sale or when cash is collected or at any intermediate point. The amount of revenue arising on a transaction is usually determined by agreement between the parties involved in the transaction. Revenue recognition is mainly concerned with the timing of recognition of revenue in the statement of profit and loss. When uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

Objectives of Revenue Recognition

The main objectives of revenue recognition are :

1. The determination of correct profit for the accounting period.
2. To reduce the confusion of the users of the accounting information regarding the profit earning capacity of the enterprise.
3. It helps to design proper internal control system which can prevent financial abuses by the CEOs /CFOs.
4. It brings transparency and truthfulness in reporting transactions.

Many international accounting scandals in the recent past was due to ***revenue manipulation***. Some of those are given below :

Sl.No.	Name of the Company	Alleged Accounting Abuses
1.	Fannie Mae	Inflated income
2.	AOL Time Warner	Inflated revenues and income
3.	Xerox	Inflated income
4.	Qwest Communications	Inflated revenues and income.
5.	Bristol-Myers Squibb	Inflated revenues and income.
6.	Nortel Networks	Understated expenses to inflate income.
7.	Halliburton	Inflated revenues and income.
8.	Global Crossing	Inflated revenues and income.
9.	Satyam Computers	Inflated revenues and income

It is clear from the above list that revenue recognition is very vital for the reliability of the profit disclosed by the companies in their Profit and Loss Account.

The Institute of Chartered Accountants of India has issued AS – 9 : 'Revenue Recognition' for this purpose.

Accounting Standard [AS–9 : 'Revenue Recognition']

Scope

This Statement does not deal with the following aspects of revenue recognition to which special consideration apply:

(i) revenue arising from construction contracts (subject matter of AS–7);
(ii) revenue arising from hire-purchase, lease agreements (subject matter of AS–19);
(iii) revenue arising from government grants and other similar subsidies (subject matter of AS–12); and
(iv) revenue of insurance companies arising from insurance contracts.

Definitions

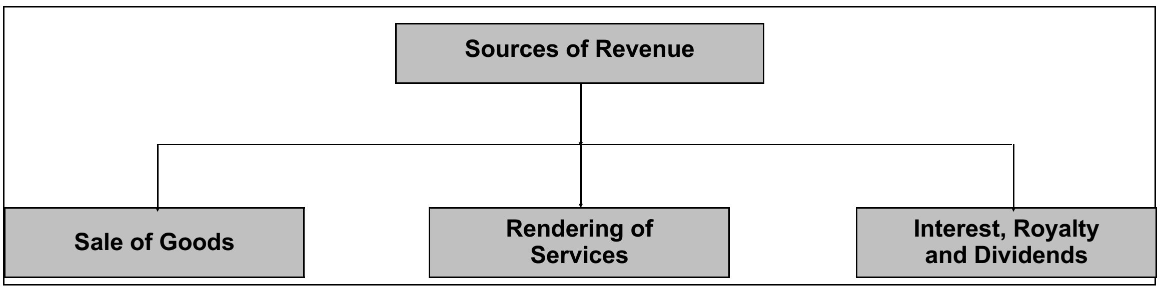
Revenue : Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends. Revenue is measured by the ***charges made to customers*** or ***clients*** for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration.

Completed Service Contract Method : Completed service contract method is a method of accounting which recognises revenue in the statement of profit and loss only when the rendering of services under a contract is completed or substantially completed.

Proportionate Completion Method : Proportionate completion method is a method of accounting which recognises revenue in the statement of profit and loss proportionately with the degree of completion of services under a contract.

This statement deals with the basis for recognition of revenue in the Profit and Loss Account of the enterprise. It is concerned with the recognition of revenue arising in the course of the ordinary activities of the enterprise from :

(i) the sale of goods
(ii) the rendering of services
(iii) the use by others of enterprise resources yielding interest, royalties and dividends.



Sale of Goods

Revenue from sale of goods is recognised when all the following conditions have been satisfied :

1. the seller of goods has transferred to the buyer the property in the goods for a price;
2. all significant risks and rewards of ownership have been transferred to the buyers;
3. the seller retains no effective control of the goods transferred to a degree usually associated with ownership;
4. no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

Example 1: Modern Furnitures (P) Ltd. sold a computer table to Ram for ₹ 6,000. Ram paid it by credit card.
Modern Furnitures (P) Ltd. will recognise ₹ 6,000 as revenue immediately.
Example 2 : Computer Point (P) Ltd. sold 10 computers to St. Xavier's College, Kolkata for ₹ 3,00,000 on credit. Here Computer Point will recognise the revenue of ₹ 3,00,000 immediately because normal credit risk derived from sales is not a reason to defer revenue recognition.

Illustration 1

Bottom Ltd. entered into a sale deed for its immovable property before the end of the year. But registration was done with Registrar subsequent to Balance Sheet date. But before finalisation, is it possible to recognise the sale and gain at the Balance Sheet date ?

Solution

According to AS—9 "Revenue Recognition" it is possible for Bottom Ltd. to recognise the sale and gain at the Balance Sheet date. It is clear that the significant risk and rewards of ownership has passed before Balance Sheet date and the registration of the property is merely a formality.

Transfer of Legal Title

It should be noted that the transfer of legal title normally passes the risks and rewards. However, there are certain cases in which risks and rewards do not get transferred to the buyer with the transfer of legal title or passing of possessions.

For example :

1. If the sale of contract allows the goods to be returned and you cannot reasonably estimate the probability of return, the sale should not be recognised until you are sure about the acceptance by the customer.
2. If installation is an important part of the sale, recognition of revenue does not takes place until installation is complete.
3. If the sale is contingent on the buyer deriving revenue from resale of the goods, revenue is recognised at the time of resale only.

Example : In January, 2015 Tata Motors Ltd. supplied 10 Indica cars to its agent, Lexus Motors (P) Ltd. on consignment basis. The selling price was ₹ 4,00,000 each and commission is payable @ 10% on sales. By 31st March, 2015, Lexus Motors sold 5 cars only.
Here, revenue of ₹ 20,00,000 only will be recognised in March 2015.
Sales commission of ₹ 2,00,000 also will be recognised as expense in March 2015.

Illustration 2

How would you deal with the following in the annual accounts of a Company, for the year ended 31.3.2015:

Some of the transport claims, lodged in 2012-13 has been settled by the Carrier in February 2015 by paying ₹ 1.15 lakhs. These claims were not recorded in the books of the Company so far.

Solution

Since the amount has been received, the revenue is measurable. Therefore, the Company should recognise this as revenue in the current year, as part of net income. The Company was correct in not providing for the same as revenue, when the claim was lodged.

Illustration 3

How will you deal with the following:

The Board of Directors decided on 31.3.2015 to increase the sale price of certain items retrospectively from 1.1.2015. In view of this price revision, w.e.f. 1.1.2015, the Company has to receive ₹ 15 lakhs from its customers in respect of sales made from 1.1.2015 to 31.3.2015 and the accountant cannot make up his mind whether to include ₹ 15 lakhs in the sales for 2014-15.

Solution

Recognition of revenue requires that it would not be unreasonable to expect ultimate collection. In other words, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made.

Here, in this case, the additional revenue arising out of price revision can be recognised as revenue in the current year provided there is certainty relating to collectibility.

Illustration 4

TVSM Company has taken a Transit Insurance Policy. Suddenly in the year 2014-15, the percentage of accident has gone up to 7% and the Company wants to recognise insurance claim as revenue in 2014-15 in accordance with relevant accounting standard. Do you agree?

Solution

Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise. As per AS–9, recognition of revenue requires that revenue is measurable and it would not be unreasonable to expect ultimate collection.

Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made.

Another essential criterion for the recognition of revenue is that the consideration receivable is reasonably determinable. When such consideration is not determinable within reasonable limits, the recognition of revenue is postponed.

Therefore, in the present case, the Company should ***postpone the revenue recognition*** as there are uncertainties in the settlement of insurance claim.

Illustration 5

Arjun Ltd. sold farm equipments through its dealers. One of the conditions at the time of sale is, payment of consideration money in 14 days and in the event of delay interest is chargeable @ 15% p.a. The company has not realised interest from the dealers in the past. However, for the year ended 31.3.2015, it wants to recognise interest due on the balances due from dealers. The amount is ascertained at ₹ 9 lakhs. Decide whether the income by way of interest from dealers is eligible for recognition as per As—9 ?

Solution

As per AS—9, recognition of revenue requires that revenue is measurable and it would not be unreasonable to expect ultimate collection.

Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made.

In this case, the company should not recognise ₹ 9 lakhs as interest income for the year ending on 31.3.2015 because there is uncertainty in respect of collection of interest.

The company should postpone the recognition until the collection of interest is made.

Rendering of Services

Revenue from rendering of services should be recognised by referring to the stage of completion at the Balance Sheet date. There are two methods for dealing with this situation :

(i) Proportionate Completion Method; and (ii) Completed Service Contract Method

(i) ***Proportionate Completion Method*** : Performance consists of the execution of more than one act. Revenue is recognised proportionately by reference to the performance of each act. The revenue recognised under this method would be determined on the ***basis of contract value, associated costs, number of acts*** or other suitable basis. For practical purposes, when services are provided by an indeterminate number of acts over a specific period of time, revenue is recognised on a straight line basis over the specific period unless there is evidence that some other method better represents the pattern of performance.

Example : Your company Hindustan Constructing Co. Ltd. (HCCL) is laying a city gas pipe line for its client REL. Total revenue of the project is ₹ 40,00,000.
HCCL has incurred cost up to 31st March, 2015 ₹ 15,00,000 and the company is expecting that ₹ 10,00,000 more will be required to complete the project.
Upto 31st December, 2014 REL has approved ₹ 12,50,000 of expenditure. HCCL is confident that the balance ₹ 2,50,000 (₹ 15,00,000 – ₹ 12,50,000) will be approved by REL when their engineer will inspect the work during the 1st week of April, 2015. No payment has been received so far.
Recognise :
(a) ₹ 12,50,000 as expenses (the amount approved)
(b) ₹ 20,00,000 as (accrued) revenue

$$\frac{12{,}50{,}000}{25{,}00{,}000} \times 40{,}00{,}000$$

(ii) ***Completed Service Contract Method*** : Performance consists of the execution of a single act. Alternatively, services are performed in more than a single act, and the services yet to be performed are so significant in relation to the transaction taken as a whole that performance cannot be deemed to have been completed until the execution of those acts. The completed service contract method is relevant to these patterns of performance and accordingly revenue is recognised when the sole or final act takes place and the service becomes chargeable.

Interest, Royalty and Dividends

Revenue arising from the use by others of enterprise resources yielding interest, royalties and dividends should only be recognised when no significant uncertainty as to measurability or collectibility exists. These revenues are recognised on the following basis:

(i) ***Interest :*** on a time proportion basis taking into account the amount outstanding and the rate applicable;
(ii) ***Royalties :*** on an accrual basis in accordance with the terms of the relevant agreement;
(iii) ***Dividends from Investments in shares :*** when the owner's right to receive payment is established.

Illustration 6

SCL Limited sells agricultural products to dealers. One of the condition of sale is that interest is payable @ 2% p.m. for delayed payment. Percentage of interest recovered is only 10% on such overdue outstanding due to various reasons. During the year 2014-15, the Company wants to recognise the entire interest receivable. Do you agree?

Solution

Revenue arising from the use by others of enterprise resources yielding interest, should only be recognised when no significant uncertainty as to measurability or collectibility exists. Interest is recognised as revenue on the following manner:

On a time proportion basis taking into account the amount outstanding and the rate applicable.

Here, in this case, as the uncertainty arises regarding collectibility of interest. The company should not recognise it as revenue of 2014-15. However, company can recognise it when cash will be received.

Illustration 7

Y Co. Ltd. used certain resources of X Co. Ltd. In return, X Co. Ltd. received ₹ 10 lakhs and ₹ 15 lakhs as interest and royalties respectively from Y Co. Ltd. during the year 2014-15.

You are required to state whether and on what basis these revenues can be recognised by X Co. Ltd.

Solution

Revenue is measured by the charges made to customers for the use of resources by them. The use by others of such enterprise resources gives rise to —

(i) **Interest —** charges for the use of cash resources or amounts due to the enterprise.

Interest accrues, in most circumstances, on the time basis determined by the amount outstanding and the rate applicable.

(ii) **Royalties —** charges for the use of such assets as know-how, patents, trade marks and copyrights.

Royalties accrue in accordance with the terms of the relevant agreement and are usually recognised on that basis unless, having regard to the substance of the transactions, it is more appropriate to recognise revenue on some other systematic and rational basis.

Here, X & Co. Ltd. should recognise ₹ 25 lakhs as revenue for the year 2014-15.

Disclosure

In addition to the disclosure required by Accounting Standard 1 on ***Disclosure of Accounting Policies*** (AS-1), an enterprise also has to disclose the circumstances in which revenue recognition has been postponed pending the resolution of significant uncertainties.

Specific Examples

Sale of Goods

1. **Delivery is delayed at buyer's request and buyer takes title and accepts billing**

In this case, revenue should be recognised though the physical delivery has not been done. However, the following conditions must be satisfied :

(i) the item must be on hand and (ii) the item is identified and ready for delivery

Example : Your company PP Ltd. is about to deliver the boiler to its client CESC Ltd. The site of the client is not yet ready for strike by the casual labours. CESC Ltd. requested PP Ltd. to hold the boiler at their risk until the site is ready.
The revenue is recognised immediately as the title to the goods and risk has passed to CESC Ltd.

2. **Delivered subject to Conditions**

(a) ***Installation and Inspection***: If the contract specifies delivery, installation and inspection, all must be completed to recognise revenue.

Example : HMT Ltd. sold a printing press to Swapna Printers Ltd. for ₹ 50,00,000. As per contract, the payment will be made only after successful installation and trial run. Revenue will not be recognised unless the installation and trial run has been done up to the satisfaction of the customer.

If the installation is very simple, revenue may be recognised on delivery.

Example : Your company, Sony India (P) Ltd. sells colour television to different customers through retail chain "Sony World". All televisions are factory tested. For installation, it requires unpacking and connecting to power plug and dish antennae cables.
Revenue can be recognised at the time of delivery only.

(b) ***On approval*** : Revenue is recognised if the goods have been formally accepted by the buyer or the buyer has done an act adopting the transaction or the time period for rejection has passed or where no time has been fixed, a reasonable time has been passed.

Example : Your company, "Modern Toys" sell electronic toys to retailers. Written communication must be made within 15 days.
After 15 days, if nothing has been rejected the revenue can be recognised.

(c) ***Guaranteed sales, i.e., delivery is made by giving the buyer an unlimited right of return*** : Recognition of revenue in such circumstances will depend on the substance of the agreement. In the case of retail sales offering a guarantee of "money back if not completely satisfied" it may be appropriate to recognise the sale but to make a suitable provision for returns based on previous experience.

(d) ***Consignment Sales***: Revenue should not be recognised until the goods are sold to a third party.

(e) ***Cash-on-delivery sale***: Revenue is recognised when delivery is complete and cash has been received by the seller or his agent.

Example : Your company "Amazon.com" sell books via internet. Customers can pay on receipt of the book. Revenue can be recognised when books have been delivered and cash has been collected by the agent on behalf of the seller.

3. **Payment by Installments followed by Delivery**

Sales where buyer makes a series of installment payments to the seller, and the seller delivers the goods only when the final payment is received.

Revenue is recognised when goods are delivered. However, when experience indicates that most customers pay all of their installments, revenue may be recognised when a significant deposit is received and the goods are ready for delivery.

Example : Your company "Ultra Soft" is developing an accounting software for its client. Price of the software is ₹ 5,00,000. As per contract, a series of payment is to be made with the progress of the work. The software is ready for delivery and so far your company has received 95% of the total price and the balance 5% is expected any time.
Revenue can be recognised fully at present.

4. **Special Order and Shipment**

When payment has been received in advance from customers for goods still to be manufactured or is to be delivered directly to the customer from a third party.

Revenue from such sales should be recognised when the goods have been manufactured, identified and ready for delivery to the buyer by the third party.

5. **Sales and Repurchases of Same Item**

Some items are sold on the condition that it will be repurchased after some time. These transactions are really financing transactions. The ***resulting cash flow will not be treated as revenue***.

Example : Your company, R.K. Securities has sold 1,000 shares of RIL @ ₹ 2,600 to Ganesh in May, 2013 on the condition that all these shares are to be repurchased after 6 months @ ₹ 2,700.
This is basically a finance transaction and no revenue should be recognised.

6. **Sales to Intermediate Parties**

Sometimes goods are sold to distributors, dealers or others for resale.

Revenue from such sales can generally be recognised if significant risks of ownership have passed.

7. **Subscriptions for Publication**

Recognise revenue on a straight line basis over time. If the items delivered vary in value from period to period, revenue should be based on the sales value of the item delivered in relation to the total sales volume of all items covered by the subscription.

8. **Installment Sales**

When the consideration is receivable in installments, revenue attributable to the sale price exclusive of interest should be recognised at the date of sale. The interest element should be recognised as revenue, proportionately to the unpaid balance due to the seller.

Example : On 1st January, 2015 A sells a mini truck to B, on the installment payment system, on the following terms and conditions :

(a) The cash selling price is ₹ 1,00,000.

(b) The amount payable to A in four equal annual installments along with 12% interest p.a. on the outstanding balance, the first installment being payable on the date of sale.

Recognise immediately ₹ 1,00,000 as revenue.

Interest will be recognised as follows :	**₹**
2015 — 12% of (₹ 1,00,000 – ₹ 25,000)	**9,000**
2016 — 12% of (₹ 75,000 – ₹ 25,000)	**6,000**
2017 — 12% of (₹ 50,000 – ₹ 25,000)	**3,000**

9. **Trade Discounts and Value Rebate**

Trade discounts and value rebates are not revenue. They represent a reduction of cost.

Rendering of Services

1. **Installation Fees**

When installation fees are charged separately, they should be recognised as revenue only when the equipment is installed and accepted by the customer.

If the job consists of the excecution of more than one act, revenue is recognised proportionately.

Example : Your company, "Compu Data Services (P) Ltd." is installing a computer network in 10 identical buildings for a customer, under a single contract.
Recognise 10% of the revenue on completion of installation in each building.

2. **Advertising and Insurance Agency Commissions**

Revenue should be recognised when the service is completed. For advertising agencies, media commissions will be recognised when the related advertisement or commercial appears before the public and the necessary intimation is received by the agency.

Insurance agency commissions should be recognised on the effective commencement or renewal dates of the related policies.

3. **Financial Service Commissions**

The following matters should be taken into account before recognition of revenue from financial service commissions. These are :

(i) whether the service has been provided "once and for all" or on a "continuing basis" ?
(ii) the incidence of costs relating to the service;
(iii) when the payment for service will be received ?

Revenue from financial service commissions are recognised in the following manner :

(a) Commissions charged for arranging or granting loan or other facilities should be recognised when a binding obligation has been entered into.

Example : Your company, SBI Housing Finance Ltd., has given a housing loan to Robin of ₹ 20,00,000. Processing fee is payable @ 0.1% on the loan amount.
As and when loan agreement will be signed between SBI Housing Finance Ltd. and Robin, ₹ 2,000 will be recognised as revenue by the company.

(b) Commitment, facility or loan management fees which relate to continuing obligations or services should normally be recognised over the life of the loan or facility having regard to the amount of the obligation outstanding, the nature of the services provided and the timing of the costs relating thereto.

4. **Admission Fees**
Revenue from artistic performances, banquets and other special events should be recognised when the event take place. When a subscription to a number of event is sold, the fees should be allocated to each event on a systematic and rational basis.

5. **Tuition Fees**
Revenue should be recognised over the period of instruction.

6. **Entrance and Membership Fees**
Revenue recognition from these sources will depend upon the nature of the services being provided. Entrance fee received is generally capitalised. If the membership fee permits only membership and all other services or products are paid for separately, or if there is a separate annual subscription, the fees should be recognised when received.

If the membership fee entitles the member to services or publications to be provided during the year, it should be recognised on a systematic and rational basis having regard to the timing and nature of all services provided.

Example : To become a student member of National Library, you have to pay ₹ 500 as entrance fee and ₹ 1,200 as annual membership fee.
Entrance fee of ₹ 500 will be capitalised and the annual membership fee will be recognised as revenue @ ₹ 100 per month by the National Library.

Recognition of Expenses

Expenses are recognised in the Statement of Profit and Loss when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably.

An expense is recognised immediately in the Statement of Profit and Loss when an expenditure produced no future economic benefits. An expense is also recognised to the extent that future economic benefits from an expenditure do not qualify, or cease to qualify, for recognition in the Balance Sheet as an asset.

Example: Swapna Printers (P) Ltd. replaced its offset printing machine with a modern Web Printing Machine during the year 2014-15.

The book value of the offset printing machine is ₹ 5,00,000 but it can be sold as scrap for ₹ 3,00,000 (net) only. Negotiation is going on with two buyers. Till the end of the accounting year (31st March, 2015) nothing has been finalised.

At the time of preparation of financial statements for the year 2014-15, this machine will be shown in the Balance Sheet at ₹ 3,00,000 and to be disclosed separately. The loss of ₹ 2,00,000 (₹ 5,00,000 – 3,00,000) will be recognised as expenses and is to be charged to the Profit and Loss Account of 2014-15.

Key Points

- In principle, revenue can be recognised at the point of sale or when cash is collected or at any intermediate point.
- The main objectives of revenue recognition are :
  1. The determination of correct profit for the accounting period.
  2. To reduce the confusion of the users of the accounting information regarding the profit earning capacity of the enterprise.
  3. It helps to design proper internal control system which can prevent financial abuses by the CEOs /CFOs.
  4. It brings transparency and truthfulness in reporting transactions.
- Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends.
- Revenue from rendering of services should be recognised by referring to the stage of completion at the Balance Sheet date. There are two methods for dealing with this situation : (i) Proportionate Completion Method; and (ii) Completed Service Contract Method.
- Revenue arising from the use by others of enterprise resources yielding interest, royalties and dividends should only be recognised when no significant uncertainty as to measurability or collectibility exists.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below :

1. When is a sale recognised ?
   A when cash is collected from customer
   B when certain conditions have been satisfied
   C whenever the seller decides to recognise it
2. Revenue
   A includes government grants and other subsidies
   B includes sales tax and VAT
   C is the gross inflow of cash receivables or other consideration arising in the course of the ordinary activities
3. Trade discounts and volume rebate should
   A be recognised as revenue
   B be ignored
   C be subtracted from cost
4. Normal credit risk derived from sales
   A is a reason to defer revenue recognition
   B is not a reason to defer revenue recognition
   C is disclosed in the directors' report

5. If the installation is an important part of the sales;
   A revenue recognition take place when goods are delivered at the site
   B recognition of revenue will take place at the end of the accounting period
   C recognition of revenue does not take place until installation is complete
6. Revenue from rendering of services should be recognised by referring the stage of completion
   A at the end of the calendar year
   B at the balance sheet date
   C none of the above
7. Once a credit sale has been recognised as revenue any risk of non-payment is treated as
   A a reduction in revenue
   B a finance charge
   C a bad or doubtful debt expenses
8. Interest revenue should be recognised on a
   A cash basis
   B time proportion basis taking into account the rate applicable
   C time proportion basis taking into account the amount outstanding and the rate applicable
9. Royalties revenue should be recognised
   A on an accrual basis in accordance with the terms of the relevant agreement
   B on a cash basis
   C on an actual basis
10. Dividends from investments in shares should be recognised
   A on a cash basis
   B when the shareholders' right to receive payment is established
   C on an accrual basis

Guide to Answers

1. B; 2. C; 3. C; 4. B; 5. C; 6. B; 7. C; 8. C; 9. A; 10. B.

14

Final Accounts

After the preparation of a Trial Balance, the next level of work in accounting is called "Final Accounts" level. Preparation of Final Accounts involves the following:

(a) Preparation of a Trading Account;
(b) Preparation of a Profit and Loss Account; and
(c) Preparation of a Balance Sheet.

Trading Account is prepared to know the gross profit or overall profit. Profit and Loss Account discloses net profit or clear profit of the business. The Balance Sheet shows the financial position of the business on a given date — generally on the last date of the accounting period.

The trial balance contains all of the account balances from the ledger. It includes assets, liabilities, expenses, income, capital and drawings. You should remember that :

(i) Debit balances usually represent either assets, expenses or drawings and these are always shown in the left hand column of the Trial Balance.
(ii) Credit balances are usually either income, liabilities or capital and these are always shown in the right hand column of the Trial Balance.
(iii) The expenses and income are shown in the Trading Account and Profit and Loss Account.
(iv) Assets, liabilities, capital and drawings are shown in the Balance Sheet.
(v) Additional information given by way of a note have not been recorded in the Ledger Accounts and consequently will require both a debit and a credit entry (which is usually effected by entering them in both the Trading and Profit and Loss Account and the Balance Sheet). Accounts appearing in the Trial Balance will be shown in the Trading Account or Profit and Loss Account or Balance Sheet. No double entry is required for these Accounts.

Trading Account

The main objective of preparing the Trading Account is to ascertain gross profit or gross loss of a business during an accounting period — usually a year. In accounting parlance, gross profit means overall profit. Gross Profit is the difference between sale proceeds of a particular period and the cost of the goods actually sold. Since gross profit means overall profit, no deduction of any sort is made, i.e. general, administrative or selling and distribution expenses. Gross Profit is said to be made when the sale proceeds exceed the cost of goods sold. Conversely, when sale proceeds are less than the cost of the goods sold, gross loss is incurred.

Features of Trading Account

1. It is a Nominal Account and part of the double-entry system.
2. It is the first stage in the preparation of final accounts of a trading concern and second stage in case of a manufacturing concern.
3. It records only sales and direct costs of goods sold.
4. The balance of this account discloses the gross profit or gross loss.
5. This account does not include any income from other sources.
6. The balance of this account is transferred to the Profit and Loss Account.
7. This account relates to a particular accounting period and is prepared at the end of that period.
8. It is often treated as a sub-section of the Profit and Loss Account.

Needs of Preparing Trading Account

1. A Trading Account shows the result of buying and selling of goods and services.
2. It is possible to make a comparison between opening stock and closing stock.
3. It is possible to justify the purchases that have been made and the direct expenses that have been incurred.
4. The percentage of gross profit on sales can easily be calculated. The percentage is the minimum margin at which goods and services are sold during an accounting period.
5. The percentage of gross profit on sales can be compared with that of the previous year(s), to have an idea about the progress of the business.
6. A Trading Account helps make a distinction between direct and indirect expenses.
7. A Trading Account can easily eliminate abnormal profits and losses, for example, loss of stock by fire.
8. A Trading Account can easily be prepared for each product or for each department of an organisation.
9. It is possible to make a comparison among purchases, sales and direct expenses for different years.
10. It helps to adjust the future prices of the products, if the required percentage of gross profit on sale is not being earned.

Style of a Trading Account

The styling of a Trading Account is very important, because we should have a clear presentation of how gross profit is achieved.

While preparing a Trading Account, one important point must be kept in mind that a closing journal entry is to be made in the journal proper. At the end of each accounting period, revenues and expenses accounts (direct) are closed by transferring their balances to Trading Account. The balances of these accounts disappear once they are absorbed by Trading Account.

Trading Account can be prepared either in horizontal format ('T' form) or vertical format.

Name of the Trader ... (1)
Trading Account .. (2)
Dr. For the year ended 31st December, 2014 ... (3) Cr.

Particulars			Rs	Particulars			Rs
To Opening Stock	... (4)		20,000	By Sales	... (7)	1,51,500	
To Purchases	... (5)	87,500		Less: Returns inwards	... (8)	1,500	1,50,000
Less: Returns outwards	... (6)	2,500	85,000	By Closing stock	... (9)		32,000
To Wages		10,000					
Add : Outstanding		5,000	15,000				
To Carriage Inwards			2,500				
To Royalty on Production	... (10)		1,500				
To Factory Expenses			1,000				
To Customs Duty and Insurance			5,000				
To Gas, Water and Fuel			2,500				
To Gross Profit	... (11)		50,000				
(Transferred to Profit and Loss Account)							
			1,82,500				1,82,500

Reference 1 : The business entity must be identified because it is the business unit, whose profit is being measured.
Reference 2 : This indicates the statement which is being prepared.
Reference 3 : Indicates the period of time covered by the statement.
Reference 4 : This is the value of the items in stock at the beginning of the year.
Reference 5 : All purchases made during the accounting period (for resale).
Reference 6 : The actual amount of goods returned to supplier during the accounting period.
Reference 7 : This is the total sales actually made in the accounting period.
Reference 8 : The actual amount of goods returned by customers during the accounting period.
Reference 9 : This is the value of the items in stock at the end of the accounting period.
Reference 10 : These expenses are directly attributable to the purchase of goods or to bring the goods into saleable condition.

Reference 11 : It is the difference between the credit side total and debit side total. It is transferred to the Profit and Loss Account for finding out the net profit of the business.

The vertical format of a Trading Account is given below. Now-a-days, this format is more commonly used for profit statements and reporting.

Trading Account of X for the year ended 31st December, 2014

Particulars	₹	₹	₹
Sales			3,03,000
Less : Returns inwards			3,000
			3,00,000
Opening Stock		40,000	
Purchases	1,75,000		
Less: Returns outwards	5,000	1,70,000	
Direct expenses:			
Freight & carriage	5,000		
Customs & insurance	10,000		
Wages	30,000		
Gas, water & fuel	3,000		
Lighting and Heating	2,000		
Factory expenses	2,000		
Royalty on production	3,000	55,000	
		2,65,000	
Less : Closing Stock		65,000	
Cost of Goods Sold			2,00,000
Gross Profit			1,00,0000

Trading Account Items

Debit Side

1. Opening Stock : In case of a merchandising business, the opening stock consists of different types of finished goods. In case of a manufacturing concern, opening stock consists of raw materials, work-in-progress and finished goods. Where a separate manufacturing account is prepared, opening stock consists of only finished goods. In case of a newly set up business, there will be no opening stock — at the beginning of the first year. The amount of the opening stock is available in the Trial Balance.

2. Purchases : The balance of the Purchase Account, as appeared in the Trial Balance, shows the total purchases made during the accounting period which includes both cash and credit purchases. In respect of purchases the following points must be noted :

(i) Purchase of capital asset should not be added with the purchases. If it is already included in purchases, it should be deducted therefrom.

(ii) If goods purchased for personal use and added with the purchases, it should be excluded. This type of purchases should be treated as drawings and following journal entry is to be passed :

Drawings Account Dr.
To Purchases Account

(iii) If some of the goods purchased are still in transit at the year end, it is better to debit Stock-in-transit Account and credit Cash or Supplier's Account.

(iv) If the amount of purchases include goods received on consignment, or on approval or on hire purchase, these should be excluded from purchases.

(v) Cost of goods sent on consignment must be deducted from the purchases in case of a trading concern.

3. Purchases Returns : When goods are returned to the supplier, for some reasons, in the books of account supplier is debited and purchases returns or returns outwards is credited. In the Trial Balance, it appears in the credit side. There are two ways of showing the purchases returns in the Trading Account. It may be shown by way of deduction from purchases in the Trading Account. An alternative way to show the purchases returns in the credit side of the Trading Account.

4. Direct Expenses : Direct expenses are shown separately in the Trading Account. Direct expenses are those expenses which are directly attributable to the purchase of goods or to bring the goods in saleable condition. Some examples of direct expenses are as under :

(a) ***Freight and insurance*** : Freight and insurance paid in connection with acquiring goods or making them saleable is debited to Trading Account. Freight and insurance paid in connection with the sale of goods is charged to Profit and Loss Account. Freight and insurance paid for acquisition of fixed assets must be capitalised.

(b) ***Carriage inwards*** : Carriage paid for bringing the goods to the godown is treated as carriage inwards and it is debited to Trading Account.

(c) ***Wages*** : Wages incurred in a business is direct, when it is incurred on manufacturing or merchandise or on making it saleable. Other wages are indirect wages. Only direct wages are debited to the Trading Account. Other wages are debited to the Profit and Loss Account. If it is not mentioned whether wages are direct or indirect, it should be assumed as direct and should appear in the Trading Account.

(d) ***Octroi*** : When goods are purchased within municipality limits, generally octroi duty has to be paid on it. It is debited to Trading Account.

(e) ***Fuel, power, lighting and heating expenses*** : Fuel and power expenses are incurred for running the machines. These are considered as direct expenses since directly related with the production and debited to Trading Account. Lighting and heating expense of factory is also charged to Trading Account but lighting expenses of administrative office or sales office are charged to Profit and Loss Account.

(f) ***Packing charges :*** There are certain types of goods which cannot be sold without a container or proper packing. These form a part of the finished product. One example is ink, which cannot be sold without a bottle. These type of packing charges are debited to Trading Account. But if the goods are packed for their safe despatch to customers, i.e. packing meant for transportation or fancy packing meant for advertisement will appear in the Profit and Loss Account.

(g) ***Duty on purchases*** : Any duty paid in connection with the purchase of goods is debited to Trading Account.

Credit Side

1. Sales: The balance of the sales account, as appears in the Trial Balance, shows the total sales made during the accounting period which includes both cash and credit sales. In respect of sales, the following points must be noted:

(a) If the goods are sold but yet to be despatched, it should not be included in sales, but the closing stock will be increased by the cost of such goods (if the property in goods has not yet been transferred).

(b) If sale of fixed asset is included in sales, it should be deducted from sales.

(c) Goods sold on approval or on consignment or on hire purchase, should be recorded separately. If these are included in sales, these should be deducted.

2. Sales Returns: When goods are returned by the buyers, for some reasons, in the books of account ''Returns Inwards Account'' or ''Sales Returns Account'' is debited and buyer is credited. In the Trial Balance, it is appearing in the debit side. There are two ways of showing sales returns in the Trading Account. It may be shown by way of deduction from sales in the Trading Account. An alternative way to show the sales returns in the debit side of the Trading Account.

3. Closing Stock: The last item in the credit side of the Trading Account is the closing stock—which is the value of goods which remain unsold at the end of the period. In case of a merchandising business, the closing stock consists of different types of finished goods. In case of a manufacturing concern, closing stock consists of raw materials, work-in-progress and finished goods. Where a separate manufacturing account is prepared, closing stock consists of only finished goods.

Closing stock is an item which is not generally available in the Trial Balance. However, if the closing stock is adjusted against the purchases it will appear in the Trial Balance. When closing stock is shown in the Trial Balance, it will not be included in the Trading Account. It is to be shown in the Balance Sheet.

In this connection, it should be noted that closing stock is valued at cost or net realisable value (NRV), whichever is lower. Therefore, in the Trading Account and/or in the Balance Sheet we will include it at cost price or NRV, whichever is lower.

Balancing of Trading Account

After recording the above items, in the respective sides of the Trading Account, the balance is calculated to ascertain Gross Profit or Gross Loss. If the total of credit side is more than that of the debit side, the excess represents Gross Profit. Conversely, if the total of debit side is more than that of the credit side, the excess represents Gross Loss. Gross Profit is transferred to the credit side of the Profit and Loss Account and Gross Loss is transferred to the debit side of the Profit and Loss Account.

It is common for the gross profit to be expressed as a percentage of the sales value when it is known as the **GROSS PROFIT MARGIN** ***or as a percentage of cost of sales when it is known as the*** **GROSS PROFIT MARK-UP.**

Closing Entries

(i) For the items of debit side

Trading Account	Dr.
To Opening Stock Account	
To Purchases Account (Net)	
To Direct Expenses Account	

(ii) For the items of credit side

Sales Account (Net)	Dr.
Closing Stock Account	Dr.
To Trading Account	

(iii) For gross profit

Trading Account	Dr.
To Profit and Loss Account	

(iv) For gross loss the above entry (iii) will be reverse.

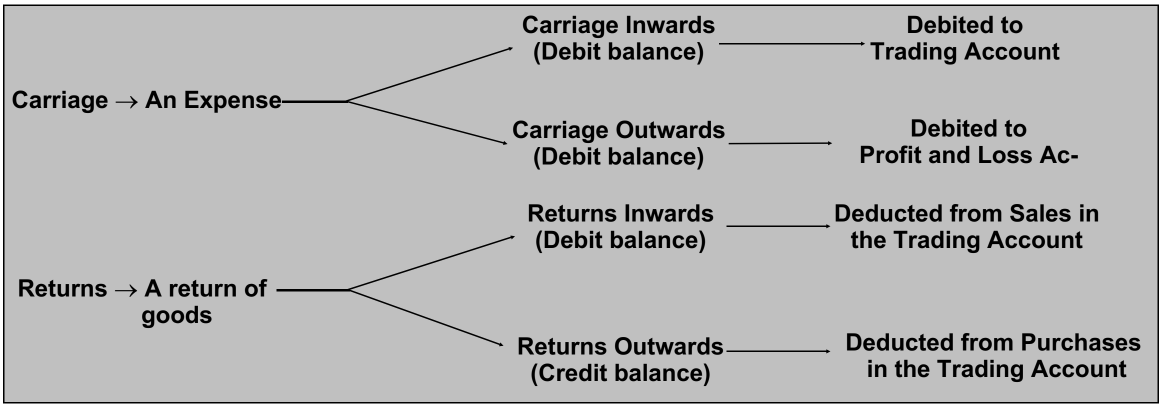
Some Important Items

1. Carriage Inwards / Carriage Outwards

Carriage on purchases is called carriage inwards and similarly carriage on sales is called carriage outwards. Carriage inwards is an additional expense on the goods bought, increasing the cost of the materials or commodities, and, as such, is a trading account expense.

Carriage outwards is a selling and distribution expense and is debited to the Profit and Loss Account along with the other administration and distribution expenses.

It should be noted that both carriages are *debits*, and must not be confused with returns inwards and returns outwards. The following diagram will clear the concept.



2. Production Wages and Office Salaries

The wages of production or of warehousing (where goods are prepared for sales) are direct expenses and are debited to the Trading Account as part of the cost of the goods produced.

The salaries of the office and administrative staff are charged to the Profit and Loss Account.

In this connection, it should be noted that if wages are not related to production, then it should not be charged to Trading Account. For example, wages paid to office cleaners are chargeable to Profit and Loss Account. Likewise, if the salaries are related to production, then it should be charged to Trading Account. For example, salaries paid to designers of the garment factory or salaries paid to works manager are chargeable to Trading Account.
The rule is that if the wages / salaries are part of the cost of the article being sold, it should appear in the Trading Account. If the wages / salaries are administrative, selling or distribution expenses, it should appear in the Profit and Loss Account.

Sometimes, Wages Account and Salaries Account are not maintained separately. One single account called Wages and Salaries Account or Salaries and Wages Account is maintained. At the time of preparation of Trading Account, students should follow the above rule.

In the examination, if nothing is mentioned, wages will be charged to Trading Account (assuming they are direct in nature) and salaries will be charged to Profit and Loss Account. For combined account — Wages and Salaries or Salaries and Wages — a proper note should be given.

3. Discount

There are basically two kinds of discounts :

(a) Trade Discount and (b) Cash Discount.

Trade Discount represents an allowance which is made by the manufacturer to the wholesalers or by the wholesalers to the retailers. Trade discount is deducted from the catalogue price of the goods when the goods are purchased. As such, trade discounts have the effect of reducing the purchase or sales figure. Since the prediscount figures (catalogue price) are typically never recorded, the sales and purchases figures are shown at net figure (i.e., catalogue price *minus* trade discount).

Cash discount is allowed to encourage a debtor to pay-off his debt within a specified time after the purchase. It should be noted that this discount is not really a reduction in the price, but an incentive to pay promptly. The sales and purchases are taken into the trading account at their full price (net of trade discount, if any), any cash discounts allowed to credit customers are treated as an expense in the Profit and Loss Account, and any cash discounts received from suppliers are treated as incomes in the Profit and Loss Account. Thus, cash discounts do not affect the ***gross profit***.

Key Points to Remember

1. ***The heading of the Trading Account should show the name of the concern or trader, the period covered and the date to which the account is made up.***
2. ***Unless stated to the contrary, wages are normally taken to the Trading Account and salaries to the Profit and Loss Account.***
3. ***Carriage inwards is debited to the Trading Account and carriage outwards is debited to the Profit and Loss Account.***
4. ***Returns inwards are deducted from sales whereas returns outwards are deducted from the purchases in the Trading Account.***
5. ***Closing stock is valued at cost or market price, whichever is lower. This value of closing stock is credited to Trading Account. However, if the closing stock has already been adjusted against the purchases, it will not be credited to Trading Account.***
6. ***Cash discount on purchases will not affect the Trading Account.***

Profit and Loss Account

After preparing Trading Account, the next step is to prepare Profit and Loss Account with a view to ascertain net profit or net loss during an accounting period. ***The Profit and Loss Account can be defined as a report that summarises the revenues and expenses of an accounting period to reflect the changes in various critical areas of firm's operations***. As pointed out earlier, the balance of the Trading Account (gross profit or gross loss) is transferred to the Profit and Loss Account, which is the starting point of the preparation of this account. This is why, Trading Account, is treated as a sub-section of the Profit and Loss Account. Profit and Loss Account shows the profit or loss on ordinary activities, profit or loss on the sale of a capital asset, other abnormal losses and gains but excludes the payment of taxation, transfer to or withdrawal from reserves or from the business and the distribution of profit. After transferring the Gross Profit or Gross Loss from the Trading Account to the Profit and Loss Account, the sources of other incomes like commission or discount received are shown on the credit side of the Profit or Loss Account. The credit side also includes the non-trading income like interest on bank deposits or securities, dividend on shares, rent of property let-out, profit arising out of sale of fixed assets, etc. On the debit side, all other expenses appearing in the Trial Balance which cannot find a place in the Trading Account, will appear. The debit side will also include the losses arising out of sale of assets and any abnormal losses.

The Profit and Loss Account measures net income by matching revenues and expenses according to the accounting principles. Net income is the difference between total revenues and total expenses. In this connection, we must remember that all the expenses, for the period are to be debited to this account —whether paid or not. If it is paid in advance or outstanding, proper adjustment are to be made (discussed later). Likewise all revenues, whether received or not are to be credited. Revenue if received in advance or accrued but not received, proper adjustment is required.

After transferring all the nominal accounts from the Trial Balance to the Profit and Loss Account, it is necessary to balance the Profit and Loss Account. If the credit side is more than the debit side, it indicates net profit for the period. Conversely, if the debit side is more than credit side, it indicates net loss for the period.

Features of a Profit and Loss Account

1. It is a nominal account and part of the double entry system.
2. It is the second stage in the preparation of final accounts of a trading concern and the third stage in case of a manufacturing concern.
3. It relates to a particular accounting period and is prepared at the end of that period.
4. This account is credited with the gross profit and income from other sources and debited with indirect expenses and losses.
5. Accrual basis of accounting is followed in the preparation of this account.

6. This account is prepared by matching revenues and expenses for an accounting period.
7. The balance of this account is the net profit or net loss.
8. The preparation of this account depends upon the accounting bases and policies of the business.
9. The capital of the owner is increased or decreased by the balance of this account.
10. This account shows how successfully and how effectively the business is being run.
11. It can be used as a basis for forecasting the future of the business.
12. This account shows whether the business can maintain its capital or not.

Advantages of Profit and Loss Account

1. It is an account of an enterprise's revenues, expenses and profit.
2. It is a link between two consecutive Balance Sheets.
3. It shows the earning power of the business.
4. It makes a distinction between trading and non-trading incomes.
5. It also makes a distinction between expenses incurred for earning revenue and losses suffered during the accounting period.
6. It is a critical study of the past happening.
7. It can be used as a basis for forecasting the future of the business.
8. It is the basis of the amount of drawings to be made by the owner.
9. Many accounts from the Trial Balance are closed by transferring them to the Profit and Loss Account.
10. It can be easily related to the Balance Sheet.

Like Trading Account, Profit and Loss Account can also be prepared either in horizontal format or vertical format.

The horizontal format of a Profit and Loss Account is given below :

Dr. Profit and Loss Account of X for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
Management expenses		**By Gross Profit b/d**	1,00,000
To Salaries (administrative)	25,000	**Other income**	
To Office rent, rates and taxes	5,000	By Discount received	12,000
To Printing and stationery	500	By Commission received	3,000
To Telephone charges	1,500	**Non-trading Income**	
To Postage and telegrams	500	By Bank Interest	13,000
To Insurance	1,000	By Rent of property let-out	16,000
To Audit fees	1,000	By Dividend from shares	11,000
To Legal charges	500	**Abnormal Gains**	
To Electricity charges	1,500	By Profit on sale of machinery	12,000
Maintenance expenses		By Profit on sale of investment	23,000
To Repairs & renewals	1,000		
To Depreciation on :			
Office equipment	200		
Office furniture	300		
Office buildings	500		
Selling and Distribution expenses			
To Salaries (selling staff)	15,000		
To Advertisement	1,000		
To Godown rent	1,200		
To Carriage outward	800		
To Bad debts	500		
To Provision for bad debts	200		
To Selling commission	1,800		
Financial expenses			
To Bank charges	100		
To Interest on loans	200		
To Discount on bills	300		
To Discount allowed to customers	400		
Abnormal losses			
To Loss on sale of machinery	Nil		
To Loss on sale of investment	Nil		
To Loss by fire	Nil		
To Net Profit (transferred to Capital A/c)	1,30,000		
	1,90,000		1,90,000

Note : (i) Gross loss will appear in the debit side of the Profit and Loss Account at the top;
(ii) Net loss will appear in the credit side of the Profit and Loss Account.

The vertical format of a Profit and Loss Account is given below. This, too is more commonly used for profit statements and reporting.

Profit and Loss Account of X for the year ended 31st December, 2014

Particular	₹	₹	₹
Gross Profit			1,00,000
Add : Other Income :			
Discount received	12,000		
Commission received	3,000	15,000	
Add : Non-Trading Income :			
Bank Interest	13,000		
Rent of property let out	16,000		
Dividend from shares	11,000	40,000	
Add : Abnormal Gains :			
Profit on sale of machinery	12,000		
Profit on sale of investments	23,000	35,000	90,000
			1,90,000
Less: Management expenses			
Salaries (administrative)	25,000		
Office rent, rates and taxes	5,000		
Printing and stationery	500		
Telephone charges	1,500		
Postage and telegrams	500		
Insurance	1,000		
Audit fees	1,000		
Legal charges	500		
Electricity charges	1,500	36,500	
Less : Maintenance expenses			
Repairs & renewals	1,000		
Depreciation on :			
Office equipment	200		
Office furniture	300		
Office buildings	500	2,000	
Less : Selling and Distribution expenses			
Salaries (selling staff)	15,000		
Advertisement	1,000		
Godown rent	1,200		
Carriage outward	800		
Bad debts	500		
Provision for bad debts	200		
Selling commission	1,800	20,500	
Less : Financial expenses			
Bank charges	100		
Interest on loans	200		
Discount on bills	300		
Discount allowed to customers	400	1,000	
Less : Abnormal losses			
Loss on sale of machinery	Nil		
Loss on sale of investment	Nil		
Loss by fire	Nil	Nil	60,000
Net Profit (transferred to Capital A/c)			1,30,000

Profit and Loss Account Items

The Debit Side

The items that will appear in the debit side of a Profit and Loss Account can broadly be classified as under :

(a) Management expenses; (b) Maintenance expenses; (c) Selling and distribution expenses; (d) Financial expenses; and (e) Abnormal losses.

(a) Management Expenses : These are the expenses incurred for carrying out the day-to-day administration of a business. Expenses under this head include office salaries, office rent and lighting, printing and stationery and telegrams, telephone charges, etc.

(b) Maintenance Expenses : These expenses are incurred for maintaining the fixed assets of the administrative office in a good condition. They include repairs and renewals, etc.

(c) Selling and Distribution Expenses : These expenses are incurred for promoting sales and distribution of sold goods. Example of such expenses are godown rent, carriage outwards, advertisement, cost of after-sales service, selling agents' commission, etc.

(d) Financial Expenses : These expenses are incurred for arranging finance necessary for running the business. These include interest on loans, discount on bills, brokerage and legal expenses for raising loan, etc.

(e) Abnormal Losses : There are some abnormal losses that may occur during the accounting period. All types of abnormal losses are treated as extraordinary expenses and debited to Profit and Loss Account. Examples are stock lost by fire and not covered by insurance, loss on sale of machinery, cash defalcation etc.

Following are the expenses not to appear in the Profit and Loss Account.

(i) Domestic and household expenses of proprietor or partners.
(ii) Drawings in the form of cash, goods by the proprietor or partners.
(iii) Personal income tax and life insurance premium paid by the firm on behalf of proprietor or partners.

The expenses of a particular accounting period include the cost of the product sold in that accounting period though these products were purchased or manufactured in an earlier period. The wages and salaries earned by the worker—whether paid or not — and rent, electricity, telephone expenses are to be taken into consideration, whether paid during the accounting period or not. To ascertain the amount of expenses to be debited to the Profit and Loss Account, four types of events are needed to be considered and the cash payment made in connection with these events. They are as under :

(i) Expenses incurred and paid out in that year: If an expenditure is incurred in one year and also paid for in the same year, the transaction becomes simplest and least troublesome. Most of the expenses for a period are generally paid before the accounting period is over. Here, when the expenses are incurred and payment is made , we debit expense account and credit cash or bank account. At the year end, the Expense Account cannot have any balance, since closed by transferring it to the Profit and Loss Account by debiting Profit and Loss Account and crediting the Expense Account.

(ii) Expenses incurred but not paid out, partly or fully, during the current year: There are some expenses, which are incurred in the current accounting period, but not paid for, partly or fully, by the end of the period, are called ***'Outstanding Expenses'***.

Outstanding expenses include outstanding salaries, interest, rent, wages and other expenses. These must be duly accounted for because the parties who furnished goods or service have a claim against the business for the amount due to them and these amounts, therefore, become the liabilities of the business at the end of the accounting period.

In fact, on the date of the final accounts, outstanding expenses, both an expense and a liability exist without having been recorded in the books of account. For recording it, the following entry is to be passed:

Expenses Account	Dr.	(Will be shown in the Profit and Loss Account)
To Outstanding Expenses Account		(Will appear in the liabilities side of the Balance Sheet)

Illustrative Example 1

Salaries paid during the year ₹ 40,000; Salaries outstanding at the end of the accounting period ₹ 5,000.

Ledger Accounts

(a) ***Before Adjusting Entry*** :

Dr.	Outstanding Salaries Account		Cr.
	₹		₹

Dr.	Salaries Account		Cr.
	₹		₹
To Cash A/c	40,000		

(b) ***After Adjusting Entry*** is posted :

Dr. Outstanding Salaries Account Cr.

	₹		₹
To Balance c/d	5,000	By Salaries	5,000

Dr. Salaries Account Cr.

	₹		₹
To Cash A/c	40,000	By P/L A/c	45,000
To Out. Salary A/c	5,000		
	45,000		45,000

Balance Sheet

Liabilities	₹	Assets	₹
Outstanding Salaries	5,000		

Dr. Profit & Loss Account Cr.

	₹		₹
To Salaries A/c	45,000		

Note : At the beginning of the next accounting year, a reverse entry will be passed :

Outstanding Salaries Account	Dr.	₹ 5,000	
To Salaries Account			₹ 5,000

Illustrative Example 2

P & Co. is in business dealing in pest control. Its owner, K. Mondal, employs a team of eight workers who were paid ₹ 3,000 per month each in the year to 31 December, 2013. At the start of 2014 he raised salaries by 10% to ₹ 3,300 per month each.

On 1 July, 2014, he hired a trainee at a salary of ₹ 2,100 per month. He pays his work force on the first working day of every month, one month in arrear, so that his employees receive their salary for January on the first working day in February etc.

You are required to :

(a) Calculate the amount of salaries which would be charged in the Profit and Loss Account of P & Co. for the year ended on 31 December, 2014.

(b) Calculate the amount actually paid in salaries during the year.

(c) Calculate the amount of outstanding salaries which would appear in the Balance Sheet of P & Co. as at 31 December, 2014.

Solution

(a)	**Salaries to be charged to Profit and Loss Account for the year ended 31 December, 2014** :	₹
	(i) Salaries of 8 employees for full year @ ₹ 3,300 per month each	3,16,800
	(ii) Salaries of trainee for 6 months @ ₹ 2,100 per month	12,600
		3,29,400
(b)	**Salaries actually paid in 2014 :**	
	(i) December, 2013 Salaries paid in January 2014 (8 x ₹ 3,000)	24,000
	(ii) Salaries of 8 employees for January to November, 2014 paid in February - December, 2014 @ ₹ 3,300 per month for 11 months	2,90,400
	(iii) Salaries of trainee for July to November paid in August - December @ ₹ 2,100 for 5 months	10,500
		3,24,900
(c)	**Outstanding salaries as at 31 December, 2014 :**	
	(i) 8 employees @ ₹ 3,300 each for 1 month	26,400
	(ii) 1 trainee @ ₹ 2,100 for 1 month	2,100
		28,500

(iii) Expenses paid for during the current year, but not yet incurred, partly or fully : Sometimes, it happens that some expenses are paid for during the current year, but not yet incurred, partly or fully, are known as '***Prepaid Expenses***'. Prepaid Expenses include prepaid insurance premium, rent, taxes, interest, etc. A prepaid expense is an asset and will be shown in the Balance Sheet. The adjusting entry to be passed :

Prepaid Expenses Account	Dr. (To be shown as asset in the Balance Sheet)
To Expenses Account	(Balance of this account is to be debited to Profit and Loss Account)

Illustrative Example 3

On 30th June, 2014 insurance premium paid for one year ₹ 1,200. The accounts are prepared on 31st December, 2014.

Out of ₹ 1,200 only ₹ 600 is related to the accounting year 2014 and the remaining ₹ 600 should be carried forward to the next period.

Ledger Accounts

(a) ***Before Adjusting Entry*** :

Dr.	Insurance Premium Account		Cr.
	₹		₹
To Bank A/c	1,200		

Dr.	Prepaid Insurance Premium Account		Cr.
	₹		₹

(b) ***After Adjusting Entry*** is posted :

Dr.	Insurance Premium Account		Cr.
	₹		₹
To Bank A/c	1,200	By Prepaid Insurance	
		Premium A/c	600
		By Profit & Loss A/c	600
	1,200		1,200

Dr.	Prepaid Insurance Premium Account		Cr.
	₹		₹
To Ins. Prem. A/c	600	By Balance c/d	600

Balance Sheet			
Liabilities	₹	Assets	₹
		Prepaid Ins. Prem.	600

Dr.	Profit & Loss Account		Cr.
	₹		₹
To Ins. Prem. A/c	600		

Note : At the beginning of the next accounting year, a reverse entry will be passed :

Insurance Premium Account	Dr.	₹ 600	
To Prepaid Insurance Premium Account			₹ 600

Illustrative Example 4

During the year to 31 December, 2014 payments were made in respect of insurance premium.

January 2nd : ₹ 16,000 for the 3 months ending 31 March, 2014

April 19th : ₹ 32,000 for the 6 months ending 30 September, 2014

October 6th : ₹ 35,000 for the 6 months ending 31 March, 2015.

You are required to calculate the amount of prepaid insurance premium for the year ending on 31 December, 2014 and also show the completed Insurance Premium Account.

Solution

You have notice that total payments of ₹ 83,000 cover a period of 15 months to 31 March 2015 whereas the accounting period ends on 31 December, 2014. The last payment made for ₹ 35,000 can be split as to ₹ 17,500 for the last quarter of 2014 and ₹ 17,500 for the first quarter of 2015. Therefore, prepaid insurance premium is ₹ 17,500. The completed Insurance Premium Account will be:

Dr. **Insurance Premium Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Jan. 2	To Bank A/c	16,000	Dec. 31	By Profit & Loss A/c	65,500
April 19	To Bank A/c	32,000	Dec. 31	By Prepaid Insurance Premium A/c	17,500
Oct. 6	To Bank A/c	35,000			
		83,000			83,000
2015					
Jan. 1	To Prepaid Insurance Premium A/c	17,500			

(iv) Expenses of the current year likely to arise in subsequent period: Sometimes, an expense or a loss may arise in the future in connection with current year's business. In such a case, we make a provision of the anticipated loss and a charge is created against the profit for the current period. This provision is shown either as a liability or as a contingent asset, i.e. it appears in the Balance Sheet as a deduction from some other asset. The best example of this anticipated expense is ***provision for bad debts.***

The Credit Side

The items that appear on the credit side of a Profit and Loss Account can broadly be classified as under:

(a) Gross Profit;

(b) Other incomes;

(c) Non-trading income; and

(d) Abnormal gains.

Gross Profit: This is the balance of the Trading Account transferred to the Profit and Loss Account. If the Trading Account shows a gross loss, it will appear on the debit side.

Other Incomes: During the course of the business, other than income from the sale of goods, the business may have some other income of financial nature. The examples are discount or commission received.

Non-trading Income: The business may have various transactions with the bank. At the end of the year, the business may earn some amount of interest which will find a place in the Profit and Loss Account as non-trading income. The business may have some investment outside the business in the form of shares or debentures or units. Any income received from these investments are also considered as non-trading income and are treated in the same way.

Abnormal Gains: There may be capital gains arising during the course of the year, e.g., profit arising out of sale of a fixed asset. The profit is shown as a separate income on the credit side of the Profit and Loss Account.

In this connection, we are to remember that all the other incomes or abnormal gains are to be credited to the Profit and Loss Account if they arise or accrue during the period. Similarly, income received in advance is to be deducted from the income. The following adjustments are to be considered:

(i) Income accrued but not received, partly or fully: Accrue means increase. Certain income such as interest on debentures, dividend on shares accrued during the accounting period but are not received. Adjusting entry is required to recognise these unrecorded increases (accruals) in income. For recording, the following entry will be passed:

Accrued Income Account	Dr. (Will be shown in the Assets side of the Balance Sheet)
To Income Account	(To be credited to Profit and Loss Account)

Illustrative Example 5

Interest on debenture received during the year, ₹ 1,000. Interest accrued but not received during the year, ₹ 200.

Ledger Accounts

(a) ***Before Adjusting Entry*** :

Dr.	Interest Received Account		Cr.
	₹		₹
		By Cash A/c	1,000

Dr.	Accrued Interest Account		Cr.
	₹		₹

(b) ***After Adjusting Entry*** is posted :

Dr.	Interest Received Account		Cr.
	₹		₹
To Profit & Loss A/c	1,200	By Cash A/c	1,000
		By Accrued Int. A/c	200
	1,200		1,200

Dr.	Accrued Interest Account		Cr.
	₹		₹
To Int. Recd. A/c	200	By Balance c/d	200
	200		200

Dr.	Profit & Loss Account		Cr.
	₹		₹
		By Int. Recd. A/c	1,200

Balance Sheet			
Liabilities	₹	Assets	₹
		Accrued Interest	200

(ii) Income received in advance during the current period: Income received in advance is not the revenue of the current accounting period. It will be recognised as income in the coming year. Income received in advance is treated as a liability and shown in the Balance Sheet. The adjusting entry will be:

Income Account	Dr. (balance to be credited to Profit and Loss Account)
To Income Received in Advance Account	(to be shown in the liability side of the Balance Sheet)

Illustrative Example 6

On November 1, 2014, X & Co. leases one of its Buildings to the Z & Co, for one year. Z & Co. paid ₹ 6,000 rent for one year in advance . The Books are being closed on December 31, 2014.

Out of ₹ 6,000 received as rent, only ₹, 1,000 (November + December) should be treated as revenue for the year 2014 and the balance of ₹ 5,000 should be treated as rent received in advance for 2015, so ₹ 5,000 should be carried to next accounting period.

Ledger Accounts

(a) ***Before Adjusting Entry*** :

Dr.	Rent Received in Advance Account		Cr.
	₹		₹

Dr.	Rent Received Account		Cr.
	₹		₹
		By Cash A/c	6,000

(b) ***After Adjusting Entry*** is posted :

Dr.	Rent Received in Advance Account		Cr.
	₹		₹
To Balance c/d	5,000	By Rent Recd. A/c	5,000
	5,000		5,000

Dr.	Rent Account		Cr.
	₹		₹
To Rent Recd in Adv.	5,000	By Cash	6,000
To Profit & Loss A/c	1,000		
	6,000		6,000

Balance Sheet			
Liabilities	₹	Assets	₹
Rent Recd in Adv.	5,000		

Dr.	Profit & Loss Account		Cr.
	₹		₹
		By Rent Recd A/c	1,000

Note : At the beginning of the next accounting year a reverse entry will be passed :

Rent Received in Advance Account	Dr.	₹ 5,000	
To Rent Received Account			₹ 5,000

Closing Entries

Following are the journal entries to be passed in connection with the preparation of the Profit and Loss Account:

(i) ***For the items of debit side:***

Profit and Loss Account Dr.
To Expenses /Losses Account

(ii) ***For Gross Profit:***

Trading Account Dr.
To Profit and Loss Account

(iii) ***For Other Income/Abnormal Gain:***

Other Income/ Abnormal gain Account Dr.
To Profit and Loss Account

Balancing the Profit and Loss Account

The balance in the Profit and Loss Account represents the net profit or net loss. If the credit side is more than the debit side , it shows the net profit, and if the debit side shows more than the credit side, it shows net loss.

When the Profit and Loss Account shows a net profit, we pass the following entry:

Profit and Loss Account Dr.
To Net Profit Account

If the Profit and Loss Account shows a net loss, the entry will be reverse.

Balance Sheet

A Balance Sheet is a list of assets and claims of a business at some specific point of time and is prepared from an adjusted Trial Balance. It shows the financial position of a business by detailing the sources of funds and the utilisation of these funds. A Balance Sheet shows the assets and liabilities grouped, properly classified and arranged in a specific manner.

It has already been stated that after a Trial Balance is prepared and adjusting entries are passed and incorporated in the Trial Balance, some accounts are closed by transferrring to the Trading Account and some accounts are closed by transferring to the Profit and Loss Account. These accounts are in the nature of expenses and revenues. With the remaining accounts lying in the Trial Balance, which mainly represent assets and liabilities and adjusting accounts, a Balance Sheet is prepared to ascertain the financial position on a given date. In this connection, we must remember that one account appearing in the unadjusted Trial Balance, has to be shown either in the Trading Account or in the Profit and Loss Account or in the Balance Sheet. However, an adjusting account figures both in the Trading, Profit and Loss Account and in the Balance Sheet. For example, ₹ 200 to be provided for outstanding salaries. In the Profit and Loss Account, Salaries Account to be increased by ₹ 200 and in the Balance Sheet outstanding salaries to be shown in the liabilities side.

Functions of a Balance Sheet

The Balance Sheet summarises the incomplete transactions of the business. The Balance Sheet accumulates the various financial data in accordance with the basic accounting equation, Assets – Liabilities = Capital. The left hand side of the Balance Sheet shows the sources from which cash can be obtained and the right hand side shows the forms in which cash has been invested. A primary function of the Balance Sheet is to provide a measure of the assets waiting to be matched with future revenues and liabilities to be met in the future. The main functions of the Balance Sheet are as under:

(1) It is a summary of various assets provided to the business and the claims to these assets. It provides information regarding the assets owned by the business and the debts owed to the outsiders, and indicates the capital of the owners in the business.

(2) It serves as a measure of liquidity. If necessary, it also shows the various assets provided to the business and claims to those assets to indicate the ability of the business to pay its debts, as and when required. The ascertainment of working capital is a basic measure of the firm's liability.

(3) It serves as a measure of solvency by providing information about the assets owned, obligations to outsiders and capital — the residual interest of the owners in the business. The solvency of a firm is measured by ascertaining the relationship of total assets to total liabilities and indicates the firm's ability to meet eventually all its short- and long-term debts.

Balance Sheet and Profit and Loss Account — Relationship

The Profit and Loss Account and the Balance Sheet are said to articulate, i.e. there is a definite relationship between them. The primary relationship between a Profit and Loss Account and a Balance Sheet is that a Profit and Loss Account is a link between the Balance Sheet at the beginning of a period and the Balance Sheet at the end of that period. The fundamental problem in the process of measuring periodic income is the division of costs incurred between the present and future accounting periods. The Profit and Loss Account and the Balance Sheet are the two technical instruments used in reporting this division. Both are necessary, because the absence of one will not exhibit the picture clearly. The profit and Loss Account shows the division of costs assigned to current period, whereas the Balance Sheet exhibits the costs incurred which are reasonably applicable to future years. The Balance Sheet thus serves as a means of carrying forward unexpired acquisition costs of assets. It also stands as a connecting link joining successive Profit and Loss Accounts — as mentioned earlier. Moreover, the amount of net profit reported on the Profit and Loss Account together with the amount of dividends, explains the changes in owners' equity between the two Balance Sheets prepared as at the beginning and the end of the accounting period.

From the foregoing discussion, we can conclude that a Balance Sheet can be described as a summary of residual transactions that results from the Profit and Loss Account transactions. And, the measurement of net assets appearing in the Balance Sheet is dependent upon the measurement of income, which, in turn, is dependent upon the measurement of revenues and expenses.

Uses of the Balance Sheet

The Balance Sheet is regarded as a prominent accounting report. The various interested parties may derive different information for their own use. Generally the following information can be derived from a Balance Sheet:

1. It enables us to ascertain the proprietary interest of a person or business organisation.
2. It enables us to calculate the actual capital employed in the business.
3. The lender can ascertain the financial position of the business.
4. It may serve as the basis for determining purchase consideration of the business.
5. The trends of working capital of the business can be determined by comparing the Balance Sheets of successive years and corrective measures can be taken, where necessary.
6. Different ratios can be calculated from the Balance Sheet and these ratios can be utilised for better management of the business.

Limitations of the Balance Sheet

Though the Balance Sheet is prepared by every organisation for disclosing its financial position, yet it suffers from the following limitations :

1. Fixed assets are shown in the Balance Sheet at historical cost less depreciation up-to-date. A conventional Balance Sheet cannot reflect the true value of these assets. Again intangible assets are shown in the Balance Sheet at book values which may bear no relationship to market values.
2. Sometimes, Balance Sheet contains some assets which command no market value such as preliminary expenses, debenture discount, etc. The inclusion of these assets unduly inflate the total value of assets.
3. The Balance Sheet cannot reflect the value of certain factors such as skill and loyalty of staff.
4. A conventional Balance Sheet may mislead untrained readers in inflationary situations.
5. The value of a major number of current assets depends upon some estimates, so it cannot reflect the true financial position of the business.

Distinction between Profit and Loss Account and the Balance Sheet

The difference betwen a Profit and Loss Account and a Balance Sheet is that while the former provides a 'historical' review of the accounts of the past transactions (how the profit is earned or loss is incurred) the latter gives a 'static' picture of the financial position as on the last day of the accounting period.

The main differences between a Profit and Loss Account and a Balance Sheet are as under:

1. Profit and Loss Account itself is an account whereas a Balance Sheet is a statement of assets and liabilities.
2. Profit and Loss Account shows the profits earned or losses incurred for the accounting period whereas the Balance Sheet shows the financial position of the business.
3. Profit and Loss Account is prepared for the accounting period ended whereas a Balance Sheet is prepared as at the last day of the accounting period.
4. The accounts that are transferred to the Profit and Loss Account are closed and cease to exist . But the accounts that are transferred to the Balance Sheet do not lose their identity and become the opening balances for the next period.

Balance Sheet Formats

A Balance Sheet may be prepared in one of two forms : (i) Horizontal (Traditional) format and (ii) Vertical format.

Horizontal (Traditional) Format

Under this format, the left hand side lists liabilities of the business as on the last day of the accounting period as well as details of its capital position; and on the right hand side are listed various assets of the enterprise. A Balance Sheet is so designed that it discloses the financial interest of the owner(s) in the business and its liabilities to outsiders— and how those amounts are represented by its various assets. Therefore, the Balance Sheet includes the net profit or net loss as disclosed by the Profit and Loss Account . There are two ways of recording net profit in the Balance Sheet. It can be shown as an addition to (in case of profit) or a deduction (in case of loss) from the capital(s) — as in the case of sole proprietorship or partnership firms. Alternatively, it may be shown as a seperate item — as in case of a limited company.

Arrangement of Assets and Liabilities

The assets on the right-hand side and liabilities and capital on the left-hand side must be properly *marshalled*, i.e. they should be shown in a certain order. Subject to any particular law, which requires the assets and liabilities are to be shown in certain order, assets and liabilities can be arranged in any form that exists in the particular organisation. There are two common ways in which the assets and liabilities can be arranged. They are as under:

(a) In the order of liquidity or dischargeability

According to this basis, assets are arranged in order of the case with which they can be converted into cash. Here, the cash in hand will come first, then cash at bank followed by other assets and land and building at the bottom of the list. In regard to the liabilities, they are so arranged in the order they are to be discharged. Bills payable appears first , then trade creditors and followed by loans, outstanding expenses. Thereafter, reserves and surplus will appear and capital at the bottom. Under this method, assets and liabilities are arranged as under:

Balance Sheet as at ...

Liabilities	₹	Assets	₹
Bills Payable		Cash in Hand	
Trade Creditors		Cash at Bank	
Loans		Government Securities	
Outstanding Expenses		Other Investments	
Reserves & Surplus		Bills Receivable	
Capital		Sundry Debtors	
		Stock	
		Furniture & Fixtures	
		Plant & Machinery	
		Land and Building	

(b) In the order of permanence

According to the second basis, assets are listed in order of permanence, i.e. starting with those least *'realisable'* and working down to the most 'liquid' assets. Liabilities are also recorded in order of their permanence, i.e. the liability which will have to be discharged last is shown first. On the assets side, the most fixed asset is land and building, will come first followed by plant and machinery, furniture and fixture, stock, debtors and cash in hand at the bottom. In regard to the liabilities, capital account heads the list, followed by reserve and surplus , and then by any creditors for outstanding expenses. Thereafter, loans from outsiders, followed by creditors will appear and bills payable at the bottom. Under this method, assets and liabilities are arranged as under:

Balance Sheet as at ...

Liabilities	₹	Assets	₹
Capital		Land and Building	
Reserves & Surplus		Plant & Machinery	
Outstanding Expenses		Furniture & Fixtures	
Loans		Stock	
Trade Creditors		Sundry Debtors	
Bills Payable		Bills Receivable	
		Other Investments	
		Government Securities	
		Cash at Bank	
		Cash in Hand	

In this connection, following are the points to be noted :

1. Assets of the same class are grouped together—all fixed assets together and all current assets together.

2. The balance of the Capital Account is shown as under.

Capital		
Opening balance	***	
Add: Profit for the period	***	
	***	
Less : Drawings for the period	***	***

Vertical Format

The Balance Sheet presentation used so far is known as the horizontal format. The disadvantages with the above presentation is that it does not show the value of the organisation. The networth of an organisation to the owner is the value of the owner's capital. The vertical format clearly displays the networth of the business to the owner — i.e. the capital. This format also displays the amount of investment in the fixed assets and in working capital (which is the difference between the current assets and current liabilities).

The vertical format merely involves a re-arrangement of the information shown by a Balance Sheet presented in Horizontal format. Many non-accountant managers are now required to make decisions based on accounting information. The vertical format is intended to help them gain a batter understanding of the financial information presented by the accountants and therefore improve their decision-making. The information shown previously is now presented in the vertical format.

Balance Sheet of X as at 31 December, 2014

	₹	₹	₹
Fixed Assets :			
Land		2,00,000	
Building		4,00,000	
Plant and Machinery		3,00,000	
Furniture		1,00,000	
Delivery Van		2,00,000	12,00,000
Current Assets :			
Stock	1,50,000		
Debtors	2,50,000		
Bills Receivable	50,000		
Cash at Bank	30,000		
Cash in Hand	20,000	5,00,000	
Current Liabilities :			
Creditors	1,00,000		
Bills Payable	50,000		
Outstanding Expenses	50,000	2,00,000	
Working Capital			3,00,000
NET ASSETS EMPLOYED			15,00,000
FINANCED BY :			
Capital		13,70,000	
Add : Net Profit		1,30,000	15,00,000

Balance Sheet — A Statement of Assets, Liabilities and Capital

A Balance Sheet is a statement of the assets, liabilities and capital of an organisation at a particular date which gives a true and fair view of the *state of affairs* of the business. The financial position of a business is indicated by its assets on a given date and its liabilities (excluding capital) on that date. Assets and liabilities are two independent variables and the capital is the dependent variable, because capital is the resultant of these two varying factors, assets and liabilities. Excess of assets over liabilities represents capital and is indicative of the financial soundness of the business.

Assets and their Classification

Assets are resources, tangible or intangible, from which probable future economic benefits are obtained and the rights to which have been acquired by a paricular entity as a result of past transactions or events. An asset (other than cash) has four essential characteristics :

1. It embodies a probable future benefit that increases a capacity, either singly or in combination with other resources, to contribute directly or indirectly to future cash inflows.
2. A particular business entity must be able to obtain the benefit from the resource and control others access to it. It must be owned by the business, i.e. an entity must have the title to the asset.
3. It is a result of past transactions or events, i.e. the transactions giving rise to the claim to or control of the benefit must already have accrued.
4. The probable future benefits must be quantifiable or measurable in monetary units.

From the above, it is clear that assets are valuable resources owned by a business which are acquired at a measurable money cost. Following are the important points of the above definition :

(i) The resource must be valuable;
(ii) The resource must be owned by a business enterprise; and
(iii) It must be acquired at a measurable money cost.

Assets of a business are generally classified into four groups: (a) Fixed Assets; (b) Current Assets; (c) Fictitious Assets; and (d) Intangible Assets.

(a) Fixed Assets : Fixed assets are defined by the CIMA Terminology (Chartered Institute of Management Accountants) as :

'Any asset . . . acquired for retention by an entity for the purpose of providing a service to the business, and not held for resale in the normal course of trading'.

These assets are tangible in nature — relatively long lived resources of a business. A business generally require these types of assets in order to use them in the production of goods and services . If the assets are held for re-sale they are classified as inventories, even though they are long lived. Therefore, fixed assets are long lived assets whose usefulness is likely to extend beyond one accounting period in the operations of the business. Fixed assets appear in the Balance Sheet at their historical costs minus accumulated depreciation. The expression "accumulated depreciation" means the portion of the original cost of the asset which has already been charged as an expense in the previous years as a cost of doing business.

The examples of fixed assets are land and building, plant and machinery, furniture and fixtures, etc. Fixed assets are generally divided into *wasting assets* and *non-wasting assets*. Wasting assets lose their value by wear and tear (plant and machinery) or by the passage of time (leasehold land) or through being worked (mines). Non-wasting assets are those which do not lose their value by any of the above reasons. A good example of a non-wasting assets is freehold land.

(b) Current Assets : Current assets are defined by the CIMA Terminology as :

'Cash or other asset, e.g., stock, debtors and short term investments, held for conversion into cash in the normal course of trading'.

These assets are reasonably expected to be realised in cash or consumed during normal operating cycle of the business. The distinction between fixed assets and current assets is important. The essence of the distinction is time. Current Assets are those that is owned by the business generally not for more than a year from the Balance Sheet date whereas fixed assets are those that are expected to be owned for more than one year. Following are the examples of the current assets :

Cash consists of funds which are readily available for disbursement without restriction. Most of these funds are usually on deposit with the banker (known as bank balance) and the balance in the temporary storage facilities (cash box) on the business premises.

Investments are easily marketable securities and are generally converted into cash within the accounting period. A business invests money, which is temporarily idle, to get some return in cash. Investments are valued in the Balance Sheet at cost or current market value, whichever is lower. It is valued at cost only when the decline in the market value is believed to be only temporary.

Sundry Debtors are amounts owed to the business generally by its customers arising out of credit sales. Sundry debtors appear in the Balance Sheet at their net expected realisable value, i.e, at their book values less an allowance for that portion of the amount owed which is not expected to be collected.

Bills Receivable are acknowledgements of debts of the customers. When the amount owed by debtors are evidenced by a written acknowledgement of obligation, it would appear not under the head "Sundry Debtors" but under the head ‘‘Bills Receivable’’. Generally, Bills Receivable is a method of converting Sundry Debtors into acceptor of bills.

Stock is the inventory of raw materials, work-in-progress and finished goods. Stock is needed by a business either for sale in the ordinary course of business, or for use in the process of production for such sale or are to be currently consumed in the production of goods and services to be available for sale. Stock is recorded in the Balance Sheet at its cost or current market value which ever is lower.

Prepaid expenses and deferred charges represent certain kinds of assets, usually of an intangible nature, usefulness of which will expire with the near future. In fact, these are expenses which are already incurred, but the entire portion could not be recognised in the current accounting period because the benefit is spread over to more than one accounting period.

(c) Fictitious Assets : These are intangible properties which are not represented by anything concrete. The examples of fictitious assets are preliminary expenses, accumulated losses, etc.

(d) Intangible Assets : Intangible assets are capital assets having no physical existence whose value depends on the rights and benefits that possession confers upon owner. These represents immaterial rights, privileges and competitive advantages owned by a business. Examples of intangible assets are Goodwill, Patents, Copyrights, Trademarks, etc.

Liabilities and their Classification

Liabilities are obligations which arise from transactions or other events that have already been occurred. It involves an enterprise in a probable future transfer of cash, goods or services or the forgoing of a future cash receipt. The amount of the liability and the date of settlement of such liabilities are the claims of the outsiders against the business or the amounts that the business owes to some person or persons other than its owners. A liability need not be a legally enforceable claim. Generally, all the liabilities are not claims against any specific asset or a group of assets. Liabilities are stated in the Balance Sheet at either the amount of cash (or its equivalent) ultimately payable including interest accumulated to that date. Interest payable subsequent to the Balance Sheet is excluded.

The liability of the business may take one of the following forms:

(a) those with fixed amounts and date of payment;
(b) those with fixed amount but date of payment is estimated;
(c) those for which the amount and the date of payment are estimated;
(d) those arise from the advances made by the cutomers.

Liabilities of a business can be classified into : (a) Fixed Liabilities; (b) Current Liabilities; and (c) Contingent Liabilities.

(a) Fixed Liabilities : Fixed liabilities are not defined as such by CIMA Terminology but these are long-term liabilities which are generally redeemed after a long period of time. These include long-term loan, redeemable debentures of a company, etc.

(b) Current Liabilities : Current liabilities are defined by CIMA Terminology as :

‘Liabilities which fall due for payment within one year. They include that part of the long term loans due for repayment within one year’.

These are obligations of the business which are payable in the near future, usually within the next accounting period. Therefore, a liability which is expected to have been paid within one year from the date of the Balance Sheet, is termed as ‘‘Current Liability’’. When a current liability is created, it increases the resources of a business in the form of current assets, e.g., buying inventory on credit. On the other hand, when the obligation for a current liability is paid for, it reduces the current assets. Current liabilities are generally obligations for the items which are entered into the operating cycle of a business, such as sundry creditors and bills payable in the acquisition of inventory, supplies to be used in the production cycle, collection received in advance against the delivery of goods, debts which arise from operations directly relating to the operating cycle such as outstanding salaries, wages, commission, royalty, rent, and so forth. It also includes income tax and other freight and taxes.

There may be other liabilities, which also fall under this category, though not related to the production cycle. These include short-term debts arising from acquisitions of capital assets, serial maturity of long term obligations (interest payment at regular intervals), and so forth. Now, we discuss some important components of current liabilities.

Sundry creditors are the claims of the suppliers against the business for the delivery of the goods on credit — which may not be evidenced by a written acknowledgement of debt.

Bills payable are the claims of the suppliers which is evidenced by a note or some other written acknowledgement of debt.

Liability for taxes are the provisions made for the estimated tax liability which is owed to the government for taxes.

Outstanding expenses are expenses which are already incurred but not paid for. These are the converse of prepaid expenses. These liabilities may be intangible in nature in the sense that they are evidenced by a legal document. The examples of outstanding expenses are outstanding wages and salary, outstanding rent, etc.

Deferred Income represents the short-term liability of a business that arises because the business has received money in advance for a service to be rendered in future. An example is rent received in advance, which means rental payment is received by the business in advance for which the business agrees to permit the tenant to make use of a property during near future.

(iii) Contingent Liabilities : These liabilities are conditions which exist at the Balance Sheet date, the outcomes of which can only be confirmed on the occurrence or non-occurrence of one or more uncertain future events. A contingent liability may also exist when a current situation may result in a future liability, but the amount of the liability in the monetary terms cannot be reasonably anticipated as on the Balance Sheet date. They do not include uncertainties connected with accounting estimates, e.g., provision for doubtful debts or provision for discount on debtors. Also, the situation must exist currently; hence, future losses from fire or flood, natural calamities or outbreak of war are not contingent liabilities. Examples of contingent liabilities are possible penalties, discounting of bills receivable, fines and penalties payable to the government or income tax authorities, etc. By contrast, if an obligation, whose amount can be reasonably estimated as a current liability, and it is not recorded in the books of account even though the exact amount is not known now.

Contingent liabilities are not recorded in the books of account; hence it does not appear on the liability side of the Balance Sheet. They are disclosed as a footnote at the bottom of the Balance Sheet.

Capital — A Liability of Business

In the accounting sense, capital is the money contributed by the owner to an organisation to enable it to function. It is measured by the excess of assets over liabilities. Capital can be brought in by a person into the business in different forms — cash or kind. When capital is brought in the form of cash, it is spent away on various items of assets that make the business a running concern.

Capital Account is the account that shows the interest of the owner in the net assets of the business.

Adjustments

1. Goods Distributed as Free Samples

This is one kind of advertisement. When goods are distributed to the prospective customers as free samples, an expense is incurred (known as advertisement expense) and there is an usual reduction from the stock of goods. The following entry is passed :

Advertisement Account	Dr.
To Purchases Account	(For a trader)
or	
To Trading Account	(For a manufacturer)

At the year end, Advertisement Account is closed by transferring to the Profit and Loss Account Account:

Profit and Loss Account	Dr.
To Advertisement Account	

2. Income Tax

Income tax is not an expense to earn revenue. Therefore, while ascertaining the profit of a concern, income tax is not treated as an expense to be deducted from the profit. For a sole proprietor, income tax is payable by the owner and not by the business. Therefore, if income tax appears in the Trial Balance, it should be treated as drawings and should be deducted from capital. Following are the entries to be passed:

(a) Income Tax Account Dr. (When paid)
    To Cash / Bank Account
(b) Drawings Account Dr.
    To Income Tax Account

But for a registered partnership firm, it is payable by the business itself and not by the partners. It generally appears as an appropriation of the net profits. The following entry is passed :

Profit and Loss Appropriation Account Dr.
    To Income Tax Account

3. Advance Tax

For a sole proprietor, advance tax is payable by the owner and not by the business. Therefore, if the advance tax appears in the Trial Balance, it should be treated as drawings and should be deducted from capital. The following are the entries to be passed :

(a) Advance Tax Account Dr. (When paid)
    To Cash / Bank Account
(b) Drawings Account Dr.
    To Advance Tax Account

4. Interest on Advance Tax

If any interest is received on advance tax, it is not the income of the business. It is the income of the proprietor. Therefore, if the interest on advance tax appears in the Trial Balance (it is shown in the credit column of the Trial Balance) it should be added with the capital.

The following are the entries to be passed :

(a) Bank Account Dr.
    To Interest on Advance Tax Account
(b) Interest on Advance Tax Account Dr.
    To Capital Account

Illustrative Example 7

The following balance of accounts are appearing in the Trial Balance of X. How do you deal with them at the time of preparing the final accounts ?

Trial Balance of X (includes)

Sl.No.	Head of Accounts	L.F.	Dr. (₹)	Cr. (₹)
	Income Tax.		50,000	
	Advance Income Tax		35,000	
	Interest on Advance Income Tax			1,000

Solution

(i) Income tax paid ₹ 50,000 will be treated as the drawings of the proprietor and it is to be deducted from his capital in the Balance Sheet.
(ii) Advance income tax paid ₹ 35,000 will also be treated as the drawings of the proprietor and it is to be deducted from his capital in the Balance Sheet.
(iii) Interest on advance income tax will be treated as private income of the proprietor and it will be treated as additional capital brought in by him. Therefore, it will be added with the capital in the Balance Sheet.

5. Drawings Made by the Proprietor

Drawings made by the proprietor(s) may be in cash or in kinds. Drawings relate to the resources of the business and the capital of the owner(s).

Drawings made in cash : In this case, following entries are passed:

(a) Drawings Account Dr.
    To Cash/ Bank Account

(b) Capital Account Dr.
To Drawings Account

Drawings made in kinds : When some of the stocks withdrawn from the business, the following entry should be passed:

(a) Drawings Account Dr.
To Purchases Account

(b) Capital Account Dr.
To Drawings Account

If the drawings made by the owner is included in sales, we are to pass a reverse entry to cancel the original entry. For the drawings, the above two entries are to be passed:

6. Mutual Indebtedness

Sometimes, a debtor may also be a creditor for the business. If finished goods sold to X for ₹ 1,000 and raw materials purchased from him ₹ 500, the name of X will appear both in the debtors and creditors list. Generally, we set off these types of accounts. We transfer the account which has a smaller balance to the account having a bigger balance and, in effect, one account is closed. The following entry is passed (the amount will be the smaller of the two figures):

Sundry Creditors Account	Dr.	₹ 500	
To Sundry Debtors Account			₹ 500

7. Debtors arising out of Dishonour of Cheques or Bills

When a cheque previously received from a debtor, is dishonoured, the old position of debtor and creditor is restored between the buyer and the seller respectively. Here, Debtor Account is debited and Bank Account is credited. In effect, the value of the sundry debtors is increased and the bank balance is decreased.

When a bill, previously drawn on a debtor, is dishonoured, Debtor Account is debited and the person who is holding the bill is credited. Here the value of the sundry debtors is increased and one of the following is credited, depending on the manner in which it has been previously dealt with:

Sundry Debtors Account	Dr. (Dishonour of bill)
To Bills Receivable Account	(When the bill is retained)
To Bills for Collection Account	(When the bill is sent to bank for collection)
To Bank Account	(When the bill is discounted with banker)
To Endorsee Account	(When the bill is endorsed)

If a provision for doubtful debts is to be created, it will be on the value of the sundry debtors after making the above adjustments.

8. Abnormal Loss of Stock by Accident, e.g., by Fire

If a portion of the stock is lost, the value of such loss is first to be ascertained. Thereafter, Abnormal Loss Account is to be debited and Trading Account is to be credited. Abnormal loss account is closed by transferring to the Profit and Loss Account, i.e. Profit and Loss Account is to be debited and abnormal loss account is to be credited. If the above loss is insured against risk, Insurance Claim Account (or Insurance Company Account) is to be debited and Abnormal Loss Account is to be credited. Till the time, money is not received, Insurance Claim (or Insurance Company Account) will find a place in the asset side of the Balance Sheet. When the money is received, Bank Account is debited and the Insurance claim (Insurance Company Account) is credited. If the goods are partially insured, the portion not covered by insurance, is to be charged to Profit and Loss Account.

Journal entry to be passed is as follows:

(i) Accidental Loss Account	Dr. (Actual loss of stock)
To Trading Account / Purchases Account	
(ii) (a) Insurance Claim Account	Dr. (Insurance claim admitted by the insurance Co.)
or (b) Insurance Company Account	Dr. (Insurance claim admitted by the insurance Co.)
Profit and Loss Account	Dr. (Claim not admitted)
To Accidental Loss Account	

9. Goods Sent on Approval Basis

When goods are sold to the customers on sale or return or on approval basis, it is not considered as sale till the time it is not approved by the customers or the expiring of a fixed period as agreed by the parties. When goods are sold initially to a customer on approval basis, we pass the entry for the sales. At the year end, if the goods are still lying with the customers awaiting approval, the following entries are to be passed:

(i) To cancel previous entry:

Sales Account Dr. (Sales value)
  To Sundry Debtors Account

(ii) To add the value of the closing stock (Cost of goods lying with the customer):

Stock with Customers Account Dr.
  To Trading Account

In the Balance Sheet, it will be deducted from sundry debtors at sales price and the closing stock will be increased by the cost of such sales.

Illustrative Example 8

Sales include goods worth ₹ 30,000 sent out to S M & Co. on approval basis and remain unsold as on 31st March, 2015, the date of closing the books of account. The cost of the goods was ₹ 25,000. How will you deal with this at the time of preparing Final Accounts ?

Solution

First, the entry for sales is to be cancelled by passing the following entry :

Sales Account Dr. ₹ 30,000
  To Sundry Debtors Account ₹ 30,000

Second, the cost of the goods lying with the customers is to be added with closing stock. The entry will be :

Stock with Customers Account Dr. ₹ 25,000
  To Trading Account ₹ 25,000

Net Effect

(i) Reduce sales by ₹ 30,000;
(ii) Reduce the balance of Sundry Debtors by ₹ 30,000;
(iii) Credit Trading Account by ₹ 25,000;
(iv) Show in the assets side of the Balance Sheet Stock with customer — ₹ 25,000.

Remember, the goods lying with customer must be valued at cost or NRV whichever is lower.

10. Goods Received on Approval Basis

Goods may be received on approval basis from the supplier. These goods are not recorded in the books of account when these are received. Only when these goods are accepted, it is recorded as purchase. Before acceptance of these goods, supplier is the owner of these goods. Therefore, these goods are not to be included in the closing stock also.

However, if these goods are recorded wrongly as purchase, the following adjustment entry is to be passed:

Suppliers / Creditors Account Dr.
  To Purchases Account

From the closing stock, cost of such goods are to be eliminated (if costs of such goods were taken into consideration at the time of closing stock valuation).

11. Interest on Loan — Not yet Paid — Fully or Partly

In the Trial Balance, the amount of the loan appears in the credit column. The amount of interest paid appears in the debit column. If a portion of the interest is still outstanding at the year end, we pass the following entry to make the adjustment:

Interest on Loan Account Dr.
  To Loan Account

If nothing has been paid as interest, we are to find out the amount by applying the rate with the amount of the loan and pass the above entry. The total amount of unpaid interest will appear in the Balance Sheet as a liability.

12. Interest on Capital

Sometimes, it may be required to make a provision for interest on the capital contributed by the proprietor or the partners. Such interest is not a charge against profit but an appropriation of profit. In this connection, the following two entries have to be passed :

(i) Profit and Loss Appropriation Account Dr.
To Interest on Capital Account
(Being interest on capital payable)

(ii) Interest on Capital Account Dr.
To Capital/Current Account
(Being interest on capital transferred to Capital/Current Account)

13. Interest on Drawings

Sometimes, interest on drawings may be charged to restrict the frequent drawings by the partners. Such interest increases the divisible profit. The following two entries have to be passed:

(i) Interest on Drawings Account Dr.
To Profit and Loss Appropriation Account

(ii) Capital/Current Account Dr.
To Interest on Drawings Account
(Being interest on drawings transferred to Capital/Current Account)

14. Sales Tax

When goods are sold to customers either in cash or credit, sales tax is collected from him along with the price of the goods sold. Periodically, this sales tax is deposited with the Government through the bank. Generally, in the Sales Day Book, a separate column is provided for sales tax. When goods are sold, sales tax is entered in that separate column and sales are entered in other column.

When these are posted in the ledger, the following entry is passed :

Sundry Debtors Account Dr.
To Sales Account
To Sales Tax Account

When goods are sold for cash the entry will be :

Cash Account Dr.
To Sales Account
To Sales Tax Account

When sales tax is paid to the Government, the following entry is passed :

Sales Tax Account Dr.
To Bank Account

Any balance in the Sales Tax Account represents amount unpaid and it is to be shown in the Balance Sheet as a liability. Sometimes, sales tax is not recorded separately but it is added with the sales. In this case, an adjusting entry is to be passed by debiting Sales Account and crediting Sales Tax Account. Unpaid amount of sales tax is to be shown in the Balance Sheet as a liability.

15. Provident Fund

As per the provision of the Provident Fund Act, both the employer and the employee must contribute a minimum fixed percentage of salary towards provident fund.

When salaries are paid to employees, employer deducts the employees' share of contribution from salary and net salary is paid to the employees. Employer's own contribution as well as deducted amount of employees are deposited within a specified period with the proper authority.

When salaries are paid, the following entry is passed :

Salary Account Dr. [Total amount payable to employees]
To Bank / Cash Account (Net amount paid)
To Provident Fund Deduction Account [Amount deducted from employees]

For employer's own contribution to Provident Fund, the following entry is passed :

Salary Account Dr.

To Own Contribution to Provident Fund Account

When both the amounts are deposited, the following entry is passed :

Provident Fund Deduction Account Dr.

Own Contribution to Provident Fund Account Dr.

To Bank / Cash Account

If the amount has not been deposited within the accounting period, it is to be shown in the Balance Sheet as a current liability.

Illustrative Example 9

The following items are appearing in the Trial Balance of Mr A as on 31st March, 2015.

Trial Balance [Extract]

Sl.No.	Head of Accounts	L.F.	Dr. (₹)	Cr. (₹)
	Salaries		16,000	
	P.F. Deducted from Salaries			1,000

Additional information : Provide employer's share of Provident Fund ₹ 1,000. How will you deal with these items at the time of preparation of final accounts ?

Solution

For employer's share of Provident Fund, Salary Account will be debited and Provident Fund Outstanding Account will be credited.

Net effect :

(i) Salary Account is to be charged to Profit and Loss Account with ₹ 17,000 (16,000 + 1,000); (ii) In the Balance both 'P.F. deducted from Salaries' and 'P.F. Outstanding' ₹ 1,000 each are to be shown as liabilities.

Illustrative Example 10

The following items are appearing in the Trial Balance of Mr X as on 31st March, 2015.

Trial Balance [Extract]

Sl.No.	Head of Accounts	L.F.	Dr. (₹)	Cr. (₹)
	Salaries *less* P.F.		5,400	
	P.F. Remittance including Proprietor's Contribution — 50%		1,200	.

How will you deal with the above items at the time of preparation of final accounts ?

Solution

Out of ₹ 1,200 Provident Fund remittance, 50% i.e. ₹ 600 is proprietor's contribution and 50% i.e. ₹ 600 was deducted from the salary of the employees. In this case, net amount paid was debited to Salaries Account. Therefore, both employees' share and proprietor's share are to be added with the salaries. The entry will be :

Salaries Account Dr. ₹ 1,200

To P.F. Remittance Account ₹ 1,200

Net Effect :

The Salaries Account will be increased by ₹ 1,200. The total salary (₹ 5,400 + ₹ 1,200) of ₹ 6,600 will be debited to Profit and Loss Account.

Alternatively, only employees' share, i.e. ₹ 600 can be added with the Salary Account and ₹ 6,000 is to be shown in the Profit and Loss Account as salary. The proprietor's share of ₹ 600 will also be shown in the Profit and Loss Account as a separate item as employer's contribution to P.F. However, the effect on Profit and Loss Account will be the same.

16. Closing Stock

(i) Closing stock appearing in the additional information will be credited in Trading Account and is to be shown as a current asset in the Balance Sheet.

(ii) If closing stock is appearing in the Trial Balance it is to be shown in the Balance Sheet only.

It should be noted that the closing stock should be valued at lower of cost and net realisable value.
Para 3 of AS—2 defines net realisable value as : Net realisable value is the estimated selling price in the ordinary course of business less the estimated cost of completion and the estimated cost necessary to make the sale.
[For details see Chapter 9 — Inventories.]

Illustration 1

Show by means of Journal Entries how the following items should be adjusted when preparing the Final Accounts of a firm for the year ended 31st March, 2015.

(i) Closing stock at market value as on March 31, 2015 was ₹ 1,00,000 (cost ₹ 80,000). Stock is being valued on a consistent basis of cost or market price whichever is lower.
(ii) No entry had been passed in the books for stock withdrawn from the business by the proprietor ₹ 10,000.
(iii) Legal charges include ₹ 20,000 for cost of stamp and registration of new building acquired during the year.
(iv) Patents and trademarks were acquired at a cost of ₹ 28,000 in 2014 and every year 1/10th is being written-off.
(v) Proprietor had withdrawn for personal use goods for which the cost was ₹ 3,500 but the market value on the date of withdrawal was ₹ 4,500. Sales were credited by ₹ 3,000.
(vi) Purchase include purchase of furniture for office use worth ₹ 10,000.
(vii) An amount of ₹ 25,000 received in respect of new capital introduced by the proprietor was wrongly credited to Sundry Debtors Account.
(viii) An amount of ₹ 5,000 received from a debtor was wrongly credited to Sales Account.
(ix) Goods costing ₹ 8,000 were despatched out on 29th March. The sale, however, took place on 2nd April, 2015, when an invoice of ₹ 9,000 was raised against the customer.

Solution

In the books of ...
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 March 31 (i)	Closing Stock A/c (Note 1)	Dr.		80,000	
	To Trading A/c				80,000
	(Being the adjustment for Closing Stock)				
(ii)	Drawings A/c	Dr.		10,000	
	To Purchases A/c				10,000
	(Being the adjustment for goods withdrawn by the proprietor)				
(iii)	Building A/c	Dr.		20,000	
	To Legal Charges A/c				20,000
	(Being cost of stamps & registration charges wrongly debited to Legal Charges Account, now adjusted)				
(iv)	Depreciation on Patent & Trademarks A/c	Dr.		2,800	
	To Patent & Trademarks A/c				2,800
	(Being the amount of depreciation written-off)				
(v)	Drawings A/c (Note 2)	Dr.		500	
	To Sales A/c (₹ 3,500 – ₹ 3,000)				500
	(Being the adjustment for goods withdrawn by the proprietor)				
(vi)	Furniture A/c	Dr.		10,000	
	To Purchases A/c				10,000
	(Being the purchase of furniture for office use wrongly debited to Purchases Account, now rectified)				
(vii)	Sundry Debtors A/c	Dr.		25,000	
	To Capital A/c				25,000
	(Being capital introduced by the proprietor wrongly credited to Sundry Debtors Account, now rectified)				
(viii)	Sales A/c	Dr.		5,000	
	To Sundry Debtors A/c				5,000
	(Being cash paid by a debtor wrongly credited to Sales Account, now rectified)				
(ix)	Goods-in-Transit A/c	Dr.		8,000	
	To Trading A/c				8,000
	(Being the adjustment for goods in transit)				

Working Notes :

(1) Closing stock is to be valued at cost or market price whichever is lower. In this case, cost price is ₹ 80,000 which is lower than the market price ₹ 1,00,000. Therefore, only ₹ 80,000 is to be adjusted.

(2) Cost of goods withdrawn by the proprietor will be treated as drawings. The market value of goods ₹ 4,500 is immaterial. Sales Account has already been credited by ₹ 3,000. Therefore, the balance (₹ 3,500 – ₹ 3,000) ₹ 500 is to be adjusted by debiting Drawings Account and crediting Sales/Purchases Account.

Illustration 2

Show by means of Journal Entries how the following matters should be adjusted when preparing the Annual Accounts of a firm for the year ended 30th September, 2014:

(a) Goods sold and recorded as sales for ₹ 4,000 were packed and the invoice for them sent to the customer. Stock taking intervened, and the parcel of goods was not despatched but was included in stock-in-hand.

(b) Several employees took their salary in advance in the month of September 2014, which was payable to them in October 2014 amounting to ₹ 2,500.

(c) A purchase made for a staff member of ₹ 1,000 and the cost was included in purchases. A deduction of similar amount was made from his salary and net payment to him posted to Salaries Account.

(d) Wages paid to the firm's own workmen for making certain additions to machinery amounting to ₹ 750, were posted to Wages Account.

(e) A dishonoured bill receivable for ₹ 500 returned by the bank with whom it had been discounted, had been credited to Bank Account and debited to Bills Receivable Account.

(f) A cheque amounting to ₹ 270 received from a customer, Mr X, was dishonoured. The returned cheque was correctly entered in the Cash Book but was posted therefrom to Allowances Account.

(g) A duplicate invoice for a purchase of machinery costing ₹ 10,000 was erroneously passed again and entered into the books.

(h) A sum of ₹ 1,000 drawn by the proprietor was debited to Travelling expenses.

Solution

In the books of ...
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2014 (a) Sept. 30	Trading A/c	Dr.		4,000	
	To Closing Stock A/c				4,000
	(Being goods already sold was wrongly included in the stock at the closing of the year, now rectified)				
(b)	Advance Salary A/c	Dr.		2,500	
	To Salaries A/c				2,500
	(Being salaries paid in advance in September 2014 transferred to Advance Salaries Account)				
(c)	Salaries A/c	Dr.		1,000	
	To Purchases A/c				1,000
	(Being goods purchased for a staff was wrongly included in purchases, now transferred to Salaries A/c)				
(d)	Machineries A/c	Dr.		750	
	To Wages A/c				750
	(Being wages paid to workers for addition to machinery was wrongly debited to Wages A/c, now adjusted)				
(e)	Sundry Debtors (Drawee) A/c	Dr.		500	
	To Bills Receivable A/c				500
	(Being dishonoured of discounted bill was wrongly debited to Bills Receivable A/c in place of Sundry Debtors A/c, now adjusted)				
(f)	Mr X A/c	Dr.		270	
	To Allowance A/c				270
	(Being a cheque received from Mr X was dishonoured but wrongly debited to Allowance Account, now adjusted)				
(g)	Creditors for Machinery A/c	Dr.		10,000	
	To Machinery A/c				10,000
	(Being a duplicate invoice for purchase of machinery was wrongly recorded in the book twice, now adjusted)				
(h)	Drawings A/c	Dr.		1,000	
	To Travelling Expenses A/c				1,000
	(Being an amount withdrawn by proprietor was wrongly debited to Travelling Expenses A/c, now adjusted)				

Suggested Steps for Preparation of Final Accounts

The students may follow the following suggested steps for the preparation of Final Accounts from a given Trial Balance with some year-end adjustments.

Step 1 : Set out a pro-forma Trading Account, Profit and Loss Account and Balance Sheet. Already you know that Final Accounts can be prepared either in Horizontal Format or in Vertical Format. Pro-forma is to be drawn up according to the requirement of the question.

Step 2 : Go down the Trial Balance and identify the items which are to be entered in the Trading Account, which are to be entered in the Profit and Loss Account and which are to be entered in the Balance Sheet. Mark these as 'T', 'P' and 'B'. In addition, it is useful to mark those values with an asterisk (*) which are to be affected by the additional information (i.e. adjustments).

Step 3 : Put all the assets and liabilities (with the mark 'B') into their appropriate position on the Balance Sheet, all the revenues and expenses (with the mark 'T' or 'P' without asterisk) into their appropriate position in the Trading, Profit and Loss Accounts. No double entry is needed since the Trial Balance figures are the result of the double entry.

Step 4 : Make necessary year end adjustment in the items marked with asterisk(*). Since no double entry have been made for these, there will be a double effect on the Final Accounts. Most adjustments will affect both the Balance Sheet and Trading / Profit and Loss Account.

Step 5 : Balance the Trading Account to find out Gross Profit / Loss and transfer it to Profit and Loss Account.

Step 6 : Balance the Profit and Loss Account to find out Net Profit / Loss and transfer it to the capital section of the Balance Sheet and total the Balance Sheet.

Illustration 3

Prepare a Trading Account and a Profit and Loss Account for the year ended 31st December 2014 and a Balance Sheet as on that date from the following Trial Balance and the adjustment items:

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Opening stock	46,000		Office electricity expenses	9,400	
Purchases and Sales	4,42,000	8,20,000	Telephone charges	4,400	
Sales returns and Purchases returns	8,000	12,000	Cash at Bank	18,000	
Discount received		2,200	Printing and Stationery	11,200	
Wages	43,500		Postage stamps	1,090	
Salaries	66,000		Furniture	2,00,000	
Carriage inwards	39,100		Petty cash	210	
Advertising expenses	10,200		Prepaid printing	1,200	
Bills receivable and payable	9,000	10,000	Insurance premium	3,000	
12% Bank loan (taken on 1st November 2014)		1,50,000	Carriage outwards	12,000	
Office equipment	1,99,700		Bad debts	800	
Land and building	3,36,000		Interest on Bank loan paid	1,500	
Provision for doubtful debts		3,200	Capital Account		4,76,900
Sundry Debtors and Sundry Creditors	45,000	40,000	Reserve for Discount on creditors	1,700	
Rates and taxes	5,300		**TOTAL**	15,14,300	15,14,300

Adjustment items:

(a) Closing stock was valued at ₹ 38,000 on 31st December 2014.

(b) Goods worth ₹ 2,500 were distributed by salesmen as free samples, but no entry has been made for this.

(c) Depreciate furniture by $7^1/_2$% p.a and office equipment by 10% p.a.

(d) Reserve for discount on creditors to be maintained at 2%.

(e) Provision for doubtful debts to be maintained at 5% on debtors.

(f) Create a provision for discount on debtors at 2%.

(g) Commission of ₹ 1,300 was earned but not yet received.

(h) Rates and taxes of ₹ 800 was paid in advance for 2015.

(i) Creditors include a debt of ₹ 4,000 to Mr Nayak who is also included in the list of debtors for ₹ 5,000 and, therefore, to be set off before calculating the reserves.

Solution

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

	₹	₹		₹	₹
To Opening Stock		46,000	By Sales	8,20,000	
To Purchases	4,42,000		Less: Sales Returns	8,000	8,12,000
Less: Purchases Returns	12,000	4,30,000	By Advertisement expenses		2,500
To Wages		43,500	By Closing stock		38,000
To Carriage inward		39,100			
To Gross Profit c/d		2,93,900			
		8,52,500			8,52,500
To Salaries		66,000	By Gross Profit b/d		2,93,900
To Advertisement expenses	10,200		By Reserve for discount on creditors (Note 1)		1,220
Add: Goods distributed as free sample	2,500	12,700	By Accrued commission		1,300

To Bank interest	1,500		By Provision for Doubtful debts:		
Add: Outstanding	1,500	3,000	Old	3,200	
To Rates & Taxes	5,300		Less: New 5% on ₹ 41,000	2,050	1,150
Less: Paid in advance	800	4,500			
To Office electricity		9,400			
To Telephone charges		4,400			
To Printing & stationery		11,200			
To Postage & stamps		1,090			
To Insurance premium		3,000			
To Carriage outwards		12,000			
To Bad debts		800			
To Depreciation:					
On Furniture	15,000				
On Office equipment	19,970	34,970			
To Prov. for disc. on Debtors @ 2% on ₹ 38,950		779			
To Net Profit (transferred to capital)		1,33,731			
		2,97,570			2,97,570

Balance Sheet as at 31st December, 2014

Liabilities	₹	₹	Assets	₹	₹
Capital (1.1.2014)	4,76,900		Land & Building		3,36,000
Add: Net Profit	1,33,731	6,10,631	Office Equipment	1,99,700	
12% Bank Loan	1,50,000		Less: Depreciation	19,970	1,79,730
Add: Outstanding Interest	1,500	1,51,500	Furniture	2,00,000	
Sundry Creditors	40,000		Less: Depreciation	15,000	1,85,000
Less: Debtors Set-off	4,000		Closing Stock		38,000
	36,000		Sundry Debtors	45,000	
Less: Reserve for Discount on Creditors	720	35,280	Less: Creditors set-off	4,000	
Bills Payable		10,000		41,000	
			Less: Provision for doubtful debts	2,050	
				38,950	
			Less: Provision for discount on Debtors	779	38,171
			Bills Receivable		9,000
			Cash at Bank		18,000
			Petty Cash		210
			Rates Paid in Advance		800
			Accrued Commission		1,300
			Prepaid Printing		1,200
		8,07,411			8,07,411

Working Notes: **(1)** When Reserve for Discount on Creditors Account is maintained, any discount received is credited to this account. For creating a new reserve, the balance of Reserve for Discount on Creditors is also taken into consideration. Thus,

Dr. Reserve for Discount on Creditors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	1,700	By Discount Received A/c	2,200
To Profit and Loss A/c (Balancing figure)	1,220	By Balance c/d (2% of ₹ 36,000)	720
	2,920		2,920

(2) Provision for Doubtful Debts and Discount

	₹
Debtors as per Trial balance	45,000
Less: Set-off with creditors	4,000
	41,000
Less: Provision for bad debts (new) 5%	2,050
	38,950
Less: Provision for Discount @ 2%	779
	38,171

Illustration 4

The following is the Trial Balance of Mr Bharat on 31st December, 2014 :

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Capital		4,000	Bills payable		560
Sundry creditors		5,200	Bills Receivable	720	
Plant & Machinery	5,000		Returns inwards	930	
Office furniture and fittings	260		Provision for doubtful debts		250

Stock as on 1st January, 2014	4,800		Drawings	700	
Motor van	1,200		Returns outwards		550
Sundry debtors	4,570		Rent	600	
Cash in hand	40		Factory lighting and heating	80	
Cash at bank	650		Insurance	630	
Wages	15,000		General expenses	100	
Salaries	1,400		Bad debts	250	
Purchases	21,350		Discount	650	370
Sales		48,000	**TOTAL**	58,930	58,930

The following adjustments are to be made :

(i) Stock on 31st December, 2014 ₹ 5,200;

(ii) 3 months factory lighting and heating is due, but not paid ₹ 30;

(iii) 5% depreciation to be written-off on furniture;

(iv) Write-off further bad debts ₹ 70;

(v) The provision for doubtful debts to be increased to ₹ 300 and provision for discount on debtors @ 2% to be made;

(vi) During the year machinery was purchased for ₹ 2,000, but it was debited to Purchases Account.

You are required to make the necessary Journal entries and prepare Trading and Profit and Loss Account and the Balance Sheet.

Solution

In the books of Bharat
Journal

Date	Particulars		Dr. ₹	Cr. ₹
2014	**Adjustment Entries**			
Dec. 31	Factory Lighting and Heating A/c	Dr.	30	
	To Outstanding Factory Lighting and Heating A/c			30
	(Being adjustment for outstanding factory lighting and heating)			
	Depreciation A/c	Dr.	13	
	To Office Furniture & Fittings A/c			13
	(Being amount written-off as depreciation on furniture @ 5% on ₹ 260)			
	Bad Debts A/c	Dr.	70	
	To Sundry Debtors A/c			70
	(Being bad debts written-off)			
	Plant & Machinery A/c	Dr.	2,000	
	To Purchases A/c			2,000
	(Being purchase of machinery wrongly debited to Purchases Account, now rectified)			
	Profit & Loss A/c	Dr.	134	
	To Provision for Bad & Doubtful Debts A/c (₹ 300 – ₹ 250)			50
	To Provision for Discount on Debtors A/c			84
	(Being the creation of necessary provision for bad and doubtful debts and discount on Debtors)			
	Closing Entries			
	Trading A/c	Dr.	38,710	
	To Opening Stock A/c			4,800
	To Purchases A/c			18,800
	To Wages A/c			15,000
	To Factory Lighting and Heating A/c			110
	(Being various accounts transferred to the Trading Account)			
	Sales A/c	Dr.	47,070	
	To Trading A/c			47,070
	(Being Sales Account transferred to the Trading Account)			
	Closing Stock A/c	Dr.	5,200	
	To Trading A/c			5,200
	(Being closing stock transferred to the credit of the Trading Account)			
	Trading A/c	Dr.	13,560	
	To Profit & Loss A/c			13,560
	(Being gross profit transferred to Profit & Loss Account)			
	Profit & Loss A/c	Dr.	3,713	
	To Salaries A/c			1,400
	To Rent A/c			600
	To Insurance A/c			630
	To General Expenses A/c			100

To Discount A/c To Bad Debts A/c To Depreciation on Furniture & Fittings A/c (Being various expenses transferred to the debit of the Profit & Loss Account)			650 320 13
Discount A/c To Profit & Loss A/c (Being discount received transferred to the credit of the Profit & Loss Account)	Dr.	370	 370
Profit & Loss A/c To Capital A/c (Being net profit transferred to Capital Account)	Dr.	10,083	 10,083

Bharat

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		4,800	By Sales	48,000	
To Purchases	21,350		Less: Returns inwards	930	47,070
Less: Returns outwards	550		By Closing stock		5,200
	20,800				
Less: Machinery purchase	2,000	18,800			
To Wages		15,000			
To Factory lighting & heating	80				
Add: Outstanding	30	110			
To Gross Profit c/d		13,560			
		52,270			52,270
To Salaries		1,400	By Gross Profit b/d		13,560
To Rent		600	By Discount		370
To Insurance		630			
To General expenses		100			
To Discount		650			
To Bad debts	250				
Add: Further bad debts	70	320			
To Provision for doubtful debts					
New	300				
Less: Old	250	50			
To Prov. for disc. on debtors @ 2% on ₹ 4,200		84			
To Depreciation on furniture @ 5% on ₹ 260		13			
To Net Profit (transferred to Capital Account)		10,083			
		13,930			13,930

Balance Sheet of Bharat as at 31st December, 2014

Liabilities	₹	₹	Assets	₹	₹
Capital: Opening balance	4,000		Plant & Machinery	5,000	
Add: Net Profit	10,083		Addition	2,000	7,000
	14,083		Motor van		1,200
Less: Drawings	700	13,383	Office furniture	260	
Bills payable		560	Less: Depreciation @ 5%	13	247
Sundry creditors		5,200	Sundry debtors	4,570	
Outstanding factory lighting & heating		30	Less: Further bad debts	70	
				4,500	
			Less: Provision for bad debts	300	
				4,200	
			Less: Provision for discount on debtors	84	4,116
			Closing stock		5,200
			Bills receivable		720
			Cash at bank		650
			Cash in hand		40
		19,173			19,173

Illustration 5

From the following figures extracted from the books of Govind, you are required to prepare a Trading and Profit and Loss Account for the year ended 31st March, 2015 and a Balance Sheet as on that date after making the necessary adjustments:

Particulars	₹	Particulars	₹
Shri Govind's capital	2,28,800	Stock 1.4.2014	38,500
Shri Govind's drawings	13,200	Wages	35,200
Plant and Machinery	99,000	Sundry Creditors	44,000
Freehold property	66,000	Postage & Telegrams	1,540

Purchases	1,10,000	Insurance	1,760
Returns outwards	1,100	Gas and fuel	2,970
Salaries	13,200	Bad debts	660
Office expenses	2,750	Office rent	2,860
Office furniture	5,500	Freight	9,900
Discounts A/c. (Dr.)	1,320	Loose tools	2,200
Sundry Debtors	29,260	Factory lighting	1,100
Loan to Shri Krishna @ 10% p.a. balance on 1.4.2014	44,000	Provision for Doubtful Debts	880
Cash at bank	29,260	Interest on loan to Shri Krishna	1,100
Bills payable	5,500	Cash in hand	2,640
Sales	2,31,440		

Adjustments :

1. Stock on 31st March, 2015 was valued at ₹ 72,600.
2. A new machine was installed during the year costing ₹ 15,400 but it was not recorded in the books as no payment was made for it. Wages ₹ 1,100 paid for its erection have been debited to wages account.
3. Depreciate Plant and Machinery by $33^1/_3$%; Furniture by 10%; and Freehold property by 5%.
4. Loose tools were valued at ₹ 1,760 on 31.3.2015.
5. Of the Sundry Debtors ₹ 660 are bad and should be written-off.
6. Maintain a provision of 5% on Sundry Debtors for doubtful debts.
7. The manager is entitled to a commission of 10% of the net profits after charging such commission.

[C.A. (Entrance) — Adapted]

Solution

Govind

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2015 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock (1.4.2014)		38,500	By Sales		2,31,440
To Purchases	1,10,000		By Closing Stock		72,600
Less: Returns	1,100	1,08,900			
To Wages	35,200				
Less: Wages for erection of machinery	1,100	34,100			
To Gas & Fuel		2,970			
To Freight		9,900			
To Factory lighting		1,100			
To Gross Profit c/d		1,08,570			
		3,04,040			3,04,040
To Salaries		13,200	By Gross Profit b/d		1,08,570
To Office expenses		2,750	By Interest	1,100	
To Postage and Telegram		1,540	Add: Outstanding	3,300	4,400
To Insurance		1,760			
To Office rent		2,860			
To Discount		1,320			
To Bad Debts		1,320			
To Provision for Doubtful debts:					
New provision	1,430				
Less: Old provision	880	550			
To Depreciation:					
On Machinery	38,500				
On Furniture	550				
On Freehold property	3,300				
On Loose tools	440	42,790			
To Commission to Manager (Note 1)		4,080			
To Net Profit (transferred to capital)		40,800			
		1,12,970			1,12,970

Balance Sheet of Govind as at 31st March, 2015

Liabilities	₹	₹	Assets	₹	₹
Capital:	2,28,800		Plant and Machinery	99,000	
Add: Net Profit	40,800		Add: New Machinery (15,400 + 1,100)	16,500	
	2,69,600			1,15,500	
Less: Drawings	13,200	2,56,400	Less: Depreciation	38,500	77,000
Bills Payable		5,500	Freehold property	66,000	
Sundry Creditors (₹ 44,000 + ₹ 15,400)		59,400	Less: Depreciation	3,300	62,700
Manager's Commission payable		4,080	Office furniture	5,500	

			Less: Depreciation	550	4,950
			Loose tools	2,200	
			Less: Depreciation	440	1,760
			Closing Stock		72,600
			Sundry Debtors	28,600	
			Less: Provision for doubtful debts	1,430	27,170
			Loan to Shri Krishna	44,000	
			Add: Interest outstanding	3,300	47,300
			Cash at bank		29,260
			Cash in hand		2,640
		3,25,380			3,25,380

Working Note : (1) Before charging manager's commission profit is ₹ 44,880. Let the profit after charging manager's commission be ₹ 100. Commission is payable @ 10%, i.e. ₹ 10. Therefore, profit before commission will be : ₹ 100 + 10 = ₹ 110. When profit before commission is ₹ 110 then commission will be ₹ 10. Therefore, when profit before commission is ₹ 44,800 then the commission will be : 10 / 110 x ₹ 44,880 = ₹ 4,080..

Illustration 6

From the following particulars extracted from the books of Ganguli, prepare Trading and Profit and Loss Account and Balance Sheet as at 31st March, 2015 after making the necessary adjustments :

Particulars	₹	Particulars	₹
Ganguli's Capital Account (Cr.)	54,050	Interest Received	725
Stock on 1.4.2014	23,400	Cash with Traders Bank Ltd.	4,000
Sales	1,44,800	Discounts Received	1,495
Sales Returns	4,300	Investments (at 5%) as on 1.4.2014	2,500
Purchases	1,21,550	Furniture as on 1.4.2014	900
Purchases Returns	2,900	Discounts Allowed	3,770
Carriage Inwards	9,300	General Expenses	1,960
Rent	2,850	Audit Fees	350
Salaries	4,650	Fire Insurance Premium	300
Sundry Debtors	12,000	Travelling Expenses	1,165
Sundry Creditors	7,400	Postage and Telegrams	435
Loan from Dena Bank Ltd. (at 12%)	10,000	Cash on Hand	190
Interest Paid	450	Deposits at 10% as on 1.4.2014 (Dr.)	15,000
Printing and Stationery	1,700	Drawings	5,000
Advertising	5,600		

Adjustments :

(1) Value of stock as on 31st March, 2015 is ₹ 39,300. This includes goods returned by customers on 31st March, 2015 to the value of ₹ 1,500 for which no entry has been passed in the books.

(2) Purchases include furniture purchased on 1st January, 2015 for ₹ 1,000.

(3) Depreciation should be provided on furniture at 10% per annum.

(4) The Loan Account from Dena Bank in the books of Ganguly appears as follows :

31.3.2015	To Balance c/d	10,000	1.4.2014	By Balance b/d	5,000
			31.3.2015	By Bank A/c	5,000
		10,000			10,000

(5) Sundry Debtors include ₹ 2,000 due from Robert and Sundry Creditors include ₹ 1,000 due to him.

(6) Interest paid include ₹ 300 paid to Dena Bank.

(7) Interest received represent ₹ 100 from the Sundry Debtors and the balance on investments and deposits.

(8) Provide for interest payable to Dena Bank and for interest receivable on investments and deposits.

(9) Make a provision for doubtful debts at 5% on the balance under "Sundry Debtors". No such provision need be made for the deposits.

Solution

Ganguli

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2015 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		23,400	By Sales	1,44,800	
To Purchases	1,21,550		Less: Sales Returns : ₹ (3,400 + 1,500)	5,800	1,39,000
Less: Purchase Returns	2,900		By Closing Stock		39,300
	1,18,650				

Less: Furniture purchase	1,000	1,17,650			
To Carriage Inwards		9,300			
To Gross Profit c/d		27,950			
		1,78,300			1,78,300
To Rent		2,850	By Gross Profit b/d		27,950
To Salaries		4,650	By Interest Received (Note 4)		1,725
To Interest (Note 1) : ₹ (450 + 300)		750	By Discount Received		1,495
To Printing and Stationery		1,700			
To Advertisement		5,600			
To Discount Allowed		3,770			
To General Expenses		1,960			
To Audit Fees		350			
To Fire Insurance Premium		300			
To Travelling Expenses		1,165			
To Postage and Telegrams		435			
To Provision for Doubtful Debts (Note 3)		475			
To Depreciation on Furniture : ₹ (90 + 25)		115			
To Net Profit (transferred to capital)		7,050			
		31,170			31,170

Balance Sheet of Ganguly as at 31st March, 2015

Liabilities	₹	₹	Assets	₹	₹
Capital:			Furniture	900	
Opening balance	54,050		Addition during the year	1,000	
Less: Net Profit during the year	7,050			1,900	
	61,100		Less : Depreciation	115	1,785
Less: Drawings	5,000	56,100	Investments		2,500
Loan from Dena Bank Ltd.		10,000	Deposits		15,000
Accrued Interest on Bank Loan (Note 1)		300	Accrued Interest on Deposits (Note 2)		1,000
Sundry Creditors : ₹ (7,400 – 1,000)		6,400	Stock-in-trade		39,300
			Sundry Debtors (Note 3)	9,500	
			Less: Provision for Doubtful Debts (Note 3)	475	9,025
			Cash with Traders Bank		4,000
			Cash in Hand		190
		72,800			72,800

Working Notes :

(1) Accrued Interest on Bank Loan		₹	**(3) Calculation of Provision for Doubtful Debts**	₹
Annual Interest @ 12% on ₹ 5,000		600	Sundry Debtors as per Trial Balance	12,000
Less: Interest paid to Dena Bank		300	Less: Sales Returns not recorded	1,500
Accrued Interest		300		10,500
(2) Interest Accrued on Deposits		₹	Less: Cancellation against Sundry Creditors	1,000
Annual interest on investments @ 5%	125		Final Balance of Sundry Debtors	9,500
Annual interest on deposits @ 10%	1,500	1,625	Provision for doubtful debts to be created @ 5%	475
Less: Interest received on investments and deposits		625	**(4)** Total interest received = ₹ 1,625 + 100 = ₹ 1,725.	
		1,000		

Illustration 7

From the following balances taken from the Ledger of Krishna on 31st March 2015, prepare the Trading and Loss Account for the year ended 31st March, 2015 and the Balance Sheet as at 31st March 2015 of Krishna **in vertical format** :

Particulars	₹	Particulars	₹
Sundry Creditors	19,000	Bad Debts	100
Building	15,000	Loan from Ram	2,500
Income tax	1,025	Sundry Debtors	9,500
Loose tools	1,000	Investments	6,500
Cash at Bank	16,200	Provision for Bad Debts	1,600
Sundry Expenses	1,990	Rent and Rates	850
Bank Interest (Cr.)	75	Furniture	3,000
Purchases	1,57,000	Stock (1-4-2014)	27,350
Wages	10,000	Capital	47,390
Carriage inwards	1,120	Discount allowed	630
Sales	1,85,000	Dividends received	535
Motor Van	12,500	Drawings	2,000
Cash in hand	335	Bills payable	10,000

Adjustments to be taken into account:

(a) Write-off further ₹ 300 as bad out of Sundry Debtors and create a provision for bad debts at 20% on Debtors.

(b) Dividends accrued and due on Investments is ₹ 135. Rates paid in advance ₹ 100 and wages owing ₹ 450.

(c) On 31.3.2015 stock was valued at ₹ 15,000 and Loose tools were valued at ₹ 800.

(d) Write-off 5% for depreciation on Buildings and 40% on Motor Van.

(e) Provide for interest at 12% p.a. due on Loan taken on 1.6.2014.

(f) Income-tax paid has to be treated as Drawings.

Solution

Krishna

Trading and Profit and Loss Account for the year ended 31st March, 2015

Particulars	₹	₹	₹
Sales			1,85,000
Opening Stock		27,350	
Purchases		1,57,000	
Wages	10,000		
Add: Outstanding	450	10,450	
Carriage inwards		1,120	
		1,95,920	
Less: Closing stock		15,000	1,80,920
Cost of goods sold			4,080
Gross Profit			75
Bank Interest			
Dividend on Investment		535	
Add: Accrued and due		135	670
			4,825
Less: Rent and Rates	850		
Less: prepaid	100	750	
Sundry expenses		1,990	
Interest on Loan (note 1)		250	
Depreciation:			
On Building @ 5%	750		
On Motor Van @ 40%	5,000		
On Loose tools @ 20%	200	5,950	
Discount allowed		630	
Bad debts (₹ 100 + ₹ 300)		400	
Provision for Bad Debts :			
New	1,840		
Less: Old	1,600	240	10,210
Net Loss (transferred to capital)			5,385

Balance Sheet of X as at 31 March, 2015

Particulars		₹	₹	₹
A. **Fixed Assets** :				
Building		15,000		
Less : Depreciation		750	14,250	
Motor Van		12,500		
Less : Depreciation		5,000	7,500	
Furniture (Note 2)			3,000	
Investment			6,500	31,250
Current Assets (x) :				
Loose Tools (Note 3)		1,000		
Less : Depreciation		200		
		800		
Dividend Accrued & Due		135		
Closing Stock		15,000		
Sundry Debtors	9,500			
Less: Bad Debts	300			
Less: Provision for bad debts	1,840	7,360		
Cash at bank		16,200		
Cash in hand		335		
Prepaid rates		100	39,930	
Current Liabilities (y) :				
Creditors for goods		19,000		
Outstanding wages		450		
Interest accrued on loans from Ram		250		
Bills payable		10,000	29,700	
B. **Working Capital** (x) – (y)				10,230
NET ASSETS EMPLOYED (A + B)				41,480

FINANCED BY :			
Capital	47,390		
Less: Net Loss	5,385	42,005	
Less: Drawings : ₹ (2,000 + 1,025)		3,025	38,980
Loan from Ram			2,500
			41,480

Working Notes : **(1)** Interest accrued on loan from Ram on ₹ 2,500 @ 12% for 10 months = ₹ 250.
(2) No Depreciation has been provided on Furniture for lack of information.
(3) Loose tools are treated as current assets.

Illustration 8

The following is the Trial Balance of Mr Mahesh as on 31.12.2014. Prepare a Trading and Profit and Loss Account for the year 2014 and the Balance Sheet as at 31.12.2014 from it :

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Purchases	1,80,000		Debtors	10,500	
Opening stock	10,000		Interest on loan	900	
Salaries less P.F.	5,400		Commission	200	
P.F. remittance incl. proprietor's contribution 50%	1,200		Building	30,000	
Rent @ ₹ 250 p.m.	2,750		Sales		2,05,000
Machinery	29,000		Loans (10% interest)		10,000
Wages	3,000		Creditors		15,000
Furniture & fittings	5,000		Capital		55,000
Electricity	550		Drawings	5,000	
Trade expenses	1,500		**TOTAL**	2,85,000	2,85,000

(1) On 1.1.2014 machinery worth ₹ 5,000 was sold for ₹ 4,000 and credited to Machinery Account. (2) Wages include ₹ 1,000 paid for machinery erection charges. (3) Purchases include cost of moped scooter for ₹ 5,000. (4) Proprietor has taken goods costing ₹ 1,000 for which no entry has been made. (5) Sundry debtors include ₹ 500 which had become bad. (6) Provide 10% provision for bad debts. (7) Electricity outstanding ₹ 50. (8) Goods costing ₹ 5,000 were destroyed by fire and insurance claim was received for ₹ 4,000. (9) Provide depreciation at 10% on machinery, furniture and moped. (10) Provide depreciation at 5% on Building. (11) Closing stock is ₹ 12,000.

Solution

Mahesh

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		10,000	By Sales		2,05,000
To Purchases	1,80,000		By Goods destroyed by fire (Note 1)		1,000
Less: Cost of Moped scooter	5,000	1,75,000	By Closing stock		12,000
To Wages	3,000		By Drawings (goods taken by proprietor)		1,000
Less: Wages for erection of machinery	1,000	2,000			
To Gross Profit c/d		32,000			
		2,19,000			2,19,000
To Salary	5,400		By Gross Profit b/d		32,000
Add: Provident Fund	600	6,000			
To Employer contribution to Provident Fund		600			
To Rent	2,750				
Add: Outstanding	250	3,000			
To Electricity	550				
Add: Outstanding	50	600			
To Commission		200			
To Trade expenses		1,500			
To Interest	900				
Add: Outstanding interest	100	1,000			
To Goods destroyed by fire		1,000			
To Bad debts		500			
To Provision for bad debts		1,000			
To Loss on sale of machinery		1,000			
To Depreciation on :					
Building	1,500				
Machinery	2,900				
Moped	500				
Furniture	500	5,400			
To Net Profit (transferred to Capital Account)		10,200			
		32,000			32,000

Balance Sheet of Mahesh as at 31st December, 2014

Liabilities	₹	₹	Assets	₹	₹
Capital Account	55,000		Building	30,000	
Add: Net Profit	10,200		Less: Depreciation	1,500	28,500
	65,200				
Less: Drawings (₹ 5,000 + 1,000)	6,000	59,200	Machinery	29,000	
Creditors		15,000	Add: Wages for erection	1,000	
10% Loan		10,000		30,000	
Outstanding Liabilities : Interest	100		Less: Loss on sale	1,000	
Rent	250			29,000	
Electricity	50	400	Less: Depreciation	2,900	26,100
			Moped Scooter	5,000	
			Less: Depreciation	500	4,500
			Furniture	5,000	
			Less: Depreciation	500	4,500
			Closing Stock		12,000
			Debtors	10,500	
			Less: Bad debts	500	
				10,000	
			Less: Provision for bad debts	1,000	9,000
		84,600			84,600

Working Note: **(1)** Total goods destroyed by fire is ₹ 5,000. Insurance claim of ₹ 4,000 has already been received and has been properly accounted for by debiting Cash Account and crediting Purchases Account. Now, adjustment is required for ₹ 1,000 only.

For adjustment of ₹ 1,000, the following entries are to be passed:

(i) Goods Destroyed by Fire Account	Dr.	1,000	
To Trading Account			1,000
(ii) Profit and Loss Account	Dr.	1,000	
To Goods Destroyed by Fire Account			1,000

Illustration 9

The accountant of M/s Kasturi Agencies extracted the following Trial Balance as on March 31, 2015.

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Capital		1,00,000	Stock as at 31.3.2015		32,000
Drawings		18,000	Establishment expenses	15,000	
Building	15,000		Freight inwards	2,000	
Furniture and fittings	7,500		Freight outwards		1,000
Motor van	25,000		Commission received		7,500
Loan from Hari @ 12% interest	15,000		Sundry debtors	28,100	
Interest paid on above	450		Bank balance	20,500	
Sales		1,00,000	Sundry creditors		10,000
Purchases	75,000				
Stock as at 1.4.2014	25,000		**TOTAL**	2,28,550	2,68,500

The accountant located the following errors but is unable to proceed any further.

(a) Totalling errors in bank column of payment side of Cash Book whereby the column was under totalled by ₹ 500.

(b) Interest on loan paid for the quarter ending December 31, 2014 ₹ 450, was omitted to be posted in the ledger. There was no further payment of interest.

(c) Goods received, on sale or return basis from Suppliers Ltd on 30th March, 2015 at a 'Proforma Invoice' cost of ₹ 5,000 have been recorded as purchase.

(d) Income tax refund of ₹ 1,900 has been recorded as receipt from debtors.

You are required to prepare the Trading and Profit and Loss Account for the year ended March 31, 2015 and the Balance Sheet as at that date, after carrying out the following:

Depreciation to be provided on: Building @ 2.5%; Furniture and fittings @ 10% p.a.; Motor van @ 25% p.a.

M/s Kasturi Agencies

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2015 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		25,000	By Sales		1,00,000
To Purchases (Note 1)		70,000	By Closing stock (Note 2)		27,000
To Freight inwards		2,000			
To Gross Profit c/f		30,000			
		1,27,000			1,27,000

To Establishment expenses		15,000	By Gross Profit b/d		30,000
To Depreciation on :			By Commission		7,500
Building @ 2.5%	375				
Furniture @ 10%	750				
Motor van @ 2.5%	6,250	7,375			
To Freight outwards		1,000			
To Interest	900				
Add: Outstanding	450	1,350			
To Net Profit (transferred to Capital Account)		12,775			
		37,500			37,500

Balance Sheet of M/s Kasturi Agencies as at 31st March, 2015

Liabilities	₹	₹	Assets	₹	₹
Capital A/c	1,00,000		**Fixed Assets**		
Add: Net Profit	12,775		Building	15,000	
	1,12,775		Less: Depreciation @ 2.5%	375	14,625
Less: Drawings	18,000		Furniture & fitxture	7,500	
	94,775		Less: Depreciation @ 10%	750	6,750
Add: Capital introduced (Note 3)	1,900	96,675	Motor van	25,000	
Loan from Hari		15,000	Less: Depreciation @ 2.5%	6,250	18,750
Interest outstanding on Loan		450	**Current Assets**		
Sundry creditors (Note 1)		5,000	Stock (Note 2)		27,000
			Sundry Debtors (Note 3 and 4)		30,000
			Bank balance		20,000
		1,17,125			1,17,125

Working Notes :

(1) Purchases of ₹ 75,000 includes goods of ₹ 5,000 which was received on sale or return basis. Therefore, to rectify this, the following entry is to be passed :

Creditors Account Dr. ₹ 5,000
To Purchases Account ₹ 5,000

Net effect :

(i) Purchases will be reduced by ₹ 5,000.

(ii) Sundry Creditors will be reduced by ₹ 5,000.

(2) Goods received on sale or return basis were included in the Stock also. Therefore, these are to be deducted from the value of closing stock. Final value of closing stock will be ₹ 27,000.

(3) Income tax refund has been recorded wrongly as payment by debtors. To rectify this, the following entry is to be passed :

Sundry Debtors Account Dr. ₹ 1,900
To Capital Account* ₹ 1,900

* New capital introduced.

(4) Final balance of Sundry Debtors = ₹ 28,100 + ₹ 1,900 = ₹ 30,000.

Illustration 10

The following is the schedule of balances as on 31.3.2015 extracted from the books of Shri Gavaskar, who carries on business under the same name and style of Messrs Gavaskar Viswanath & Co., at Bombay:

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Cash in hand	1,400		Interest on loan from Viswanath	2,700	
Cash at bank	2,600		Rates & taxes	2,100	
Sundry Debtors	86,000		Discount allowed to Debtors	2,400	
Stock on 1.4.2014	62,000		Discount received from creditors		1,600
Furniture & fixtures	21,400		Freight on purchases	1,200	
Office equipment	16,000		Carriage outwards	2,000	
Buildings	60,000		Drawings	12,000	
Motor car	20,000		Printing and Stationery	1,800	
Sundry creditors		43,000	Electricity charges	2,200	
Loan from Viswanath		30,000	Insurance premium	5,500	
Provision for bad debts		3,000	General office expenses	3,000	
Purchases	1,40,000		Bad debts	2,000	
Purchase Returns		2,600	Bank charges	1,600	
Sales		2,30,000	Motor car expenses	3,600	
Sales Returns	4,200		Capital A/c		1,62,000
Salaries	11,000				
Rent for godown	5,500		**TOTAL**	4,72,200	4,72,200

Prepare Trading and Profit and Loss Account for the year ended 31st March, 2015 and the Balance Sheet as at that date after making provision for the following :

1. Depreciate : (a) Building used for business by 5 percent; (b) Furniture and fixtures by 10 percent; One steel table purchased during the year for ₹ 1,400 was sold for same price but the sale proceeds were wrongly credited to Sales Account; (c) Office equipment by 15 percent; Purchase of a typewriter during the year for ₹ 4,000 has been wrongly debited to purchase; and (d) Motor car by 20 percent.
2. Stock consists of 11,000 units of goods purchased @ ₹ 4 per unit, but unit price has fallen to ₹ 3.25. This price reduction is anticipated to be permanent. The firm has already decided that if the price reduction lasts longer than two months it will reduce sale price of the item from ₹ 6.50 to ₹ 5.75.
3. One month's rent for godown is outstanding.
4. One month's salary is outstanding.
5. Interest on loan from Viswanath is payable at 12 percent per annum, this loan was taken on 1.5.2014.
6. Provision for bad debts is to be maintained at 5 per cent of Sundry Debtors.
7. Insurance premium includes ₹ 4,000 paid towards proprietor's life insurance policy and the balance of the insurance charges cover the period from 1.4.2014 to 30.6.2015.
8. Half of the buildings are used for residential purposes of Shri Gavaskar.
9. A debit balance of ₹ 420 existed in the creditors ledger at the end of March 2015, representing advance to supplier, the suppliers concerned cannot be traced and it has been decided to write-off the balance.
10. The actual cash balance in office cash box is ₹ 1,300.

Solution

M/s Gavaskar Viswanath & Co.

Dr. Trading and Profit and Loss Account for the year ended 31st, March 2015 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		62,000	By Sales	2,30,000	
To Purchases	1,40,000		Less: Sale of furniture included in sale	1,400	
Less: Typewriter included in purchases	4,000			2,28,600	
	1,36,000		Less: Sales Returns	4,200	2,24,400
Less: Purchase Returns	2,600	1,33,400	By Closing stock (Note 4)		44,000
To Freight on purchase		1,200			
To Gross Profit c/d		71,800			
		2,68,400			2,68,400
To Salaries	11,000		By Gross Profit b/d		71,800
Add: Outstanding	1,000	12,000	By Discount received		1,600
To Rent for Godown	5,500				
Add: Outstanding	500	6,000			
To Provision for Doubtful debts					
New	4,300				
Less: Old	3,000	1,300			
To Rent and taxes		2,100			
To Discount allowed		2,400			
To Carriage outwards		2,000			
To Printing and stationery		1,800			
To Electricity charges		2,200			
To Insurance premium (Note 1)		1,200			
To Depreciation (Note 2)		10,500			
To General office expenses		3,000			
To Bad debts		2,000			
To Bank charges		1,600			
To Interest on loan	2,700				
Add: Outstanding (Note 3)	600	3,300			
To Creditors A/c (Note 5)		420			
To Miscellaneous Expenses (Note 6)		100			
To Motor car		3,600			
To Net Profit (transferred to capital)		17,880			
		73,400			73,400

Balance Sheet of M/s Gavaskar Viswanath & Co. as at 31st March, 2015

Liabilities	₹	₹	Assets	₹	₹
Capital Account	1,62,000		Fixed Assets		
Add: Net Profit	17,880		Building	60,000	
	1,79,880		Less: Depreciation	3,000	57,000
Less: Drawings	12,000		Motor Car	20,000	
	1,67,880		Less: Depreciation	4,000	16,000

Less: Insurance premium	4,000		Office equipment (₹ 16,000 + ₹ 4,000)	20,000	
Less: 1/2 of Depreciation on Buildings	1,500	1,62,380	Less: Depreciation	3,000	17,000
Loan from Viswanath	30,000		Furniture & fixtures (₹ 21,400 – ₹ 1,400)	20,000	
Add: Outstanding	600	30,600	Less: Depreciation	2,000	18,000
Sundry Creditors (Note 5)		43,420	Current Assets		
Outstanding expenses :			Stock in trade		44,000
Salaries	1,000		Sundry Debtors	86,000	
Rent	500	1,500	Less: Provision for doubtful debts	4,300	81,700
			Cash at bank		2,600
			Cash in hand		1,300
			Prepaid insurance (Note 1)		300
		2,37,900			2,37,900

Working Notes : (1) Insurance Premium	₹	**(2) Calculation of Depreciation**		₹
Insurance premium as per Trial Balance	5,500	On Building @ 5% on ₹ 60,000	3,000	
Less: Proprietor's life insurance policy premium	4,000	Less: 1/2 for private use	1,500	1,500
Premium for 15 months	1,500	On Motor car @ 20% on ₹ 20,000		4,000
Less: Prepaid for 3 months	300	On Furniture & fittings @ 10% (₹ 21,400—₹ 1,400)		2,000
Charged to Profit and Loss A/c	1,200	On Office equipment as per Trial Balance	16,000	
		Addition (typewriter)	4,000	
			20,000	3,000
				10,500

(3) Calculation of Interest on Loan : (₹ 30,000 x 12 x 11) / 100 x 12 = ₹ 3,300; Outstanding ₹ 3,300 – ₹ 2,700 = ₹ 600.

(4) Para 24 of AS—2 states that ***materials and other supplies held for use in the production of inventories are not written down below cost, if the finished products in which they will be incorporated are expected to be sold at or above cost***.
In this case, though the unit price has fallen to ₹ 3.25 from ₹ 4.00, the stock will be valued @ ₹ 4.00 because it will not exceed the revised selling price of ₹ 5.75.
Therefore, the value of the stock will be : 11,000 × ₹ 4.00 = ₹ **44,000**.

(5) In the creditors ledger a debit balance of ₹ 420 existed representing advance to supplier. At the time of preparation of trial balance net amount of creditors was shown.
Actual position was as follows :
₹ 43,420 (Cr.) less 420 (Dr.). Therefore, net amount ₹ 43,000.
Now the supplier can not be traced. Therefore, it is to be written-off by passing the following entry :
Profit and Loss Account Dr. ₹ 420
To Suppliers / Creditors Account ₹ 420
Final balance of creditors in the Balance Sheet will be ₹ 43,420 (Cr.) after cancellation of ₹ 420 (Dr.)

(6) Cash book balance is ₹ 1,400 but Cash box balance is ₹ 1,300. This difference can be treated as miscellaneous expenses and charged to Profit and Loss Account. The final balance of cash in the Balance Sheet will be ₹ 1,300.

Illustration 11

Below is given the Trial Balance of Ghosh and Guha Co. as on 31st March, 2015. The partners share profit as Ghosh 2/3; and Guha 1/3rd upto 50% of the distributable profit to the company and the balance equally :

Debit Balances	₹	**Credit Balances**	₹
Freehold premises	1,50,000	Capital Account	
Plant and Machinery	45,000	Ghosh	50,000
Wages	20,000	Guha	30,000
Opening stock :		Sundry creditors	25,000
Finished goods	40,000	Sales (net)	3,25,000
Raw materials	20,000	Discount	2,500
Work-in-progress	18,000	Bad debts provision	1,500
Sundry Debtors	50,000	Commission	10,000
Carriage inwards	1,500	Guha Loan A/c	30,000
Carriage outwards	900		
Factory expenses	7,500		
Royalties	1,500		
Purchases of raw materials (net)	75,000		
Factory rent & taxes	6,500		
Discount	2,900		
Office rent	4,000		
Insurance	2,000		

Bad debts	1,500		
Office expenses	7,500		
Salaries of works manager	12,000		
Cash at bank	8,200		
	4,74,000		4,74,000

The following additional information is to be taken into consideration :

(a) Closing stock : Finished goods ₹ 50,000; Raw materials ₹ 30,000; Work-in-process ₹ 25,000;

(b) Outstanding liabilities to be provided for wages ₹ 5,000; Office salaries ₹ 6,000; and Office rent ₹ 2,000.

(c) Bad debts provision to be adjusted to 2.5% on Sundry debtors, Insurance premium paid in advance ₹ 500.

(d) Depreciate freehold premises by 2.5% and plant and machinery by 5%.

(e) Partnership salary to be allowed to Ghosh ₹ 6,000 and Guha ₹ 3,000. The Loan Account of Guha was raised in the books before the commencement of the year.

You are required to prepare the Trading and Profit and Loss Account for the year ended 31st March 2015 and the Balance Sheet at that date.

Solution **Ghosh & Guha Company**

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2015 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Raw Materials consumed:			By Work-in-progress		
Opening	20,000		Closing	25,000	
Add: Purchase	75,000		Less: Opening	18,000	7,000
	95,000		By Cost of production c/d		1,14,250
Less: Closing	30,000	65,000			
To Wages	20,000				
Add: Outstanding wages	5,000	25,000			
To Carriage inwards		1,500			
To Factory expenses		7,500			
To Royalties		1,500			
To Factory rent & taxes		6,500			
To Salaries of works manager		12,000			
To Depreciation of plant and machinery		2,250			
		1,21,250			1,21,250
To Cost of production b/d		1,14,250	By Sales		3,25,000
To Opening stock of finished goods		40,000	By Closing stock of finished goods		50,000
To Gross Profit c/d		2,20,750			
		3,75,000			3,75,000
To Carriage outwards		900	By Gross Profit b/d		2,20,750
To Discount		2,900	By Discount		2,500
To Office rent	4,000		By Commission		10,000
Add: Outstanding	2,000	6,000	By Provision for bad debts:		
To Insurance	2,000		Old	1,500	
Less: Insurance paid in advance	500	1,500	Less: New	1,250	250
To Office expenses		7,500			
To Office salaries outstanding		6,000			
To Bad Debts		1,500			
To Depreciation on premises		3,750			
To Net Profit c/d		2,03,450			
		2,33,500			2,33,500

Dr. Profit & Loss Appropriation Account for the year ended 31st March, 2015 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Interest on loan @ 6% to Guha		1,800	By Net Profit b/d		2,03,450
To Salary to Partners					
Ghosh	6,000				
Guha	3,000	9,000			
To Net Divisible Profit (transferred to Capital A/c)					
Ghosh	1,12,380				
Guha	80,270	1,92,650			
		2,03,450			2,03,450

Balance Sheet of Ghosh & Guha Co. as at 31st March, 2015

Liabilities	₹	₹	Assets	₹	₹
Capital Account:			Freehold premises	1,50,000	
Ghosh	50,000		Less: Depreciation @ 2.5%	3,750	1,46,250
Add: Salary	6,000		Plant & Machinery	45,000	
Add: Net Profit	1,12,380	1,68,380	Less: Depreciation	2,250	42,750
Guha	30,000		Sundry Debtors	50,000	
Add: Interest on Loan	1,800		Less: Provision for bad debt	1,250	48,750
Salary	3,000		Stock in trade:		
Net Profit	80,270	1,15,070	Finished goods	50,000	
Sundry creditors		25,000	Raw materials	30,000	
Guha's Loan A/c		30,000	Work-in-progress	25,000	1,05,000
Outstanding Liabilities for expenses :			Cash at bank		8,200
Wages	5,000		Insurance paid in advance		500
Office rent	2,000				
Office salaries	6,000	13,000			
		3,51,450			3,51,450

Advanced Adjustments

1. Pre-payment and Outstanding

Illustrative Example 1

Beta, a sole proprietor, prepares his financial statements for the year to 31st March each year. He pays rent for his premises quarterly in advance on 1 December, 1 March, 1 June and 1 September. The annual rent was ₹ 84,000 until 31st May, 2014. It was increased from that date to ₹ 96,000 per year. What rent expenses and end year prepayment should be included in the financial statements for the year end 31st March, 2015 ?

Solution

	₹
Rent Expenses	
(i) 2/12 × ₹ 84,000 (April + May)	14,000
(ii) 10/12 × ₹ 96,000	80,000
	94,000
Prepayment	
2/12 × ₹ 96,000	16,000

Tutorial Note :

On 1st March, 2015 Beta paid ₹ 24,000 for the month of March, April and May, 2015. Payment for April and May 2015 will be treated as prepayments.

Illustrative Example 2

During the year 2014, cash payments of ₹ 1,56,000 were made in respect of general operating expenses. As at 31st December 2013, outstanding and prepayments in respect of such expenses were ₹ 6,744 and ₹ 3,328 respectively. The following information is relevant for determining the equivalent figures at 31st December, 2014.

Item	Amount (₹)	Payment Date	Details
Rates	13,000	30 November, 2014	Quarter ending 28 February, 2015
Electricity	9,678	1 January, 2015	Quarter ending 31 December, 2014
Heat and Light	5,167	11 December, 2014	Six months ending 30 November, 2014
Telephone	2,978	30 October, 2014	Quarter ending 30 October, 2014 (includes ₹ 1,905 rental for lease line for internet for quarter ending 31 January, 2015)
Telephone	3,148 (Estimated)	31 January, 2015	Quarter ending 31 January, 2015 (includes ₹ 1,905 rental for lease line for internet for quarter ending 30 April, 2015)

You are required to :

(i) calculate the amount of outstanding and prepayments of general operating expenses which will be shown in the Balance Sheet as at 31 December, 2014.

(ii) calculate the amount of general operating expenses which will be charged to Profit and Loss Account for the year ended 31 December, 2014.

Solution

(1) Calculation of Outstanding and Prepayments of General Operating Expenses

Expenses	Notes	Outstanding (₹)	Prepayments (₹)
Rates	(1)	—	8,667
Electricity	(2)	9,678	—
Heat and Light	(3)	861	—
Telephone	(4)	829	635
Total		11,368	9,302

Dr. General Operating Expenses Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Jan. 1	To Prepaid Expenses A/c	3,328	Jan. 1	By Oustanding Expenses A/c	6,744
?	To Bank / Cash A/c	1,56,000	Dec. 31	By Profit and Loss A/c	1,54,650
Dec. 31	To Outstanding Expenses A/c	11,368	"	By Prepaid Expenses A/c	9,302
		1,70,696			1,70,696

Amount of General Operating Expenses to be charged to Profit and Loss Account = ₹ 1,54,650.

Working Notes :

(1) Rates : ₹ 13,000 was paid on 30 November, 2014 for three months, i.e., for December, 2014, January and February, 2015. Therefore, prepaid amount of rates = ₹ 13,000 / 3 × 2 = ₹ 8,667.

(2) Electricity : ₹ 9,678 was payable for the quarter ending on 31 December, 2014 but it was paid on 1 January, 2015. Therefore, the entire amount will be treated as outstanding expenses for the year 2014.

(3) Heat and Light : ₹ 5,167 was paid for 6 months ending on 30th November. Therefore, outstanding amount for the year 2014 will be : ₹ 5,167 / 6 × 1 = ₹ 861.

(4) Telephone : (i) ₹ 1,905 was paid on 30 October for lease line for 3 months, i.e., for November and December 2014 plus January 2015. Therefore, prepaid amount will be : ₹ 1,905 / 3 × 1 = ₹ 635.

(ii) ₹ 1,243 (₹ 3,148 – ₹ 1,905) is payable on 31 January, 2015 for November and December 2014 and January 2015. Therefore, the amount of outstanding will be : ₹ 1,243 / 3 × 2 = ₹ 829.

2. Inventories

Illustrative Example 3

Cost of inventory obtained from physical count on 31st March, 2015 — ₹ 77,700. This figure does not include any amounts for the two items below :

(i) An inventory line which had cost ₹ 1,800 was found to be damaged. Remedial work costing ₹ 300 is needed to enable the items to be sold for ₹ 1,700. Selling expenses of ₹ 100 would also be incurred in selling these items.

(ii) Goods sent to a customer on approval in February, 2015 were not included in the inventory. The sale price of the goods was ₹ 4,000 and the cost ₹ 3,000. The customer notified his acceptance of the goods in April, 2015.

You are required to compute the adjusted closing inventory figures from this information.

Solution **Computation of Adjusted Closing Inventory**

As per inventory count	₹ 77,700
Damaged items (₹ 1,700 – ₹ 300 – ₹ 100)	*1,300
Goods on approval	3,000
	82,000

* Inventory is valued at lower of cost and net realisable value. Here, cost is ₹ 1,800 but NRV is ₹ 1,300. Therefore, the value of damaged items will be ₹ 1,300.

3. Depreciation

Illustrative Example 4

J K is the sole proprietor of a business which is involved in the purchase and resale of software packages for use on personal computers. He is currently engaged in preparing his annual accounts for the year ended on 31st December, 2014, and has asked your assistance for calculating the amount of depreciation for the year 2014. The following information is available in respect of fixed assets. As at 1st January, 2014, the original cost and accumulated depreciation of the fixed assets held by the business were as follows :

Asset	Original Cost (₹)	Accumulated Depreciation (₹)
Buildings	3,56,782	1,55,985
Furnitures	1,01,545	46,328
Motor Vehicles	92,874	51,301
Total	5,51,201	2,53,614

During the year, the business acquired new assets as follows :

Asset	Six Months to 30th June, 2014 (₹)	Six Months to 31st December, 2014 (₹)	Total (₹)
Buildings	—	65,800	65,800
Furnitures	27,385	10,100	37,485
Motor Vehicles	28,954	—	28,954
Total	56,339	75,900	1,32,239

During the year, the following fixed asset disposals were made :

Asset	Original Cost (₹)	Accumulated Depreciation at 31st December, 2013 (₹)	Proceeds (₹)
Furnitures — 7th April, 2014	6,300	2,175	2,000
10th September, 2014	31,907	10,548	52,058
Motor Vehicles — 31st August, 2014	21,560	10,870	14,300
Total	59,767	23,593	68,358

The fixed assets are depreciated on a straight-line basis and to an estimated residual value of zero over the following economic lives :

Buildings	20 years
Furnitures	7 years
Motor Vehicles	4 years

Depreciation is calculated on a semi-annual basis, with a full six months' charge in the half-year of acquisition and no charge in the half-year of disposal.

You are required to calculate the amount of depreciation for the year 2014.

Solution **Depreciation Charge for the year 2014**

Particulars	Original Cost ₹	Depreciation ₹
Buildings		
Balance b/d	3,56,782	
Less: Disposal	—	
Add: Acquisition	—	
Balance at 30.6.2014	3,56,782	
Depreciation for 6 months (₹ 3,56,782 / 20 x 6/12)		8,920
Less: Disposal	—	
Add: Acquisition	65,800	
Balance at 31.12.2014	4,22,582	
Depreciation for 6 months (₹ 4,22,582 / 20 x 6/12)		10,565
Total		19,485
Furnitures		
Balance b/d	1,01,545	
Less: Disposal	(6,300)	
Add: Acquisition	27,385	
Balance at 30.6.2014	1,22,630	
Depreciation for 6 months (₹ 1,22,630 / 7 x 6/12)		8,759
Less: Disposal	(31.907)	
Add: Acquisition	10,100	
Balance at 31.12.2014	1,00,823	
Depreciation for 6 months (₹ 1,00,823 / 7 x 6/12)		7,202
Total		15,961
Motor Vehicles		
Balance b/d	92,874	
Less: Disposal	—	
Add: Acquisition	28,954	
Balance at 30.6.2014	1,21,828	
Depreciation for 6 months (₹ 1,21,828 / 4 x 6/12)		15,229
Less: Disposal	(21,560)	
Add: Acquisition	—	
Balance at 31.12.2014	1,00,268	
Depreciation for 6 months (₹ 1,00,268 / 4 x 6/12)		12,534
Total		27,763

4. Commission to Manager

Sometimes, the manager of a concern is given a percentage of the net profit as commission. Since it is an expense like salaries, we must account for it. The entry will be :

Profit and Loss Account Dr.

To Commission Account

If the amount is not paid within the accounting period, it will be shown in the liability side of the Balance Sheet. The problem arises as to the ascertainment of the amount payable as commission. This is because the commission may be paid at a certain percentage before or after charging such commission.

The calculation of commission in the above two cases are different.

Case 1 : When commission is paid at a fixed percentage of net profit before charging such commission.

$$\text{Commission} = \text{Net Profit before commission} \times \text{Rate of commission}$$

Illustrative Example 5

The manager is entitled to a commission of 10% on net profit before charging such commission. Net Profit before charging such commission is ₹ 1,10,000. Find out the commission payable to manager.

Solution

Commission = Net Profit before Commission x Rate of Commission = ₹ 1,10,0000 x 10% = ₹ 11,000.

Case 2 : When commission is paid at a fixed percentage of net profit after charging such commission.

$$\text{Commission} = \text{Net Profit before such commission} \times \frac{\text{Rate of commission}}{100 + \text{Rate of commission}}$$

Illustrative Example 6

The manager is entitled to a commission of 10% on net profit after charging such commission. Net Profit before charging such commission is ₹ 1,10,000. Find out the commission payable to manager.

Solution

$$\text{Commission} = \text{Net Profit before such commission} \times \frac{\text{Rate of commission}}{100 + \text{Rate of commission}} = ₹\ 1{,}10{,}000 \times \frac{10}{110} = ₹\ 10{,}000.$$

Alternatively,

Let total commission payable be x

x = 10% (₹ 1,100,000 – x) or x = 11,000 – .1x or 1.1x = 11,000 or x = ₹ 10,000.

Illustrative Example 7

(i) The General Manager is to be given commission of 10% after charging the commission of Works Manager and his own on net profits.

(ii) The Works Manager is to be given commission of 5% after charging commission of General Manager and his own on net profits. Such commission shall be calculated to the nearest multiple of a rupee.

(iii) Net profit before charging commission = ₹ 82,960.

Calculate the commission of general manager and works manager.

Solution

In this case, commission payable to General Manager and Works Manager are to be calculated with the help of simultaneous equations.

Let x be the total commission to General Manager

Let y be the total commission to Works Manager

Therefore,

x = 10/110 (₹ 82,960 – y) . . . . (1)

y = 5/105 (₹ 82,960 – x) . . . . (2)

or, x = .09091 (₹ 82,960 – y)

or, x + .091y = 7541.818 . . . . (3)

Similarly, y = .04762 (₹ 82,960 – x)

or, .04762x + y = ₹ 3,950.476 . . . . (4)

Multiplying equation 4 by 21 and 3 by 1 we get the following :

x + 21y = 82,960 . . . . (5)

x + .091y = 7,541.818 . . . . (6)

20.909y = 75,418.18 (Subtracting 6 from 5)

y = 75,418.18 / 20.909 = ₹ **3,607**

x = 82,960 – 21 x 3,609.97 = ₹ 7,213.58, say ₹ **7,214**.

5. Stationery Included in Opening Stock and Closing Stock

Illustrative Example 8

From the following information, calculate the amount of stationery is to be charged to Profit and Loss Account and also show the effect on opening stock, closing stock, purchases and trade expenses, etc.

(i) Opening stock ₹ 50,000.
(ii) Closing stock ₹ 45,000.
(iii) Opening stock and closing stock include stock of stationery, amounting to ₹ 2,000 and ₹ 1,500 respectively. Trade expenses include payment for stationery of ₹ 18,000. Credit purchases of stationery for ₹ 4,500 recorded as ordinary purchases. Stationery of ₹ 500 is consumed by the proprietor.

Solution

(i) Amount of Stationery to be Charged to Profit and Loss Account

Particulars	₹
Opening Balance of Stationery	2,000
Add : Cash Purchases of Stationery included in Trade Exp.	18,000
Add: Credit Purchases of Stationery included in Purchase	4,500
	24,500
Less: Closing Balance of Stationery	1,500
	23,000
Less: Stationery Consumed by the Proprietor	500
	22,500

(ii) Opening stock is to be reduced by ₹ 2,000.
The balance of ₹ 48,000 is to be debited to Trading Account.
(iii) Closing stock is to be reduced by ₹ 1,500.
The balance of ₹ 43,500 is to be credited to Trading Account.
(iv) Purchases is to be reduced by ₹ 4,500
(v) Trade expenses is to be reduced by ₹ 18,000
(vi) Drawings will be increased by ₹ 500.
(vii) Stock of stationery will be shown in the Balance Sheet as a separate item.

6. Loss or Profit on Sale / Exchange of an Asset

Any loss on sale / exchange of an asset will be debited to Profit and Loss Account. Similarly, any profit on sale / exchange will be credited to Profit and Loss Account. For calculating loss / profit on sale or exchange, the W.D.V. on the date of sale and exchange or sale value are to be compared. If the exchange or sale value is less than the W.D.V., then there is a loss. If the exchange or sale value is more than the W.D.V., then there is a profit.

[*See Chapter 9 for details*.]

Illustrative Example 9

(i) Furniture appearing in the Trial Balance of X as on 31.12.2015 at ₹ 56,000.
(ii) Rate of depreciation on furniture 10% p.a.
(iii) Furniture appearing in the book on 1.1.2015 at ₹ 16,000 was disposed of on 30.6.2015 at ₹ 13,500 in part exchange of a new furniture costing ₹ 15,000. The net invoice for ₹ 1,500 was passed through Purchases Day Book.

Calculate : (a) Loss on exchange of furniture; (b) Total depreciation is to be charged to Profit and Loss Account and (c) Book value of furniture on 31.12.2015.

Solution

(i) Depreciation on old furniture in use = 10% (₹ 56,000 – ₹ 16,000) = ₹ 4,000. Depreciation on new furniture for 6 months @ 10% p.a. on ₹ 15,000 = ₹ 750. Therefore, total depreciation on furniture in use = ₹ 4,000 + ₹ 750 = ₹ 4,750.
(ii) Depreciation on furniture disposed of = 10% of ₹ 16,000 for 6 months = ₹ 800.
(iii) Total amount of depreciation is to be charged to Profit and Loss Account = ₹ 4,750 + ₹ 800 = ₹ **5,550**.

(iv) Loss on Exchange

Particulars	₹
Book value of furniture on 1.1.2015	16,000
Less : Depreciation for 6 months @ 10%	800
Written-down value on 30.6.2015	15,200
Less : Exchange value	13,500
	1,700

(v) Book Value of Furniture on 31.12.2015

	₹
Opening balance	56,000
Less : Book value of Furniture sold	16,000
	40,000
Add: Purchase of new furniture	15,000
	55,000
Less : Depreciation (i)	4,750
	50,250

7. Goods Sent on Consignment

When goods are sent on consignment basis, the cost of the goods sent either deducted from Purchases or credited to Trading Account. Profit or loss from consignment is transferred to Profit and Loss Account. Any stock on consignment left with the consignee will be valued at cost or market price (N.R.V.) whichever is lower. The value of such goods is shown in the Balance Sheet only. For calculating profit, Consignment Account is to be prepared.

Illustrative Example 10

Trial Balance of X as at 31.3.2015

Heads of Account	Dr. (₹)	Cr. (₹)
Stock on 1.4.2014	4,00,000	
Purchases	8,00,000	
Suspense Account of P		40,000
Capital		6,00,000
Other balances	2,00,000	7,60,000
	14,00,000	14,00,000

Additional information : Goods costing ₹ 1,00,000 were consigned to P for sale on 10% commission basis. P sold 4/5th of the goods at a profit of 20% on sales. The unsold stock was to be valued at cost. P sent an advance of ₹ 40,000 which was credited to his Suspense Account.

You are required to make necessary adjustments for consignment transactions and also show relevant Ledger Accounts.

Solution

No entry has been made in respect of transaction relating to consignment except cash received from P which has been credited to Suspense Account of P. The following adjustment entries are to be passed in this respect:

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

Date	Particulars		₹	₹
2015 March 31	(i) **For Goods Sent on Consignment**			
	Consignment to P A/c	Dr.	1,00,000	
	To Goods Sent on Consignment A/c			1,00,000
	(ii) **For Sale of Goods by P**			
	P A/c (Note 1)	Dr.	1,00,000	
	To Consignment to P A/c			1,00,000
	(iii) **For Commission at 10% on Sales**			
	Consignment to P A/c	Dr.	10,000	
	To P A/c			10,000
	(iv) **For Stock on Consignment**			
	Stock on Consignment A/c	Dr.	20,000	
	To Consignment to P A/c			20,000
	(v) **For Adjusting Purchases**			
	Goods Sent on Consignment A/c	Dr.	1,00,000	
	To Purchases A/c			1,00,000
	(vi) **For Closing Suspense Account of P**			
	Suspense Account of P	Dr.	40,000	
	To P A/c			40,000

Dr. **P Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to P A/c (Sales)	1,00,000		By Suspense Account of P	40,000
				By Consignment to P A/c (Commission)	10,000
				By Balance c/d	50,000
		1,00,000			1,00,000

Dr. **Consignment to P Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c	1,00,000		By P A/c (Note 1)	1,00,000
	To P A/c (commission)	10,000		By Stock on Consignment A/c	20,000
	To Profit on Consignment A/c	10,000			
		1,20,000			1,20,000

Dr. **Goods Sent on Consignment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Purchases A/c	1,00,000		By Consignment to P A/c	1,00,000

Net Effect

(1) Profit on consignment of ₹ 10,000 will be credited to Profit and Loss Account.
(2) ₹ 1,00,000 will be deducted from Purchases. Net purchases of ₹ 7,00,000 will be shown in the Trading Account.
(3) Stock on consignment of ₹ 20,000 will be shown in the assets side of the Balance Sheet.
(4) Suspense Account of P will be eliminated.
(5) Amount due from P of ₹ 50,000 will be shown in the assets side of the Balance Sheet.

Working Notes :

(1) Cost of goods sold = 4/5 of ₹ 1,00,000 = ₹ 80,000. Goods are sold at a profit of 20% on sales i.e. 25% on cost. Therefore, sales = ₹ 80,000 + 25% of ₹ 80,000 = ₹ 1,00,000.

(2) Cost of goods unsold = 1/5 of ₹ 1,00,000 = ₹ 20,000.

8. Profit / Loss on Joint Venture

Any profit earned from Joint Venture will be credited to Profit and Loss Account.

Illustrative Example 11

Trial Balance of X as at 31.3.2015

Heads of Account	Dr. (₹)	Cr. (₹)
Stock on 1.4.2014	4,00,000	
Purchases	8,00,000	
Suspense Account of Q	20,000	
Capital and other Balances		12,20,000
	12,20,000	12,20,000

Additional information :

(i) A joint venture was made with Q for which an advance of ₹ 20,000 was made. The venture yield a profit of ₹ 18,000, 2/3 of which is attributable to X.

You are required to make necessary adjustments for joint venture transactions and also show relevant Ledger Accounts.

Solution

No entry has been made in respect of transaction relating to joint venture except cash sent to Q which has been debited to Suspense Account of Q. The following adjustment entries are to be passed :

Journal **Dr. Cr.**

Date	Particulars		₹	₹
2015	(i) **For Closing Suspense Account of Q**			
March 31	Q A/c	Dr.	20,000	
	To Suspense Account of Q			20,000
	(ii) **For Profit on Joint Venture**			
	Q A/c (Note 1)	Dr.	12,000	
	To Profit and Loss A/c			12,000

Dr. Q Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Suspense Account of Q	20,000		By Balance c/d	32,000
	To Profit and Loss A/c	12,000			
		32,000			32,000

Net Effect

(1) Share of profit on joint venture of ₹ 12,000 will be credited to Profit and Loss Account.

(2) Balance of ₹ 32,000 in the Q Account will be shown in the Balance Sheet in the assets side.

(3) Suspense Account of Q will be eliminated.

Working Note :

(1) Total profit on joint venture is ₹ 18,000; 2/3rd belongs to X. Therefore, ₹ 12,000 will be credited to Profit and Loss Account of X.

Illustrative Example 12

Trial Balance of X as at 31.3.2015

Heads of Account	Dr. (₹)	Cr. (₹)
Stock on 1.4.2014	40,000	
Purchases and Sales	1,60,000	3,00,000
Joint Venture Suspense Account	2,000	
Sundry Debtors and Sundry Creditors	88,000	60,000
Other Assets	3,10,000	
Capital		1,40,000
Other Liabilities		1,00,000
	6,00,000	6,00,000

Additional information : On 1.1.2015, X entered into a joint venture with Y on an equal profit sharing basis. Y supplied goods costing ₹ 30,000 which were recorded through Purchases Day Book. X sold these goods at a gross profit of 25% on sales and included these in Sales Account. Y spent ₹ 1,000 in despatching goods for which no entry was made. Joint Venture Suspense Account represented the expenses incurred by X. You are required to make necessary adjustments in respect of joint venture transactions and also show the relevant Ledger Accounts.

Solution

Goods sent by Y in connection with joint venture was wrongly recorded through Purchases Day Book. In the ledger, Purchases Account was debited and Sundry Creditors Account was credited. For joint venture transactions, the following adjustment entries are to be passed:

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

Date	Particulars		₹	₹
2015 March 31	(i) **For Cancelling Purchases** Joint Venture with Y A/c To Purchases A/c	Dr.	30,000	30,000
	(ii) **For Adjusting Creditors** Sundry Creditors A/c To Y A/c	Dr.	30,000	30,000
	(iii) **For Recording Expenses paid by Y** Joint Venture with Y A/c To Y A/c	Dr.	1,000	1,000
	(iv) **For Cancelling Joint Venture Suspense Account** Joint Venture with Y A/c To Joint Venture Suspense A/c	Dr.	2,000	2,000
	(v) **For Joint Venture Sales** Sales A/c To Joint Venture with Y A/c	Dr.	40,000	40,000

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

Date	Particulars	₹	Date	Particulars	₹
	To Balance c/d	34,500		By Sundry Creditors A/c	30,000
				By Joint Venture with Y A/c (expenses)	1,000
				By Joint Venture with Y A/c (share of profit)	3,500
		34,500			34,500

Dr. **Joint Venture with Y Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Purchases A/c	30,000		By Sales A/c (Note 1)	40,000
	To Y A/c (Expenses)	1,000			
	To Joint Venture Suspense A/c (expenses)	2,000			
	To Profit and Loss A/c (share of profit)	3,500			
	To Y A/c (share of profit)	3,500			
		40,000			40,000

Net Effect

(1) Purchases will be reduced by ₹ 30,000.
(2) Sales will be reduced by ₹ 40,000.
(3) Sundry Creditors will be reduced by ₹ 30,000.
(4) Joint Venture Suspense Account will be eliminated.
(5) Balance due to Y ₹ 34,500 will be shown in the Balance Sheet as a liability.

Working Note : **(1)** Profit on sale is 25%, i.e. $33^1/_3$% profit on cost. Therefore, sales = ₹ 30,000 + $33^1/_3$ of ₹ 30,000 = ₹ 40,000.

9. Petty Cash

For meeting small expenses, e.g. purchase of stationery, purchase of newspaper, and so on, head cashier transfers a small amount to a petty cashier. At the time of transferring money, Petty Cash Account is debited and Cash Account is credited. When the given amount of money is exhausted, the petty cashier submits the petty cash vouchers to get the reimbursement from the head cashier. For recording petty expenses different Petty Expenses Accounts are debited and Petty Cash Account is credited. At the end of the accounting period, the above entries are passed (even if the money is not exhausted) to record the petty expenses upto the closing date. The balance in the petty cash account is carried forward to the next accounting period.

Illustrative Example 13

Trial Balance (Extract)

Heads of Account	Dr. (₹)	Cr. (₹)
Petty Cash Account	1,000	
Petty Cash Expenses	9,600	

Additional information : The petty cash balance represents the month-end imprest system. As on the closing date the petty cashier had vouchers totalling ₹ 400 for which he had not received reimbursement from the head cashier.

You are required to pass adjusting entry for petty expenses.

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

Date	Particulars	₹	₹
	Petty Cash Expenses Dr. To Petty Cash A/c (Being the adjustment for petty cash expenses)	400	400

Net Effect

(1) Petty cash expenses of ₹ 10,000 (₹ 9,600 + ₹ 400) will be debited to Profit and Loss Account.

(2) Petty cash of ₹ 600 (₹ 1,000 – ₹ 400) will be shown in the Balance Sheet.

Illustration 12

From the following balances extracted from the books of a trader on December 31, 2014, prepare a Trading and Profit and Loss Account for the year ended on that date and also a Balance Sheet as on the same day :

Particulars	₹	Particulars	₹
Cash in hand	480	Capital Account	42,500
Drawings	7,100	Sales	1,19,060
Plant and Machinery	9,500	Purchases Return	2,910
Stock in Trade	14,600	Bank Overdraft	1,200
Purchases	1,03,620	Creditors	10,000
Sales Return	2,100	Provision for Doubtful Debts	1,050
General Expenses	2,000		
Wages	2,400		
Rent and Rates	3,200		
Bad Debts	1,720		
Debtors	30,000		
	1,76,720		1,76,720

Note :

(a) Provide 10% depreciation on plant and machinery.

(b) Provision for doubtful debts is to be increased to 5% of debtors.

(c) A credit sale of ₹ 2,000 has not been recorded in the books.

(d) Plant and machinery worth ₹ 1,000 purchased during the year (on September 30, 2014) has been included in Purchases.

(e) Rent paid in advance ₹ 800.

(f) Stock on December 31, 2014 was valued at ₹ 17,300. These does not include the value of the machinery bought on 30.9.2014.

(g) Wages include ₹ 200 for installation of plant.

Solution

Dr. **Trading and Profit and Loss Account for the year ended 31st December, 2014** **Cr.**

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		14,600	By Sales	1,19,060	
To Purchases	1,03,620		Add: Unrecorded Sales	2,000	
Less: Purchase of Machine	1,000			1,21,060	
	1,02,620		Less: Sales Return	2,100	1,18,960
Less: Purchase Return	2,910	99,710	By Closing Stock		17,300
To Wages	2,400				
Less: Installation of Machine	200	2,200			
To Gross Profit c/d		19,750			
		1,36,260			1,36,260
To General Expenses		2,000	By Gross Profit b/d		19,750
To Rent and Rates	3,200				
Less: Prepaid	800	2,400			
To Bad Debts		1,720			
To Depreciation on machinery (Note 1)		980			
To Provision for Doubtful Debts :					
New Provision	1,600				
Less: Old Provision	1,050	550			
To Net Profit (Transferred to Capital)		12,100			
		19,750			19,750

Balance Sheet as at 31st December, 2014

Liabilities	₹	₹	Assets	₹	₹
Capital	42,500		Plant and Machinery	9,500	
Add: Net Profit	12,100		Add: Purchase	1,000	
	54,600			10,500	
Less: Drawings	7,100	47,500	Add: Installation Charge	200	
Creditors		10,000		10,700	
Bank Overdraft		1,200	Less: Depreciation (Note 1)	980	9,720
			Stock		17,300
			Debtors	30,000	
			Add: Unrecorded Sales	2,000	
				32,000	
			Less: Provision for Doubtful Debts (Note 2)	1,600	30,400
			Prepaid Rent		800
			Cash		480
		58,700			58,700

Working Note :

(1) Depreciation on Plant and Machinery

	₹
On existing plant and machinery (₹ 9,500 × 10/100)	950
On new purchase for 3 months (₹ 1,000 + ₹ 200) × 10/100 × 3/12	30
	980

(2) Required provision for doubtful debts = 50% of ₹ 32,000 = ₹ **1,600**.

Illustration 13

From the following prepare the Trading and Profit and Loss Account for the year ended 31st March, 2015 and Balance Sheet of Mr Z as on that date :

Particulars	₹	Particulars	₹
Capital	50,450	Machinery, Plant and Furniture (cost ₹ 25,000)	15,000
Trade Creditors	10,000	Book Debts	16,400
Bills Payable	1,000	Bank Balance (Dr.)	3,400
General Reserve	5,000	Investment, 4% Government Loan at par	10,000
Provision for Bad and Doubtful Debts	1,000	Bills Receivable	5,050
Sales	75,000	Salaries and Wages	13,000
Discount Allowed	750	Audit Fee	2,000
Stock at April 1, 2014	15,000	Office Expenses	2,000
Purchases	48,000	Repairs and Renewals	1,800
Discount Received	400	Interest Paid	700
Building	10,000	Bad Debts Recovered	250

Additional information :

(a) The value of Stock on hand as at 31st March, 2015 was ₹ 18,000 included goods costing ₹ 900 received on 30th March, 2015 in respect of which supplier's bill had not yet been received.

(b) Goods of the cost of ₹ 1,500 were sent to a customer on sale on approval basis but recorded in Sales Book at sales price of ₹ 2,000. Approval for the sale were not received till 31st March, 2015.

(c) Provisions were made for doubtful debts to the extent of ₹ 400 and for depreciation on building at 2% per annum.

(d) Machinery, Plant and Furniture was depreciated at 20% on the diminishing value; Mr. Z, however, considered that the proper method would be 8% on the original cost and wanted to adopt it from April 1, 2013.

Solution

Mr. Z

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2015 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		15,000	By Sales	75,000	
To Purchases	48,000		Less: Goods sent on approval basis		
Add: Unrecorded Purchases	900	48,900	not yet approved	2,000	73,000
To Gross Profit c/d		28,600	By Closing Stock	18,000	
			Add: Cost of goods lying with customers	1,500	19,500
			on approval basis		
		92,500			92,500
To Salaries and Wages		13,000	By Gross Profit b/d		28,600
To Office Expenses		2,000	By Discount Received		400
To Repairs and Renewals		1,800	By Bad Debt Recovery		250

To Discount Allowed		750	By Provision for Doubtful Debts :		
To Audit Fee		2,000	Old Provision	1,000	
To Interest		700	Less: New Provision	400	600
To Depreciation on :			By Interest on Investment (Note 2)		400
Building	200		By Machinery, Plant and Furniture (Note 1)		1,750
Machinery, Plant and Furniture	2,000	2,200	(Excess depreciation written back)		
To Net Profit (Transferred to Capital)		9,550			
		32,000			32,000

Balance Sheet of Mr. Z as at 31st March, 2015

Liabilities	₹	₹	Assets	₹	₹
Capital	50,450		Building	10,000	
Add: Net Profit	9,550	60,000	Less: Depreciation	200	9,800
General Reserve		5,000	Machinery, Plant and Furniture	15,000	
Trade Creditors	10,000		Add: Excess Depreciation provided	1,750	
Add: Unrecorded Purchases	900	10,900		16,750	
Bills Payable		1,000	Less: Depreciation for 2014-15	2,000	14,750
			Closing Stock	18,000	
			Add: Cost of goods lying with customers	1,500	19,500
			Book Debts	16,400	
			Less: Sale Price of goods lying with customers on approval basis	2,000	
				14,400	
			Less: Provision for Doubtful Debts	400	14,000
			Bills Receivable		5,050
			Investment (4% Govt. Loan at par)	10,000	
			Add: Accrued Interest	400	10,400
			Bank		3,400
		76,900			76,900

Working Notes :

(1) Machinery, Plant and Furniture - Change in Method of Depreciation

W.D.V. on 1.4.2013 = ₹ 15,000 + 20/80 of ₹ 15,000 = ₹ 18,750.

Depreciation to be provided = 8% of ₹ 25,000 = ₹ 2,000.

Excess depreciation to be written back = ₹ 3,750 – ₹ 2,000 = ₹ 1,750.

Depreciation for 2014-15 = 8% of ₹ 25,000 = ₹ 2,000.

(2) Accrued Interest = 4% of ₹ 10,000 = ₹ **400**.

Illustration 14

From the following balances extracted from the books of a trader on December 31, 2014, prepare a Trading and Profit and Loss Account for the year ended on that date and also a Balance Sheet as on same date :

Debit Balances	₹	Credit Balances	₹
Drawings Account	7,100	Capital Account	42,500
Plant and machinery	9,500	Sales	1,19,060
Stock on 1.1.2014	14,600	Purchases Return	2,910
Purchases	1,03,620	Bank Overdraft	1,200
Sales Return	2,100	Creditors	10,000
General Expenses	2,000	Provision for Doubtful Debts	1,050
Wages	2,400		
Rent and Rates	3,200		
Bad Debts	1,720		
Debtors	30,000		
Cash in Hand	480		
	1,76,720		1,76,720

Notes :

(i) Provide 10% depreciation on plant and machinery.

(ii) Provision for doubtful debts is to be increased to 5% of Debtors.

(iii) A credit sale of ₹ 2,000 has not been recorded in the books.

(iv) Plant and machinery worth ₹ 1,000 purchased during the year (on September 30, 2014) has been included in Purchases.

(v) Stock on 31.12.2014 has been valued at ₹ 17,300. This does not include the value of the plant and machinery bought on 30.09.2014.

(vi) Wages includes ₹ 200 for installation of plant.

(vii) Goods costing ₹ 600 have been stolen by a dishonest employee.

(viii) ₹ 510 received from a Debtor whose balance was written off as bad, has been recorded as cash sale.

(ix) A sales return of ₹ 500 was not entered in the accounts though it was duly taken in the stock.

(x) Goods (cost price ₹ 720) (minimum sale price ₹ 900) was consigned to an agent. But those remain still unsold.

Solution

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		14,600	By Sales	1,19,060	
To Purchases	1,03,620		Less: Sales Return (2,100 + 500)	2,600	
Less: Purchase Return	2,910			1,16,460	
	1,00,710		Less: Bad Debts recovery included in Sales	510	
Less: Goods Stolen	600			1,15,950	
	1,00,110		Add: Unrecorded Credit Sales	2,000	1,17,950
Less: Purchase of Plant and Machinery	1,000		By Closing Stock		17,300
	99,110				
Less: Goods Sent on Consignment (cost)	720	98,390			
To Wages	2,400				
Less: Installation of Plant	200	2,200			
To Gross Profit c/d		20,060			
		1,35,250			1,35,250
To General Expenses		2,000	By Gross Profit b/d		20,060
To Rent and Rates		3,200	By Bad Debts Recovery		510
To Bad Debts		1,720			
To Goods Stolen		600			
To Provision for Doubtful Debts					
Provision required 5% of ₹ 31,500	1,575				
Less: Existing Provision	1,050	525			
To Depreciation on Plant and Machinery (Note 1)		980			
To Net Profit (Transferred to Capital)		11,545			
		20,570			20,570

Balance Sheet as at 31st December, 2014

Liabilities	₹	₹	Assets	₹	₹
Capital	42,500		Plant and Machinery	9,500	
Add: Net Profit	11,545		Add: Purchase of Machinery	1,000	
	54,045		Add: Installation charges	200	
Less: Drawings	7,100	46,945		10,700	
Creditors		10,000	Less: Depreciation (Note 1)	980	9,720
Bank Overdraft		1,200	Stock		17,300
			Consignment Stock (at cost)		720
			Debtors	30,000	
			Add: Unrecorded Sales	2,000	
				32,000	
			Less: Unrecorded Sales Return	500	
				31,500	
			Less: Provision for Doubtful Debts @ 5%	1,575	29,925
			Cash		480
		58,145			58,145

Working Note :

(1) Depreciation on Plant and Machinery

	₹
On existing plant and machinery (₹ 9,500 × 10/100)	950
On new purchase for 3 months (₹ 1,000 + ₹ 200) × 10/100 × 3/12	30
	980

Illustration 15

X started a business on January 1, 2014 with ₹ 10,000 in cash, ₹ 5,000 in goods and ₹ 10,000 in furniture. His Trial Balance on December 31, 2006 was drawn as follows :

Particulars	₹	Particulars	₹
Bad Debts	3,500	Capital	30,000
Stock in Trade	5,000	Creditors	5,000
Furniture	15,000	Loan	2,400
Drawings	4,500	Commission Received	200
Wages	1,800	Sales	28,700
Purchases	18,000		
Advertisement	1,400		
Debtors	9,000		
Cash	3,200		
Interest on Loan	400		
Commission Paid	600		
Miscellaneous Expenses	700		
Insurance Premium	800		
Salaries	2,400		
	66,300		66,300

Prepare Trading Account, Profit and Loss Account for the year ended December 31, 2014 and a Balance Sheet as at December 31, 2014 after taking into consideration the following :

(i) Goods valued at ₹ 15,000 were destroyed by fire; against this an insurance claim of ₹ 10,000 was to be received.

(ii) During the year, proprietor had taken goods of ₹ 2,000 for personal consumption. The value of the remaining stock in hand was ₹ 8,000.

(iii) Depreciate furniture by 10% p.a.. The addition to furniture was made on 1st April.

(iv) Y, a debtor for ₹ 2,000 was declared insolvent, only 50 paise in the rupee was receivable against his estate.

(v) Create a provision for doubtful debts at 5% and provision for discount at 20% on Debtors as well as on Creditors.

(vi) Goods sold to Robin for ₹ 500 wrongly debited to Rathin's Account.

(vii) Cheque issued to a Creditor for ₹ 800 was wrongly debited to Purchase Account.

(viii) 1/4th of advertisement expenses is to be carried forward.

Solution

X

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Stock in Trade		5,000	By Sales		28,700
To Purchases	18,000		By Goods destroyed by Fire		15,000
Less: Drawings	2,000		By Closing Stock		8,000
	16,000				
Less: Cheque paid to Creditor, wrongly debited to Purchases A/c	800	15,200			
To Wages		1,800			
To Gross Profit c/d		29,700			
		51,700			51,700
To Bad Debts		3,500	By Gross Profit b/d		29,700
To Goods Destroyed by Fire (Loss)		5,000	By Commission Received		200
To Depreciation on Furniture (Note 6)		1,375	By Provision for Discount on Creditors (20% of ₹ 4,200)		840
To Advertisement	1,400				
Less: Unexpired (1/4 of ₹ 1,400)	350	1,050			
To Interest on Loan		400			
To Commission Paid		600			
To Miscellaneous Expenses		700			
To Insurance Premium		800			
To Salaries		2,400			
To Provision for Doubtful Debts (Note 2)		1,350			
To Prov. for Discount on Debtors (Note 3)		1,530			
To Net Profit (Transferred to Capital)		12,035			
		30,740			30,740

Balance Sheet of X as at 31st December, 2014

Liabilities	₹	₹	Assets	₹	₹
Capital (10,000 + 5,000 + 10,000)	25,000		Furniture	10,000	
Add: Additional Capital Introduced	5,000		Add: Purchases	5,000	
	30,000			15,000	
Less: Drawings (4,500 + 2,000)	6,500		Less: Depreciation	1,375	13,625
	23,500		Closing Stock		8,000
Add: Net Profit	12,035	35,535	Debtors (Note 1)	9,000	
Loan		2,400	Less: Provi. for Doubtful Debts (Note 3 & 4)	1,350	
Creditors	5,000			7,650	
Less: Cheque issued wrongly included			Less: Prov. for Disc. on Debtors (Note 3)	1,530	6,120
in Purchases	800		Insurance Company — Claim receivable		10,000
	4,200		Cash		3,200
Less: Provision for Discount			Advertisement (Note 5)		350
(20% of ₹ 4,200)	840	3,360			
		41,295			41,295

Working Notes :

(1) For goods sold to Robin wrongly debited to Rathin's Account, the following rectification entry will be passed :

Robin's Account	Dr.	500	
To Rathin's Account			500

(2) Provision for Doubtful Debtors

	₹
Specific provision (for Debtory Y) ₹ 2,000 × 50/100	1,000
General provision (for other Debtors) (₹ 9,000 – ₹ 2,000) × 5/100	350
Total provision required	1,350

(3) Provision for Discount on Debtors = ₹ 7,650 × 20/100 — 1,530

(4) Specific provision for doubtful debt (Debtor Y) has been created as the amount is still receivable.

(5) It has been assumed that 1/4 of the advertisement expenses is prepaid.

(6) Depreciation on Furniture :

	₹
On ₹ 10,000 @ 10% for full year	1,000
On ₹ 5,000 @ 10% for 9 months	375
	1,375

Illustration 16

The following Trial Balance was extracted from the books of Mr Roy as on 31st March, 2015 :

Particulars	Dr. (₹)	Particulars	Cr. (₹)
Plant and Machinery	2,00,000	Capital Account	8,00,000
Manufacturing Wages	3,45,000	Sundry Creditors	4,65,060
Salaries	1,58,500	Bank Loan @ 12% Interest taken on 01.08.2014	1,50,000
Furniture	1,00,000	Purchase Returns	17,400
Freight on Purchase	18,600	Sales	25,08,500
Freight on Sales	21,400	Provision for Doubtful Debts	20,000
Buildings	2,40,000		
Manufacturing Expenses	95,000		
Insurance and Tax	42,500		
Patent and Trademark	2,50,000		
General Expenses	74,000		
Factory Fuel and Power	12,800		
Sundry Debtors	8,02,000		
Factory Lighting	9,500		
Stock (31.3.2014)	3,42,000		
Motor Car	1,20,000		
Purchases	10,20,000		
Sales Returns	31,000		
Bad Debts	14,000		
Bank Charges	4,000		
Interest on Bank Loan	8,000		
Cash at Bank	42,000		
Cash in Hand	11,200		
	39,61,500		39,61,500

Prepare the Trading and Profit and Loss Accounts for the year ended 31st March, 2015 and a Balance Sheet as on that date taking into consideration the following information :

(a) Stock in hand as on 31st March, 2015 was :
Cost price — ₹ 3,05,000
Net realisable value — ₹ 3,20,000.

(b) Depreciate plant and machinery @ 10% p.a.; furniture @ 5% p.a.; and motor car by ₹ 10,000.

(c) Mr Basak, a customer from whom ₹ 15,000 was due, declared insolvent and nothing is expected to be realised out of his estate. Create provision for doubtful debts at 5% on general debtors.

(d) ₹ 5,000 is due from Mr Basu Ray and at the same time ₹ 8,000 is due to him.

(e) A commission of 1% on the gross profit is to be provided to Works Manager.

(f) General Manager is to be allowed a commission @ 2% on net profit after charging Works Manager's commission and before charging General Manager's commission.

(g) Two cheques of ₹ 2,000 and ₹ 5,000 were deposited into bank on 29th March, 2015 but were credited by the bank on 5th April, 2015.

Solution

Mr. Roy

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2015 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		3,42,000	By Sales	25,08,500	
To Manufacturing Wages		3,45,000	Less: Sales Returns	31,000	24,77,500
To Freight on Purchases		18,600	By Closing Stock (Note 4)		3,05,000
To Manufacturing Expenses		95,000			
To Factory Fuel and Power		12,800			
To Factory Lighting		9,500			
To Purchases	10,20,000				
Less: Purchases Returns	17,400	10,02,600			
To Gross Profit c/d		9,57,000			
		27,82,500			27,82,500
To Salaries		1,58,500	By Gross Profit b/d		9,57,000
To Freight on Sales		21,400			
To Insurance and Tax		42,500			
To General Expenses		74,000			
To Bad Debts		14,000			
To Bank Charges		4,000			
To Interest on Bank Loan	8,000				
Add: Outstanding (Note 5)	4,000	12,000			
To Depreciation on :					
Plant and Machinery	20,000				
Furniture	5,000				
Motor Car	10,000	35,000			
To Provision for Doubtful Debts :					
New Provision	54,100				
Less: Old Provision (Note 2)	20,000	34,100			
To Net Profit before Commission		5,61,500			
		9,57,000			9,57,000
To Commission to Works Manager (Note 6)		9,570	By Net Profit before Commission		5,61,500
To Commission to General Manager (Note 7)		11,039			
To Net Profit (Transferred to Capital)		5,40,891			
		5,61,500			5,61,500

Balance Sheet of X as at 31st March, 2015

Liabilities	₹	₹	Assets	₹	₹
Capital	8,00,000		Buildings		2,40,000
Add: Net Profit	5,40,891	13,40,891	Plant and Machinery	2,00,000	
Bank Loan @ 12%	1,50,000		Less: Depreciation	20,000	1,80,000
Add: Outstanding	4,000	1,54,000	Furniture	1,00,000	
Sundry Creditors	4,65,600		Less: Depreciation	5,000	95,000
Less: Mutual Debt	5,000	4,60,600	Motor Car	1,20,000	
Commission Payable to :			Less: Depreciation	10,000	1,10,000
Works Manager	9,570		Patent and Trademark		2,50,000
General Manager	11,039	20,609	Closing Stock		3,05,000
			Debtors	8,02,000	
			Less: Mutual Debt	5,000	

				7,97,000	
			Less: Provision for Doubtful Debts	54,100	7,42,900
			Bank		42,000
			Cash in Hand		11,200
		19,76,100			19,76,100

Working Notes :

(1) Specific provision should be created for Mr Basak as nothing is yet realised from his estate.

(2) Required Provision for Doubtful Debts

	₹
Specific provision (Mr Basak)	15,000
Provision on general debtors (₹ 8,02,000 – ₹ 5,000 – ₹ 15,000) × 5/100	39,100
	54,100

(3) For two cheques of ₹ 2,000 and ₹ 5,000 deposited into bank on 29th March, 2015 which were credited on 5th April, 2015, nothing is required to be done as Balance Sheet is prepared with Bank Balance as per Cash Book.

(4) Closing Stock is valued at cost or Net Realisable Value (NRV) whichever is lower. Here, cost ₹ 3,05,000 is lower than NRV (₹ 3,20,000). Therefore, the value of closing stock will be ₹ 3,05,000.

(5) Interest on bank loan for 8 months = (₹ 1,50,000 × 12% × 8/12) = ₹ 12,000. ₹ 8,000 has already been paid. Therefore, ₹ 4,000 (₹ 12,000 – ₹ 8,000) is outstanding.

(6) Commission Payable to Works Manager = 1% of Gross Profit = 1% of ₹ 9,57,000 = ₹ 9,570.

(7) Commission Payable to General Manager

	₹
Net Profit before Commission of Works Manager	5,61,500
Less: Works Manager's Commission (Note 6)	9,570
Net Profit after Commission of Works Manager	5,51,930
Less: General Manager's Commission @ 2% of ₹ 5,51,930	11,039
Net Profit after General Manager's Commission	5,40,891

Illustration 17

Rico Traders prepared the following Trial Balance with the balances of the accounts drawn on 31 December, 2014 :

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Capital		5,00,000	Carriage inward	1,000	
Sundry Creditors		45,000	Carriage outward	5,000	
Goods Sent on Consignment		30,000	Return inward	4,000	
Provision for Doubtful Debt		10,000	Salary	40,000	
Provision for Depreciation		15,000	Advertisement	10,000	
Bank Loan (Interest rate 15% p.a.)		10,000	Stationery and Printing	5,000	
Consignment (Profit)		5,000	Discount	6,000	4,000
Land	3,20,000		Advance Salary	3,500	
Furniture	40,000		Electricity and Telephone	6,800	
Debtors	80,000		Sales		2,10,000
Opening Stock	60,000		Bills Payable		15,000
Closing Stock	75,000		Cash in Hand	28,700	
Purchase (Less Closing Stock)	1,30,000		Cash at Bank	20,000	
Rent	9,000		**TOTAL**	8,44,000	8,44,000

Adjustments :

(a) The closing stock was valued at market price. But the cost price per unit of product was ₹ 12 which at that time was lower than market price by ₹ 3.

(b) ₹ 35,000 which was receivable from the consignee was included in Debtors Account. Bad debt was ₹ 3,000 and 5% provision for doubtful debt was to be made on Debtors.

(c) Depreciation on depreciable fixed assets was to be charged @ 10% per annum on diminishing balance method.

(d) The benefits from advertisement would be received for 5 years.

(e) Cash found short by ₹ 1,000 at the time of cash counting.

Prepare Trading and Profit & Loss Account for the year ended 31 December, 2014 and a Balance Sheet as on that date.

Solution

Rico Traders

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		60,000	By Sales	2,10,000	
To Purchases (including Closing Stock)		2,05,000	Less: Return Inwards	4,000	2,06,000
To Carriage Inwards		1,000	By Goods Sent on Consignment		30,000
To Gross Profit c/d		30,000	By Closing Stock	75,000	
			Less: Reduction in Value of Stock (Note 1)	15,000	60,000
		2,96,000			2,96,000

	₹	₹		₹	₹
To Rent		9,000	By Gross Profit b/d		30,000
To Salary		40,000	By Consignment – Profit		5,000
To Advertisement (Note 4)		10,000	By Discount Received		4,000
To Carriage Outwards		5,000	By Provision for Doubtful Debts :		
To Printing and Stationery		5,000	Old Provision	10,000	
To Discount Allowed		6,000	Less: New Provision	2,100	7,900
To Electricity and Telephone		6,800	By Net Loss (Transferred to Capital)		42,900
To Cash (Shortage) (Note 3)		1,000			
To Depreciation on Furniture (Note 2)		2,500			
To Interest on Bank Loan		1,500			
To Bad Debts		3,000			
		89,800			89,800

Balance Sheet of Rico Traders as at 31st December, 2014

Liabilities	₹	₹	Assets	₹	₹
Capital	5,00,000		Land	3,20,000	
Less: Net Loss	42,900	4,57,100	Furniture	40,000	
Bank Loan	10,000		Total Fixed Assets	3,60,000	
Add: Outstanding Interest	1,500	11,500	Less: Provision for Depreciation	17,500	3,42,500
Sundry Creditors		45,000	(₹ 15,000 + 2,500)		
Bills Payable		15,000	Stock		60,000
			Debtors	80,000	
			Less: Due from Consignee	35,000	
				45,000	
			Less: Bad Debts	3,000	
				42,000	
			Less: Provision for Doubtful Debts	2,100	39,900
			Due from Consignee		35,000
			Advance Salary		3,500
			Bank		20,000
			Cash	28,700	
			Less: Shortage	1,000	27,700
		5,28,600			5,28,600

Working Notes : (1) Reduction in Stock		**(2) Depreciation on Furniture**
Cost price per unit	₹ 12	(₹ 40,000 – ₹ 15,000) × 10/100 = ₹ 2,500
Market price pre unit	₹ 12 + ₹ 3 = ₹ 15	**(3)** Cash shortage will be treated as misappropriation by employees and
Closing stock (at cost)	₹ 75,000 x (₹ 12 / ₹ 15) = ₹ 60,000	it is assumed that there is no insurance coverage. It is incidental to
Reduction in stock	₹ 75,000 – ₹ 60,000 = ₹ 15,000.	business and normal and should be charged to Profit and Loss Account.

(4) Though the effects of advertisement is expected to last for 5 years, 4/5 of ₹ 10,000, i.e., ₹ 8,000 cannot be shown as an asset in the Balance Sheet as Deferred Revenue Expenditure. Because the framework for preparation and presentation of Financial Statements states that "***An asset is recognised in the Balance Sheet when it is probable that the future economic benefits associated with it will flow to the enterprise and the asset has a cost or value that can be measured reliably***.
Therefore, the entire amount of advertisement expenses of ₹ 10,000 is to be charged to the Profit and Loss Account.
[For details, see Chapter 13 : 'Revenue Recognition – Page 13.8 (Recognition of Expenses).]

Illustration 18

The following Trial Balance has been prepared by Acharya as on 31.3.2015 :

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Capital and Drawings	3,600	90,400	Furniture and Fixtures	3,100	
Stock (1.4.2014)	12,300		Bad Debts	560	
Wages	16,400		Provision for Bad Debts		480
Plant and Machinery	34,000		Patent and Trademark	4,100	
Sundry Debtors	13,160	*1,000	Electricity	1,290	
Sundry Creditors		12,750	Loose Tools	1,510	
Purchases and Sales	52,300	99,150	Advertisement Suspense	4,200	
Freehold Property	29,700		Gas and Fuel	2,050	
Returns	320	540	Insurance	1,330	
Salaries	12,800		Bank	5,200	
Rent	2,400		Cash	2,140	
Outstanding Rent		200			
Trade Expenses	2,060		**TOTAL**	2,04,520	2,04,520

*Advance

Additional information :

(i) Stock was not taken on 31.3.2015 but actually taken on 7.4.2015 at ₹ 10,200. Transactions during the week ended 7.4.2015 were :
Sales — ₹ 12,800; Purchases — ₹ 8,100
A uniform $16\frac{2}{3}\%$ profit is made on the selling price.

(ii) ₹ 510 received from a debtor whose balance had been written-off as bad, was recorded as Cash Sale.

(iii) Private goods of Acharya costing ₹ 2,400 sold for ₹ 2,880 was included in Sales.

(iv) Advance from customers is entitled to 12% interest which is due for 2 months.

(v) Electricity expenses include a deposit of ₹ 600 to the W.B. State Electricity Board.

(vi) The effect of advertisement is expected to last for the coming two years also.

(vii) A furniture costing ₹ 1,600 purchased on 31.12.2014 from M/s Assam Furniture Mart on credit was omitted to be recorded.

(viii) Cash embezzled by a dishonest employee — ₹ 900.

(ix) Patent and Trademark is to be amortized in 10 equal instalments.

(x) Provision for Bad Debts is to be adjusted to 5% of Sundry Debtors; Loose Tools are valued at ₹ 1,020. Provide depreciation : @ 10% p.a. on Plant and Machinery; and @ 15% p.a on Furniture.

You are required to prepare Trading and Profit and Loss Account for the year ended 31st March, 2015 and a Balance Sheet as on that date.

Solution

Acharya

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2015 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		12,300	By Sales	99,150	
To Purchases	52,300		Less: Returns	320	
Less: Returns	540	51,760		98,830	
To Wages		16,400	Less: Bad Debts Recovery	510	
To Gas and Fuel		2,050		98,320	
To Gross Profit c/d		25,697	Less: Sale of Private Goods	2,880	95,440
			By Closing Stock (Note 1)		12,767
		1,08,207			1,08,207
To Salaries		12,800	By Gross Profit b/d		25,697
To Rent		2,400	By Bad Debts Recovered		510
To Trade Expenses		2,060	By Net Loss (transferred to Capital Account)		3,756
To Bad Debts		560			
To Electricity	1,290				
Less: Deposit	600	690			
To Advertisement Suspense (Note 3)		4,200			
To Insurance		1,330			
To Cash Embezzlement		900			
To Interest on Customers' Advance		20			
To Provision for Bad Debts :					
New	658				
Less: Old	480	178			
To Depreciation on :					
Plant and Machinery	3,400				
Furniture (Note 2)	525				
Loose Tools (₹ 1,510 – 1,020)	490	4,415			
To Amortization of Patent and Trademark		410			
		29,963			29,963

Balance Sheet of Acharya as at 31st March, 2015

Liabilities	₹	₹	Assets	₹	₹
Capital :			Freehold Property		29,700
Opening balance	90,400		Plant and Machinery	34,000	
Add: Capital Introduced (private goods)	2,880	93,280	Less: Depreciation	3,400	30,600
Less: Net Loss	3,756		Furniture and Fixtures	3,100	
Drawings	3,600	7,356	Add: Further Purchased	1,600	
		85,924		4,700	
Customers' Advance	1,000		Less: Depreciation (Note 2)	525	4,175
Add: Outstanding Interest	20	1,020	Patent and Trademark	4,100	
Sundry Creditors		12,750	Less: Amortization	410	3,690

Creditors for Furniture		1,600	Loose Tools	1,510	
Outstanding Rent		200	Less: Depreciation	490	1,020
			Closing Stock (Note 1)		12,767
			Sundry Debtors	13,160	
			Less: Provision for Bad Debts	658	12,502
			Deposit with WBSEB		600
			Bank		5,200
			Cash	2,140	
			Less: Embezzlement	900	1,240
		1,01,494			1,01,494

Working Notes: (1) Calculation of Closing Stock : Valuation of stock is given as ₹ 10,200 on 7.4.2015. But we are to find out the value of stock as on 31.3.2015. For that, we are to prepare a Memorandum Trading Account for the period 31.3.2015 to 7.4.2015, as under:

Dr. **Memorandum Trading Account for the Period 31.3.2015 to 7.4.2015** **Cr.**

Particulars	₹	Particulars	₹
To Opening Stock (Balancing figure)	12,767	By Sales	12,800
To Purchases	8,100	By Closing Stock	10,200
To Gross Profit ($16\frac{2}{3}$ % of ₹ 12,800)	2,133		
	23,000		23,000

Therefore, the value of closing stock on 31st March, 2015 was ₹ 12,767.

(2) Depreciation on ₹ 3,100 has been charged for the full year and on ₹ 1,600 for 3 months. Therefore, total depreciation : ₹ 465 + 60 = ₹ 525.

(3) Though the effect of advertisement is expected to last for the coming two years also, 2/3rd of ₹ 4,200, i.e., ₹ 2,800 cannot be shown as an asset in the Balance Sheet as Deferred Revenue Expenditure. This is because of the following :
"***An asset is recognised in the Balance Sheet when it is probable that the future economic benefits associated with it will flow to the enterprise and the asset has a cost or value that can be measured reliably.***"
Therefore, the entire amount of advertisement suspense of ₹ 4,200 is to be charged to the Profit and Loss Account.

Illustration 19

From the following Trial Balance of Sri Samaddar, prepare a Trading and Profit and Loss Account for the year ending on 31st December, 2014 and a Balance Sheet as on that date after taking into consideration the necessary adjustments :

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Capital and Drawings	10,200	95,000	Furniture and Fixture	8,600	
Stock (1.1.1998)	18,900		Trade Expenses	12,650	
Purchases and Sales	1,38,600	2,02,000	Outstanding Trade Expenses		1,600
Printing and Stationery	2,600		Provision for Doubtful Debts		2,200
Debtors and Creditors	22,800	16,020	Bad Debt Recovered		700
Freehold Premises	39,000		Income Tax	7,900	
Deposit with Das at 10% (since 30.6.2014)	18,000		Bank Balance	6,950	
Salaries (including advance ₹ 3,500)	28,200		Cash in Hand	6,310	
Returns	890	1,580	Patent Right	5,400	
Provident Funds		6,550	Suspense Account		900
Interest on Deposit with Das		450	**TOTAL**	3,27,000	3,27,000

Adjustments :

(i) Last year's closing stock was valued at 10% below cost. Sri Samaddar wants to revert to cost. Stock as on 31.12.2014 was valued at ₹ 16,400 (at cost).

(ii) Goods costing ₹ 650 pilferred by a dishonest employee and furniture (book value on 1.1.2014 ₹ 700) destroyed by an accidental fire on 31.12.2014.

(iii) Bhowmick is included in both debtors and creditors — the amount due from him is ₹ 430 and the amount due to him is ₹ 200.

(iv) New furniture costing ₹ 1,200 was purchased on 31.12.2014 on credit but not yet recorded.

(v) Suspense Account represents a cheque received from a debtor in full settlement of a claim of ₹ 1,000. The cheque was deposited into bank and duly collected also.

(vi) The employer's contribution to provident fund ₹ 1,240 is yet to be paid.

(vii) Write-off ₹ 400 as bad and maintain provision for doubtful debts @ 5% on debtors.

(viii) Depreciate all tangible fixed assets @ 10% p.a. Patent was acquired in 2013 and annual amortization equal to 1/10th of the cost started last year.

(ix) Creditors include suppliers of stationery ₹ 200.

Solution

Samaddar

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock (Note 1)		21,000	By Sales	2,02,000	
To Purchases	1,38,600		Less: Sales Returns	890	2,01,110
Less: Purchases Returns	1,580		By Closing Stock		16,400
	1,37,020				
Less: Goods Pilferred	650	1,36,370			
To Gross Profit c/d		60,140			
		2,17,510			2,17,510
To Goods Pilferred		650	By Gross Profit b/d		60,140
To Printing and Stationery		2,600	By Interest on Deposit	450	
To Salaries	28,200		Add: Accrued Interest	450	900
Less: Advance Salary	3,500		By Provision for Doubtful Debts :		
	24,700		Old	2,200	
Add: Employer's contribution to P.F.	1,240	25,940	Less: New (Note 2)	1,060	1,140
To Trade Expenses		12,650	By Bad Debts Recovered		700
To Loss on Furniture Destroyed (Note 3)		630			
To Discount Allowed (₹ 1,000 – 900)		100			
To Bad Debts		400			
To Depreciation on :					
Freehold Premises	3,900				
Furniture and Fixture (Note 4)	860	4,760			
To Amortization of Patent Right (₹ 5,400 / 9)		600			
To Net Profit c/d (Current)		14,550			
		62,880			62,880
To Net Profit c/d (Transferred to Capital A/c)		16,650	By Net Profit b/d		14,550
			By Opening Stock		2,100
		16,650			16,650

Balance Sheet of Samaddar as at 31st December, 2014

Liabilities	₹	₹	Assets	₹	₹
Capital :			Freehold Premises	39,000	
Opening Balance	95,000		Less: Depreciation	3,900	35,100
Add: Net Profit	16,650	1,11,650	Furniture and Fixture (Note 4)	9,100	
Less: Drawings	10,200		Less: Depreciation	790	8,310
Income Tax	7,900	18,100	Patent Right	5,400	
		93,550	Less: Amortization	600	4,800
Provident Fund	6,550		Debtors (Note 2)	21,200	
Add: Employer's Contribution	1,240	7,790	Less: Provision for Doubtful Debts	1,060	20,140
Creditors for :			Deposit with Das	18,000	
Goods	16,020		Add: Accrued Interest	450	18,450
Less: Mutual Indebtedness	(200)		Closing Stock		16,400
Creditors for Stationery	(200)		Advance Salaries		3,500
	15,600		Bank Balance		6,950
Furniture	1,200		Cash in Hand		6,310
Stationery	200	17,020			
Outstanding Trade Expenses		1,600			
		1,19,960			1,19,960

Working Notes :

(1) Last year's closing stock is this year's opening stock, which is valued at 10% below cost. Therefore, it appears in the Trial Balance at 90%. In effect, the actual cost of opening stock = ₹ 18,900 / 90% = ₹ 21,000. Assuming that the market value of opening stock is more than ₹ 21,000, the value of opening stock is to be increased by ₹ 2,100 (₹ 21,000 – 18,900).

Tutorial Note : Para 19 of AS—5 states that ***prior period items are normally included in the determination of net profit or loss for the current period. An alternative approach is to show such items in the statement of profit and loss after determination of current net profit or loss.*** This is a prior period item.Therefore,it is to be shown in the Profit and Loss Account itself. It is better to show this after determination of current year's profit.

(2) Closing Value of Debtors

	₹
Debtors as per Trial balance	22,800
Less: Received from a Debtor	1,000
	21,800
Less: Mutual Indebtedness	200
	21,600
Less: Bad Debts	400
Closing Value of Debtors	21,200

Provision is required = 5% on ₹ 21,200 = ₹ 1,060.

(3) Loss on Furniture Destroyed

Book value of furniture destroyed ₹ 700. Depreciation @ 10% p.a. for 1 year = 10% of ₹ 700 = ₹ 70.
Therefore, loss on furniture destroyed = ₹ (700 – 70) = ₹ 630.

(4) Closing Value of Furniture and Fixture and Depreciation Thereon

		₹
Book value as per trial balance		8,600
Less: Book value of furniture destroyed on 31.12.1998		700
		7,900
Add: Purchase of furniture		1,200
		9,100
Depreciation @ 10% p.a. on ₹ 700		70
	₹ (8,600 – 700)	790
	₹ 1,200	—
		860

Illustration 20

The accountants of Mr P Sundaram, a sole proprietor of a business, extracted the following Trial Balance as on 31.3.2015:

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Cash	16,000		Purchases	1,40,000	
Bank	25,000		Freight Inward	10,000	
Petty Cash	1,000		Postage and Trade Expenses	5,000	
Furniture and Fixture	10,000		Bad Debts	1,000	
Plant and Machinery	50,000		9% Loan taken from D Kumaran (1.10.2014)		15,000
Capital		60,000	Interest on Loan	500	
Drawings	10,000		Creditors		37,500
Insurance	1,000		Bills Receivable	10,000	
Salaries	12,000		Sales		2,60,000
Wages	5,000		Outstanding Liability for Expenses	1,000	
Sundry Debtors	22,000		Petty Cash Expenses	3,000	
Stock (as on 1.4.2014)	28,000		Bills Payable		15,000
Trademark Rights (10 years from 1.4.2012)	32,000				
Rent and Rates	5,000		**TOTAL**	3,87,500	3,87,500

Adjustments :

(i) Stock lying in godown as on 31.3.2015 ₹ 38,000.

(ii) Invoices of the value of ₹ 5,000 were recorded in Sales Book on 27.3.2015 but goods were not dispatched until 5.4.2015. The cost of such goods was ₹ 4,000.

(iii) The Petty Cash balance represents the month-end imprest amount. As on 31.3.2015 the petty cashier had vouchers totalling to ₹ 400 for which he had not received reimbursement from the main cashier.

(iv) Rent and rates of ₹ 1,000 relating to 2013-14 had not been provided in that year but were paid in May, 2014 by debiting outstanding liability for expenses.

(v) Bills receivable of ₹ 5,000 were endorsed in favour of creditors during the year 2014-15. Of these bills, a bill for ₹ 2,000 was dishonoured but not recorded in the books. Other bills would mature in June 2015.

(vi) Two dishonoured cheques of ₹ 400 and ₹ 600 respectively had not been entered in the Cash Book. The first cheque for ₹ 400 was known to be bad. In case of the second cheque, it was expected that the debtor would be in a position to pay only 50 paise in a rupee. For other debtors, provision for doubtful debts to be provided @ 5%.

(vii) Provide depreciation on all tangible fixed assets @ 10% p.a.

Prepare Trading and Profit and Loss Account for the year ended 31st March, 2015 and a Balance Sheet as on that date.

Solution

P. Sundaram

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2015 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		28,000	By Sales		2,60,000
To Purchases	1,40,000		By Closing Stock (₹ 38,000 – 4,000)		34,000
Add: Freight Inward	10,000	1,50,000			
To Wages		5,000			
To Gross Profit c/d		1,11,000			
		2,94,000			2,94,000

	₹	₹		₹	₹
To Insurance		1,000	By Gross Profit b/d		1,11,000
To Salaries		12,000			
To Rent and Rates		5,000			
To Postage and Other Trade Expenses		5,000			
To Bad Debts (₹ 1,000 + 400)		1,400			
To Provision for Doubtful Debts (Note 2)		1,500			
To Petty Cash Expenses (₹ 3,000 + 400)		3,400			
To Interest on Loan	500				
Add: Outstanding Interest	175	675			
To Depreciation on :					
Plant and Machinery	5,000				
Furniture and Fixture	1,000	6,000			
To Amortization of Trademark Rights (Note 4)		4,000			
To Net Profit c/d (Current)		71,025			
		1,11,000			1,11,000
To Outstanding Liability for Expenses (Note 1)		1,000	By Net Profit b/d		71,025
To Net Profit (Transferred to Capital Account)		70,025			
		71,025			71,025

Balance Sheet of P. Sundaram as at 31st March, 2015

Liabilities	₹	₹	Assets	₹	₹
Capital :			Plant and Machinery	50,000	
Opening Balance	60,000		Less: Depreciation	5,000	45,000
Add: Net Profit	70,025		Furniture and Fixture	10,000	
	1,30,025		Less: Depreciation	1,000	9,000
Less: Drawings	10,000	1,20,025	Trademark Rights	32,000	
9% Loan	15,000		Less: Amortization (Note 4)	4,000	28,000
Add: Outstanding Interest (Note 5)	175	15,175	Closing Stock		34,000
Creditors	37,500		Sundry Debtors (Note 2)	24,600	
Add: Endorsed Bill Dishonoured	2,000	39,500	Less: Provision for Doubtful Debts	1,500	23,100
Bills Payable		15,000	Bills Receivable		10,000
			Bank (Note 3)		24,000
			Cash		16,000
			Petty Cash (₹ 1,000 – 400)		600
		1,89,700			1,89,700

Working Notes :

(1) An amount of ₹ 1,000 paid during the year for rent and rates is actually related to the previous year. When this payment was made, Outstanding Liability for Expenses Account was debited and cash Account was credited.
Para 19 of AS—5 states that ***prior period items are normally included in the determination of net profit or loss for the current period. An alternative approach is to show such items in the statement of profit and loss after determination of current net profit or loss.***
This is a prior period item. Therefore, it is to be shown in the Profit and Loss Account itself. It is better to show this after determination of current year's profit.

(2) Ascertainment of Closing Debtors and Provision for Doubtful Debts

	₹
Debtors as per Trial Balance	22,000
Add: Dishonoured cheque	600
Endorsed bill dishonoured	2,000
	24,600
Provision for Doubtful Debts :	
50% on ₹ 600	300
5% on ₹ (24,600 – 600)	1,200
	1,500

(3) Bank Balance

Balance as per Trial Balance	25,000
Less: Dishonoured cheques (₹ 400 + 600)	1,000
	24,000

(4) Remaining life of trade mark right is 8 years. The amount is to be amortized = ₹ 32,000 / 8 = ₹ 4,000.

(5) Interest on loan from D Kumaran = ₹ 15,000 × 9/100 × 1/2 = ₹ 675. Out of ₹ 675 only ₹ 500 has been paid.
Therefore, ₹ 125 is outstanding.

Illustration 21

From the following balances and information, prepare Trading and Profit and Loss Account of Mr A Sen for the year ended 31st December, 2014 and a Balance Sheet as on that date :

Particulars	Dr. (₹)	Particulars	Cr. (₹)
Stock (1.1.2014)	15,100	Sales	1,67,200
Purchases	94,500	Returns Outward	1,500
Wages	30,900	Provision for Doubtful Debts	3,200
Electricity	3,750	Sundry Creditors	35,600
Furniture	12,500	Capital	80,000
Machinery	18,000	Discount Received	1,280
Motor Car	10,240		
Fuel	3,180		
Rent @ ₹ 450 p.m.	4,050		
Printing and Stationery	5,200		
Fixed Deposit (at 10% p.a.)	25,000		
Sundry Debtors	42,000		
Discount Allowed	1,400		
Insurance Premium	4,800		
Telephone Charges	3,750		
Bad Debts	500		
Bank	11,300		
Cash	2,610		
	2,88,780		2,88,780

Other information :

(i) Stock on 31.12.2014 is ₹ 26,700. The stock includes goods returned by a customer on 31st December, 2014 to the value of ₹ 2,200 for which no entry has been made.

(ii) Stock valuing ₹ 5,000 destroyed by fire. ₹ 500 realised through sale of damaged goods and insurance company paid ₹ 3,000 only against the claim.

(iii) Mr A Sen has been providing for depreciation on motor car @ 20% under Diminishing Balance Method. Now he wants to provide depreciation @ 6% under Straight-line Method with effect from 1.1.2014 (the date of purchase of the motor car).

(iv) Mr A Sen's bank has debited ₹ 150 in the Pass Book as clearing charge which has not been entered in the Cash Book.

(v) Creditors include a balance of ₹ 1,600 to the credit of S Chand in respect of which it has been decided and settled with the party to pay only ₹ 1,000.

(vi) Provide depreciation on machinery @ 15% and on furniture @ 10% per annum.

(vii) A debtor of ₹ 12,000 accepted a bill drawn by Mr Sen.

(viii) Create a provision for doubtful debts at 5% on Sundry Debtors.

Solution

A. Sen

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		15,100	By Sales	1,67,200	
To Purchases	94,500		Less: Returns Outward	(2,200)	
Less: Returns Outward	1,500	93,000	Sale of Damaged Goods	(500)	1,64,500
To Wages		30,900	By Stock Destroyed by Fire		5,000
To Fuel		3,180	By Closing Stock		26,700
To Gross Profit c/d		54,020			
		1,96,200			1,96,200
To Electricity		3,750	By Gross Profit b/d		54,020
To Rent	4,050		By Discount Received		1,280
Add: Outstanding	1,350	5,400	By Interest on Fixed Deposit		2,500
To Printing and Stationery		5,200	By Creditors (₹ 1,600 – 1,000)		600
To Discount Allowed		1,400	By Provision for Doubtful Debts :		
To Insurance Premium		4,800	Old	3,200	
To Telephone Charges		3,750	Less : New (Note 1)	1,390	1,810
To Bad Debts		500	By Motor Car (Note 2)		6,160
To Loss on Stock Destroyed by Fire (₹ 5,000 – 500 – 3,000)		1,500			
To Depreciation on :					
Machinery	2,700				
Motor Car (Note 2)	1,200				
Furniture	1,250	5,150			
To Bank Charges		150			
To Net Profit (transferred to Capital Account)		34,770			
		66,370			66,370

Balance Sheet of A. Sen as at 31st December, 2014

Liabilities	₹	₹	Assets	₹	₹
Capital :			Machinery	18,000	
Opening Balance	80,000		Less: Depreciation	2,700	15,300
Add: Net Profit	34,770	1,14,770	Furniture	12,500	
Sundry Creditors (₹ 35,600 – 600)		35,000	Less: Depreciation	1,250	11,250
Outstanding Rent		1,350	Motor Car (Note 2)	16,400	
			Less: Depreciation	1,200	15,200
			10% Fixed Deposit	25,000	
			Add: Accrued Interest	2,500	27,500
			Sundry Debtors (Note 1)	27,800	
			Less: Provision for Doubtful Debts	1,390	26,410
			Bills Receivable		12,000
			Closing Stock		26,700
			Bank (Note 3)		14,150
			Cash		2,610
		1,51,120			1,51,120

Working Notes :

(1) Closing Value of Debtors and Related Provision

	₹
Debtors as per Trial Balance	42,000
Less: Returns not recorded	2,200
	39,800
Less: Debtor accepted bill	12,000
	27,800

Provision for doubtful debts : @ 5% on ₹ 27,800 = ₹ 1,390.

(2) Let the original cost of motor car on 1.1.2011

Let the original cost of motor car on 1.1.2011	100.00
Less: Depreciation @ 20% for 2011	20.00
	80.00
Less: Depreciation @ 20% on ₹ 80 for 2012	16.00
	64.00
Less: Depreciation @ 20% on ₹ 64 for 2013	12.80
Written-down Value on 31.12.2013	51.20

When written-down value is ₹ 51.20 the original cost is ₹ 100.

When written-down value is ₹ 1.00 the original cost is 100 / 51.20

When written-down value is ₹ 10.240 the original cost is 100 / 51.20 × 10.240 = ₹ **20,000**.

Adjustment for Depreciation

Diminishing Balance Method	₹	Straight Line Method	₹
2011 (20% x ₹ 20,000)	4,000	2011	1,200
2012 (20% x ₹ 16,000)	3,200	2012	1,200
2013 (20% x ₹ 12,800)	2,560	2013	1,200
	9,760		3,600

Depreciation over-charged = ₹ 9,760 – 3,600 = ₹ 6,160.

Valuation of motor car after adjustment of over-depreciation will be : ₹ 10,240 + 6,160 = ₹ **16,400**.

For adjusting over-depreciation, the following entry is passed :

Motor Car Account	Dr.	₹ 6,160	
To Profit and Loss Account			₹ 6,160

Tutorial Note : Para 21 of AS—6 states that ***the deficiency or surplus arising from retrospective recomputation of depreciation in accordance with the new method should be adjusted in the accounts in the year in which the method of depreciation is changed. In case the change in the method results in deficiency in depreciation in respect of past years, the deficiency should be charged in the statement of profit and loss. In case the change in the method results in surplus, the surplus should be credited to the statement of profit and loss. Such a change should be treated as a change in accounting policy and its effect should be quantified and disclosed***.

(3) Calculation of Bank Balance

	₹
Bank balance as per Trial Balance	11,300
Add: Insurance claim received	3,000
	14,300
Less: Bank charges	150
	14,150

Illustration 22

Nag, Paul and Sen are partners in a firm sharing profits and losses, Nag 2/5th, Paul 2/5th and Sen 1/5th. Sen's annual share of profit (including salary and interest) is to be a minimum of ₹ 28,000, any deficit being borne by the other two partners in their profit-sharing ratio. No interest is allowed or charged on Partners' Current Accounts, but Fixed Capital Accounts carry interest at 6% p.a.

Dr. Trial Balance as on 31st March, 2015 Cr.

Particulars	(₹)	Particulars		(₹)
Freehold Premises at cost	1,26,000	Capital Accounts :		
Plant and Machinery at cost	1,12,000	Nag	1,12,000	
Motor Vehicles at cost	33,600	Paul	84,000	
Purchases	6,32,000	Sen	42,000	2,38,000
Stock, 1st April, 2014	1,00,800	Current Accounts, 1st April, 2014 :		
Wages	64,800	Nag	25,200	
Salaries	1,25,600	Paul	8,400	33,600
Trade Expenses	8,400	Sales		10,49,200
Repairs	16,800	Creditors		58,800
Discount Allowed	3,360	Provision for Doubtful Debts, 1st April, 2014		4,760
Office Expenses	50,400	Discount Received		5,880
Carriage Inwards	8,680	Provision for Depreciation, 1st April, 2014:		
Insurance	19,600	Plant and Machinery		33,600
Professional Charges	19,600	Motor Vehicles		16,800
Debtors	95,200			
Bank	11,200			
Current Account, 1st April, 2014 : Sen	1,400			
Carriage Outwards	11,200			
	14,40,640			14,40,640

Additional information :

(a) Stock on hand on 31st March, 2015 amounted to ₹ 95,720.

(b) Sales include ₹ 33,600 goods sent to Goon and Co., on consignment basis at cost plus 20%. The goods remained in their hands unsold on 31st March, 2015.

(c) The following amounts have been drawn each month by the partners as salaries : Nag — ₹ 500; Paul — ₹ 600; Sen — ₹ 300.

(d) Paul is to be debited with ₹ 3,500 for goods taken by him from stock for personal purpose.

(e) Nag is to be credited with ₹ 2,500 for travelling expenses incurred by him for the purpose of the firm.

(f) Repairs include an item of ₹ 8,000 for alteration to the office, which should be capitalised.

(g) Insurance includes a premium of ₹ 6,000 paid for the year ended 30th September, 2000 and office expenses accrued amount to ₹ 4,200.

(h) A motor vehicle costing ₹ 12,600 had been purchased during the year against which ₹ 5,000 had been allowed on the sale of an old vehicle, the net amount ₹ 7,600 being debited to Purchases Account. The vehicle sold had cost ₹ 10,500 and had been written-down to ₹ 3,000.

(i) Depreciation on plant and machinery and motor vehicles is to be provided at the rate of 10% and 20% p.a. respectively on the original cost. (No depreciation on assets sold and full year's depreciation on assets purchased during the year is chargeable).

(j) A debt of ₹ 840 is to be written-off and the provision for doubtful debts is to be increased to ₹ 6,800.

Prepare a Trading and Profit and Loss Account for the year ended 31st March, 2015 and a Balance Sheet as on that date.

Solution **Nag, Paul and Sen**

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2015 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		1,00,800	By Sales	10,49,200	
To Purchases	6,32,000		Less : Goods Sent on Consignment		
Less: Goods Withdrawn by Paul	3,500		(invoice price)	33,600	10,15,600
	6,28,500		By Closing Stock		95,720
Less: Purchase of Motor Vehicle	7,600	6,20,900	By Stock with Consignee (Note 4)		
To Wages		64,800	(₹ 33,600 / 120 x 100)		28,000
To Carriage Inwards		8,680			
To Gross Profit c/d		3,44,140			
		11,39,320			11,39,320
To Salaries	1,25,600		By Gross Profit b/d		3,44,140
Less: Partners' Salaries	16,800	1,08,800	By Discount Received		5,880
To Trade Expenses		8,400	By Profit on Exchange of Motor Vehicle (Note 3)		2,000
To Repairs	16,800				
Less: Capitalised	8,000	8,800			
To Discount Allowed		3,360			
To Office Expenses	50,400				
Add: Outstanding	4,200	54,600			

To Insurance	19,600				
Less: Prepaid	3,000	16,600			
To Professional Charges		19,600			
To Carriage Outwards		11,200			
To Travelling Expenses		2,500			
To Bad Debts		840			
To Provision for Doubtful Debts :					
New	6,800				
Less: Old	4,760	2,040			
To Depreciation on :					
Plant and Machinery	11,200				
Motor Vehicles (Note 3)	7,140	18,340			
To Net Profit c/d		96,940			
		3,52,020			3,52,020

Balance Sheet of Nag, Paul and Sen as at 31st March, 2015

Liabilities	₹	₹	Assets	₹	₹
Capital Accounts :			Freehold Premises	1,26,000	
Nag	1,12,000		Add: Alterations Capitalised	8,000	1,34,000
Paul	84,000		Plant and Machinery	1,12,000	
Sen	42,000	2,38,000	Less: Provision for Depreciation		
Current Accounts (Note 2) :			(₹ 33,600 + 11,200)	44,800	67,200
Nag	56,410		Motor Vehicles (Note 3)	35,700	
Paul	31,930		Less: Provision for Depreciation (Note 3)	16,440	19,260
Sen	23,000	1,11,340	Closing Stock		95,720
Creditors		58,800	Stock with Consingee (Note 4)		28,000
Outstanding Office Expenses		4,200	Debtors	95,200	
			Less: Goods Sent on Consignment at Invoice Price (Note 4)	33,600	
				61,600	
			Less: Bad Debts	840	
				60,760	
			Less: Provision for Doubtful Debts	6,800	53,960
			Prepaid Insurance		3,000
			Bank		11,200
		4,12,340			4,12,340

Working Notes : (1) Profit and Loss Appropriation Account for the year ended 31.3.2015

Particulars	₹	Particulars	₹
To Interest on Capital A/c (Nag—₹ 6,720; Paul—₹ 5,040; Sen—₹ 2,520)	14,280	By Profit and Loss A/c — Net profit	96,940
To Partners' Salaries A/c (Nag—₹ 6,000; Paul—₹ 7,200; Sen—₹ 3,600)	16,800		
To Share of Profit A/c : (Nag—₹ 21,990; Paul—₹ 21,990; Sen—₹ 21,880)	65,860		
	96,940		96,940

Sen's share of profit (including salary and interest) should not be less than ₹ 28,000. Sen's interest on capital and salary = ₹ 2,520 + ₹ 3,600 = ₹ 6,120. Therefore only share of profit should not be less than (₹ 28,000 – ₹ 6,120) = ₹ 21,880.

Divisible profit of the firm = ₹ 96,940 – 14,280 – 16,800 = ₹ 65,860. Actual share of profit of Sen is ₹ 13,172. But he should get minimum of ₹ 21,880. The shortfall of ₹ 8,708 will be shared by Nag and Paul equally.

Share of Profit : Nag : ₹ 26,344 – 4,354 = ₹ 21,990. Paul : ₹ 26,344 – 4,354 = ₹ 21,990. Sen : ₹ 13,172 + 8,708 = ₹ 21,880.

Dr. (2) Partners' Current Accounts [all figures in rupees] Cr.

Dae	Particulars	Nag	Paul	Sen	Date	Particulars	Nag	Paul	Sen
2014					2014				
Apr 1	To Balance b/d	—	—	1,400	Apr 1	By Balance b/d	25,200	8,400	—
						By Travelling Expenses	2,500	—	—
2015					2015				
Mar 31	To Cash A/c	6,000	7,200	3,600	Mar 31	By Interest on Capital A/c	6,720	5,040	2,520
	To Purchases A/c	—	3,500	—		By Partners' Salaries A/c	6,000	7,200	3,600
	To Balance c/d	56,410	31,930	23,000		By Share of Profit A/c	21,990	21,990	21,880
		62,410	42,630	28,000			62,410	42,630	28,000

(3) Profit on Exchange of Motor Vehicle

Written-down value of motor vehicle sold is ₹ 3,000. It was exchanged for ₹ 5,000. Therefore, profit on exchange will be ₹ 5,000 – ₹ 3,000 = ₹ 2,000. To rectify the errors for purchase of new motor vehicle, the entry is to be passed :

New Motor Vehicle Account	Dr.	₹ 12,600	
Provision for Depreciation on Motor Vehicles Account	Dr.	7,500	
To Purchases Account			₹ 7,600

To Old Motor Vehicles Account 10,500

To Profit on Exchange of Motor Vehicles Account 2,000

(i) The final balance of motor vehicles (at cost) will be : ₹ 33,600 – 10,500 + 12,600 = ₹ **35,700**.
Depreciation @ 20% on ₹ 35,700 = ₹ **7,140**.

(ii) The final balance of provision for depreciation on motor vehicles will be : ₹ 16,800 – 7,500 + 7,140 = ₹ **16,440**.

(4) When goods were sent on consignment, Consignor Account was debited and Sales Account was credited. In the sundry debtors, consignee's balance is included. To rectify this, the following entry is to be passed :

Sales Account Dr. ₹ 33,600

To Sundry Debtors Account ₹ 33,600

Net Effect :

(i) Sales will be reduced by ₹ 33,600.

(ii) Sundry Debtors will be reduced by ₹ 33,600.

(iii) Cost of goods sent ₹ 28,000 will be credited to Trading Account and will be shown in the Balance Sheet.

Illustration 23

Following is the Trial Balance of X as on 31.3.2015. You are required to prepare Trading and Profit and Loss Account for the year ended 31.3.2015 and a Balance Sheet as on that date.

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Capital		60,000	Accrued Income	1,500	
Plant and Machinery	18,000		Salaries Outstanding		2,000
Depreciation on Plant and Machinery	2,000		Bills Receivable	30,000	
Repairs to Plant	1,600		Bills Payable		3,000
Wages	28,000		Provision for Bad and Doubtful Debts		6,000
Salaries	4,000		Bad Debts	1,000	
Income Tax	500		Discount Received		4,000
Cash in Hand	2,000		Sundry Debtors	35,000	
Land	24,500		Sundry Creditors		23,300
Depreciation on Building	2,500		Opening Stock (1.4.2014)	37,000	
Purchases less Returns	1,23,500		Building	50,000	
Sales		2,49,000			
Bank Overdraft		13,800	**TOTAL**	3,61,100	3,61,100

Additional information :

(1) Stock on 31.3.2015 was ₹ 30,000.

(2) Write-off ₹ 3,000 as bad debts and maintain a provision for bad and doubtful debts at 5% on sundry debtors.

(3) Goods costing ₹ 5,000 were sent to a customer on "Sale or Approval Basis" on 30.3.2015. These were recorded as actual sales. The rate of gross profit was 1/6th of sales.

(4) ₹ 1,200 paid as rent of the office were debited to landlord account and were included in sundry debtors.

(5) General Manager is to be paid commission at 10% after charging the commission of Works Manager and his own on net profits.

(6) Works Manager is to be given commission at 5% after charging commission of General Manager and his own on net profits. Such commission shall be calculated to the nearest multiple of rupee.

Solution

Mr. X

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2015 Cr.

Particulars		₹	Particulars		₹
To Opening Stock		37,000	By Sales	2,49,000	
To Purchase (less returns)		1,23,500	Less: Sale or Approval	6,000	2,43,000
To Wages		28,000	By Closing Stock	30,000	
To Gross Profit c/d		89,500	Add: Sale or Approval (Note 3)	5,000	35,000
		2,78,000			2,78,000
To Salaries		4,000	By Gross Profit b/d		89,500
To Rent		1,200	By Provision for Bad and Doubtful Debts (Note 2)		760
To Depreciation :			By Discount Received		4,000
Plant and Machinery	2,000				
Building	2,500	4,500			
To Repairs to Plant		1,600			
To General Manager's Comm. (Note 1)		7,214			
To Works Manager's Commission (Note 1)		3,607			
To Net Profit (transferred to Capital)		72,139			
		94,260			94,260

Working Notes (1) : Net profit before charging Commission ₹ 82,960

Less : Works Manager's Commission (see below)	₹ 3,607	
General Manager's Commission	₹ 7,214	₹ 10,821
Net Profit after charging Commission		₹ 72,139

Let x be the total commission to General Manager and y be the total commission to Works Manager.

x = 10/110 (₹ 82,960 – y) . . . . (1)

y = 5/105 (₹ 82,960 – x) . . . . (2)

or, x = .09091 (₹ 82,960 – y) . . . . (1) y = .04762 (82,960 – x)

or, x + .091 y = 7,541.818

or, x + 21 y = 82,960

x + .09091 y = 7541.818

20.909 y = 75418.18 or, y = **3,607** and x = .82960 – 21 x 3,606.97 or x = 7,213.58 (say) **7,214.**

Balance Sheet of Mr X as at 31st March, 2015

Liabilities	₹	₹	Assets	₹	₹
Capital : Opening	60,000		Plant and Machinery	20,000	
Add: Net Profit	72,139		Less: Depreciation	2,000	18,000
	1,32,139		Land		24,500
Less: Drawings (Income tax)	500	1,31,639	Building	52,500	
Commission payable to General Manager		7,214	Less: Depreciation	2,500	50,000
Commission payable to Works Manager		3,607	Closing Stock	30,000	
Sundry Creditors		23,300	Add: Sales or Approval	5,000	35,000
Bills Payable		3,000	Sundry Debtors	24,800	
Bank Overdraft		13,800	Less: Prov. for Bad & Doubtful Debts	1,240	23,560
Salaries Outstanding		2,000	Bills Receivable		30,000
			Cash in hand		2,000
			Accrued Income		1,500
		1,84,560			1,84,560

(2) Provision for Bad and Doubtful Debts Account

	₹		₹
To Bad Debts	1,000	By Balance b/f	6,000
To Bad Debts	3,000		
To Profit & Loss A/c	760		
To Balance c/d	1,240		
	6,000		6,000

Calculation of Closing Debtors

Sundry Debtors		35,000
Less: Sale or Approval	6,000	
Bad debts	3,000	
Rent	1,200	10,200
		24,800
Less: New prov. for bad debts		1,240
Closing Sundry Debtors		23,560

(3) Cost price of stock of goods sent on sale or approval = ₹ 6,000 – 1/6 (₹ 6,000) = ₹ 5,000.

Illustration 24

Following is the Trial Balance of Sri Rahul as at 31.12.2014. You are required to prepare Trading and Profit and Loss Account for the year ended 31.12.2014 and a Balance Sheet as on that date after making necessary adjustments:

Debit Balances	₹	Credit Balances	₹
Purchases	60,000	Sales	1,00,000
Sales Ledger Balances	30,400	Purchases Ledger Balances	24,400
Returns Inward	2,000	Discount Received	600
Discount Allowed	2,000	Returns Outward	2,400
Building	44,000	Capital	53,200
Depreciation on Building	2,000	Suspense Account	2,000
Income Tax	2,000	Goods Sent on Consignment	5,000
Wages	4,000	Profit on Consignment	1,000
Salaries	6,000	Apprenticeship Premium (for the year ending 31.3.2015)	2,400
Consignment Stock (31.12.2014)	1,200	Provision for Bad Debts	2,000
Stock-in-Trade (1.1.2014)	20,000	Commission	1,600
Trade Expenses	4,000		
Insurance	400		
Cash at Bank	12,600		
Deposit with Asha	4,000		
	1,94,600		1,94,600

Adjustments :

(i) Stock-in-trade on 31.12.2014 was valued at ₹ 20,000.

(ii) Stock valued at ₹ 4,000 was destroyed by fire on 25.12.2014 for which insurance company admitted a claim of ₹ 2,400 only.

(iii) Deposit with Asha was realised together with interest @ 10% p.a. for 6 months and deposited the same into Fixed Deposit Account with Bank of India on 1.10.2014 bearing interest @ 16% p.a., but no entry had since been made.

(iv) Out of purchases, goods of ₹ 4,000 was distributed as free samples.

(v) Suspense Account represents a cheque received from Bapi, a customer, in settlement of ₹ 2,400 due from him. The cheque was duly deposited and credited by the Bank.

(vi) Maintain provision for bad debts @ 5% on Debtors and provision for discount @ 2% on both Debtors and Creditors.

Solution

Sri Rahul

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Stock-in-trade		20,000	By Sales	1,00,000	
To Purchases	60,000		Less: Returns Inward	2,000	98,000
Less: Goods distributed as free sample	4,000		By Stock Lost by Fire		4,000
	56,000		By Closing Stock		20,000
Less: Goods Sent on Consignment	5,000				
	51,000				
Less: Returns Outward	2,400	48,600			
To Wages		4,000			
To Gross Profit c/d		49,400			
		1,22,000			1,22,000
To Salaries		6,000	By Gross Profit b/d		49,400
To Trade Expenses		4,000	By Profit on Consignment		1,000
To Insurance		400	By Discount Received		600
To Discount Allowed	2,000		By Apprenticeship Premium	2,400	
Add: Discount Allowed to Bapi (Note 2)	400	2,400	Less: Received in Advance	600	1,800
To Depreciation on Building		2,000	By Commission		1,600
To Prov. for Discount on Debtors (Note 4)		532	By Interest on Deposit with Asha		200
To Stock Lost by Fire (₹ 4,000 – 2,400)		1,600	By Accrued Interest on Deposit with SBI		168
To Advertisement		4,000	By Provision for Bad Debts :		
(Goods distributed as free sample)			Old	2,000	
To Net Profit (transferred to Capital)		34,924	Less: New (Note 3)	1,400	600
			By Reserve for Disc. on Creditors (Note 5)		488
		55,856			55,856

Balance Sheet of Sri Rahul as at 31st December, 2014

Liabilities	₹	₹	Assets	₹	₹
Capital :			Building		44,000
Opening balance	53,200		Stock-in-trade		20,000
Add: Net Profit	34,924		Consignment Stock		1,200
	88,124		Sales Ledger Balances (30,400 – 2,400)	28,000	
Less: Income Tax (Drawings)	2,000	86,124	Less: Provision for Bad Debts (Note3)	1,400	
Purchase Ledger Balances (Note 6)	24,400			26,600	
Less: Reserve for Discount on Creditors	488	23,912	Less: Provision for Discount on Debtors	532	26,068
Apprenticeship Premium recd. in advance		600	Deposit with Bank of India		4,200
			Accrued Interest on Deposit with BOI		168
			Insurance Claim		2,400
			Cash and Bank		12,600
		1,10,636			1,10,636

Working Notes :

(1) Deposit with Asha was realised alongwith interest @ 10% p.a. on 30.6.2014 and ₹ 4,200 was received. It was deposited with Bank of India at a interest of 16% p.a. on 1.10.2014 Therefore, accrued interest on this deposit will be ₹ 168 (3/12 x 16/100 x ₹ 4,200).

(2) For adjustment of Suspense Account, the following entry is to be passed :

Suspense Account	Dr.	₹ 2,000	
Discount Allowed Account	Dr.	₹ 400	
To Sundry Debtors Account			₹ 2,400

(3) Calculation of Provision for Bad Debts

	₹
Sales Ledger Balance (i.e. Sundry Debtors)	30,400
Less : Adjustment of cheque received from Bapi	(2,000)
Less : Discount allowed to Bapi	(400)
Final balance of Debtors	28,000

Provision for bad debts to be maintained @ 5% on Debtors, i.e. 5% of ₹ 28,000 = ₹ 1,400.

(4) Provision for discount on debtors will be @ 2% on ₹ (28,000 – 1,400) = ₹ 532.
(5) Reserve for discount on creditors will be @ 2% on ₹ 24,400 = ₹ 488.
(6) Purchases Ledger balances means Sundry Creditors. Similarly, Sales Ledger balances means Sundry Debtors.

Illustration 25

The following is the Trial Balance of M/s Ray Traders as at 31st December, 2014. You are asked to prepare the Trading and Profit and Loss Account for the year ended 31st December, 1992 and Balance Sheet as on that date: (all figures in ₹)

Particulars	Dr.	Cr.	Particulars	Dr.	Cr.
Ray's Capital		2,16,000	Income from investments		500
Stock as on 1st January 2014	93,600		Cash at bank	23,000	
Sales and sales returns	17,200	5,79,200	Discount received		8,560
Purchase and purchase returns	4,86,200	11,600	Investments	10,000	
Freight and carriage	37,200		Furniture and fittings	13,600	
Rent and taxes	11,400		Discounts paid	5,080	
Salaries and wages	18,600		General expenses	7,820	
Sundry debtors	48,000		Audit fees	1,400	
Sundry creditors		29,600	Insurance	1,200	
Bank loan (at 12% p.a.)		40,000	Travelling expenses	4,660	
Bank Interest on above	3,800		Postage and telegram	1,740	
Advertisement	20,200		Cash in hand	20,760	
Drawings	20,000		Fixed deposit with State Bank of India	40,000	
			TOTAL	8,85,460	8,85,460

Additional information: (a) Closing stock as on 31.12.2014 ₹ 1,57,200. (b) Included amongst the Debtors is ₹ 6,000 from Mr S. Naha and included amongst the creditors is ₹ 2,000 to Mr S. Naha. (c) The effect of advertisement being not yet expired, a quarter of the amount of Advertisement is to be carried forward to the next year. (d) Provide 2% for Discount on Debtors and create a provision for Bad and Doubtful Debts at 5% on Debtors. (e) Depreciation of 10% is to be written-off on Furniture and fittings. (f) Wages owing on 31st December, 1992 ₹ 600, and salaries owing ₹ 1,000. (g) Insurance was paid in advance upto 31st March, 1993. (h) Furniture which stood at ₹ 1,200 in the books on 1st January, 1992 was disposed of at ₹ 580 on 30th June, 1992 in part exchange for a new furniture costing ₹ 1,040. The net amount payable ₹ 460 was passed through the purchase book by mistake. (i) Two dishonoured cheques for ₹ 400 and ₹ 600 respectively had not been entered in the cash book. The first for ₹ 400 is known to be bad. In the case of the second cheque for ₹ 600, it is expected that the Debtor would be in a position to pay a dividend of 60 paise in the rupee. (j) Interest receivable from Fixed Deposit with State Bank of India @ 12% p.a. and provide for interest on Bank loan for the whole year. (working notes must be shown).

M/s. Ray Traders

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		93,600	By Sales	5,79,200	
To Purchases (Note 1)	4,85,740		Less: Sales returns	17,200	5,62,000
Less: Purchases returns	11,600	4,74,140	By Closing Stock		1,57,200
To Freight & Carriage		37,200			
To Gross Profit c/d		1,14,260			
		7,19,200			7,19,200
To Rent and Taxes		11,400	By Gross Profit b/d		1,14,260
To Salaries & Wages	18,600		By Income from investments		500
Add: Outstanding salaries & wages	1,600	20,200	By Accrued interest on fixed deposit		4,800
To Advertisement (see Tutorial Note)		20,200	By Discount received		8,560
To Bad debt (dishonoured cheque)		400			
To Discount		5,080			
To General expenses		7,820			
To Audit fees		1,400			
To Interest on loans	3,800				
Add: Accrued interest	1,000	4,800			
To Travelling expenses		4,660			
To Postage & telegram		1,740			
To Provision for bad & doubtful debts (Note 2)		2,540			
To Provision for discount on Debtors (Note 4)		874			
To Loss on exchange of furniture (Note 5)		620			
To Depreciation on furniture & fittings (Note 5)		1,344			

	₹	₹		₹	₹
To Insurance premium	1,200				
Less: Prepaid (Note 6)	240	960			
To Net Profit (transferred to Capital)		44,082			
		1,28,120			1,28,120

Balance Sheet of M/s Ray Trader as at 31st December, 2014

Liabilities	₹	₹	Assets	₹	₹
Capital: Opening	2,16,000		Furniture (Note 5)	13,440	
Add: Net profit	44,082		Less: Depreciation 10% (Note 7)	1,344	12,096
	2,60,082		Fixed Deposit with SBI		40,000
Less: Drawings	20,000	2,40,082	Investments		10,000
Sundry Creditors (₹ 29,600 – ₹ 460)	29,140		Closing Stock		1,57,200
Less: Due to S. Naha	2,000	27,140	Sundry Debtors (Note 2)	46,600	
12% Bank Loan	40,000		Less: Provision for bad and doubtful debts	2,540	
Add: Accrued interest (not yet paid)	1,000	41,000		44,060	
Outstanding expenses:			Less: Provision for discount on Debtors	874	43,186
Salaries	1,000		Accrued interest on fixed deposit		4,800
Wages	600	1,600	Prepaid insurance premium		240
Creditors for purchase of furniture		460	Cash at Bank (Note 3)		22,000
			Cash in hand		20,760
		3,10,282			3,10,282

Working Notes: **(1)** Purchases as per Trial Balance ₹ 4,86,200; Less: Purchase of furniture ₹ 460; Net amount = ₹ 4,85,740.

(2) Sundry Debtors	₹	**(3) Cash at Bank**	₹
As per Balance Sheet	48,000	As per trial balance	23,000
Less: Due from S.Naha	2,000	Less: Dishonoured cheques : ₹ (400 + 600)	1,000
	46,000		22,000
Add: Dishonoured cheque	600	**(4) Provision for Discount on Debtors**	₹
	46,600	@ 2% on (₹ 46,000 – ₹ 2,300)	874
Provision for doubtful debts @ 5% on ₹ 46,000	2,300	No provision for discount is to be created for dishonoured cheque of ₹ 600.	
Add: Additional provision @ 40% on ₹ 600	240		
	2,540		

(5) Loss on exchange of furniture: Book value of furniture sold is ₹ 1,200. It was exchanged for ₹ 580. Therefore, loss on exchange will be ₹ 1,200 – ₹ 580 = ₹ 620. (No depreciation has been charged on old furniture). To rectify the error for purchase of new furniture, the following entry is to be passed:

New Furniture Account	Dr.	₹ 1,040	
Profit and Loss Account	Dr.	₹ 620	
To Purchases Account			₹ 460
To Old Furniture Account			₹ 1,200

The final balance of Furniture Account will be: ₹ 13,600 – ₹ 1,200 + ₹ 1,040 = ₹ 13,440. Therefore, depreciation will be 10% of ₹ 13,440 = ₹ 1,344.

(6) Insurance of ₹ 1,200 paid for 15 months. Therefore, three month's insurance premium should be carried forward = ₹ 1,200 ÷ 15 × 3 = ₹ 240.

(7) It should be noted that depreciation on furniture is to be charged @ 10% (not 10% p.a.). Therefore, depreciation on new furniture has been charged for the full year and no depreciation has been charged on exchanged furniture.

Tutorial Note :Though it has been given in the problem, a quarter of the amount of Advertisement is to be carried forward to the next year. However, it cannot be shown in the Balance Sheet as deferred revenue expenditure because the Accounting Standards states that "***An asset is recognised in the Balance Sheet when it is probable that the future economic benefits associated with it will flow to the enterprise and the asset has a cost or value that can be measured reliably***." So, the entire Advertisement Expenses has been charged to Profit and Loss Account.

Illustration 26

The following is the Trial Balance of Mr. Tendulkar as at 31.3.2015 :

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Stock (1.4.2014)	45,000		Building	35,000	
Sales		3,25,000	Discount Received		2,300
Purchases	2,40,000		Drawings	10,000	
Capital		1,30,000	Bank Current Account	24,000	
Wages	10,000		Fixed Deposit Bank Account	16,000	
Salaries	15,000		Provision for Doubtful Debts		1,500
Discount Allowed	3,000		Debtors	45,000	

Creditors		35,000	Bills Receivable	10,000	
Rent and Rates	2,000		Cash	8,000	
Trade Expenses	15,000		Sales Return	2,000	
Purchases Return		3,000	Sale of Furniture		1,200
Furniture (1.4.1994)	18,000		**TOTAL**	4,98,000	4,98,000

Prepare Trading and Profit and Loss Account for the year ended 31.3.2015 and the Balance Sheet as on that date after taking into account the following adjustments :

(a) Stock on 31.3.2015 ₹ 40,000.

(b) Opening and Closing stock includes stock of stationery amounting to ₹ 200 and ₹ 150 respectively. Trade Expenses include payment of stationery of ₹ 1,800. Credit purchase of stationery for ₹ 450 recorded as ordinary purchases. Stationery of ₹ 300 is consumed by the proprietor.

(c) Furniture which stood in the books of ₹ 2,000 on 1.4.2014 was sold on 30.9.2014.

(d) Bills receivable include a dishonoured bill of ₹ 1,500 and debtors include an amount of ₹ 1,000 in respect of an insolvent customer whose estate is expected to realise only 50 paise in the rupee.

(e) Tendulkar received ₹ 15,000 from Kambli in respect of joint business with him. The sum received so credited to Sundry Creditors Account. It is noted that a sum of ₹ 5,000 is due to Tendulkar as his share of profit from the business.

(f) During the year the proceeds of a matured fixed deposit amounting to ₹ 14,000 has been credited to Fixed Deposit Account. The original amount was ₹ 10,000.

(g) Provide depreciation on all fixed assets @ 10% p.a. and provide 5% for doubtful debts of unknown nature.

Solution

Mr. Tendulkar

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2015 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock	45,000		By Sales	3,25,000	
Less: Stock of Stationery	200	44,800	Less: Sales Returns	2,000	3,23,000
To Purchases	2,40,000		By Closing Stock	40,000	
Less: Purchases of Stationery	450		Less: Stock of Stationery	150	39,850
	2,39,550				
Less: Purchases Return	3,000	2,36,550			
To Wages		10,000			
To Gross Profit c/d		71,500			
		3,62,850			3,62,850
To Salaries		15,000	By Gross Profit b/d		71,500
To Discount Allowed		3,000	By Discount Received		2,300
To Rent and Rates		2,000	By Interest on Fixed Deposit		4,000
To Trade Expenses	15,000		By Share of Profit of Joint Business		5,000
Less: Payment for Stationery	1,800	13,200			
To Depreciation on :					
Building	3,500				
Furniture (Note 4)	1,700	5,200			
To Loss on Sale of Furniture (Note 3)		700			
To Stationery (Note 1)		2,000			
To Provision for Doubtful Debts :					
New (Note 2)	2,775				
Less: Old	1,500	1,275			
To Net Profit (transferred to Capital)		40,425			
		82,800			82,800

Balance Sheet of Mr. Tendulkar as at 31st March, 2015

Liabilities	₹	₹	Assets	₹	₹
Capital :			Building	35,000	
Opening Balance	1,30,000		Less: Depreciation (10%)	3,500	31,500
Add: Net Profit	40,425		Furniture	18,000	
	1,70,425		Less: Sale of Furniture	2,000	
Less: Drawings : ₹ (10,000 + 300)	10,300	1,60,125		16,000	
Creditors	35,000		Less: Depreciation	1,600	14,400
Less: Amount received from Kambli	15,000	20,000	Closing Stock	40,000	
Amount due to Kambli	15,000		Less: Stock of Stationery	150	39,850
Less: Share of Profit	5,000	10,000	Stock of Stationery		150

			Fixed Deposit Bank Account	16,000	
			Add: Interest wrongly credited	4,000	20,000
			Sundry Debtors	45,000	
			Add: Dishonoured Bill	1,500	
				46,500	
			Less: Prov. for Doubtful Debts (Note 2)	2,775	43,725
			Bills Receivable	10,000	
			Less: Dishonoured Bill	1,500	8,500
			Bank Current Account		24,000
			Cash		8,000
		1,90,125			1,90,125

Working Notes : **(1) Stationery Consumed**

Particulars	₹
Opening Balance	200
Add: Cash Purchases*	1,800
Add: Credit Purchases**	450
	2,450
Less: Closing Balance	150
	2,300
Less: Consumed by the Proprietor	300
	2,000

(2) Provision for Doubtful Debts

Particulars	₹
Debtors	45,000
Add: Dishonoured Bill	1,500
	46,500
On ₹ 1,000 @ 50%	500
On ₹ 45,500 @ 5%	2,275
	2,775

(3) Loss on Sale of Furniture

	₹
Book Value of Furniture on 1.4.2014	2,000
Less: Depreciation upto 30.9.2014 (See note below)	100
	1,900
Less: Sale proceeds	1,200
	700

(4) Depreciation on Furniture

	₹
Book value on 1.4.2014	18,000
Less: Sale of Furniture	2,000
Book value on 31.3.2015	16,000
Total Depreciation on furniture = 10% of 16,000 = ₹ 1,600	
Add : Depreciation on furniture sold = ₹ 100	1,700

* (included in Trade Expenses)
** (included in Purchases)

Tutorial Note : In this problem, depreciation on furniture sold has been charged for 6 months because it has been asked to charge depreciation on all fixed assets @ 10% p.a. However, in the previous illustration, no depreciation has been charged on furniture disposed off because in that problem, it was asked to charge depreciation @ 10% only (not 10% p.a.)

Illustration 27

Sri Amit is in business as stationery merchant. He also acts as a selling agent of Sri Asit and for this he is given a commission @ 10% on sales. From the following Trial Balance, you are required to prepare Trading and Profit and Loss Account for the year ended 31.12.2015 and a Balance Sheet as on that date after taking into consideration the adjustments noted below:

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Furniture and fittings	36,000		Salaries	25,000	
Opening Stock	80,000		Sales Return	3,000	
Sundry Debtors	75,000		Purchases Return		2,000
Sales		6,65,000	Printing and Advertising	12,000	
Bills Receivable	40,000		Postage	4,500	
Cash at Bank	36,000		Discount Allowed	2,500	
Cash in Hand	10,000		Discount Received		2,000
Capital		1,90,000	Drawings	15,000	
Purchases	5,20,000		Other Trade Expenses	10,000	
Wages	5,000		Cash Sent to Consignor	75,000	
Sundry Creditors		60,000	Consignor's Balance (1.1.2015)		30,000
			TOTAL	9,49,000	9,49,000

Adjustments :

(1) Stock on 31.12.2015 valued at cost ₹ 64,000.

(2) The effect of advertising is expected to last for coming year also and as such half of printing and advertising is to be carried forward.

(3) A cheque of ₹ 5,000 received from a customer was returned dishonoured by bank but the same has not been recorded in the books. The customer has become insolvent and 60% is expected to realise from his estate.

(4) Furniture appearing in the books on 1.1.2015 at ₹ 6,000 was disposed of on 30.6.2015 at ₹ 3,500 in part exchange of a new furniture costing ₹ 5,000. A net invoice for ₹ 1,500 was passed through Purchases Day Book.

(5) Provide depreciation on furniture and fittings @ 10% p.a.

(6) Sales include ₹ 75,000 for goods sold in cash on behalf of Sri Asit. Trade expenses also include ₹ 4,000 as expenses in connection with this sale.

(7) Opening stock has been valued at 20% below cost but final accounts should be prepared by taking stock at cost.

Solution

Sri Amit

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2015 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock (Note 1)		1,00,000	By Sales	6,65,000	
To Purchases	5,20,000		Less: Goods sold on Consignment	75,000	
Less: Purchases Return	2,000		(on behalf of Asit)	5,90,000	
Less: Purchase of Furniture	1,500	5,16,500	Less: Sales Return	3,000	5,87,000
To Wages		5,000	By Closing Stock		64,000
To Gross Profit c/d		29,500			
		6,51,000			6,51,000
To Salaries		25,000	By Gross Profit b/d		29,500
To Printing and Advertising	12,000		By Discount Received		2,000
Less: Unexpired Amount	6,000	6,000	By Commission Received (from Asit)		7,500
To Postage		4,500	By Net Loss		12,750
To Discount Allowed		2,500			
To Other Trade Expenses	10,000				
Less: Exp. for Consignment Sale	4,000	6,000			
To Provision for Bad Debts (Note 2)		2,000			
To Depreciation on :					
Furniture in use (Note 3)		3,250			
Furniture Disposed off (Note 4)		300			
To Loss on Exchange of Furniture (Note 5)		2,200			
		51,750			51,750
To Net Loss		12,750	By Opening Stock (See Tutorial Note)		20,000
To Net Profit (Transferred to Capital A/c)		7,250			
		20,000			20,000

Balance Sheet of Sri Amit as at 31st December, 2015

Liabilities	₹	₹	Assets	₹	₹
Capital :			Furniture and Fitting (Note 6)		31,750
Opening balance	1,90,000		Closing Stock		64,000
Add: Net Profit	7,250		Sundry Debtors	75,000	
	1,97,250		Add: Cheque dishonoured	5,000	
Less: Drawings	15,000	1,82,250		80,000	
Sundry Creditors		60,000	Less: Prov. for Bad Debts (Note 2)	2,000	78,000
Balance due to Sri Asit (Note 7)		18,500	Bills Receivables		40,000
			Unexpired Printing and Advertising		6,000
			Cash at Bank : ₹ (36,000 – 5,000)		31,000
			Cash in Hand		10,000
		2,60,750			2,60,750

Working Notes :

(1) Opening stock has been under-valued by 20%. Therefore, it appears in the Trial Balance at 80%. So, the actual cost of opening stock = 80,000 / 80% = ₹ 1,00,000. Assuming that the market value of opening stock is more than ₹ 1,00,000, the value of opening stock is to be increased by ₹ 20,000.

Tutorial Note : Para 19 of AS—5 states that ***prior period items are normally included in the determination of net profit or loss for the current period. An alternative approach is to show such items in the statement of profit and loss after determination of current net profit or loss.*** This is a prior period item.Therefore,it is to be shown in the Profit and Loss Account itself. It is better to show it after determination of current year's profit.

(2) 60% is expected to be realised from the estate of the insolvent debtor owing ₹ 5,000. Therefore, a provision for bad debts is to be created @ 40% on ₹ 5,000, i.e. ₹ 2,000.

(3) Depreciation on old furniture in use = 10% ₹ (36,000 – 6,000) = ₹ 3,000. Depreciation on new furniture for 6 months @ 10% p.a. on ₹ 5,000 = ₹ 250. Therefore, total depreciation on furniture in use = ₹ 3,000 + ₹ 250 = ₹ 3,250.

(4) Depreciation on furniture disposed off = 10% of ₹ 6,000 for 6 months = ₹ 300.

(5) Calculation of Loss on Exchange of Furniture		(6) Book Value of Furniture as on 31.12.2015	
Particulars	₹	Particulars	₹
Book value of furniture (exchanged) on 1.1.1995	6,000	Opening Balance	36,000
Less: Depreciation for 6 months @ 10% p.a.	300	Less: Book value of furniture sold	6,000
Written-down value on 30.6.1995	5,700		30,000
Less: Exchange value	3,500	Add: New furniture purchased	5,000
	2,200		35,000
		Less: Depreciation for 2015 (Note 3)	3,250
			31,750

Dr. (7) Sri Asit (Consignor) Account Cr.

Particulars	₹	Particulars	₹
To Cash Sent to Consignor A/c	75,000	By Balance b/d	30,000
To Trade Expenses	4,000	By Sales	75,000
To Commission on Sale @ 10%	7,500		
To Balance c/d	18,500		
	1,05,000		1,05,000

Illustration 28

From the following Trial Balance of Sri Sengupta and the additional information, prepare a Trading and Profit and Loss Account for the year ending on 31.12.2014 and a Balance Sheet as at that date :

Debit Balances	₹	Credit Balances	₹
Materials Consumed	1,75,000	Capital	75,000
Stock on 31.12.2014	37,500	Sales	3,00,000
Debtors	30,000	Creditors	25,000
Wages — Productive	45,000	Commission Received	1,500
Wages — Others	7,500	Special Rebate Received	2,000
Salaries	7,500	Suspense Account — Sri Roy	27,500
Electric Charges	2,500		
Freight and Insurance on Purchases	1,500		
Delivery Charges	1,000		
Depreciation	5,000		
Commission Paid	1,000		
Special Rebate Allowed	1,000		
Plant and Machinery	32,500		
Furniture	6,500		
Land and Building	47,500		
Suspense Account — Smt. Banerjee	10,000		
Drawings	7,500		
Cash	2,000		
Bank	10,500		
	4,31,000		4,31,000

Additional information :

(a) Salary includes the proprietor's salary of ₹ 3,000 for the year.

(b) Suspense Account of Sri Roy represents a cheque received from him against sale proceeds of goods sent to him on consignment. Goods costing ₹ 32,500 were sent to him on consignment. 4/5th of the goods were sold by him for ₹ 45,000. He is entitled to a commission at 10% on sale proceeds. The only entry passed in this connection was for the cheque received from him.

(c) Suspense Account of Smt. Banerjee represents an advance of ₹ 10,000 to her in connection with a joint venture agreement entered into with her for which she is to get 2/5th share of profit. It is ascertained that the venture has earned a profit of ₹ 7,500.

(d) The scrutiny of the Schedule of Debtors reveals the following :
(i) ₹ 7,500 fully realisable; (ii) ₹ 5,000 — 75% realisable; (iii) ₹ 2,500 — 50% realisable; (iv) Provision for doubtful debts has to be provided for at 5% on the balance besides the amount that may be required as above.

Solution

Sri Sengupta

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Materials Consumed	1,75,000	By Sales	3,00,000
To Wages — Productive	45,000	By Goods Sent on Consignment	32,500
To Freight and Insurance on Purchases	1,500		
To Gross Profit c/d	1,11,000		
	3,32,500		3,32,500

To Wages — Others		7,500	By Gross Profit b/d	1,11,000
To Salaries	7,500		By Commission Received	1,500
Less: Proprietor's salary	3,000	4,500	By Special Rebate Received	2,000
To Electric Charges		2,500	By Profit on Consignment (Note 1)	14,500
To Delivery Charges		1,000	By Profit on Joint Venture (3/5th of ₹ 7,500)	4,500
To Depreciation		5,000		
To Commission Paid		1,000		
To Special Rebate Allowed		1,000		
To Provision for Doubtful Debts (Note 4)		3,250		
To Net Profit (transferred to Capital)		1,07,750		
		1,33,500		1,33,500

Balance Sheet of Sri Sengupta as at 31st December, 2014

Liabilities	₹	₹	Assets	₹	₹
Capital :			Land and Building		47,500
Opening Balance	75,000		Plant and Machinery		32,500
Add: Net Profit	1,07,750		Furniture		6,500
	1,82,750		Closing Stock		37,500
Less: Drawings : ₹ (7,500 + 3,000)	10,500	1,72,250	Stock on Consignment		6,500
Creditors		25,000	Debtors	30,000	
			Less: Provision for Doubtful Debts	3,250	26,750
			Amount Due from Smt. Banerjee (Note 3)		14,500
			Amount Due from Sri Roy (Note 2)		13,000
			Cash at Bank		10,500
			Cash in Hand		2,000
		1,97,250			1,97,250

Working Notes :

Dr. (1) Consignment to Sri Roy Account Cr.

Particulars	₹	Particulars	₹
To Goods Sent on Consignment A/c	32,500	By Sri Roy A/c — Sales Proceeds	45,000
To Sri Roy A/c — Commission 10% on ₹ 45,000	4,500	By Stock on Consignment A/c (1/5 of ₹ 32,500)	6,500
To Profit on Consignment A/c	14,500		
	51,500		51,500

Dr. (2) Sri Roy Account Cr.

Particulars	₹	Particulars	₹
To Consignment to Sri Roy A/c	45,000	By Suspense A/c — Sri Roy	27,500
		By Consignment A/c (commission)	4,500
		By Balance c/d	13,000
	45,000		45,000

Dr. (3) Smt. Banerjee Account Cr.

Particulars	₹	Particulars	₹
To Suspense A/c — Smt. Banerjee	10,000	By Balance c/d	14,500
To Share of Profit — 3/5 of ₹ 7,500	4,500		
	14,500		14,500

(4) Calculation of Provision for Doubtful Debts

	₹	
(i) On ₹ 7,500	Nil	
(ii) On ₹ 5,000 @ 25%	1,250	
(iii) On ₹ 2,500 @ 50%	1,250	
(iv) On ₹ 15,000 @ 5%	750	3,250

Key Points

- Trading Account is prepared to know the gross profit or overall profit. Profit and Loss Account discloses net profit or clear profit of the business. The Balance Sheet shows the financial position of the business on a given date — generally on the last date of the accounting period.
- Freight and insurance paid in connection with acquiring goods or making them saleable is debited to Trading Account. Freight and insurance paid in connection with the sale of goods is charged to Profit and Loss Account.
- When goods are purchased within municipality limits, generally octroi duty has to be paid on it. It is debited to Trading Account.

THEORETICAL QUESTIONS

1. What is a Trading Account? Why is it prepared?
2. What do you mean by Profit and Loss Account? Why is it prepared?
3. What adjustments are usually necessary at the time of preparing the Final Accounts?
4. What are closing entries? How are various accounts closed?
5. What adjusting entries would you pass in respect of (i) Income received in advance; (ii) Outstanding expenses; (iii) Accrued Income; and (iv) Depreciation?
6. What is Balance Sheet? Distinguish between Profit and Loss Account and Balance Sheet. What are the uses and limitations of the Balance Sheet?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below.

1. Relating to the 'closing stock' for an accounting period, which of following is true ?
   A the figure is shown only in the trading account
   B the figure is shown only in the balance sheet
   C the figure is shown in the trading account and the balance sheet
   D the figure is shown as part of purchases in the trading account
2. Depreciation of a delivery van used for carriage inwards and carriage outwards will appear in
   A profit and loss account
   B trading account
   C trading account and profit and loss account
   D profit and loss account and balance sheet
3. A profit on the disposal of a fixed asset can also be described as an :
   A over-provision for depreciation on the asset
   B increase in fixed assets on the balance sheet
   C increase in the bank balance
   D under-provision for depreciation on the asset
4. What is the effect of overvaluing closing stock on the current year's profits ?
   A decreases the gross profit and net profit
   B increases the gross profit but decreases net profit
   C decreases the gross profit and increases net profit
   D increases the gross profit and net profit
5. Which of the following would appear in a trading account ?
   A discount allowed
   B carriage outward
   C carriage inward
   D discount received
6. How should a contingent liability be included in a firm's financial statements if the likelihood of a transfer of economic benefit to settle it is remote ?
   A disclosed by note with some provisions being made
   B disclosed by note with no provision being made
   C neither disclosure nor provision is required
   D adequate provision should be made
7. Which of the following should be classified as current liabilities ?
   (i) sundry debtors
   (ii) sales tax payable
   (iii) sundry creditors
   (iv) investments
   A (i) and (ii)
   B (i) and (iv)
   C (ii) and (iii)
   D (iii) and (iv)

8. Which of the following would be classified as revenue expenditure for a shop ?
   (i) assistant's wages
   (ii) trade licence fee paid
   (iii) purchase of a new shop counter
   (iv) repainting of the outside of the shop
   A (i) and (ii)
   B (i) and (iv)
   C (i) and (iii)
   D (i); (ii) and (iv)
9. Relating to the opening and closing stock for a financial period, which of the following is true ?
   A both figures are shown in the trading account but only the opening stock is shown in the balance sheet
   B only the opening stock is shown in the trading account, but both figures are shown in the balance sheet
   C both figures are shown in the trading account but only the closing stock is shown in the balance sheet
   D only the closing stock is shown in the trading account, but both figures are shown in the balance sheet
10. Which of the following is capital expenditure ?
   A cost of installing a new machine
   B interest paid on loan borrowed to finance the purchase of a new machine
   C cost of replacing parts to maintain the efficiency of a machine
   D cost of electricity to run a machine
11. Which of the following is not capital expenditure ?
   A a major overhaul to the motor of a delivery van to extend its useful life
   B an air-conditioner fixed to a delivery van
   C cost of replacing tyres of a delivery van
   D an extra body is added to a delivery van to increase the carrying capacity
12. Which of the following is not shown in the balance sheet ?
   A fixed deposit
   B opening stock
   C mortgage on land
   D bank overdraft
13. Gross profit is
   A sales less purchases
   B net sales less cost of goods sold
   C net profit less expenses
   D sales less purchases plus opening stock
14. Net profit is determined in the
   A trial balance
   B balance sheet
   C profit and loss account
   D trading account
15. Salaries are expenses incurred in making goods into a saleable condition, they should be charged to the
   A balance sheet
   B trading account
   C profit and loss account
   D trial balance
16. The accounts of a business have been prepared, but no adjustments have been made for accrued expenses at the end of the year.
   What effect will these omissions have on the accounts ?

	Net Profit	Current Assets	Current Liabilities
A	overstated	no effect	understated
B	understated	no effect	overstated
C	overstated	understated	no effect
D	understated	overstated	no effect

PRACTICAL QUESTIONS

1. From the following Trial Balance of Mr Krishna Gupta, prepare Trading and Profit and Loss Account for the year ended 31st December, 2014 and a Balance Sheet as on that date, after giving effect to the adjustments :

	Dr. (₹)	Cr. (₹)		Dr. (₹)	Cr. (₹)
Capital		1,80,000	Debtors	40,000	
Drawings	32,500		Goodwill	17,300	
Stock (1.1.2014)	1,74,450		Creditors		30,000
Return inwards	5,540		Advertisement expenses	9,540	
Carriages inwards	12,400		Provision for doubtful debts		12,000
Deposits with Mr Kamal (interest free)	13,750		Bad debts	4,000	
Carriage outwards	7,250		Patents and trade marks	5.000	
Loan to Anil @ 5% given on 1.1.2014	10,000		Cash in hand	620	
Returns outwards		8,400	Discount allowed	3,300	
Interest on the above loan		250	Wages	7,540	
Rent	8,200		Plant and machinery (purchased on 1.2014	30,000	
Rent outstanding		1,300	Purchases	11,29,700	
Sales		12,79,140	**TOTAL**	15,11,090	15,11,090

Adjustments :
1. Increase bad debts by ₹ 6,000. Make provision for doubtful debts @ 10% and provision for discount on debtors @ 5%.
2. The value of the closing stock is ₹ 1,87,920.
3. Wages include ₹ 2,000 paid for the erection of machinery on 1.1.2014.
4. Provide depreciation machinery @ 10% p.a.

2. From the following balances of Amal, Bimal as on 31.12.2014, prepare Trading Account, Profit and Loss Account for the year ended 31.12.2014 and the Balance Sheet as at 31.12.2014.

	₹		₹
Opening stock	30,000	Machinery at cost (including ₹ 10,000 new)	60,000
Purchases	1,10,000	Sundry Debtors	20,000
Sales	2,50,000	Bad debts	3,000
Building	55,000	Depreciation fund	25,000
Wages	23,000	Sundry Creditors	24,000
Carriage inwards	3,000	Rent,rates and taxes	4,000
Bills payable	10,000	Trade expenses	4,000
Furniture	9,000	Capital : Amal	50,000
Salaries	42,000	Capital : Bimal	40,000
Advertisement	24,000	Petty expenses	4,000
Coal and coke	2,000	Provision for bad debts	1,000
Cash at bank	14,000	Gas and water	1,200
Prepaid wages	1,000	Cash in hand	800
Depreciation fund investment	25,000	Outstanding rent	400
		Bank loan	34,600

The following additional information is supplied :
(a) The partners share profits and losses as Amal 2/5 and Bimal 3/5.
(b) Closing stock — ₹ 15,000.
(c) Stock valued at ₹ 10,000 was destroyed by fire but the Insurance Company admitted a claim of ₹ 8,500 only, and the claim is not yet paid.
(d) Wages include ₹ 2,000 for installation of a new machinery on 1.9.2014.
(e) Depreciate machinery at 10% p.a.

3. Mr P. Sharma is in business as a stationery merchant. From the following business extracted from his books of accounts, you are required to prepare Trading and Profit and Loss Account for the year ended 31st December, 2014 and a Balance Sheet as on that date :

	Dr. (₹)	Cr. (₹)		Dr. (₹)	Cr. (₹)
Cash in hand	20,000		Opening stock	20,000	
Cash at bank	25,000		Trade mark rights (10 years from 1.1.2014)	40,000	
Plant and machinery	50,000		Purchases	1,50,000	
Furniture and fixtures	10,000		Postages and telegrams	2,000	

Drawings	10,000		Bad debts	1,000	
Capital		90,000	Loan from R.D. Bansal @ 6% p.a. (taken on 1.7.2014)		15,000
Insurance charges	1,000		Interest on loan from Bansal	200	
Salaries and wages	25,000		Creditors		54,200
Sundry debtors	35,000		Sales		2,30,000
			TOTAL	3,89,200	3,89,200

Additional information :

1. Stock on 31.12.2014 — ₹ 38,000.
2. Depreciate plant and machinery at 10% and furniture and fixtures at 5% p.a.
3. Invoices of the value of ₹ 3,000 were recorded in the Sales Book on 29th December, 2014, but goods were not despatched until 7th January, 2015 and were included in the closing stock.
4. Of the sundry debtors ₹ 1,000 are bad and should be written-off.
5. Sundry debtors include ₹ 6,000 due from B N Sen whereas sundry creditors include ₹ 1,000 also due to him.
6. Create a provision of 5% on Sundry debtors for bad and doubtful debts.

4. From the following particulars prepare the Trading and Profit and Loss A/c for the year 2014 and the Balance Sheet as on 31.12.2014 of Prem Niwas :

	Dr. (₹)	Cr. (₹)		Dr. (₹)	Cr. (₹)
Building	50,000		Rent	6,000	
Machinery	22,000		Establishment	16,000	
Furniture	10,000		P.F. deducted from salaries		1,000
Bank	9,000		Interest (10%)	2,000	
Cash	1,000		Electricity	1,000	
Loans (since 1.1.2014)		30,000	Phone	1,000	
Capital		52,000	Commission	6,000	
Debtors/Creditors	50,000	40,000	Insurance premium	1,000	
Opening stock	12,000		Bad debts	2,000	
Purchase/Purchase returns	2,50,000	10,000	Bills receivable	4,000	
Sales returns/Sales	12,000	3,22,000	**TOTAL**	4,55,000	4,55,000

Provide depreciation on building @ 5%, machinery @ 15% and furniture @ 10%. Stock was not taken on 31.12.2014 but only on 7.1.2015. The transactions from 1.1.2015 to 7.1.2015 are Sales ₹ 25,000; Purchases ₹ 15,000; Stock on 7.1.2015 ₹ 18,000; and Gross Profit 20%. During the year machinery to the value of ₹ 10,000 was destroyed by fire and the insurance claim was settled at ₹ 8,000 and credit to Machinery Account. Also provide Employer's share of P.F. ₹ 1,000, Provision for bad debts at 5%, Commission to the manager @ 10% on net profit after providing the commission.

5. From the following Trial Balance of Hari and additional information prepare Trading and Profit and Loss Account for the year ended 31st March, 2015 and a Balance Sheet as on that date :

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Capital		1,00,000	Bad Debt written-off	7,000	
Furniture	20,000		Creditors		1,20,000
Purchases	1,50,000		Drawings	24,000	
Debtors	2,00,000		Provision for bad debts		6,000
Interest earned		4,000	Printing and Stationery	8,000	
Salaries	30,000		Insurance	12,000	
Sales		3,21,000	Opening stock	50,000	
Purchase returns		5,000	Office expenses	12,000	
Wages	20,000		Provision for Depreciation		2,000
Rent	15,000				
Sales Return	10,000		**TOTAL**	5,58,000	5,58,000

Additional information :

(1) Depreciate Furniture by 10% on original cost.
(2) A Provision for Doubtful Debts is to be created to the extent of 5% on Sundry Debtors.
(3) Salaries for the month of March 2015 amounting to ₹ 3,000 were unpaid which must be provided for. However, salaries included ₹ 2,000 paid in advance.
(4) Insurance amounting to ₹ 2,000 is prepaid.
(5) Provide for outstanding office expenses ₹ 8,000.
(6) Stock used for private purpose ₹ 6,000; and Closing Stock-in-trade ₹ 60,000.

6. The following is the Trial Balance of Shri Paras, as on 31st March, 2015. You are requested to prepare the final accounts in vertical format, after giving effect to the adjustments:

Particulars	(Dr.) ₹	(Cr.) ₹	Particulars	(Dr.) ₹	(Cr.) ₹
Sundry Creditors	—	63,000	Carriage on Purchases	20,400	—
Sundry Debtors	1,45,000	—	Carriage on Sales	32,000	—
Capital Account	—	7,10,000	Fuel and Power	47,300	—
Drawings	52,450	—	Wages	1,04,800	—
Insurance	6,000	—	Returns Outwards	—	5,000
General Expenses	30,000	—	Returns Inwards	6,800	—
Salaries	1,50,000	—	Sales	—	9,87,800
Patents	75,000	—	Purchases	4,06,750	—
Machinery	2,00,000	—	Cash at Bank	26,300	—
Freehold Land	1,00,000	—	Cash in hand	5,400	—
Building	3,00,000	—			
Stock on 1.4.2014	57,600	—	**TOTAL**	17,65,800	17,65,800

The following adjustment are to be made: (1) Stock on 31st March, 2015 was valued at ₹ 68,000; (2) A provision for bad and doubtful debts is to be created to the extent of 5% on Sundry Debtors; (3) Depreciate Machinery by 10% and Patents by 20%; (4) Wages include a sum of ₹ 20,000 spent on the erection of a cycle shed for employees and customers; (5) Salaries for the month of March, 2015 amounting to ₹ 15,000 were unpaid; (6) Insurance includes a premium of ₹ 1,700 on a policy, expiring on 30 September, 2015.

7. The Trial Balance of M/s R.S. Corporation as on December 31, 2014 was as under :

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Rajeev's Capital A/c		80,000	Bad debts	300	
Suresh's Capital A/c		1,00,000	Bills payable		12,000
Stock as on 1.1.2014			Discount		500
Raw materials	2,500		Land and Building	90,000	
Finished goods	6,500		Plant and machinery	70,000	
Purchases	64,500		Furniture	1,000	
Sales		1,19,000	Sundry Debtors	25,400	
Sales returns	2,000		Sundry Creditors		42,000
Wages	16,000		Drawings :		
Manufacturing expenses	12,000		Rajeev	1,800	
Salaries	8,000		Suresh	1,400	
Insurance	1,500		Cash in hand	500	
Postage	100		Cash at bank	49,000	
Advertisement	1,000		**TOTAL**	3,53,500	3,53,500

Rajeev and Suresh share profits and losses equally. Prepare Trading, Profit & Loss Account for the year ended 31st December 2014, and also the Balance Sheet as on that date after taking into consideration the following adjustments:

1. Stock on 31st December, 2014 : Raw materials ₹ 4,000; Finished goods ₹ 12,000.
2. Provide depreciation on land and building @ 5%; on furniture @ 10%; and on plant & machinery @ 5%.
3. Outstanding expenses : Salaries ₹ 1,500; Wages ₹ 2,100.
4. Insurance paid for 15 months upto March, 2015.
5. Write-off bad debts of ₹ 400
6. Reserve for doubtful debts @ 5% of Debtors.
7. Goods withdrawn by Rajeev for personal use ₹ 2,000.

8. A and B are partners sharing profits in proportion to their capitals. At the close of their financial year on 30th September, 2013, the following balances stood to the credit of the partners.

Capital Accounts: A — ₹ 20,000; B — ₹ 5,000 Current Accounts: A — ₹ 1,060; B — ₹ 2,800

The partnership deed provides :

(a) B shall be credited with a partnership salary of ₹ 1,000 per annum for running business;
(b) B shall be entitled to a commission of 10% of the divisible profit before charging such commission;
(c) Interest at 5% per annum to be allowed on Capital and Current Accounts.
(d) The partners drawings were : A — ₹ 10,000; B — ₹ 3,000
(e) The interest to be charged on such drawings were : A — ₹ 330; B — ₹ 80.

In addition to the entries necessary to record the above particulars, the following balances were extracted from the books of the firm as on 30th September, 2014:

Particulars	₹	Particulars	₹
Freehold premises	15,000	Machinery and plant — balance at the beginning	13,280
Sundry creditors	24,150	Machinery — additions	1,560
Advertising	4,339	Motor vans	900
Office salaries	2,189	Factory expenses paid in advance	70
Sundry Debtors	16,020	Cash at bank	2,841
Office expenses	622	Cash in hand	31
Insurance	364	Mortgage on freehold premises at 6% per annum	10,000
Delivery expenses	2,203	Office furniture	300
Stock	21,069	Mortgage interest	450
Provision for doubtful debts — as on 30.9.2014	600	Patents	4,000
Trading Account credit balance	34,628		

You are required to prepare a Profit & Loss Account for the year ended 30th September, 2014, and the Balance Sheet as on that date.

Given below are the additional information towards the preparation of the required Final Accounts.

(a) Depreciation to be provided as follows :
Plant, old balance 10% p.a.; Plant — additions (for full year) 25% p.a.;
Office furniture 10% p.a.; Patents 10% p.a.

(b) Motor vans are to be taken at ₹ 800 for the purpose of Final Accounts.

(c) The provision for bad debts is to be made upto 5% on Sundry Debtors.

(d) Interest on the mortgage has been paid up to 30th June, 2014.

(e) The following amounts are to be carried forward to next year :
Insurance ₹ 62; Advertising ₹ 878.

(f) Office salaries ₹ 69 were owing at the end of the year.

9. Smt. Ghosal submits you the following Trial Balance which she has not been able to agree. Prepare the Trial Balance after correcting the errors committed by her and prepare a Trading and Profit and Loss Account for the year ended 31.12.2014 and a Balance Sheet as at that date after giving effect to the undermentioned adjustments :

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Capital		15,000	Purchases	12,970	
Drawings	3,250		Debtors	4,000	
Stock (1.1.2014)	17,445		Creditors		3,000
Returns Inward		554	Provision for Doubtful Debts		1,200
Carriage Inward	1,240		Advertisement Expenses	954	
Deposit with Basak		1,375	Bad Debts	400	
Returns Outward	840		Patents	500	
Carriage Outward		725	Sales		27,914
Loan to Chatterjee @ 5% p.a. on 1.1.2014		1,000	Discount Allowed		330
Interest on the above Loan		25	Wages	754	
Rent	820		Cash	62	
Rent Outstanding	130		Goodwill	1,730	
Stock (31.12.2014)		18,792	**TOTAL**	45,095	69,915

(i) The manager of Smt. Ghosal is entitled to a commission of 10% of the net profit calculated after charging such commission.

(ii) Increase bad debts by ₹ 600. Provision for doubtful debts is to be @ 10% and provision for discount on debtors is to be @ 5% on Sundry Debtors.

(iii) Stock valued at ₹ 1,500 was destroyed by fire on 25.12.2014 but the Insurance Company admitted a claim of ₹ 950 only and paid it in 2015.

(iv) ₹ 200 out of the advertisement expenses are to be carried forward to the next year.

10. Mr A, a shopkeeper, had prepared the following Trial Balance from his ledger as on 31st March, 2015 :

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Purchases	3,10,000		Furniture and fittings	22,000	
Sales		4,15,000	Printing and stationery	3,000	
Stock of goods as on 1.4.2014	50,000		Motor car	48,000	
Cash in hand	2,100		Bad debts	2,000	
Cash at bank	12,000		Cash discounts	4,000	

Mr A's capital		2,88,600	General expenses	14,000	
Drawings	4,000		Carriage inwards	10,000	
Rates and taxes	5,000		Carriage outwards	22,000	
Salaries	32,000		Wages	20,000	
Postage and telephone	11,500		Outstanding liability for expenses	11,000	
Salesmen's commission	35,000		Sundry creditors		40,000
Insurance	9,000		Sundry debtors	1,00,000	
Advertisement	17,000		**TOTAL**	7,43,600	7,43,600

You are requested to prepare Trading and Profit and Loss Account for the year ended 31st March, 2015 and the Balance Sheet as on that date. You are also given the following further information :

(a) Cost of goods in stock as on 31st March, 2015 — ₹ 1,45,000;
(b) Mr A had withdrawn goods worth ₹ 5,000 during the year;
(c) Printing and stationery expenses of ₹ 11,000 relating to 2013-14 accounting year had not been provided in that year but was paid in this year by debiting outstanding liabilities;
(d) Purchases include purchase of furniture worth ₹ 10,000;
(e) Debtors include ₹ 5,000 bad debts;
(f) Creditors include a balance of ₹ 4,000 to the credit of L.M. Corporation in respect of which it has been decided and settled with the party to pay only ₹ 1,000;
(g) Sales include goods worth ₹ 15,000 sent out to S.M. & Co on approval and remained unsold as on 31st March, 2015. The cost of the goods was ₹ 10,000;
(h) Provision for bad debts is to be created at 5% on Sundry debtors;
(i) Depreciation on furniture and fittings by 10%; motor car by 20%;
(j) The salesmen are entitled to a commission of 10% on total sales.
(k) The purchase department has informed the accounts department that it is in possession of a number of free samples given to them by the potential suppliers. Their estimated value at purchase cost is ₹ 5,000. They were not included in the stock referred to (a) above.

11. Hari Singh has extracted the following Trial Balance from his books as on March 31, 2015 :

	Dr. (₹)	Cr. (₹)		Dr. (₹)	Cr. (₹)
Drawings	16,000		Electricity	6,000	
Cash	6,760		Motor car	10,240	
Petty cash	1,000		Advertising	9,000	
Leasehold land	20,000		Sundry creditors		35,000
Opening stock at market value	50,000		Purchases / Sales	4,00,000	6,00,000
Salary	12,000		Postage and telephone	3,000	
Sundry debtors	50,000		Discount	11,400	
Wages	40,000		General charges	4,000	
Bank	21,000		Petty cash expenses	9,600	
Capital		34,000	Suspense		10,000
Rent	9,000		**TOTAL**	6,79,000	6,79,000

You are required to prepare a Trading, Profit and Loss Account and the Balance Sheet using the following information:

(a) Closing stock as on 31st March, 2015 amounted to ₹ 76,000 at cost. A review of inventory items revealed the need for some adjustments for the following :
Items which had cost ₹ 8,000 and which would normally sell for ₹ 12,000 were found to have deteriorated. Remedial work costing ₹ 2,000 would be needed to enable the item to be sold for ₹ 9,000.
(b) The petty cash balance represents the month-end imprest amount. As on the closing date, the petty cashier had vouchers totalling to ₹ 400 for which he had not received reimbursement from the main cashier.
(c) Discounts allowed amounting to ₹ 1,000 had been posted to the debit of Sundry Debtors.
(d) Cash withdrawn from bank ₹ 4,000 had not been entered in the bank column of the cash book.
(e) Sales Account had been undercast on the credit side by ₹ 4,000.
(f) The motor car which had been purchased in 2012-13 was being depreciated at 20% on the reducing balance method. The original cost of the car is ₹ 20,000. It is now decided to charge depreciation at 6% on the straight line method and to make the change effective from the year of purchase of the car.
(g) The leasehold land was purchased during the year. On the date of purchase the unexpired period of the lease was 5 years.
(h) No entry had been passed in the books for stock withdrawn from the business by the proprietor ₹ 10,000.
(i) Telephone bills amounting to ₹ 1,000 remained unpaid.

12. Mr X, a trader, has extracted the following Trial Balance from his books as on 31st March, 2015 :

	Dr. (₹)	Cr. (₹)		Dr. (₹)	Cr. (₹)
Purchases	4,00,000		Claim recoverable	5,000	
Sundry debtors	1,50,000		Research and Development	9,000	
Cash in hand	4,000		Furniture and fittings	23,000	
Cash at bank	8,000		Deposit with supplier	6,000	
Rent, rates and taxes	3,000		Office equipment	10,000	
Insurance premium	9,000		Bills receivable	6,000	
Salaries	42,000		Bad debts	4,000	
Carriage outwards	21,000		Sales		7,00,000
Carriage inwards	18,000		Opening stock	30,000	
Sundry creditors		50,000	Electricity expenses	2,000	
			TOTAL	7,50,000	7,50,000

The following further information is provided :

1. A purchase invoice for ₹ 15,000, received from a creditor, has not been entered through oversight.
2. The claim recoverable has been settled with the insurance company for ₹ 2,000.
3. Break-up for Research and Development is ₹ 3,000 reserach and ₹ 6,000 development. It has been decided to amortise it over a period of 4 years.
4. Depreciation is to be provided on straight-line method on furniture and fittings and office equipment at 5%. The original costs were : Furniture and fittings ₹ 30,000; Office equipment ₹ 15,000.
5. Goods costing ₹ 5,000 were despatched out on 29th March. The sale, however, took place on 2nd April, 2015, when an invoice for ₹ 7,500 was raised against the customer.
6. Insurance premium includes a prepaid amount of ₹ 1,000.
7. The deposit with a supplier was made on 1st October, 2014. It carried interest @ 12% p.a.
8. Two bills receivable from customers of ₹ 700 and ₹ 1,300, were dishonoured on 30th March. These had earlier been discounted with the bank.
9. Provide 2% on sundry debtors for doubtful debts.
10. Physical stock of goods on hand on 31st March, 2015 at cost was ₹ 1,00,000.

Prepare Trading, Profit and Loss Account and the Balance Sheet from the above information.

13. The following are the closing balance as on 31.12.2014 extracted from the books of Mr Mehta. Prepare the Trading and Profit and Loss Account for the year ending 31.12.2014 and the Balance Sheet as on that date after making the necessary adjustments :

	₹		₹
Mr Mehta's Capital Account	1,65,000	Interest received from A.N. Sen	400
Stock on January 1, 2014	70,200	Cash at bank	12,000
Sales	4,34,400	Discounts received	6,300
Purchases	3,64,650	Investment	7,500
Carriage inwards	27,900	Furniture and fittings	2,700
Rent and rates	8,550	Discounts paid	11,310
Sales returns	12,900	General expenses	6,000
Salaries	13,950	Audit fees	1,050
Purchases returns	8,700	Insurance	900
Sundry debtors	36,000	Travelling expenses	3,500
Sundry creditors	26,350	Postage and telegrams	4,070
Bank loan at 6% (1.1.2014)	30,000	Cash in hand	570
Interest paid on above	1,350	Deposit with Mr A N Sen (1.1.2014) Interest @ 9%	45,000
Printing and advertising	21,900	Drawings Account : Mr Mehta	15,000
Motor Van, at cost	8,000	Disposal of Motor Van	250
Provision for Depreciation on motor van at 31.12.2013	3,600		

Adjustments :

(a) Stock as on December 31, 2014 was ₹ 1,20,000.

(b) Sundry Debtors included a sum of ₹ 3,000 due from Mr Nair and Sundry creditors included a sum of ₹ 4,000 due to Mr Nair.

(c) (i) During 2014 a motor van which was purchased during 2006 for ₹ 1,000, was sold for ₹ 250. The only entry which has been made is to credit the ₹ 250 to Disposal of Motor Van Account.

(ii) Depreciation has been and is to be charged on motor van at 20% of cost. A full year's depreciation is charged in the year of purchase none in the year of sale.

(d) Provide 5% for bad debts and 2% on the balance for discount for prompt payment.
(e) Write off depreciation at 10% of furniture and fittings. Depreciation in respect of items sold off during the year need not to be provided.
(f) As on December 31, 2014 salaries and carriage inwards that remain unpaid were ₹ 1,200 and ₹ 150 respectively.
(g) Insurance paid in advance as on 31.12.2014 was ₹ 120.
(h) Furniture of the book value of ₹ 900 as on 1.1.2014 had been disposed off for ₹ 500 on 30.6.2014. The sale proceeds had been credited to the Furniture Account but the loss on sale of furniture had not been written off in the books.
(i) Furniture purchased for ₹ 1,000 on 1.1.2014 had been debited in the Purchases Account.
(j) Purchases to the value of ₹ 1,800 had been omitted from the books.
(k) Personal purchase of ₹ 700 made by Mr Mehta had been included in the purchase.
(l) Provide for interest on: (i) the Deposits with Mr A N Sen; and (ii) Bank loan.

14. The books of Mr X, a trader in tea, showed the following balances as on 31st March, 2015 :

	₹		₹
Opening stock of tea	1,00,000	Commission to sales manager	32,400
Purchases : Tea	4,00,000	Furniture and fittings	35,000
Salaries paid	80,000	Airconditioners	30,000
Buildings	95,000	Sundry debtors	1,00,000
Cash in hand	2,000	Sundry creditors	80,000
Cash at bank	1,35,000	Loan on mortgage	70,000
Rent, rates and taxes	15,000	Interest paid on above	3,000
Insurance premium paid	3,000	Prepaid expenses	4,000
Miscellaneous receipts	10,000	Drawings	18,000
Sales	7,20,000	Bills payable	30,000
Cash discount allowed	4,750	Bank charges	2,000
Bad debts	3,250	Legal charges	6,000
Repairs — Buildings	2,900	Motor vehicles	80,000
Miscellaneous expenses	8,700	Travelling and conveyance	10,000
Advertisement	20,000	Capital	2,80,000

The following further information was obtained :

1. Closing stock ₹ 55,000.
2. Legal charges include ₹ 5,000 for cost of stamps and registration of new building acquired during the year.
3. Purchases include 4,000 kg tea valued at ₹ 20,000 which was found totally spoiled. Insurance claim lodged in this respect is expected to realise ₹ 15,000.
4. Travelling and conveyance include proprietor's personal travelling for which he is to be charged with ₹ 4,800.
5. Loan on mortgage bears interest at 12% p.a.. The loan was taken on 1st June, 2014. One instalment of ₹ 10,000 was repaid on 1st December, 2014.
6. The sales manager is entitled to a commission of 7.5% of total sales. However, the actual bad debts incurred during the year is deductible from such commission entitlements.
7. Debtors include : (a) ₹ 10,000 due from M. & Co. (creditors include ₹ 18,000 due to the same party); (b) ₹ 5,000 due on account of sale of furniture; (c) Bad debts of ₹ 2,000;
8. Provision for bad debts is to be created at 2% of net outstanding debtors.
9. Depreciation is chargeable as follows : (a) Buildings at 2.5%; (b) Furniture and fittings at 10%; (c) Airconditioners at 15%; (d) Motor vehicles at 20%.
10. Miscellaneous receipts represent sale proceeds of furniture, written down value of which was ₹ 12,000.
11. Prepaid expenses include insurance premium of ₹ 1,000 for period from 1st April, 2014 to 30th September, 2014 paid in 2013-14.
12. Bills payable include a bill of ₹ 10,000 which fell due on 31st March, 2015 and was paid by the bank as per standing instructions. The bank charges in this connection amounted to ₹ 100.
13. The balance as per bank as on 31st March, 2015 was ₹ 1,24,900.

Prepare Trading and Profit and Loss Account for the year ended on 31st March, 2015 and the Balance Sheet as on that date from the above information.

15. Padmanabhan, who commenced business as a retail trader on January 1, 2014 extracted the following balances as on 31st December, 2014 :

	₹		₹
Capital A/c	6,00,000	Establishment charges	20,000
Drawings A/c	12,000	Electricity charges	6,575
Building A/c	2,00,000	Postage and telegram	1,284

Furniture and fitting	30,000	Travelling and conveyance	3,816
Depreciation reserve — Buildings	10,000	Advance for salesman's commission	1,000
Depreciation reserve — Furniture	3,000	Insurance	2,500
Depreciation for the year	13,000	Rent received	12,000
Purchases	4,00,000	Motor van (purchased on 1.1.2014)	80,000
Sundry creditors	40,000	Motor van maintenance	23,425
Sales	5,00,000	Fixed deposit (deposited on 1.9.2014)	1,00,000
Sundry debtors	1,20,000	Cash in hand	1,823
Cash at bank	1,47,977		

In view of the difference in Trial Balance, an examination of the books was conducted which revealed the following errors :

(i) ₹ 25 conveyance paid was debited to Motor Van Maintenance Account;
(ii) ₹ 2,000 drawn from bank towards establishment charges for November, was omitted to be posted into ledger.
(iii) The cash column in the cash book on the receipts side, stands excess totalled by ₹ 400.

You are required to prepare Trading and Profit and Loss Account for the year 2014 and a Balance Sheet at the end of the year after taking into consideration the under noted adjustments :

1. Establishment charges have been paid only upto November and provision of ₹ 2,000 has to be made for December.
2. Electricity charges are outstanding to the tune of ₹ 25.
3. 1/2% commission on total sales is payable to the salesman towards which ₹ 1,000 has been paid as advance.
4. Fixed deposit earns interest @ 9% p.a.
5. Provide depreciation @ 20% p.a. on motor van.
6. Closing stock as on 31.12.2014 ₹ 1,00,000.

16. From the following Trial Balance of R. Ramnath as at September 30, 2014 you are required to prepare a Trading and Profit and Loss Account for the year ending September 30, 2014 and a Balance Sheet as on that date, after making the necessary adjustments :

	Dr. (₹)	Cr. (₹)		Dr. (₹)	Cr. (₹)
R. Ramnath — Capital A/c		1,00,000	Printing and stationery	500	
R. Ramnath — Drawings	12,000		Insurance charges	1,000	
Land and buildings	60,000		Provision for doubtful debts		1,000
Plant and machinery	20,000		Provision for discounts on debtors		380
Furniture and fixtures	5,000		Bad debts	400	
Leasehold premises (lease to run for 5 years from 1.10.2014)	30,000		Profit of textiles department		10,000
Sales		1,40,000	Stock of general goods on 1.10.2014	21,300	
Returns outwards		4,000	Salaries and wages	18,500	
Sundry debtors	18,400		Sundry creditors	12,000	
Loan from D. Das @ 6% taken on 1.1.2014		30,000	Trade expenses	800	
Purchases	80,000		Stock of textiles goods on 30.9.2014	8,000	
Returns inwards	5,000		Cash at bank	4,600	
Freight and duty	10,000		Cash in hand	1,280	
Sundry expenses	600		**TOTAL**	2,97,380	2,97,380

Adjustments :

(a) The stock on hand on September 30, 2014 was valued at ₹ 27,300.
(b) On September 23, 2014 a fire broke out and destroyed stock of the value of ₹ 10,000. The insurance company admitted the claim for loss of stock to the value of ₹ 6,000 only, and paid the amount on October 10, 2014.
(c) Of the Sundry Debtors ₹ 400 are bad and should be written-off. The Provison for doubtful debts should be maintained at 5% on Debtors and the provision for discount on debtors at 2%. Also maintain a reserve for discount on creditors at 2%.
(d) Goods of the value of ₹ 6,000 has been received on September 27, 2014 but the purchase invoice was omitted from the Purchase Book.
(e) Ramnath had utilised goods of the value of ₹ 2,000 for his personal use, but no record was made of it.
(f) Depreciate land and buildings at 2%, plant and machinery at 20% and furniture and fixtures at 5%.
(g) Prepaid insurance was ₹ 200.

17. From the following Trial Balance and accompanying adjustments of Jailal Billu & Sons, prepare Trading and Profit and Loss Account for the year ended 31st December, 2014 and a Balance Sheet as on that date :

	₹		₹
Plant and machinery	10,000	Sales	2,00,000
Purchases *less* returns	90,000	Capital	80,000
Factory building	50,000	Interest on income tax paid in advance	400
Wages	10,000	Suspense A/c of Choti Lal	30,000
Fuel and power	2,000	Interest received in advance	3,600
Commission paid to purchase manager	1,000	Creditors	15,000
Insurance and taxes	4,000		
Life insurance	1,000		
Goodwill	30,000		
Debtors	70,000		
Bad debts	1,000		
Income tax advance payment	4,000		
Income tax	10,000		
Cash in hand and at bank	15,000		
Stock on 31.12.2014	20,000		
Suspense A/c of Moti Lal	10,000		
Commission paid in advance	1,000		
	3,29,000		3,29,000

Additional information :

1. On investigation, it was found that goods costing ₹ 40,000 were sent to Choti Lal under consignment; 3/4ths of the goods were sold by him for ₹ 60,000. Remaining stock was valued at cost. A cheque of ₹ 30,000 was received from Choti Lal. Entry for cash received was passed and credited to his Suspense Account. Commission of 5% on sale is payable to Choti Lal.
2. Similarly, a joint venture agreement was made with Moti Lal for which an advance of ₹ 10,000 was entered. It is now ascertained that venture earned a profit of ₹ 6,000 of which Jailal Billu & Sons are entitled to get 2/3rd share.
3. Debtors included an amount due from Chandi Ram ₹ 2,000 and creditors included amount due to Chandi Ram ₹ 3,000.
4. Purchases included purchase of materials used for the building for ₹ 2,000.
5. During the year a new plant was erected and firm's own man had spent time thereon amounting to ₹ 200. The amount was included in Wages Account.
6. Goods costing ₹ 600 (sales price ₹ 900) were sent on approval on 28th December and recorded as sale, but no consent has been received up to 31st December.
7. Make provision for doubtful debts at 5% and depreciate plant at 10% and building at 5%.

18. R retired from a company and started a business in Madras. On retirement, he got ₹ 1,00,000 from his employer which he invested in his business on 1.4.2014. He got from Life Insurance Corporation ₹ 20,000 on maturity of his policy which he also invested in his business. He draws ₹ 1,000 for his personal expenses every month from 30th April, 2014. The following figures are extracted from his books on 31st December, 2014 :

	₹		₹
Purchases	3,10,000	Bad debts	2,000
Cartage	5,000	Sundry debtors	45,000
Salaries and wages	24,000	Bills receivable	30,000
Electricity charges	4,500	Cash in hand	7,997
Travelling	8,900	Sales	3,00,000
Telephone	4,300	Income from personal investment	20,000
Advertisement	10,000	Creditors	85,000
Repairs and renewals	3,303	Bank overdraft	80,000
Plant and machinery	1,50,000	Building (Cr)	10,000

You are requested to prepare a Trading and Profit and Loss Account of the business for the period ended 31st December, 2014 and also the Balance Sheet as on that date after taking into consideration the following further information :

1. Purchase include ₹ 10,000 representing the value of furniture purchased.
2. ₹ 4,000 representing erection wages on plant and machinery was debited to salaries and wages.
3. Electricity charges include ₹ 2,500 paid as deposits to Electric Supply Company. There are bills outstanding to the extent of ₹ 500.
4. Advertisement includes ₹ 4,000 representing the cost of a neon sign.
5. A dishonoured bill of ₹ 5,000 stands debited to the debtor. 50% thereof considered doubtful and has to be provided accordingly.

6. A debtor for ₹ 1,000 was declared insolvent on 30th December, 2014, and it is expected that nothing would be recovered from his estate.
7. Provide 5% discount on net realisable debtors.
8. R received ₹ 25,000 in respect of a business with B. The sum received stood credited to sundry creditors. It is noted that, a sum of ₹ 5,000 was due to R as his share of profit from that business.
9. During the period there was a fire damaging stock costing ₹ 50,000. The damaged goods were sold for ₹ 20,000.
   This sum of ₹ 20,000 is included in sales. The insurance company paid ₹ 25,000 towards the loss of stock. The godown containing the stock was also damaged to the extent of ₹ 15,000, which has also been paid by the insurance company.
   The total amount received from the insurance company was credited to Building Account.
10. The bank overdraft was given on the hypothecation of stock-in-trade. You are informed that the bank had a margin of $33^1/_3$% and the overdraft balance on 31st December, 2014, was the maximum which could have been drawn on the basis of this margin.
11. The manager of the business is entitled to a commission of 10% of net profit after charging such commission.
12. Provide 10% depreciation on plant and machinery and on furniture and fittings and 5% on building. Depreciation to be provided on closing balance.

19. Mr Reddy, a retired government official who started business in Calcutta on 1st April, 2014, gives you the following balances relating to the year ending 31st March, 2015 :

	₹		₹
Sundry Debtors	84,000	Salaries	18,910
Sundry creditors	38,000	Suspense A/c (Dr.)	3,000
Stock in trade (1.4.2014)	40,000	Bad debts	1,200
Machineries	56,000	Reserve for doubtful debts	3,200
Furniture	8,500	Purchases	4,95,000
Bills receivable	4,900	Sales	6,76,000
Bills payable	3,700	Printing charges	2,300
Building rent	9,600	Postage	1,500
Cash in hand	4,250	Travelling expenses	7,900
Cash at bank	17,394	Telephone	1,600
Drawings	12,000	Miscellaneous expenses	41,806
Capital A/c (Cr)	90,000	Insurance	1,040

Additional information :

1. An old furniture which stood at ₹ 1,200 in the books on 1st April, 2014 was disposed of at ₹ 580 on 30th September, 2014 in part exchange for a new furniture costing ₹ 1,040. A net invoice at ₹ 460 was passed through the Purchases Day Book.
2. Sales include ₹ 20,000 as hire purchases sale. Hire purchase sales prices are determined after adding $33^1/_3$ % to cost price. 40% of the instalments have not fell due as yet (profit or loss on H.P. sales is to be shown in Profit and Loss Account).
3. Suspense Account represents money advanced to sales manager who was sent to Delhi in August, 2014 for sales promotion. On returning to Calcutta he submitted a statement disclosing that ₹ 1,200 was incurred for travelling, ₹ 500 for legal expenses and ₹ 900 for miscellaneous expenses. The balance lying with him is yet to be refunded.
4. Mr Reddy desires to change the method of depreciation on machineries from straight line method (i.e. on original cost), to diminishing balance method with retrospective effect from April 2007 and adjust the difference in the accounting year 2014-15. The rate of depreciation will, however, remain unchanged.
5. Business is carried on in a rented house. The ground floor being 50% of the accommodation, is used for business. Mr Reddy lives with his family on the first floor.
6. Total bad debts for the period amounted to ₹ 2,000. Reserve for doubtful debt is to be maintained at 5% on outstanding debtors.
7. Insurance premium covers a period of one month in advance.
8. Depreciation on time basis is to be provided on machineries at 10% per annum as instructed and on furniture at 5% per annum on diminishing balance method.
9. Closing stock amounted to ₹ 50,000.

Prepare Mr Reddy's Trading and Profit and Loss Account for the year ended 31st March, 2015 and a Balance Sheet as on that date after taking into consideration the above-mentioned information.

20. Mr Gavaskar is the proprietor of a large business. The following Trial Balance was prepared from his book as on 31st March, 2015.

	₹		₹
Land and Building	40,000	12% Bank Loan (S.B.I.)	
Cash at bank	25,000	(No movement during the year)	50,000
Motor car	20,000	Capital of Gavaskar	75,000
Furniture	10,000	Bills payable	5,000
Sundry Debtors	60,000	Sundry Creditors	65,000
Cash in hand	5,000	Returns outwards	4,000
Stock (1.4.2014)	55,000	Discount received	1,000
Returns inwards	5,000	Sales	4,50,000
Printing and Stationery	2,000		
Drawings	8,000		
Bills receivable	5,000		
Travelling expenses	6,000		
Discount allowed	2,000		
Miscellaneous expenses	19,000		
Postage	1,000		
Joint Venture Suspense A/c	1,000		
Investments (Market value ₹ 14,000)	15,000		
Interest on Bank Loan	4,000		
Salaries (including Advance for ₹ 2,000)	27,000		
Entertainment expenses	2,000		
Purchases	3,25,000		
Carriage inwards	4,000		
Advertisements	9,000		
	6,50,000		6,50,000

Additional Information:

1. On 1st October, 2014 Mr Gavaskar entered into a joint venture with Mr Kapil with an agreement to share the profits and losses equally. Kapil supplied goods totalling ₹ 30,000 which wrongly passed through the Purchase Day Book.
   The goods were sold for cash at a profit of 25% on sales and stood credited to Sales Account. Kapil had earlier incurred amount of ₹ 2,000 on account of Freight and Insurance. Joint Venture Suspense Account represents expenses incurred by Gavaskar on Joint Venture.
2. Bills Receivable for ₹ 4,000 endorsed on 21st December, 2014 in favour of creditors were subsequently dishonoured but no entry for the dishonoured has been passed.
3. Three cheques of ₹ 1,500, ₹ 2,000 and ₹ 3,000 issued to parties on 30th March, 2015, were lying unpresented on 31st March, 2015.
4. Sales included a sum of ₹ 30,000 received from sale of goods on behalf of Mr Salvey. The cost of these goods to Mr Salvey was ₹ 25,000, Mr Gavaskar is entitled to a commission of 5% on Sales, for which effect should be given, and reimbursement of selling expenses of ₹ 1,000 were debited to Miscellaneous Expenses Account.
5. 1/3rd of the advertisement expenses are to be carried forward.
6. Of the Debtors a sum of ₹ 1,000 is to be written-off as bad debt.
   Create provision for doubtful debts @ 2%.
7. Depreciate Fixed Assets by 10% except Motor car which is to be depreciated at 20%.
8. Stock at the end ₹ 45,000.
9. During the year some goods (invoiced at ₹ 10,000) were sent to sundry customers on sale or approval.
   On 31st March, 2015 of these goods remained with customers as the period of approval did not expire as yet. Proper adjustment should be made in respect of the above.
   Mr Gavaskar makes his invoices at cost plus 25%.

You are required to prepare Trading and Profit and Loss Account for the year ended 31st March, 2015 and a Balance Sheet as on that date.

Guide to Answers

Multiple Choice

1. C 2. C 3. A 4. D 5. C 6. C 7. C 8. D 9. C 10. A 11. C 12. B 13. B 14. C 15. B 16. A

Practical Questions

1. **Gross Profit ₹ 1,47,830; Net Profit ₹ 1,13,910; Balance Sheet total ₹ 2,92,710.**
2. **Gross Profit ₹ 1,07,800; Net Profit ₹ 19,900; Balance Sheet total ₹ 1,78,900.**

3. **Gross Profit ₹ 95,000; Net Profit ₹ 53,400; Balance Sheet total ₹ 2,01,850.**
4. **Gross Profit ₹ 81,000; Net Profit ₹ 30,000; Closing Stock ₹ 23,000; Manager's Commission ₹ 3,000; Balance Sheet total ₹ 1,58,000.**
5. **Gross Profit ₹ 1,62,000; Net Profit ₹ 69,000; Balance Sheet total ₹ 2,70,000.**
6. **Gross Profit ₹ 5,43,850; Net Profit ₹ 2,74,400; Net Assets employed ₹ 8,20,300.**
7. **Gross Profit ₹ 31,400; Net Profit ₹ 10,050; Balance Sheet total ₹ 2,42,450.**
8. **Net profit ₹ 22,733; Balance Sheet total ₹ 72,962.**
9. **Total of Trial balance ₹ 48,109; Gross Profit ₹ 16,083; Net Profit ₹ 11,510; Balance Sheet total ₹ 27,541.**
10. **Gross Profit ₹ 1,80,000; Net Profit ₹ 1,700; Net Loss transferred to Capital ₹ 9,300; Balance Sheet total ₹ 3,12,300.**
11. **Gross Profit ₹ 1,99,000; Net Profit transferred to Capital ₹ 1,34,560; Balance Sheet total ₹ 1,78,560.**
12. **Gross Profit ₹ 3,42,000; Net Profit ₹ 2,49,570; Balance Sheet total ₹ 3,14,570.**
13. **Gross Profit ₹ 87,200; Net Profit ₹ 18,883; Balance Sheet total ₹ 2,25,133.**
14. **Gross Profit ₹ 2,95,000; Net Profit ₹ 57,290; Balance Sheet total ₹ 4,95,440.**
15. **Gross Profit ₹ 2,00,000; Net Profit ₹ 1,21,875; Balance Sheet total ₹ 7,53,400.**
16. **Gross Profit ₹ 61,000; Net Profit ₹ 32,698; Balance Sheet toal ₹ 1,67,688.**
17. **Gross Profit ₹ 1,38,900; Net Profit : from Business ₹ 1,26,925; from Joint Venture ₹ 4,000; Profit from Consignment ₹ 27,000; Balance Sheet total ₹ 2,39,925.**
18. **Gross Profit ₹ 1,45,000; Net Profit from business ₹ 63,520; Income from Joint Venture ₹ 5,000; Balance Sheet total ₹ 3,65,372; Commission to Manager ₹ 6,352.**
19. **Gross Profit ₹ 1,86,460; Net Profit ₹ 1,00,001; Balance Sheet total ₹ 2,14,901. Loss on sale of furniture ₹ 590; Sales for Trading Account ₹ 6,76,000 – ₹ 20,000 = ₹ 6,56,000; Hire Purchase Profit ₹ 3,000; Purchase for Trading Account ₹ 4,79,540; Provision for Doubtful Debts ₹ 3,760.**
20. **Gross Profit ₹ 68,000; Net loss ₹ 5,060; Balance Sheet total ₹ 2,20,940; Share of Profit on Joint Venture ₹ 3,500; Balance of Kapil Account ₹ 35,500.**

15

Rectification of Errors

Introduction

Errors are unintentional misstatements or omission of amounts or disclosures in financial statements. They include mistakes in gathering or processing accounting data from which financial statements are prepared. Errors can also result from incorrect accounting estimates arising from oversight or misinterpretation of facts, and mistakes in the application of accounting principles relating to account classification, manner of presentation or disclosure.

Therefore, accounting errors result from mistakes or omissions in the financial accounting process. Typical errors include (i) Mathematical mistakes; (ii) Mistake in the application of accounting principles; (iii) Oversight; and (iv) Misuse of facts.

Students are advised to reread carefully Chapter 4 (Errors Revealed and Not Revealed By Trial Balance and Types of Errors).

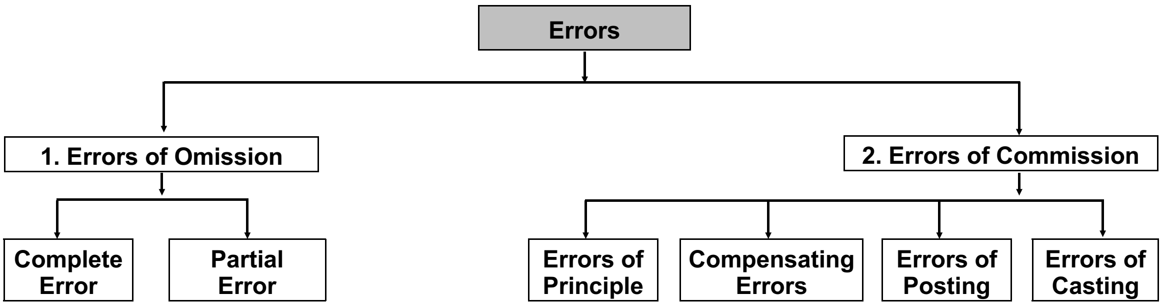
When errors are detected, it is necessary to analyse them to determine what action is appropriate under the circumstances. Since the Trial Balance is prepared to ensure that there is no mathematical error in recording ledger entries or in adding or balancing the accounts, the first step in the process of locating errors is to find out the difference in the Trial Balance totals.

Whenever a Trial Balance disagrees, it indicates that an error has been committed, which must be located and rectified. If the location and rectification of errors takes time and, in the meanwhile, the Trial Balance can not be allowed to remain out of balance, a new account—'Suspense Account' is opened in the Ledger and the difference in Trial Balance is transferred to that account, and the Trial Balance can thus be totalled up and balanced. Afterwards when the errors are located, those can be rectified through the Suspense Account.

Types of Errors

Before explaining how errors are located and rectified, we should know the kinds of errors that usually occur in the books of account. These errors can broadly be divided into two classes —

1. Errors of Omission; and
2. Errors of Commission.



1. Errors of Omission

Errors of omission are errors resulting from the complete failure to enter a transaction in the books. Such errors creep in as a result of some act of omission on the part of the person responsible for the maintenance of the books of account. These errors can further be classified into: (a) Complete error; and (b) Partial error.

(a) Complete Error : When any particular transaction has not at all been entered in the Journal or a book of original entry, it cannot be posted into the Ledger , and a 'complete error of omission' will occur. A complete error will affect both the debit and the credit side of the entry and it will not hamper the agreement of the Trial Balance. Instances of complete errors are :

(i) A receipt of ₹ 1,000 from Ravi is omitted from being entered in the Cash Book.
(ii) Goods sold to Ramesh on credit for ₹ 500 has not been entered in the 'Sales Day Book'.

(b) Partial Error : If a transaction has been journalised or recorded in a subsidiary book but has not been posted in both the Ledger Accounts, it will be an error of partial omission and it will not hamper the agreement of the Trial Balance. For example, discount allowed to a customer has not been debited to 'Discount Allowed Account' in the General Ledger and has also not been credited to Customer Account in the Customer Ledger.

2. Errors of Commission

These errors are the result of some positive act of commission on the part of the person responsible for the maintenance of the books of account. For example, if wrong accounts are entered either in the Journal or in the Ledger, or when the totals are wrongly made, or when the posting is done to wrong accounts, errors of commission are occurred. Errors of commission may further be classified into :

(a) Errors of Principle : These errors arise because of an incorrect application of the principles of accounting, and failure to differentiate between capital and revenue expenditure. Their existence are not usually disclosed by the Trial Balance. Instances of errors of principle are:

(i) Wages paid for the installation of machinery debited to Wages Account. Here, Machinery Account should be debited in place of Wages Account.
(ii) A purchase of furniture passed through the Purchases Day Book. Here, Furniture Account should be debited in place of Purchases Account.

(b) Compensating Errors : These are a group of errors, the total effect of which are not reflected in the Trial Balance. These errors are of a neutralizing nature. One error is compensated by the other error or errors of an opposite nature. For example, an extra debit in Salary Account for ₹ 100 may be compensated by an extra credit of ₹ 100 in Sales Account.

Neither the original error nor the compensating error will thus be detected by a failure to balance, since one error conceals another error. The point to note is that there is no connection between an error and its compensating error other than the coincidence that they are equal and opposite in amount.

(c) Errors of Posting : If a transaction has been journalised or recorded in a subsidiary book but has been posted wrongly in the Ledger Account, it is an error of posting. The following are examples of errors of posting:

(a) Goods sold to Ram on credit for ₹ 210 have been posted in Ram Account as ₹ 21.
(b) Goods purchased from Robin for ₹ 300 have been posted to Rahim Account.

(d) Errors of Casting : Casting is an accounting term for addition. These errors may occur due to short casting or excess casting in any subsidiary book or in any account in the Ledger. These errors are reflected in the Trial Balance unless it is compensated by other errors.

Opportunities may arise to detect and rectify errors in accounts in any of the following stages:

1. Before the preparation of the Trial Balance.
2. After the preparation of the Trial Balance but before the preparation of the Final Accounts.
3. After the preparation of the Final Accounts.

Procedure for correcting errors

The three questions which must be answered before an error can be corrected are :

1. What should have happened ?
2. What has happened ?
3. What action will correct the error ?

1. Rectification of errors before the preparation of the Trial Balance

When errors are detected before the preparation of the Trial Balance, it should be assessed whether they are one-sided errors or two-sided errors. According to the nature of errors, different steps are taken for their rectification.

(a) One-sided errors: For rectification of these types of errors, no journal entry is required to be passed. Only the relevant account in the Ledger is to be debited (for short debit or excess credit) or to be credited (for short credit or excess debit), according to the situation. The following illustrations are self-explanatory.

Illustration 1

Purchases Day Book was cast ₹ 1,500 in place of ₹ 2,000. It means Purchases Account has been debited ₹ 500 short. Therefore, to rectify, the Purchases Account should be debited further by ₹ 500. The following shows it more clearly.

Dr. **Purchases Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Sundry Creditors A/c To Sundry Creditors A/c (Error in casting)	1,500 500			

It is assumed that Individual Creditors' Account is maintained in the General Ledger.

Illustration 2

Sales Day Book was cast ₹ 2,000 in place of ₹ 1,800. It means Sales Account has received excess credit for ₹ 200. Therefore, to rectify, the Sales Account should be debited by ₹ 200.

Dr. **Sales Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Sundry Debtors A/c (Error in casting)	200		By Sundry Debtors A/c	2,000

It is assumed that Individual Debtors' Account is maintained in the General Ledger.

Illustration 3

Return Outward Book was cast ₹ 1,000 in place of ₹ 1,600. It means that Return Outward Account has been credited ₹ 600 short. Therefore, to rectify, the Return Outward Account is to be credited further with ₹ 600.

Dr. **Return Outward Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
				By Sundry Creditors A/c By Sundry Creditors A/c (Error in casting)	1,000 600

It is assumed that Individual Creditors' Account is maintained in the General Ledger.

(b) Two-sided errors: For rectification of these types of errors, the following steps should be taken:

Step 1 Write down in the rough sheet the correct entry necessary for recording the transaction.

Step 2 Write down in the rough sheet the entry that has actually been passed.

Step 3 Pass in the Journal, the required entry to arrive at the correct entry of Step 1 and to cancel the entry of Step 2.

The following illustrations explain it more clearly:

Illustration 4

A purchase of ₹ 1,000 from Rahim entered in the Day Book as ₹ 100.

Solution

The Rectification of this error shall call for:

(a)	Purchases Account	Dr.	1,000		Correct entry
	To Rahim Account			1,000	
(b)	Purchases Account	Dr.	100		Entry as passed
	To Rahim Account			100	
(c)	*The rectifying entry in the journal will be* :				
	Purchases Account	Dr.	900		Rectifying entry
	To Rahim Account			900	

Illustration 5

A cash sales of ₹ 600 has completely been omitted to be recorded in the books.

Solution

The Rectification of this error shall call for:

(a)	Cash Account	Dr.	600		Correct entry
	To Sales Account			600	
(b)	Nil				Entry as passed
(c)	*The rectifying entry in the journal will be* :				
	Cash Account	Dr.	600		Rectifying entry
	To Sales Account			600	

Illustration 6

₹ 500 received from B. Sen entered as ₹ 300 in the Cash Book.

Solution

The Rectification of this error shall call for:

(a)	Cash Account	Dr.	500		Correct entry
	To B. Sen Account			500	
(b)	Cash Account	Dr.	300		Entry as passed
	To B. Sen Account			300	
(c)	*The rectifying entry in the journal will be* :				
	Cash Account	Dr.	200		Rectifying entry
	To B. Sen Account			200	

Illustration 7

The following errors have been detected before the preparation of the final Trial Balance. You are required to pass the journal entries, where necessary, or if no journal entry is required, state how they will be corrected:

(i) The Sales Day Book has been undercast by ₹ 800; (ii) The total of the discount column on the debit side of the Cash Book was cast short by ₹ 50. (iii) Repairs to Building charged to Building Account ₹ 500. (iv) Goods worth ₹ 645 sold to Zishan Ali, but the latter's account was credited with ₹ 654. (v) Wages paid for installation of the machinery debited to Wages Account ₹ 1,000.

Solution

(i) The total of Sales Day Book is credited to Sales Account in the Ledger. Here, Sales Day Book has been undercast by ₹ 800. It means that Sales Account has been under-credited by ₹ 800. This error can be corrected by crediting Sales Account further by ₹ 800 (After correcting the total of the Sales Day Book).

(ii) The discount column of the debit side of the Cash Book represents discount allowed. Here, it was cast short by ₹ 50. It means that the Discount Allowed Account was short-debited by ₹ 50. This error can be corrected by debiting Discount Allowed Account further by ₹ 50.

(iii) Repairs to building should be treated as revenue expenditure and it should be debited to Repairs Account in place of Building Account. So, to rectify the error, the following Journal entry should be passed:

Repairs Account	Dr.	₹ 500	
To Building Account			₹ 500

(iv) Goods have been sold to Zishan Ali for ₹ 645. His account should be debited but his account has actually been credited by ₹ 654. To rectify this error, Zishan's account should be debited by ₹ (645+654) = ₹ 1,299.

(v) Wages paid for installation of machinery should be debited to Machinery Account because it is a capital expenditure. So, to rectify, the following entry should be passed:

Machinery Account	Dr.	₹ 1,000	
To Wages Account			₹ 1,000

Illustration 8

Pass rectification entries for the following transactions:

1. A builder's bill for ₹ 4,600 for the erection of a small shed was debited to Repairs Account.
2. Repairs to plant amounting to ₹ 900 had been charged to Plant and Machinery Account.
3. Wages paid to the firm's workmen for making certain additions to machinery amounting to ₹ 340 were debited to Wages Account.
4. A cheque for ₹ 750 received from S Desai was credited to the account of R Ram.
5. Goods to the value of ₹ 700 returned by X were included in closing stock, but no entry was made in the books.
6. Goods costing ₹ 2,000 were purchased for various members of the staff and the cost was included in Purchases. A similar amount was deducted from the salaries of the staff members concerned and the net payments to them debited to Salaries Account.
7. A bill of exchange (received from Hari) for ₹ 3,000 had been returned by the Bank, with whom it had been discounted, as dishonoured and had been credited to Bank Account and debited to Bills Receivable Account.
8. Goods sold to Z for ₹ 475 have been wrongly entered in the Sales Book as ₹ 745.

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

Date	Particulars		L.F.	₹	₹
1.	Building A/c	Dr.		4,600	
	To Repairs A/c				4,600
	(Being expenses for erection of a small shed had been wrongly debited to repairs account, in place of building account, now rectified)				
2.	Repairs A/c	Dr.		900	
	To Plant & Machinery A/c				900
	(Being repairs to Plant & Machinery had been wrongly charged to Plant & Machinery A/c, now rectified)				
3.	Plant & Machinery A/c	Dr.		340	
	To Wages A/c				340
	(Being wages paid for addition to machinery had been wrongly debited to Wages A/c in place of Machinery A/c, now rectified)				
4.	R. Ram A/c	Dr.		750	
	To S. Desai A/c				750
	(Being cheque from S. Desai wrongly credited to R. Ram, now rectified)				
5.	Return Inward A/c	Dr.		700	
	To X A/c				700
	(Being goods returned by X not recorded in the book, now rectified)				
6.	Salaries A/c	Dr.		2,000	
	To Purchases A/c				2,000
	(Being goods purchased for staff members not debited to Salaries A/c, now rectified)				
7.	Hari A/c	Dr.		3,000	
	To Bills Receivable A/c				3,000
	(Being bill accepted by Hari was dishonoured but wrongly debited to Bills Receivable A/c, now rectified)				
8.	Sales A/c (₹ 745 – 475)	Dr.		270	
	To Z A/c				270
	(Being sales to Z of ₹ 475 wrongly recorded in the sales book as ₹ 745, now rectified)				

2. Rectification of errors after the preparation of Trial Balance but before the preparation of Final Accounts

When errors are detected after the preparation of the Trial Balance, it should be rectified in the following manner:

(a) One-sided errors: Most of the one-sided errors will be rectified by passing a journal entry via Suspense Account.

Suspense Account

A Suspense Account is a Ledger Account in which entries are made on a temporary basis when the correct account cannot be immediately identified. This may be so because further information has to become available or while preparing the accounts, the accountant is unsure of how to proceed with it.It is opened in the following cases: (i) to balance a disagreed Trial Balance; (ii) to post doubtful items; and (iii) to record incomplete transactions.

(i) To Balance a Disagreed Trial Balance Sometimes, a Trial Balance does not tally despite all efforts; but one cannot wait indefinitely as accounts must be closed at the end of a financial year. In such a case, the amount of difference is entered in the lighter column against Suspense Account. ***The point to note is that no double entry will be possible.*** Later, when the mistakes are detected, the rectifying entries are passed.

(ii) To Post Doubtful Items Sometimes, an item cannot be posted to the correct account for one reason or another. For instance, you may receive a remittance of ₹ 1,500 but you may not know who has sent it. You then pass the following entry:

Journal **Dr. Cr.**

Date	Particulars		L.F.	₹	₹
	Cash A/c	Dr.		1,500	
	To Suspense A/c				1,500
	(Being remittance, received from unknown sender)				

Later, you get the information that Ram, Shyam & Co has sent this amount. Then you should pass the following entry:

Journal **Dr. Cr.**

Date	Particulars		L.F.	₹	₹
	Suspense A/c	Dr.		1,500	
	To Ram, Shyam & Co A/c				1,500
	(Being credit given to the sender for a remittance which had been credited previously to Suspense Account)				

(iii) To Record Incomplete Transactions Sometimes a Suspense Account is opened to record a balance that has not yet been finalised because a particular deal has not been concluded. For example, an advance of ₹ 10,000 received from X for the goods to be delivered in the future, subject to availability. A Suspense Account can include many transactions of this nature, without involving any error.

Now, the following illustrations show the way for rectification of one-sided errors:

Illustration 9

Goods worth ₹ 1,000 were sold to Mr R Sharma on credit. This was entered in the Sales Day Book, but was not posted into R Sharma Account.

Here, only Sales Account has been credited by ₹ 1,000 without a corresponding debit. In effect, the Trial Balance will show a short debit for ₹ 1,000. Now, if the difference in Trial Balance has been transferred to Suspense Account, it implies that Suspense Account has been debited by ₹ 1,000. For rectification, R Sharma Account is to be debited and Suspense Account is to be cancelled by crediting it. Therefore, the effective entry will be:

R Sharma Account	Dr.	1,000	
To Suspense Account			1,000

Illustration 10

Cash paid to Ram ₹ 400 was posted to the credit of his account as ₹ 440 from Cash Book.

Here, Cash Account has been credited by ₹ 400 without any debit and Ram Account has also been credited by ₹ 440 without corresponding debit. In effect, the Trial Balance will show a short debit of (₹ 400 + ₹ 440) ₹ 840. If the difference in account has been transferred to Suspense Account, it implies that Suspense Account has been debited by ₹ 840 to bring the Trial Balance in agreement. For rectification : (i) Ram Account should be debited by ₹ 840 so that he gets a net debit of ₹ 400; and (ii) The Suspense Account should also be cancelled.

The effective entry will be :

Ram Account	Dr.	840	
To Suspense Account			840

(b) Two-sided Error For rectification of two-sided errors, the following steps should be taken:

Step 1 Write down in the rough sheet the correct entry necessary for recording the transaction.

Step 2 Write down in the rough sheet the entry that has actually been passed.

Step 3 Pass in the Journal, the required entry to arrive at the correct entry of Step 1 and to cancel the entry of Step 2.

Illustration 11

Purchase of stationery for ₹ 400 has been recorded in the Cash Book as ₹ 40.

Solution

(a)	Stationery Account	Dr.	400		Correct entry
	To Cash Account			400	
(b)	Stationery Account	Dr.	40		Entry as passed
	To Cash Account			40	
(c)	*The rectifying entry in the journal will be* :				
	Stationery Account	Dr.	360		Rectifying entry
	To Cash Account			360	

Illustration 12

Sale of old furniture has been credited to Sales Account for ₹ 200

Solution

(a)	Cash Account	Dr.	200		Correct entry
	To Furniture Account			200	
(b)	Cash Account	Dr.	200		Entry as passed
	To Sales Account			200	
(c)	*The rectifying entry in the journal will be* :				
	Sales Account	Dr.	200		Rectifying entry
	To Furniture Account			200	

Illustration 13

a) An inexperienced bookkeeper has drawn up a Trial Balance for the year ended 30th June, 2015 : Dr. Cr.

Heads of Accounts	₹	₹
Provision for Doubtful Debts	200	
Bank Overdraft	1,654	
Capital		4,591
Creditors		1,637
Debtors	2,983	
Discount Received	252	
Discount Allowed		733
Drawings	1,200	
Office Furniture	2,155	
General Expenses		829
Purchases	10,923	
Returns Inward		330
Rent & Rates	314	
Salaries	2,520	
Sales		16,882
Stock	2,418	
Provision for Depreciation on Furniture	364	
Total	24,983	25,002

Required : (a) Draw up a 'Corrected' Trial Balance, debiting or crediting any residual errors to a Suspense Account.
(b) Further investigation of the Suspense Account, ascertained in (a) above reveals the following errors:

(i) Goods bought from J Jones amounting to ₹ 13 had been posted to his account as ₹ 33.
(ii) Furniture which had cost ₹ 173 had been debited to the General Expenses Account.
(iii) An invoice from Suppliers Ltd., for ₹ 370 had been omitted from the Purchases Account, but credited to Suppliers Ltd. Account.
(iv) Sales on credit to A Hope Ltd, for ₹ 450 had been posted to the Sales Account, but not to A Hope Ltd Account.
(v) The balance on the Capital Account had been incorrectly brought forward in the Ledger, and should have been ₹ 4,291.
(vi) An amount of ₹ 86 received from A. Blunt, a debtor, in settlement of his account had been treated as a cash sale.
(vii) Discount allowed has been undertotalled by ₹ 35.

Required : Prepare Journal entries correcting each of the above errors and write up the Suspense Account.

Solution **Trial Balance as on 30th June, 2015**

Heads of Accounts	Dr. ₹	Cr. ₹
Provision for Doubtful Debts		200
Bank Overdraft		1,654
Capital		4,591
Creditors		1,637
Debtors	2,983	
Discount Received		252
Discount Allowed	733	
Drawings	1,200	
Office Furniture	2,155	
General Expenses	829	
Purchases	10,923	
Returns Inward	330	
Rent & Rates	314	
Salaries	2,520	
Stock	2,418	
Provision for Depreciation on Furniture		364
Sales		16,882
Suspense (Balancing figure)	1,175	
Total	25,580	25,580

Journal

Date		Particulars	L.F.	Dr. ₹	Cr. ₹
2015 June 30	(i)	J. Jones A/c Dr. To Suspense A/c (Being goods purchased from J. Jones for ₹ 13 had been wrongly posted to his account as ₹ 33, now rectified)		20	20
	(ii)	Furniture A/c Dr. To General Expenses A/c (Being purchase of furniture had been wrongly debited to General Expenses A/c, now rectified)		173	173
	(iii)	Purchases A/c Dr. To Suspense A/c (Being a purchase of ₹ 370 had been omitted from Purchases A/c, now rectified)		370	370
	(iv)	A. Hope Ltd A/c Dr. To Suspense A/c (Being goods sold to A. Hope Ltd had not been posted to his account, now rectified)		450	450
	(v)	Capital A/c ₹ (4,591 – 4,291) Dr. To Suspense A/c (Being the balance of capital account brought forward as ₹ 4,591 in place of ₹ 4,291, now rectified)		300	300
	(vi)	Sales A/c Dr. To A. Blunt A/c (Being cash received from A. Blunt, a debtor, treated as cash sales, now rectified)		86	86
	(vii)	Discount Allowed A/c Dr. To Suspense A/c (Being discount allowed had been undertotalled by ₹ 35, now rectified)		35	35

Dr. **Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 June 30	To Balance b/f	1,175	2015 June 30	By J Jones A/c	20
				By Purchases A/c	370
				By A Hope Ltd A/c	450
				By Capital A/c	300
				By Discount Allowed A/c	35
		1,175			1,175

Illustration 14

Pass necessary Journal Entries to rectify the following errors :

(a) Sales day book undercast by ₹ 500
(b) Sales day book overcast by ₹ 1,000
(c) Sales returns day book undercast by ₹ 600
(d) Sales returns day book overcast by ₹ 1,600
(e) Purchases day book undercast by ₹ 500
(f) Purchases day book overcast by ₹ 1,500
(g) Purchases returns day book undercast by ₹ 500
(h) Purchases returns day book overcast by ₹ 1,000
(i) Bills receivable book undercast by ₹ 500
(j) Bills payable book undercast by ₹ 1,000
(k) Bills receivable book overcast by ₹ 600
(l) Bills payable book overcast by ₹ 500

Solution

The question is solved assuming subsidiary ledger is not maintained.

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

Date	Particulars		L.F.	₹	₹
(a)	Suspense A/c	Dr.		500	
	To Sales A/c				500
	(Being sales day book was undercast by ₹ 500, now rectified)				
(b)	Sales A/c	Dr.		1,000	
	To Suspense A/c				1,000
	(Being sales day book was overcast by ₹ 1,000, now rectified)				
(c)	Sales Returns A/c	Dr.		600	
	To Suspense A/c				600
	(Being sales returns day book was undercast by ₹ 600, now rectified)				
(d)	Suspense A/c	Dr.		1,600	
	To Sales Returns A/c				1,600
	(Being sales returns day book was overcast by ₹ 1,600, now rectified)				
(e)	Purchases A/c	Dr.		500	
	To Suspense A/c				500
	(Being purchases day book was undercast by ₹ 500, now rectified)				
(f)	Suspense A/c	Dr.		1,500	
	To Purchases A/c				1,500
	(Being purchases dayy book was overcast by ₹ 1,500, now rectified)				
(g)	Suspense A/c	Dr.		500	
	To Purchases Returns A/c				500
	(Being purchases returns day book was undercast by ₹ 500, now rectified)				
(h)	Purchases Returns A/c	Dr.		1,000	
	To Suspense A/c				1,000
	(Being purchases returns day book was overcast by ₹ 1,000, now rectified)				
(i)	Bills Receivable A/c	Dr.		500	
	To Suspense A/c				500
	(Being bills receivable book was undercast by ₹ 500, now rectified)				
(j)	Suspense A/c	Dr.		1,000	
	To Bills Payable A/c				1,000
	(Being bills payable book was undercast by ₹ 1,000, now rectified)				
(k)	Suspense A/c	Dr.		600	
	To Bills Receivable A/c				600
	(Being bills receivable book was overcast by ₹ 600, now rectified)				
(l)	Bills Payable A/c	Dr.		500	
	To Suspense A/c				500
	(Being bills payable book was overcast by ₹ 500, now rectified)				

Illustration 15

At 31st March, 2015, the accountant of ABC & Co. has failed to balance his books of account. The difference has been carried to Suspense Account. Subsequently, the following errors are discovered before finalisation of account. Give journal entries to rectify these errors.

(a) Cash discount allowed for ₹ 600 and discount received for ₹ 400 have been posted to the wrong sides of the Discount Account in the ledger.

(b) An amount of ₹ 2,000 withdrawn by the proprietor for his personal use had been debited to Travelling Expenses Account.

(c) Return inward book was overcast by ₹ 300.

(d) A cheque for ₹ 3,456 received from Mr P after allowing him a discount of ₹ 46, was endorsed to Mr N in full settlement for ₹ 3,500. The cheque was finally dishonoured but no entries for dishonour were passed in the books.

Solution **In the books of ABC & Co.**

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

Date	Particulars		L.F.	₹	₹
(a)	Discount Allowed A/c	Dr.		1,200	
	To Discount Received A/c				800
	To Suspense A/c				400
	(Being discount allowed ₹ 600 and discount received ₹ 400 posted on the wrong sides of the respective accounts, now rectified)				

(b)	Drawings A/c Dr. To Travelling Expenses A/c (Being cash withdrawn by the proprietor for personal use, debited to Travelling Expenses Account, now rectified)		2,000	2,000
(c)	Suspense A/c Dr. To Return Inward a/c (Being the overcasting in the Return Inward Book, now rectified)		300	300
(d)	P A/c Dr. Discount Received A/c Dr. To N A/c To Discount Allowed A/c (Being cheque received from P for ₹ 3,456 after allowing him discount of ₹ 46 endorsed in favour of N in full settlement for ₹ 3,500. The cheque was dishonoured but no entry were passed, now rectified)		3,502 44	3,500 46

Illustration 16

Ravi Shastri could not agree the Trial Balance. He transferred to the Suspense Account amount of ₹ 296, being excess of the debit side total. The following errors were subsequently discovered:

(i) Sales Book was overcast by ₹ 300; (ii) Purchase of furniture for ₹ 615 passed through Purchase Book; (iii) An amount of ₹ 55 received from Yograj Singh was posted to his account as ₹ 550; (iv) Purchase Return Book total on a folio was carried forward as ₹ 221 instead of ₹ 112; (v) A cash sale of ₹ 1,235 duly entered in the Cash Book but posted to Sales Account as ₹ 235; and (vi) Rest of the difference was due to incorrect total in the Salaries Account in the Ledger. Give journal entries to rectify the above and prepare Suspense Account.

Solution

In the books of Ravi Shastri

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
(i)	Sales A/c Dr. To Suspense A/c (Being Sales Book was overcast by ₹ 300, now rectified)		300	300
(ii)	Furniture A/c Dr. To Purchases A/c (Being purchase of furniture passed through Purchases Day Book, now rectified)		615	615
(iii)	Yograj Singh A/c Dr. To Suspense A/c (Being an amount of ₹ 55 recd. from Yograj was wrongly entered in his account as ₹ 550 ,now rectified)		495	495
(iv)	Purchases Return A/c Dr. To Suspense A/c (Being total of purchases return book was carried forward as ₹ 221 in place of ₹ 112, now rectified)		109	109
(v)	Suspense A/c Dr. To Sales A/c (Being Cash Sales of ₹ 1,235 wrongly posted in the Sales Account as ₹ 235, now rectified)		1,000	1,000
(vi)	Suspense A/c Dr. To Salaries A/c (Being Salaries Account was overcasted by ₹ 200, now rectified)		200	200

Dr. Suspense Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Sales A/c	1,000		By Balance b/f	296
	To Salaries A/c (Balancing figure)	200		By Sales A/c	300
				By Yograj A/c	495
				By Purchases Return A/c	109
		1,200			1,200

Illustration 17

The trial balance of Shri Govind shows a difference of ₹ 500, the credit side being in excess. The difference is subsequently found due to the following mistakes:

(a) The purchase of an office table costing ₹ 2,000 had been passed through the Purchases Day Book.

(b) A motor car had been purchased for ₹ 3,400. Cash had been correctly credited but the Motor Car Account had been debited with ₹ 3,140 only.

(c) Interest on deposits received ₹ 60 had been debited in the Cash Account, but had not been credited to the Interest Account.

(d) The balance in the account of Mr Rahim ₹ 100 had been written off as bad but no other account had been debited.

(e) A debit balance of ₹ 200 on the personal account of Mr John (correctly shown in the Ledger) had been omitted when extracting a Trial Balance.

Give the necessary journal entries and show the Suspense Account. ***[C.A. (Entrance) — Adapted]***

Solution

In the books of Shree Govind

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
(a)	Furniture A/c Dr.		2,000	
	To Purchases A/c			2,000
	(Being the purchase of office table wrongly passed through Purchases Day Book, now rectified)			
(b)	Motor Car A/c Dr.		260	
	To Suspense A/c			260
	(Being motor car of ₹ 3,400 has been posted as ₹ 3,140, now rectified)			
(c)	Suspense A/c Dr.		60	
	To Interest Received A/c			60
	(Being interest received had not been credited to Interest Account, now recorded)			
(d)	Bad Debt A/c Dr.		100	
	To Suspense A/c			100
	(Being bad debt written off had not been debited to Bad Debt Account, now rectified)			
(e)	Sundry Debtors A/c Dr.		200	
	To Suspense A/c			200
	(Being the debit balance of John's account had been omitted in the Trial Balance, now rectified)			

Dr. Suspense Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	500		By Motor Car A/c	260
	To Interest Received A/c	60		By Bad Debt A/c	100
				By Sundry Debtors A/c	200
		560			560

Illustration 18

Ganesh drew a Trial Balance of his operations for the year ended 31.03.2015. There was a difference in the Trial Balance which he closed with a Suspense Account. On a scrutiny by the auditors, the following errors were found :

(i) Purchases Day Book for the month of April 2014 was undercast by ₹ 1,000.

(ii) Sales Day Book of October 2014 was overcast by ₹ 10,000.

(iii) A furniture purchased for ₹ 8,100 was entered in the Furniture Account as ₹ 810.

(iv) A bill for ₹ 10,000 drawn by Ganesh was not entered in the Bills Receivable Book.

(v) A machinery purchased for ₹ 10,000 was entered in the Purchases Day Book.

Pass necessary Journal Entries to rectify the same and ascertain the difference in the Trial Balance that was shown under the Suspense Account in respect of the above items.

[C.A. (Foundation) — Adapted]

Solution

In the books of Ganesh

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2015 (i) March 31	Purchases A/c Dr.		1,000	
	To Suspense A/c			1,000
	(Being the Purchases Day Book undercast by ₹ 1,000, now rectified)			
(ii)	Sales A/c Dr.		10,000	
	To Suspense A/c			10,000
	(Being the Sales Day Book overcast by ₹ 10,000, now rectified)			
(iii)	Furniture A/c ₹ (8,100 – 810) Dr.		7,290	
	To Suspense A/c			7,290
	(Being the purchase of furniture of ₹ 8,100 entered in the Furniture Account as ₹ 810, now rectified)			
(iv)	Bills Receivable A/c Dr.		10,000	
	To Sundry Debtors A/c			10,000
	(Being the bill drawn on debtors not recorded in the Bills Receivable Book, now recorded)			
(v)	Machinery A/c Dr.		10,000	
	To Purchases A/c			10,000
	(Being the purchase of machinery wrongly entered in the Purchases Day Book, now rectified)			

Dr. **Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 March 31	To Balance b/f (Balancing figure)	18,290	2015 March 31	By Purchases A/c	1,000
				By Sales A/c	10,000
				By Furniture A/c	7,290
		18,290			18,290

Illustration 19

In taking out a Trial balance, a book-keeper finds that debit total exceeds the credit total by ₹ 352. The amount is placed to the credit of a newly opened Suspense Account. Subsequently, the following mistakes were discovered.

You are required to pass the necessary entries for rectifying the mistakes and show the Suspense Account.

(a) Sales Day Book was overcast by ₹ 100;
(b) A sale of ₹ 50 to Shri Ram was wrongly debited to Sri Krishna;
(c) General expenses ₹ 18 was posted as ₹ 80;
(d) Cash received from Shri Govind was debited to his account ₹ 150;
(e) While carrying forward the total of one page of the Purchases Day Book to the next, the amount of ₹ 1,235 was entered as ₹ 1,325. ***[C.A. (Entrance) — Adapted]***

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

Date	Particulars	L.F.	₹	₹
(a)	Sales A/c Dr.		100	
	To Suspense A/c			100
	(Being Sales Day Book was overcast by ₹ 100, now rectified)			
(b)	Shri Ram A/c Dr.		50	
	To Shri Krishna A/c			50
	(Being sale of ₹ 50 to Shri Ram wrongly debited to Shri Krishna, now rectified)			
(c)	Suspense A/c ₹ (80 – 18) Dr.		62	
	To General Expenses A/c			62
	(Being general expenses of ₹ 18 was posted as ₹ 80, now rectified)			
(d)	Suspense A/c ₹ (150 x 2) Dr.		300	
	To Shri Govind A/c			300
	(Being cash received from Shri Govind was debited to his account, now rectified)			
(e)	Suspense A/c ₹ (1,325 – 1,235) Dr.		90	
	To Purchases A/c			90
	(Being the total of Purshases Day Book of ₹ 1235 was entered as ₹ 1325, now rectified)			

Dr. **Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To General Expense A/c	62		By Balance b/d	352
	To Shri Govind A/c	300		By Sales A/c	100
	To Purchases A/c	90			
		452			452

Illustration 20

Rectify the following errors found in the books of Mr S K Sharma. The Trial balance had ₹ 1,860 excess credit. The difference has been posted to a Suspense Account:

(i) The total of Returns Inward Book has been cast ₹ 2,000 short.
(ii) The purchase of an office table costing ₹ 6,000 has been passed through the Purchases Day Book.
(iii) ₹ 7,500 paid for wages to workman for making showcases had been charged to Wages Account.
(iv) A purchase of ₹ 1,340 had been posted to the Creditor's Account as ₹ 600.
(v) A cheque for ₹ 4,000 received from Mr P C Joshi had been dishonoured and was passed to the debit of 'Allowances Account'.

After rectification, reflect the transactions in the Suspense Account.

Solution **In the books of S K Sharma**

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

Date	Particulars	L.F.	₹	₹
(i)	Returns Inward A/c Dr.		2,000	
	To Suspense A/c			2,000
	(Being the Returns Inward Book cast short by ₹ 2,000, now rectified)			

(ii)	Furniture A/c Dr.		6,000	
	To Purchases A/c			6,000
	(Being purchase of office table passed through the Purchases Day Book, now rectified)			
(iii)	Furniture A/c Dr.		7,500	
	To Wages A/c			7,500
	(Being wages paid for making showcases wrongly debited to Wages Account, now rectified)			
(iv)	Suspense A/c ₹ (1,340 – 600) Dr.		740	
	To Creditors A/c			740
	(Being purchase of ₹ 1,340 wrongly credited to Creditors Account for ₹ 600, now rectified)			
(v)	Mr. P.C. Joshi A/c Dr.		4,000	
	To Allowances A/c			4,000
	(Being a cheque recd. from Mr. Joshi dishonoured but debited to Allowances Account ,now rectified)			

Dr. **Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	1,860		By Returns Inward A/c	2,000
	To Creditors A/c	740		By Balance c/d (See Note)	600
		2,600			2,600

Note: The balance in the Suspense Account indicates that there are other undetected errors in the books.

Illustration 21

At 31.12.2014, the accountant of TTC & Co has failed to balance the books of accounts. The difference has been carried to a Suspense Account. Subsequently, the following errors are discovered :

(a) The total of the Purchases Day Book for September has been posted in the Nominal Ledger as ₹ 3,850. The Day Book total is ₹ 3,580.

(b) Cash discounts allowed for the month of November ₹ 750, and discounts received ₹ 430 have been posted to the wrong sides of the Discount Account in the ledger.

(c) A return of goods by a customer ₹ 150 has been posted to the debit side in the Sales Ledger.

(d) A book debt of ₹ 260 due by Sujay Sen has been omitted from the list of Sales Ledger Balances.

(e) Cash drawings of the proprietor, amounting to ₹ 500, have not been posted to the ledger.

(f) An amount of ₹ 200, being insurance paid in advance in the previous year, had not been brought forward as an opening balance in the Insurance Account.

After the discovery and correction of errors mentioned, the book balanced.

You are required to :

(i) Prepare and complete the Suspense Account showing the requisite corrective entries in it. (Journal entries are not required but the appropriate names of the opposite accounts should be written in the Suspense Account).

(ii) State the incorrect total of the credit column of the Trial Balance, given that the incorrect total of the debit column was ₹ 1,37,560.

Solution

In the books of TTC & Co

Dr. **(i) Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Dec. 31	To Balance b/f (Balancing figure)	1,030	Dec. 31	By Discount Allowed A/c (₹ 750 x 2)	1,500
"	To Purchases A/c (₹ 3,850 – 3,580)	270	"	By Sundry Debtors A/c	260
"	To Discount Received A/c (₹ 430 x 2)	860	"	By Drawings A/c	500
"	To Sundry Debtors A/c (₹ 150 x 2)	300	"	By Insurance A/c	200
		1,600			1,600

(ii) Ascertainment of the Incorrect Total of the Credit Column of the Trial Balance

Particulars	Dr. (₹)	Cr. (₹)
Incorrect total of Trial Balance (debit column — as given)	1,37,560	
Suspense Account balance (as above)	1,030	
Incorrect total of Trial Balance (credit column)		1,38,590

Illustration 22

Rectify the following errors by way of Journal Entries and work out their effect on the Profit and Loss Account of the concern:

1. Returns Inwards Book for December was short-totalled by ₹ 100.
2. ₹ 5,810 being cash paid to Hira Chand was debited to Ram Chand as ₹ 5,010.
3. ₹ 1,500 worth of furniture purchased on credit was debited to Purchases Account.
4. A purchase made for ₹ 500 was posted to the Purchases Account as ₹ 50.
5. Wages paid for the erection of machinery amounting to ₹ 700 was debited to Wages Account.
6. Goods purchased for proprietor's use for ₹ 1,000 was debited to Purchases Account.
7. A sum of ₹ 1,000 written off from machinery has not been posted to Depreciation Account.
8. ₹ 100 received from Raghu has been debited to Sunder.
9. ₹ 1,150 received from Radhey Mohan was debited to his account.
10. Purchase returns worth ₹ 980 to Shri Hari Kishan were not recorded in the books.

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

Date	Particulars		L.F.	₹	₹
1.	Returns Inwards A/c	Dr.		100	
	To Suspense A/c				100
	(Being Returns Inwards Book undercast by ₹ 100, now rectified)				
2.	Hirachand A/c	Dr.		5,810	
	To Ramchand A/c				5,010
	To Suspense A/c				800
	(Being cash of ₹ 5,810 paid to Hira was wrongly debited to Ramchand A/c as ₹ 5,010, now rectified)				
3.	Furniture A/c	Dr.		1,500	
	To Purchases A/c				1,500
	(Being purchase of furniture was wrongly debited to Purchases Account, now rectified)				
4.	Purchases A/c	Dr.		450	
	To Suspense A/c				450
	(Being purchase of ₹ 500 was wrongly posted as ₹ 50 to the Purchases Account, now rectified)				
5.	Machinery A/c	Dr.		700	
	To Wages A/c				700
	(Being wages paid for erection of machinery was wrongly debited to Wages Account, now rectified)				
6.	Drawings A/c	Dr.		1,000	
	To Purchases A/c				1,000
	(Being goods purchased for personal use was wrongly debited to Purchases Account, now recorded)				
7.	Depreciation A/c	Dr.		1,000	
	To Suspense A/c				1,000
	(Being depreciation on machinery was not posted to Depreciation Account, now rectified)				
8.	Suspense A/c	Dr.		200	
	To Sundar A/c				100
	To Raghu A/c				100
	(Being ₹ 100 received from Raghu was wrongly debited to Sundar's Account, now rectified)				
9.	Suspense A/c	Dr.		2,300	
	To Radhey Mohan A/c (₹ 1,150 x 2)				2,300
	(Being cash recd. from Radhey Mohan of ₹ 1,150 was wrongly debited to his account, now rectified)				
10.	Hari Krishan A/c	Dr.		980	
	To Purchases Return A/c				980
	(Being purchases return to Hari Krishan were not recorded in the book, now recorded)				

Effect of Rectification of Errors on Net Profit

Items	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	Total
Increase (₹)	—	—	1,500	—	700	1,000	—	—	—	980	4,180
Decrease (₹)	100	—	—	450	—	—	1,000	—	—	—	1,550
										Net Increase in Profit =	2,630

Illustration 23

The difference in Trial Balance is kept in Suspense Account. Before preparing the final accounts, the following errors were detected:

(a) Purchase for ₹ 540 was written in Sales Day Book, but was posted to the correct side of party's account.
(b) Salary Account total ₹12,600 on page 32 was carried over to the next page as ₹ 1,260 on the wrong side.
(c) Interest on overdraft ₹ 650 was not posted to the Ledger from the Cash Book.
(d) ₹ 600 collected from a party in respect of the old dues from him which had been written off as bad two years ago, was credited to the party's Account.

Show rectification entries and Suspense Account. State to what extent the Profit and Loss Account would have been affected if the above errors had not been detected and corrected.

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

Date	Particulars		L.F.	₹	₹
(a)	Purchases A/c	Dr.		540	
	Sales A/c	Dr.		540	
	To Suspense A/c				1,080
	(Being Purchase was wrongly posted through Sales Day Book, now rectified)				
(b)	Salary A/c ₹ (12,600 + 1,260)	Dr.		13,860	
	To Suspense A/c				13,860
	(Being salary account total of ₹ 12,600 carried forward to next page as ₹ 1,260 on the wrong side, now rectified)				
(c)	Interest A/c	Dr.		650	
	To Suspense A/c				650
	(Being interest on overdraft was not posted to the ledger from cash book, now recorded)				
(d)	Party A/c	Dr.		600	
	To Bad Debt Recovery A/c				600
	(Being bad debt recovered was wrongly credited to party's account, now rectified)				

Dr. **Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d (Balancing figure)	15,590		By Purchases A/c	540
				By Sales A/c	540
				By Salary A/c	13,860
				By Interest A/c	650
		15,590			15,590

Effect of Rectification of Errors on Net Profit

Items	(a)	(b)	(c)	(d)	Total
Increase (₹)	—	—	—	600	600
Decrease (₹)	1,080	13,860	650	—	15,590
				Decrease in Net Profit =	14,990

Tutorial Note : When bad debt is recovered, Cash Account is debited and Bad Debt Recovery Account, is credited. At the end of the accounting period it is transferred to the credit side of the Profit and Loss Account.

Illustration 24

The Trial Balance of Tony Ltd at 31st December 2014 is as follows :

Heads of Accounts	Dr. (₹)	Cr. (₹)
Equity Share Capital — ₹ 10 each		1,00,000
Profit and Loss Account		1,90,000
Sales and Purchases	6,10,000	10,00,0000
Sales Returns and Purchases Returns	20,000	40,000
Debtors and Creditors	2,00,000	70,000
Land and Building (at cost)	4,00,000	
Plant (at cost and provision for depreciation on 1st January, 2014)	5,00,000	2,20,000
10% Debentures		3,00,000
Opening Stock	1,50,000	
Operating Expenses	90,000	
Administrative Expenses	70,000	
Selling Expenses	60,000	

Bank		80,000
Suspense Account		1,00,000
TOTAL	21,00,000	21,00,000

Additional information :

(1) 5,000 new shares were issued during the year at ₹ 16 per share. The proceeds have been credited to the Suspense Account.

(2) Sales returns of ₹ 10,000 have been entered in the sales day book as if they were sales.

(3) The book keeper has adjusted the opening provision for doubtful debts of ₹ 8,000 in the Selling Expenses Account in the Trial Balance.

(4) The remaining balance on the Suspense Account after the above, represents the sales proceeds of a fully depreciated item of plant, costing ₹ 1,00,000. No other entries (except bank) have made concerning this disposal.

You are required to pass necessary Journal Entries to rectify the above errors and also show the Suspense Account.

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

Date	Particulars	L.F.	₹	₹
2014	Suspense A/c Dr.		80,000	
Dec. 31	To Equity Share Capital A/c			50,000
	To Share Premium A/c			30,000
	(Being issue of 5,000 equity shares of ₹ 10 each at a premium of ₹ 6 each wrongly credited to Suspense Account, now rectified)			
"	Sales Returns A/c Dr.		10,000	
	Sales A/c Dr.		10,000	
	To Debtors A/c			20,000
	(Being sales returns wrongly entered in the book as credit sales, now rectified)			
"	Selling Expenses A/c Dr.		8,000	
	To Provision for Doubtful Debts A/c			8,000
	(Being opening balance of provision for Doubtful Debts Account adjusted against selling expenses, now rectified)			
"	Suspense A/c Dr.		20,000	
	To Profit on Sale of Plant A/c			20,000
	(Being profit on sale of plant not credited to Profit on Sale of Plant Account, now rectified)			
"	Provision for Depreciation on Plant A/c Dr.		1,00,000	
	To Plant A/c			1,00,000
	(Being the adjustment for disposal of fully depreciated plant)			

Dr. **Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014	To Equity Share Capital A/c	50,000	2014	By Balance b/d	1,00,000
Dec. 31	To Share Premium A/c	30,000	Dec. 31		
"	To Profit on Sale of Plant A/c	20,000			
		1,00,000			1,00,000

Illustration 25

You are presented with a Trial Balance of Saxena as on 30.6.2015, showing the credit is in excess by ₹ 415, which has been carried to Suspense Account. On close scrutiny of the books, the following errors are revealed:

(a) A cheque of ₹ 3,456 received from Sankar, after allowing him a discount of ₹ 46 was endorsed to Sharma in full settlement for ₹ 3,500. The cheque was finally dishonoured but no entries were passed in the books.

(b) Goods valued ₹ 230 returned by Swaminathan were entered in the Purchases Book and posted therefrom to Swaika's Account for ₹ 320.

(c) Bad debt amounting to ₹ 505 written-off during the year in Sales Ledger but were not recorded in the General Ledger

(d) Bill for ₹ 750 received from Sureka for repairs to machinery was entered in the Inward Invoice Book as ₹ 650.

(e) Goods worth ₹ 1,234 purchased from Sharaf on 29.6.2015 had been entered in the Purchase Day Book and credited to him but were not delivered till 5th July, 2015, stock being taken on 30.6.2015. The title of the goods was, however, passed on 29.6.2015.

(f) ₹ 79 paid for freight on machinery was debited to Freight Account as ₹ 97.

You are required to pass the necessary Journal entries for correcting the above errors.

Solution **In the books of Saxena**

Journal **Dr. Cr.**

Date		Particulars		L.F.	₹	₹
2015 June 30	(a)	Sankar A/c	Dr.		3,502	
		Discount Received A/c	Dr.		44	
		To Sharma A/c				3,500
		To Discount Allowed A/c				46
		(Being a cheque received from Sankar for ₹ 3,456 after allowing discount of ₹ 46 — was endorsed to Sharma for ₹ 3,500. The cheque was dishonoured and no entry was made in the books, now recorded)				
	(b)	Returns Inward A/c	Dr.		230	
		Swaika A/c	Dr.		320	
		To Purchases A/c				230
		To Swaminathan A/c				230
		To Suspense A/c				90
		(Being goods returned by Swaminathan for ₹ 230 — was wrongly entered in the Purchases Day Book and credited to Swaika's Account for ₹ 320, now rectified)				
	(c)	Bad Debt A/c	Dr.		505	
		To Suspense A/c				505
		(Being bad debt written-off but were not recorded in the General Ledger, now recorded)				
	(d)	Repairs to Machinery A/c	Dr.		750	
		To Purchases A/c				650
		To Sureka A/c				100
		(Being repairs to machinery ₹ 750 wrongly passed through Purchases Day Book as ₹ 650, now rectified)				
	(e)	No journal entry is required. Only closing stock is to be increased by ₹ 1,234				
	(f)	Machinery A/c	Dr.		79	
		Suspense A/c	Dr.		18	
		To Freight A/c				97
		(Being freight of ₹ 79 paid for machinery wrongly debited to Freight Account as ₹ 97, now rectified)				

Dr. **Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015	To Balance b/f	415	2015	By Swaika A/c	90
June 30	To Freight A/c	18	June 30	By Bad Debt A/c	505
"	To Balance c/d	162			
		595			595

Note : The balance in the Suspense Account indicates that there are other undetected errors in the books.

Illustration 26

The bookkeeper of a firm having been unable to agree the Trial Balance, raised a Suspense Account, in which he entered the amount by which he was out of balance. The following errors were discovered:

(a) The addition of the analysis column in the tabular Purchases Journal posted to Goods Purchased for Resale Account was found to be ₹ 150 short, though the addition of the total column was correct.

(b) Goods bought from a supplier amounting to ₹ 77 had been posted to the credit of his account at ₹ 770.

(c) A dishonoured bill of exchange receivable for ₹ 1,600 returned by the firm's bank had been credited to the Bank Account and debited to the Bills Receivable Account. A cheque was received later from the customer for ₹ 1,600 and duly paid.

(d) An item of ₹ 80 entered in the Sales Returns Book had been posted to the debit of the customers who returned the goods.

(e) Sundry items of plant sold amounting to ₹ 3,000 had been entered in Sales Day Book, the total of which book had been posted to the credit of Sales Account.

(f) An account of ₹ 800 owing by a customer, had been omitted from the list of Sundry Debtors.

(g) Discount amounting to ₹ 30 allowed to a customer, had been duly entered in his account, but not posted to the Discount Account.

(h) An amount of ₹ 100, being rates treated as paid in advance in the previous year, had not been brought forward as a balance on the Rates Account.

You are required to : (i) Pass necessary Journal entries; (ii) Show the Suspense Account.

Solution

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
(a)	Goods Purchased for Resale A/c	Dr.		150	
	To Suspense A/c				150
	(Being casting error in Day Book, now rectified)				
(b)	Sundry Creditors A/c ₹ (770 – 77)	Dr.		693	
	To Suspense A/c				693
	(Being Supplier's Account has been credited by ₹ 770 in place of ₹ 77, now rectified)				
(c) (i)	Customer A/c	Dr.		1,600	
	To Bills Receivable A/c				1,600
	(Being bill dishonoured wrongly debited to Bills Receivable A/c, now rectified)				
(c) (ii)	Bank A/c	Dr.		1,600	
	To Customer A/c				1,600
	(Being cheque received from customer and paid into bank)				
(d)	Suspense A/c (₹ 80 x 2)	Dr.		160	
	To Customer A/c				160
	(Being goods returned by customer wrongly debited to his account, now rectified)				
(e)	Sales A/c	Dr.		3,000	
	To Plant A/c				3,000
	(Being sale of plant wrongly credited to Sales Account, now rectified)				
(f)	Sundry Debtors A/c	Dr.		800	
	To Suspense A/c				800
	(Being an amount of ₹ 800 was omitted from Sundry Debtors list, now recorded)				
(g)	Discount Allowed A/c	Dr.		30	
	To Suspense A/c				30
	(Being discount allowed to a customer was not posted to Discount Allowed Account, now recorded)				
(h)	Rates A/c	Dr.		100	
	To Suspense A/c				100
	(Being advance rates had not been brought forward, now rectified)				

Dr. Suspense Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/f (Balancing figure)	1,613		By Goods Purchased for Resale A/c	150
	To Customer A/c	160		By Sundry Creditors A/c	693
				By Sundry Debtors A/c	800
				By Discount Allowed A/c	30
				By Rates A/c	100
		1,773			1,773

Illustration 27

Prosperity & Co has produced a Trial Balance as on March 31, 2015 which does not balance, the difference of ₹ 1,760 being transferred to the Suspense Account. On examination of the Company's books discloses the following errors:

(a) The Sales Day Book has been undercast by ₹ 800 and posted to the Debtors Control Account accordingly.

(b) Goods received from XYZ Limited on March 31, 2015 costing ₹ 9,690 have been included in stock but the invoice has not been received.

(c) Sales Account in the General Ledger has been credited with a credit note for ₹ 950 being trade-in-allowance given on a company van. This amount had already been taken into account when dealing with the replacement in the motor van account.

(d) An invoice from Joseph & Co, amounting ₹ 4,450 for goods purchased has been omitted from the Purchases Day Book and posted direct to Purchases Account in the General Ledger and Joseph & Co. Account in the Suppliers' Ledger but has not been included in the Suppliers' Ledger Control Account in the Trial Balance.

(e) Discount allowed for the month of March amounting to ₹ 1,740 has not been posted to Discount Allowed Account in the General Ledger.

(f) A cheque for ₹ 1,920 received from Jolly Limited, a debtor, has been posted directly to the Sales Account in the General Ledger.

You are required : (i) to give the journal entries, where necessary, to correct these errors, or if no journal entry is required, state how they will be corrected; (ii) to prepare a statement showing the effect the corrections would have on the company's profit for the year; and (iii) to prepare Suspense Account.

Solution

In the books of Prosperity & Co.
Journal

Date		Particulars		L.F.	Dr. ₹	Cr. ₹
2015 Mar. 31	(a)	Debtors Control A/c	Dr.		800	
		To Sales A/c				800
		(Being Sales Day Book was undercast by ₹ 800, now rectified)				
	(b)	No Journal entries are required — only ₹ 9,690 should be deducted from Stock Sheet				
	(c)	Sales A/c	Dr.		950	
		To Suspense A/c				950
		(Being trade-in-allowance wrongly credited to Sales Account, now recorded)				
	(d)	Suspense A/c	Dr.		4,450	
		To Suppliers' Ledger Control A/c				4,450
		(Being credit purchase had not been posted in the general ledger, now rectified)				
	(e)	Discount Allowed A/c	Dr.		1,740	
		To Suspense A/c				1,740
		(Being discount allowed to customers had not been posted to Discount Allowed Account in general ledger, now reorded)				
	(f)	Sales A/c	Dr.		1,920	
		To Debtors Control A/c				1,920
		(Being cheque received from debtors wrongly credited to Sales Account, now rectified)				

Effects of Rectification of Errors on Net Profit

Items	(a)	(b)	(c)	(d)	(e)	(f)	Total
Increase (₹)	800	—	—	—	—	—	800
Decrease (₹)	—	—	950	—	1,740	1,920	4,610
						Net Decrease in Profit =	3,810

Dr. **Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Mar 31	To Supplier's Ledger Control A/c	4,450	2015 Mar 31	By Balance b/d	1,760
				By Sales A/c	950
			"	By Discount Allowed A/c	1,740
		4,450			4,450

Tutorial Note : (i) When ledgers are kept under 'Self Balancing System', in the general ledger Supplier's Ledger Control Account is kept in place of Sundry Creditors Account. In this case, Purchases Account has been debited without a corresponding credit in the Supplier's Ledger Control Account. Therefore, Supplier's Ledger Control Account is to be credited and Suspense Account is to be debited. (ii) Stock has been adjusted, therefore, it will not affect profit.

Illustration 28

How would you rectify the following errors discovered after the preparation of the Trial Balance :

(a) A cheque for ₹ 12,500 received as insurance claim for loss of goods in transit at the time of import was deposited by the proprietor into his Private Bank Account. The full value of the invoice was passed through the Purchases Book.

(b) A purchase of ₹ 500 from A & Co, on the last date of the year was taken into stock, but the invoice was not passed through the Purchase Book.

(c) Sale of goods on approval amounting to ₹ 300 was included in Sales Account, out of which goods to the value of ₹ 125 were returned. No record of the return was made in the books, though the returned goods were included in the stock at their cost of ₹ 100.

(d) A typewriter which stood in the books at ₹ 2,000 was sold for ₹ 1,250 in part exchange of a new typewriter costing ₹ 6,250 and net invoice of ₹ 5,000 was passed through the Purchases Book.

(e) Four per cent G.P. Notes of the face value of ₹ 5,000 purchased through Lakhotia at 96% ex-dividend, brokerage ₹ 25. Accrued interest to date of purchase was ₹ 130. The total payment of ₹ 4,955 stands debited in the books in the name of the broker Lakhotia.

Solution **Journal**

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
(a)	Drawings A/c	Dr.		12,500	
	To Purchases A/c				12,500
	(Being chq recd. for Insurance claim for loss of goods was deposited into personal Bank A/c, now rectified)				
(b)	Purchases A/c	Dr.		500	
	To A & Co A/c				500
	(Being goods purchased from A & Co but no entry was made, now recorded)				
(c)	Return Inward A/c	Dr.		125	
	To Customer A/c				125
	(Being goods returned by customer, (sold on approval), not entered in the books, now recorded)				
(d)	Typewriter (New) A/c	Dr.		6,250	
	Loss on Sale of Old Typewriter A/c	Dr.		750	
	To Purchases A/c				5,000
	To Old Typewriter A/c				2,000
	(Being a new typewriter purchased in part exchange of an old typewriter but it was wrongly entered in the Purchases Day Book, now rectified)				
(e)	Investment A/c ₹ (5,000 x 96/100 + 25)	Dr.		4,825	
	Interest on Investment A/c	Dr.		130	
	To Lakhotia A/c				4,955
	(Being G.P. notes purchased and accrued interest wrongly debited to Lakhotia A/c, now rectified)				

Illustration 29

Messrs Modern Chemicals were unable to agree the Trial Balance on 30th June, 2015 and have raised a Suspense Account for the difference. Later, the following errors were discovered and rectified and the Suspense Account was closed:

(a) The addition of the 'Sundry Purchases' column in the tabular Purchases Journal was short by ₹ 150 and other totals were in order.

(b) A bill of exchange (received from Gupta) for ₹ 2,000 had been returned by the bank as dishonoured and had been credited to the bank and debited to Bills Receivable Account.

(c) Goods to the value of ₹ 105 returned by a customer, Thomas, had been posted to the debit of Thomas and also to Sales Returns.

(d) Sundry items of furniture sold for ₹ 3,000 had been entered in the Sales Day Book, the total of which had been posted to Sales Account.

(e) An amount of ₹ 600 due from Z, a customer, had been omitted from the schedule of sundry debtors.

(f) Discount amounting to ₹ 30 allowed to a customer, had been posted in his account, but not posted to Discount Account.

(g) Insurance premium of ₹ 450 paid on June 30, 2014 for the year ended 30th June, 2015 had not been brought forward.

You are required to: (i) Pass journal entries to rectify the above mistakes; and (ii) Draw up the Suspense Account after rectifying the above mistakes and explain how the above errors affect the book profits for the year ended June 30, 2015.

Solution **In the books of Messrs Modern Chemical**
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 June 30 (a)	Sundry Purchases A/c	Dr.		150	
	To Suspense A/c				150
	(Being Sundry Purchases journal was cast short by ₹ 150, now rectified)				
(b)	Gupta A/c	Dr.		2,000	
	To Bills Receivable A/c				2,000
	(Being B/R was dishonoured by bank but wrongly debited to B/R A/c in place of Gupta A/c, now rectified)				
(c)	Suspense A/c	Dr.		210	
	To Thomas A/c (₹ 105 x 2)				210
	(Being goods returned by Thomas wrongly debited to his Account, now rectified)				
(d)	Sales A/c	Dr.		3,000	
	To Furniture A/c				3,000
	(Being sale of furniture wrongly passed through Sales Day Book, now rectified)				
(e)	Sundry Debtors A/c	Dr.		600	
	To Suspense A/c				600
	(Being an amount of ₹ 600 due from Z has not been included in the Sundry Debtors list, now rectified)				

			Dr. (₹)	Cr. (₹)
(f)	Discount Allowed A/c Dr. To Suspense A/c (Being discount allowed has not been posted in the Discount Allowed Account, now recorded)		30	30
(g)	Insurance Premium A/c Dr. To Suspense A/c (Being insurance premium for the year ended on 30.6.09 has not been brought forward, now rectified)		450	450

Dr. **Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 June 30	To Balance b/f (Balancing figure) To Thomas A/c	1,020 210	2015 June 30 " "	By Sundry Purchases A/c By Sundry Debtors A/c By Discount Allowed A/c By Insurance Premium A/c	150 600 30 450
		1,230			1,230

Effects of Rectification of Errors on Net Profit

Items	(a)	(b)	(c)	(d)	(e)	(f)	(g)	Total
Increase (₹)	—	—	—	—	—	—	—	—
Decrease (₹)	150	—	—	3,000	—	30	450	3,630
							Net Decrease in Profit =	3,630

3. Rectification of errors after preparation of Final Accounts

When errors are detected after preparation of Final Accounts, the following points should be kept in mind:

1. ***All the Nominal Accounts have been closed, after transferring to Trading Account, or Profit and Loss Account.***
2. ***The Suspense Account, if any, has been carried forward to the next period. It should appear in the Balance Sheet under current assets if it has a debit balance and under current liabilities if it has a credit balance.***
3. ***Real and Personal Accounts have also been carried forward to the next period.***

The rectification of errors at this stage should be done in the same manner as we do in case of Stage 2. The only exception is that all Nominal Accounts in the rectification entries shall be substituted by 'Profit and Loss Adjustment Account'. The following illustrations shall clear the conception.

Example : (a) Wages of ₹ 1,000 paid for installation of machinery charged to Wages Account.

In the ordinary course, the rectifying entry would be :

Machinery Account	Dr.	₹ 1,000	
To Wages Account			₹ 1,000

Now, as the Final Accounts have been prepared, the Wages Account has been closed by transferring to Trading Account.

Therefore, the rectifying entry will be:

Machinery Account	Dr.	₹ 1,000	
To Profit and Loss Adjustment Account			₹ 1,000

Example : (b) Purchase of furniture has been passed through Purchases Day Book worth ₹ 2,000.

In the ordinary course, the rectifying entry would be:

Furniture Account	Dr.	₹ 2,000	
To Purchases Account			₹ 2,000

Now, as the Final Accounts have been prepared, the Purchase Account has been closed by transferring to Trading Account

Therefore, the rectifying entry will be:

Furniture Account	Dr.	₹ 2,000	
To Profit and Loss Adjustment Account			₹ 2,000

Example : (c) Wages paid ₹ 200 posted to Salaries Account in the Ledger.

In the ordinary course, the entry would be:

Wages Account	Dr.	₹ 200	
To Salaries Account			₹ 200

Now, as the Final Accounts have been prepared, no entry is required to be passed because both the accounts are Nominal Accounts.

The main purpose of preparing a Profit and Loss Adjustment Account is to show the net effect on the profit and loss of the preceding year. After rectification, the balance of this account is transferred to Capital Accounts in case of a sole proprietorship or partnership business. In case of a company, the revised balance is transferred to Balance Sheet.

Illustration 30

The Trial Balance extracted from a set of books showed a difference which was placed in a Suspense Account to prepare the Final Accounts at that time. Subsequently, the following mistakes were detected :

(a) A dishonoured cheque for ₹ 500 received from A and returned by the Bank has been credited to the Bank Account and debited to Sundry Creditors Account.
(b) Several items of Furniture sold for ₹ 2,500 had been entered in the Sales Day Book.
(c) Goods purchased from X, a supplier, for ₹ 155 had been posted to the debit of his account as ₹ 150.
(d) ₹ 600 due from B had been omitted from the schedule of Sundry Debtors.

Show the necessary entries in the jounral properly ruled and with suitable narration to rectify these errors. Show also how non-detection of these errors affected last year's Profit and Loss Account.

Solution

In the books of ...
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
(a)	Sundry Debtors A/c (A A/c) Dr.		500	
	To Sundry Creditors A/c			500
	(Being a cheque received from A for ₹ 500 was deposited into bank but it was dishonoured and Sundry Creditors Account was wrongly debited, now rectified)			
(b)	Profit and Loss A/c Dr.		2,500	
	To Furniture A/c			2,500
	(Being sale of furniture wrongly recorded in the Sales Day Book, now rectified)			
(c)	Suspense A/c Dr.		305	
	To X A/c			305
	(Being goods purchased from X for ₹ 155 wrongly debited to his account by ₹ 150, now rectified)			
(d)	Sundry Debtors A/c Dr.		600	
	To Suspense A/c			600
	(Being ₹ 600 due from B had been omitted from the schedule of sundry debtors, now rectified)			

Note : Effect of correction on last year's profit — Profit will be reduced by ₹ 2,500 subject to depreciation on furniture of ₹ 2,500.

Illustration 31

The books of account of A Co. Ltd for the year ending 31st December, 2014 were closed with a difference in books carried forward. The following errors were detected in 2015 :

(a) Returns Outward Book was undercast by ₹ 150.
(b) ₹ 1,500 being the total of the discount column on the credit side of the Cash Book was not posted in General Ledger.
(c) ₹ 6,000 being the cost of purchase of office furniture was entered in the Purchase Account.
(d) A credit sale of ₹ 760 was wrongly posted as ₹ 670 to the Customer's Account in the Sales Ledger.
(e) Closing stock was overstated by ₹ 9,000, being casting error in the schedule of inventory.

Pass rectification entries, prepare Suspense Account and find out the effect of corrections on 2014 profit.

Solution

In the books of A. Co Ltd
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2015 (a)	Suspense A/c Dr.		150	
	To Profit & Loss Adjustment A/c			150
	(Being return outward book undercast by ₹ 150, now rectified)			
(b)	Suspense A/c Dr.		1,500	
	To Profit & Loss Adjustment A/c			1,500
	(Being discount received not posted from Cash Book to Ledger, now recorded)			
(c)	Office Furniture A/c Dr.		6,000	
	To Profit & Loss Adjustment A/c			6,000
	(Being purchase of office furniture wrongly entered in the Purchases Account, now rectified)			

(d)	Customer A/c Dr. To Suspense A/c (Being credit sale of ₹ 760 wrongly posted as ₹ 670 to the Customer's Account, now rectified)		90	90
(e)	Profit & Loss Adjustment A/c Dr. To Opening Stock A/c (Being closing stock overcast by ₹ 9,000, now rectified)		9,000	9,000

Dr. Suspense Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015	To Profit & Loss Adjustment A/c	150	2015	By Balance b/f (Balancing figure)	1,560
	To Profit & Loss Adjustment A/c	1,500		By Customer A/c	90
		1,650			1,650

Dr. Profit & Loss Adjustment Account Cr.

Particulars	₹	Particulars	₹
To Opening Stock A/c	9,000	By Suspense A/c	150
		By Suspense A/c	1,500
		By Office Furniture A/c	6,000
		By Net Profit (transferred)	1,350
	9,000		9,000

Note : **Effect of correction on 2014 profit —** Profit will be reduced by ₹ 1,350 subject to Depreciation on Furniture of ₹ 6,000.

Illustration 32

A trader agreed his Trial Balance by putting the difference in a Suspense Account and prepared a Trading and Profit and Loss Account and a Balance Sheet. On subsequent scrutiny the books disclosed several errors as detailed below :

(a) A cheque of ₹ 750 received for loss of stock by fire had been deposited in the proprietor's private bank account.

(b) An item of purchase of ₹ 151 was entered in the Inward Invoice Book as ₹ 15 and posted to the Supplier's Account as ₹ 51.

(c) A sales return of ₹ 500 was not entered in the financial accounts though it was duly taken in the stock book.

(d) An amount of ₹ 300 was received in full settlement from a customer after he was allowed a discount of ₹ 50, but while writing the books, the amount received was entered in the discount column and the discount allowed was entered in the amount received column.

(e) Bills receivable from Mr X of ₹ 1,000 was posted to the credit of Bills Payable Account and also credited to the account of Mr X.

Prepare Suspense Account and Profit and Loss Adjustment Account.

Solution

Dr. Suspense Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d (Balancing figure)	2,036		By Profit and Loss Adjustment A/c	36
				By X A/c (Note 1)	2,000
		2,036			2,036

Dr. Profit and Loss Adjustment Account Cr.

Particulars	₹	Particulars	₹
To Creditors A/c	100	By Capital A/c	750
To Suspense A/c	36	By Bank A/c	250
To Debtors A/c	500		
To Capital A/c	364		
	1,000		1,000

Working Note :

(1) Bills receivable received from X is nothing but Bills payable of the trader. Bills Payable Account has been correctly credited but X was not debited. However, X Account was credited wrongly. Therefore, for rectification — X Account will be debited with ₹ 2,000 and Suspense Account will be credited by the same amount.

Illustration 33

After getting an agreed Trial Balance, the accountant of M/s Senco Brothers drafted the Trading and Profit and Loss Account, and the Balance Sheet.

The following errors were then detected by the auditors :

(a) ₹ 2,500 received from the insurance company in full settlement of the claim for loss of stock-in-transit, was deposited by the proprietor into his private bank account and was not recorded in the business books.

(b) Goods purchased for ₹ 2,000 were included in stock, but the invoice was not entered in the books for the period under review.

(c) There were compensating errors in the books, namely —
   (i) a payment of ₹ 300 as commission to a sales agent had not been posted from the Cash Book;
   (ii) dividends received were undercast by ₹ 100;
   (iii) purchases amounting to ₹ 190 were not posted to the account of the supplier from Purchases Journal; and
   (iv) debit side of a customer's account in the Sales Ledger was overcast by ₹ 10.

(d) Goods sold for ₹ 500 were returned by a customer, but no record of the return was made in the books although the returned goods were included in the stock at their cost price of ₹ 380.

Show the Journal Entries and the effect of these errors and summarise the alterations necessary in the originally drafted statement of Accounts.

Solution **In the books of Senco Brothers**

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
(a)	Capital A/c	Dr.		2,500	
	To Profit and Loss Adjustment A/c				2,500
	(Being insurance claim received for loss of stock-in-transit wrongly deposited by the proprietor to his private bank account, now rectified)				
(b)	Profit and Loss Adjustment A/c A/c	Dr.		2,000	
	To Sundry Creditors A/c				2,000
	(Being credit purchases not recorded in the books, now rectified)				
(c)	(i) Profit and Loss Adjustment A/c	Dr.		300	
	To Suspense A/c				300
	(Being sales commission not posted from the Cash Book, now rectified)				
	(ii) Suspense A/c	Dr.		100	
	To Profit and Loss Adjustment A/c				100
	(Being dividends received undercast, now rectified)				
	(iii) Suspense A/c	Dr.		190	
	To Sundry Creditors A/c				190
	(Being purchases not posted from purchases journal to suppliers account, now rectified)				
	(iv) Suspense A/c	Dr.		10	
	To Sundry Debtors A/c				10
	(Being the debit side of a customer's account overcast, now rectified)				
(d)	Profit and Loss Adjustment A/c	Dr.		500	
	To Sundry Debtors A/c				500
	(Being goods returned not recorded in the books, now rectified)				
	Capital A/c	Dr.		200	
	To Profit & Loss Adjustment A/c				200
	(Being the net loss transferred to Capital Account)				

Dr. **Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Profit and Loss Adjustment A/c	100		By Profit and Loss Adjustment A/c	300
	To Sundry Creditors A/c	190			
	To Sundry Debtors A/c	10			
		300			300

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

Date	Particulars	₹	Date	Particulars	₹
	To Sundry Creditors A/c	2,000		By Capital A/c	2,500
	To Suspense A/c	300		By Suspense A/c	100
	To Sundry Debtors A/c	500		By Capital A/c (Loss)	200
		2,800			2,800

Illustration 34

The Trial Balance of M/s Roy & Sen & Co at 31.3.2015 did not agree. In order to close the books, the accountant placed the difference to the Suspense Account newly opened and carried forward this difference to the next period for necessary adjustments. Later, the following errors, arising in 2014-10 were detected:

(a) A purchase of ₹ 162 was recorded in the Day Book as ₹ 62 and posted to debit side Supplier's Account as ₹ 26.

(b) Sales Day Book was overcast by ₹ 100 in January, 2015.

(c) Furniture purchased for ₹ 2,500 cash was posted to the Purchase Account in the Ledger.

(d) Credit sale of ₹ 97 was posted to the credit of the Customer's Account as ₹ 79.

(e) ₹ 50 allowed as cash discount to a trade debtor was not debited to the Discount Account.

Show the necessary Journal entries to rectify these errors and show Suspense Account; and Profit and Loss Adjustment Account and state the ultimate effect of these correcting entries in the books for 2014-10.

Solution **In the books of M/s Roy & Sen & Co**

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

Date		Particulars		L.F.	₹	₹
2015 April 1	(a)	Profit & Loss Adjustment A/c ₹ (162 – 62)	Dr.		100	
		Suspense A/c ₹ (26 + 62)	Dr.		88	
		To Supplier A/c				188
		(Being purchase of ₹ 162 entered in the Purchases Book as ₹ 62 but posted to the debit of Supplier A/c as ₹ 26, now rectified)				
	(b)	Profit & Loss Adjustment A/c	Dr.		100	
		To Suspense A/c				100
		(Being Sales Day Book was overcast by ₹ 100, now rectified)				
	(c)	Furniture A/c	Dr.		2,500	
		To Profit & Loss Adjustment A/c				2,500
		(Being furniture purchased has been posted to the Purchases Account, now rectified)				
	(d)	Customer A/c ₹ (97 + 79)	Dr.		176	
		To Suspense A/c				176
		(Being credit sale of ₹ 97 wrongly posted to the credit of Customer's Account, as ₹ 79, now rectified)				
	(e)	Profit & Loss Adjustment A/c	Dr.		50	
		To Suspense A/c				50
		(Being discount allowed not posted to Discount Allowed Account, now rectified)				

Dr. **Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 April 1	To Balance b/f (Balancing figure)	238	2015 April 1	By Profit & Loss Adjustment A/c	100
	To Supplier A/c	88	"	By Customer A/c	176
				By Profit & Loss Adjustment A/c	50
		326			326

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

Particulars	₹	Particulars	₹
To Supplier A/c	100	By Furniture A/c	2,500
To Suspense A/c	100		
To Suspense A/c	50		
To Partners' Capital A/c (Balancing figure)	2,250		
	2,500		2,500

Effect of corrections

(i) Suspense Account will be nil; (ii) Sundry Debtors Account will be increased by ₹ 176; (iii) Sundry Creditors Account will be increased by ₹ 188; (iv) Furniture Account will be increased by ₹ 2,500; and (v) Partners' Capital Accounts will be increased due to increase in profit by ₹ 2,250 subject to depreciation on furniture wrongly posted to the Purchase Account.

Illustration 35

There was a difference in Trial Balance of Mr S Basu, a trader, on 31.12.2014 and the difference in books was carried to a Suspense Account and the books were closed. Subsequently, on going through the books, the following errors were located :

(a) ₹ 2,296 paid for repairs to motor car, was debited to Motor Car Account as ₹ 696.

(b) A sale of ₹ 1,400 to J Das entered in the sales book as ₹ 2,120.

(c) A cash discount of ₹ 800 received was entered in the cash book but was not posted in the ledger.

(d) ₹ 400 being purchase returns posted to the debit of Purchases Account.

(e) The purchase of a machine on 1.4.2014 for ₹ 24,000 was entered in the purchases book.

(f) While carrying forward total of one page in N Das's Account, the amount of ₹ 1,000 was written on the credit side instead of the debit side.

(g) A cheque of ₹ 6,192 received from S Das (after allowing a discount of ₹ 92) was endorsed to P. Ghosh in full settlement for ₹ 7,000. The cheque was finally dishonoured but no entry is passed in the books.

Give Journal Entries to rectify the above errors and prepare Suspense Account.

Solution **In the books of S. Basu**

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2014 (a) Dec. 31	Profit & Loss Adjustment A/c	Dr.		2,296	
	To Motor Car A/c				696
	To Suspense A/c				1,600
	(Being repairs to motor car of ₹ 2,296 wrongly debited to Motor Car Account as ₹ 696, now rectified)				
(b)	Profit & Loss Adjustment A/c	Dr.		720	
	To J. Das A/c (Note 1)				720
	(Being a sale of ₹ 1,400 wrongly entered in the Sales Day Book as ₹ 2,120, now rectified)				
(c)	Suspense A/c	Dr.		800	
	To Profit & Loss Adjustment A/c				800
	(Being discount received entered in the cash book but wrongly not posted in Ledger, now rectified)				
(d)	Suspense A/c	Dr.		800	
	To Profit & Loss Adjustment A/c				800
	(Being purchase return of ₹ 400 posted wrongly to the debit of Purchases Account, now rectified)				
(e)	Machiney A/c (Note 2)	Dr.		24,000	
	To Profit & Loss Adjustment A/c				24,000
	(Being purchase of machinery for ₹ 24,000 entered wrongly in the Purchases Day Book, now rectified)				
(f)	N. Das A/c	Dr.		2,000	
	To Suspense A/c				2,000
	(Being a debit amount of ₹ 1,000 wrongly carried forward as credit amount, now rectified)				
(g)	S. Das A/c (₹ 6,192 + 92)	Dr.		6,284	
	Profit & Loss Adjustment A/c	Dr.		716	
	To P. Ghosh A/c				7,000
	(Being a cheque of ₹ 6,192 received from Mr. S. Das endorsed to P. Ghosh for full settlement of ₹ 7,000 and dishonoured but no entry was passed, now rectified)				

Working Note : (1) It is assumed that all customers accounts are maintained in the general ledger itself. Sale of ₹ 1,400 wrongly recorded in the Sales Day Book as ₹ 2,120 affects Sales and J. Das Account. therefore, no amount will be carried to Suspense Account.

(2) For lack of information regarding depreciation rate, no effect has been given in the Profit and Loss Adjustment Account.

Dr. **Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014	To Balance b/d (Balancing figure)	2,000	2014	By Profit & Loss Adjustment A/c	1,600
Dec. 31	To Profit & Loss Adjustment A/c	800	Dec. 31	By N. Das A/c	2,000
"	To Profit & Loss Adjustment A/c	800			
		3,600			3,600

Illustration 36

A Mukherjee has agreed his Trial Balance by putting the difference in a Suspense Account and has prepared a Trading and Profit and Loss Account and the Balance Sheet. On subsequent scrutiny, the books disclosed several errors as detailed below. Rectify these errors and ascertain the amount carried to Suspense Account:

(i) A sale of goods to X for ₹ 350 has been credited to his account.

(ii) Goods purchased from Y amounting to ₹ 750 were entered in the Purchases Day Book but were omitted from Y's Account in the Creditors' Ledger.

(iii) An office typewriter purchased for ₹ 500 has been passed through the Purchase Account.

(iv) Goods returned to S Sen valued at ₹ 75 were debited to P Sen's Account.

(v) Repairs to office car valued at ₹ 750 were debited to the Office Car Account.

(vi) Goods sold to R Banerjee valued at ₹ 730 have been posted into his account as ₹ 370.

Will the above rectification affect the profit figure? If so, to what extent?

Solution **In the books of A. Mukherjee**

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
(i)	X A/c (₹ 350 x 2)	Dr.		700	
	To Suspense A/c				700
	(Being sale of goods to X for ₹ 350 wrongly credited to his account, now rectified)				

(ii)	Suspense A/c Dr. To Y A/c (Being goods purchased from Y wrongly not credited to his account, now rectified)		750	750
(iii)	Typewriter A/c Dr. To Profit & Loss Adjustment A/c (Being purchase of typewriter passed through Purchases Account, now rectified)		500	500
(iv)	S. Sen A/c Dr. To P. Sen A/c (Being goods returned to S. Sen wrongly debited to P. Sen Account, now rectified)		75	75
(v)	Profit & Loss Adjustment A/c Dr. To Office Car A/c (Being repair to car debited to office car account, now rectified)		750	750
(vi)	R. Banerjee A/c Dr. To Suspense A/c (Being goods sold to R. Banerjee for ₹ 730 wrongly posted to his account as ₹ 370 , now rectified)		360	360
(vii)	Capital A/c Dr. To Profit & Loss Adjustment A/c (Being net profit transferred to Proprietor's Capital Account)		250	250

Dr. **Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	310		By X A/c	700
	To Y A/c	750		By R. Banerjee A/c	360
		1,060			1,060

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

Particulars	₹	Particulars	₹
To Office Car A/c	750	By Typewriter A/c	500
		By Capital A/c	250
	750		750

Illustration 37

A book keeper while preparing his Trial Balance finds that the debit exceeds by ₹ 7,250. For preparing Final Accounts he places the difference to a Suspense Account. In the next year, the following mistakes were discovered :

(a) A sale of ₹ 4,000 has been passed through the Purchases Day Book. The entry in customer's Account has been correctly recorded.
(b) Goods worth ₹ 2,500 taken away by the proprietor for his use has been debited to Repairs Account.
(c) A bill receivable for ₹ 1,300 received from Krishna has been dishonoured on maturity but no entry passed.
(d) Salary of ₹ 650 paid to a clerk has been debited to his Personal Account.
(e) A purchase of ₹ 750 from Raghubir has been debited to his account. Purchases Account has been correctly debited.
(f) A sum of ₹ 2,250 written off as depreciation on furniture has not been debited to Depreciation Account.

Draft the journal entries for rectifying the above mistakes and prepare Suspense Account.

[C.A. (Foundation) — Adapted]

Solution

In the books of ...
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
(a)	Suspense A/c Dr. To Profit and Loss Adjustment A/c (Being credit sales of ₹ 4,000 wrongly passed through Purchases Day Book, now rectified)		8,000	8,000
(b)	Drawings A/c Dr. To Profit and Loss Adjustment A/c (Being goods taken for personal use wrongly debited to Repairs Account, now rectified)		2,500	2,500
(c)	Sundry Debtors A/c Dr. To Bills Receivable A/c (Being the bill of Krishna dishonoured on maturity but no entry was passed, now rectified)		1,300	1,300
(d)	Profit and Loss Adjustment A/c Dr. To Clerk's Personal A/c (Being salary paid to a clerk wrongly debited to his Personal Account, now rectified)		650	650

(e)	Suspense A/c Dr. To Raghubir A/c (Being purchase from Raghubir wrongly debited to his account, now rectified)		1,500	1,500
(f)	Profit and Loss Adjustment A/c Dr. To Suspense A/c (Being depreciation on furniture not posted to Depreciation Account, now rectified)		2,250	2,250

Dr. Suspense Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Profit and Loss Adjustment A/c	8,000		By Balance b/d	7,250
	To Raghubir A/c	1,500		By Profit and Loss Adjustment A/c	2,250
		9,500			9,500

Illustration 38

The following Balance Sheet was prepared by a novice on 31.12.2014 :

Liabilities	₹	Assets	₹
Capital	98,500	Furniture and other Fixed Assets	59,500
Net Profit during the year	45,700	Stock	61,000
Loan	50,000	Debtors	38,190
Creditors	22,150	Fixed Deposits	25,750
Suspense Account	2,110	Bank	19,820
		Drawings	14,200
	2,18,460		2,18,460

On close scrutiny, the following errors were discovered :

(a) Closing stock was overvalued by ₹ 4,000.

(b) A sale of ₹ 2,300 was recorded in Sales Day Book as ₹ 3,200, though it was rightly posted in Sales Account.

(c) The total of one page of Purchases Day Book was carried forward as ₹ 3,800 instead of ₹ 8,300.

(d) Outstanding telephone bill of ₹ 510 was not recorded in the books.

(e) A collection of ₹ 2,000 from a customer was posted in Creditors Account.

(f) Rent for one month ₹ 2,500 was recorded in the books as rent of the residential house of the proprietor.

(g) Some old furnitures were purchased at ₹ 2,000 for resale. But they were recorded in the books as fixed assets and depreciation was charged @ 10%.

(h) A fixed deposit of ₹ 5,000 was matured and ₹ 7,500 was realised. But the entire amount was credited to Fixed Deposit Account.

Show the necessary journal entries to rectify the errors, prepare a Profit and Loss Adjustment Account and a Balance Sheet after rectification.

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

Date	Particulars	L.F.	₹	₹
(a)	Profit & Loss Adjustment A/c Dr. To Stock A/c (Being closing stock overvalued by ₹ 4,000, now rectified)		4,000	4,000
(b)	Suspense A/c Dr. To Debtors A/c (Being sale of ₹ 2,300 wrongly entered in the Sales Day Book as ₹ 3,200 and posted correctly in the Sales Account, now rectified)		900	900
(c)	Profit & Loss Adjustment A/c (₹ 8,300 – 3,800) Dr. To Suspense A/c (Note 1) (Being total of one page of Purchases Day Book carried forward as ₹ 3,800 in place of ₹ 8,300, now rectified)		4,500	4,500
(d)	Profit & Loss Adjustment A/c Dr. To Outstanding Telephone Bill A/c (Being outstanding telephone bill not recorded in the books, now rectified)		510	510
(e)	Creditors A/c Dr. To Debtors A/c (Being collection from debtors wrongly posted in the Creditors Account, now rectified)		2,000	2,000
(f)	Profit & Loss Adjustment A/c Dr. To Drawings A/c (Being business rent wrongly recorded in the books as private rent, now rectified)		2,500	2,500
(g)	Stock A/c Dr. To Fixed Assets A/c To Profit & Loss Adjustment A/c (Note 2) (Being old furniture purchased for resale wrongly recorded in the books as fixed assets, now rectified)		2,000	1,800 200

(h)	Fixed Deposits A/c Dr. To Profit & Loss Adjustment A/c (Being interest on fixed deposit wrongly credited to Fixed Deposit Account, now rectified)		2,500	 2,500

Dr. **Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Sundry Debtors A/c	900		By Balance b/d	2,110
	To Balance c/d	5,710		By Profit and Loss Adjustment A/c	4,500
		6,610			6,610

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

Particulars	₹	Particulars	₹
To Stock A/c	4,000	By Balance b/d	45,700
To Suspense A/c	4,500	By Stock A/c	200
To Outstanding Telephone Bill A/c	510	By Fixed Deposit A/c	2,500
To Drawings A/c	2,500		
To Balance c/d	36,890		
	48,400		48,400

Working Notes :

(1) It is assumed that the Individual Creditors' Account is maintained in the General Ledger itself and Creditors' Account has been credited correctly.

(2) Depreciation rate is 10% (not 10% p.a.). Therefore, it has been calculated ignoring the time of purchase.

Balance Sheet as at 31st December, 2014

Liabilities		₹	Assets	₹
Capital	98,500		Furniture and other Fixed Assets ₹ (59,500 – 1,800)	57,700
Add: Profit (as above)	36,890		Stock ₹ (61,000 – 4,000 + 2,000)	59,000
	1,35,390		Debtors ₹ (38,190 – 900 – 2,000)	35,290
Less : Drawings	11,700	1,23,690	Fixed Deposits ₹ (25,750 + 2,500)	28,250
Loan		50,000	Bank	19,820
Creditors (₹ 22,150 – ₹ 2,000)		20,150		
Outstanding Telephone Bill		510		
Suspense Account		5,710		
		2,00,060		2,00,060

Tutorial Note : It should be noted that after rectification of given errors, the balance of Suspense Account has been increased to ₹ 5,710. It means that there are other undetected errors in the books of account.

Special Problems

Illustration 39

Balance Sheet of J Thomson as at 31st March, 2015

Liabilities		₹	Assets		₹
Capital at April 1, 2014		18,900	Land and Building at valuation		15,500
Profit for the year ended 31.3.2015	4,500		Machinery (Cost)	13,000	
Less : Drawings	1,500	3,000	*Less* : Depreciation	7,500	5,500
Creditors		6,300	Stock at cost		5,700
Overdraft		2,700	Debtors		4,200
		30,900			30,900

Further investigation reveals the following information:

(i) The Closing Stock includes damaged goods which, although they had costed ₹ 100, have an estimated sale value of ₹ 75.

(ii) Debtors include ₹ 200 in respect of a customer who had gone bankrupt. A doubtful debt provision of $2^1/_2$% is also required.

(iii) The machinery was acquired five years ago, and it is being depreciated down to its scrap value on a straight-line basis over eight years. A more realistic estimate indicates that the life span will be ten years.

(iv) The land and building were revalued in December 2014 by Mr. Thompson. The original cost was ₹ 13,500 and the surplus was credited to the Profit and Loss Account for the year.

(v) Wages owing at March 31, 2015 amounted to ₹ 95 but this has not been reflected in the accounts.

(vi) Charges for the bank overdraft, amounting to ₹ 80, have not been recorded in the accounts.

(vii) In arriving at the profit for the period, a salary of ₹ 1,000 paid to Mr. Thompson had been deducted as an expense.

(viii) ₹ 200 rent owing to Mr. Thompson for the letting of part of his business premises had not been received, and no entry had been made in the books in respect of this item.

Required to: (a) Prepare Journal entries to reflect such corrections as you consider necessary; (b) Draw up a statement of revised profit for the period, and prepare a new Balance Sheet as at 31st March, 2015.

Solution

In the books of J Thompson

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 (i)	Profit & Loss Adjustment A/c	Dr.		25	
	To Stock A/c				25
	(Being the value of the stock adjusted)				
(ii) (a)	Profit & Loss Adjustment A/c	Dr.		200	
	To Debtors A/c				200
	(Being bad debt written-off)				
(ii) (b)	Profit & Loss Adjustment A/c	Dr.		100	
	To Provision for Doubtful Debts A/c				100
	(Being the creation of provision @ 2.5 % on ₹ 4,000)				
(iii)	Depreciation Provision A/c (Note 1)	Dr.		1,500	
	To Profit & Loss Adjustment A/c				300
	To Capital A/c				1,200
	(Being depreciation overcharged, now adjusted)				
(iv)	Profit & Loss Adjustment A/c	Dr.		2,000	
	To Capital A/c				2,000
	(Being revaluation profit transferred to Profit & Loss A/c, now rectified)				
(v)	Profit & Loss Adjustment A/c	Dr.		95	
	To Outstanding Wages A/c				95
	(Being outstanding wages provided for)				
(vi)	Profit & Loss Adjustment A/c	Dr.		80	
	To Bank A/c				80
	(Being bank charges previously not recorded, now rectified)				
(vii)	Drawings A/c	Dr.		1,000	
	To Profit & Loss Adjustment A/c				1,000
	(Being salary paid to Proprietor, wrongly treated as an expense, now rectified)				
(viii)	Rent Receivable A/c	Dr.		200	
	To Profit & Loss Adjustment A/c				200
	(Being rent due but not received, now adjusted)				

Dr. Profit & Loss Adjustment Account Cr.

Particulars	₹	Particulars	₹
To Stock A/c	25	By Balance b/d	4,500
To Debtors A/c	200	By Depreciation Provision A/c	300
To Provision for Doubtful Debts A/c	100	By Drawings A/c	1,000
To Capital A/c	2,000	By Rent Receivable A/c	200
To Outstanding Wages A/c	95		
To Bank A/c	80		
To Balance c/d	3,500		
	6,000		6,000

Balance Sheet of J Thompson as at 31st March, 2015

Liabilities		₹	Assets		₹
Capital at April 1, 2014	18,900		Land and Building at valuation		15,500
Profit for the year ended 31.3.2015	3,500		Machinery (Cost)	13,000	
Add: Over-depreciation	1,200		*Less* : Depreciation (₹ 7,500 – 1,500)	6,000	7,000
Revaluation Profit	2,000		Stock at cost		5,675
Less : Drawings	(2,500)	23,100	Debtors	4,200	
Outstanding Wages		95	Less : Bad Debt	200	
Creditors		6,300		4,000	
Overdraft (₹ 2,700 + ₹ 80)		2,780	Less : Provision for doubtful debt	100	3,900
			Rent Receivable		200
		32,275			32,275

Notes : (a) Total Depreciation 7,500/5 x 8 = ₹ 12,000; (b) Revised Depreciation per year 12,000/10 = ₹ 1,200; (c) Depreciation to be written back 5 x (₹ 1,500 – ₹ 1,200) = ₹ 1,500; (d) Out of ₹ 1,500, only ₹ 300 to be adjusted with current year's profit and balance to be credited to Capital Account.

Illustration 40

After completing a draft Profit and Loss Account for the year ended April 30, 2015 of ABC Limited, the following balances remained and a Suspense Account entry was required for the difference which had arisen: (all figures in ₹)

Fixed Assets at Cost	60,000	
Provision for Depreciation		31,000
Ordinary Share Capital		35,000
Retained earnings		12,300
Stock in trade, at cost	14,000	
Sales Ledger Control Account	9,600	
Purchases Ledger Control Account		6,500
Balance at Bank	1,640	
Suspense Account (Difference on balance)		440
	85,240	85,240

After investigation, the following discoveries were made:

(i) A rent payment of ₹ 350 in March 2015 had been debited in the Sales Ledger Control Account.

(ii) Although instructed to do so, the accounts clerk had not set a debt due from B Bell of ₹ 1,560 in the Sales Ledger Control Account against an amount due to B Bell in the Purchases Ledger Control Account.

(iii) Discounts allowed of ₹ 500 during the year ended 30 April, 2015 had not been recorded in the company's accounts.

(iv) No entry had been made for the refund of ₹ 2,620 made by cheque to L. Green in March 2015, in respect of defective goods returned to the company. [*Note*: The correct entries had been made previously for the return of the goods to ABC Limited.]

(v) The Purchases Day Book for February, 2015 had been undercast by ₹ 300.

(vi) A payment of ₹ 1,000 to K. Bloom in January, 2015 for cash purchases had debited in the Purchases Ledger Control Account. [*Note*: The company does not maintain a credit account with K. Bloom.]

(vii) No entries had been made in the company's books for cash sales of ₹ 2,450 on April 30, 2015 and banked on that date.

(viii) No entries had been made in the company's books for the bank charges of ₹ 910 debited in the company's bank account in December, 2014.

(ix) The company's Cash Book (bank debit column) had been overcast by ₹ 1,900 in March 2015.

(x) A cheque payment of ₹ 8,640 for new fixtures and fittings in April, 2015 had not been recorded in the company's books.

(xi) A payment by cheque for ₹ 1,460 in June 2014 for stationery had not been posted to the appropriate nominal account.

You are required to prepare :

(a) Journal entries to reflect the above; (b) The Suspense Account, clearing the balance and;

(c) A corrected Balance Sheet.

Solution

In the books of ABC Limited

Journal

Date		Particulars		L.F.	Dr. ₹	Cr. ₹
2015	(i)	Profit & Loss Adjustment A/c	Dr.		350	
		To Sales Ledger Control A/c				350
		(Being rent paid was wrongly debited to Sales Ledger Control Account, now rectified)				
	(ii)	Purchase Ledger Control A/c	Dr.		1,560	
		To Sales Ledger Control A/c				1,560
		(Being contra between B Bell's A/c in Sales and Purchases Ledger)				
	(iii)	Profit & Loss Adjustment A/c	Dr.		500	
		To Sales Ledger Control A/c				500
		(Being discount allowed not recorded in the books, now rectified)				
	(iv)	Sales Ledger Control A/c	Dr.		2,620	
		To Bank A/c				2,620
		(Being money refunded to customer L. Green not recorded in the books, now rectified)				
	(v)	Profit & Loss Adjustment A/c	Dr.		300	
		To Purchases Ledger Control A/c				300
		(Being the undercasting in the Purchases Day Book, now rectified)				
	(vi)	Profit & Loss Adjustment A/c	Dr.		1,000	
		To Purchases Ledger Control A/c				1,000
		(Being goods purchased for cash was wrongly posted to Purchase Ledger Control Account, now rectified)				

(vii)	Bank A/c To Profit & Loss Adjustment A/c (Being cash sales not recorded in the books of account, now rectified)	Dr.		2,450	2,450
(viii)	Profit & Loss Adjustment A/c To Bank A/c (Being bank charges not recorded in the Cash Book, now rectified)	Dr.		910	910
(ix)	Suspense A/c To Bank A/c (Being overcasting in the debit side of the Cash Book)	Dr.		1,900	1,900
(x)	Furniture & Fittings A/c To Bank A/c (Being furniture purchased not recorded in the books of account, now rectified)	Dr.		8,640	8,640
(xi)	Profit & Loss Adjustment A/c To Suspense A/c (Being stationery purchased for cash not posted to stationery account, now rectified)	Dr.		1,460	1,460

Dr. **Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 ?	To Bank A/c	1,900	2015 April 1	By Balance b/f By Profit & Loss Adjustment A/c	440 1,460
		1,900			1,900

Balance Sheet of ABC Limited as at 30th April, 2015

Liabilities	₹	Assets		₹
Share Capital	35,000	**Fixed Assets** (at cost) (₹ 60,000 + ₹ 8,640)	68,640	
Reserve & Surplus		Less : Provision for Depreciation	31,000	37,640
Profit & Loss A/c	10,230	**Current Assets**		
Current Liabilities		Debtors (SLCA)		9,810
Creditors (PLCA)	6,240	Stock-in-trade		14,000
Bank Overdraft	9,980			
	61,450			61,450

Workings :

Dr. **Cash Book (Bank Column only)** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/f	1,640	By Sales Ledger Control A/c	2,620
To Profit & Loss Adjustment A/c	2,450	By Profit & Loss Adjustment A/c	910
To Balance c/d	9,980	By Suspense A/c	1,900
		By Furniture & Fittings A/c	8,640
	14,070		14,070

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

Particulars	₹	Particulars	₹
To Sales Ledger Control A/c	350	By Balance b/d	12,300
To Sales Ledger Control A/c	500	By Bank A/c	2,450
To Purchases Ledger Control A/c	300		
To Purchases Ledger Control A/c	1,000		
To Bank A/c	910		
To Suspense A/c	1,460		
To Balance c/d	10,230		
	14,750		14,750

Dr. **Sales Ledger Control Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	9,600		By Profit & Loss Adjustment A/c	350
	To Bank A/c	2,620		By Purchases Ledger Control A/c	1,560
				By Profit & Loss Adjustment A/c	500
				By Balance c/d	9,810
		12,220			12,220

Dr. **Purchases Ledger Control Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Sales Ledger Control A/c	1,560		By Balance b/d	6,500
	To Balance c/d	6,240		By Profit & Loss Adjustment A/c	300
				By Profit & Loss Adjustment A/c	1,000
		7,800			7,800

Key Points

- **Errors** are unintentional misstatements or omission of amounts or disclosures in financial statements.
- **Typical errors** include : (i) Mathematical mistakes; (ii) Mistake in the application of accounting principles; (iii) Oversight; and (iv) Misuse of facts.
- Errors of Omission are errors resulting from the complete failure to enter a transaction in the books.
- **Errors of Principle** arise because of an incorrect application of the principles of accounting, and failure to differentiate between capital and revenue expenditure.
- **Compensating Errors** are a group of errors, the total effect of which are not reflected in the Trial Balance.
- **Errors of Posting** : If a transaction has been journalised or recorded in a subsidiary book but has been posted wrongly in the Ledger Account, it is an error of posting.
- **Errors of Casting** : Casting is an accounting term for addition. These errors may occur due to short casting or excess casting in any subsidiary book or in any account in the Ledger.

THEORETICAL QUESTIONS

1. What are the different types of errors? Explain each one of them with examples.
2. What is Suspense Account? When is it used?
3. What are the different types of errors that affect the agreement of Trial Balance?
4. What are one-sided and two-sided errors? How will you rectify these if detected before preparation of a Trial Balance?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below.

1. A trial balance failed to agree and a suspense account was opened. It was then found that rent received of ₹ 500 had been debited to the rent payable account. Which entries are required to correct this error?

	Rent Received Account		Rent Payable Account		Suspense Account	
A	credit	500	credit	500	debit	1,000
B	credit	500	debit	500	no entry	
C	debit	500	credit	500	debit	1,000
D	debit	500	credit	500	no entry	

2. The total of the sales day book for one month is ₹ 9,160. It has been entered in the sales account as ₹ 9,610. Which entries are required to correct the error ?

	Debit		Credit	
A	Sales account	₹ 450	Sales day book	₹ 450
B	Sales day book	450	Sales account	450
C	Sales account	450	Suspense account	450
D	Suspense account	450	Sales account	450

3. An invoice for repairs to machinery ₹ 500, has been entered in the Machinery account. Which entries are required to correct the error ?

	Debit		Credit	
A	Machinery account	500	Repairs to machinery account	500
B	Repairs to machinery account	500	Machinery account	500
C	Repairs to machinery account	500	Suspense account	500
D	Suspense account	500	Machinery account	500

4. When Sachin's trial balance was extracted, the total of the debit balances was ₹ 450 less than the total of the credit balances so a suspense account was opened. After checking he found that :
   (i) a supplier's invoice for ₹ 225 had been debited to both the expenses account and the creditors' control account.
   (ii) a cash sale for ₹ 900 had been omitted from the accounting records.
   When these errors are corrected, what is the balance on the suspense account ?
   A ₹ 900 debit
   B ₹ 900 credit
   C ₹ 1,800 debit

5. A book-keeper has made the following errors :
   (i) A cash transaction of ₹ 100 has not been entered in the books at all.
   (ii) A discount received of ₹ 30 was entered in the debit side of the discounts allowed and correctly posted to the creditors account.
   (iii) ₹ 300 cash drawings were entered in the repair expense account and correctly recorded in the cash book.
   What would be the balance on the suspense account before these errors were corrected ?
   A ₹ 30 (Cr.)
   B ₹ 100 (Dr.)
   C ₹ 300 (Cr.)
   D ₹ 60 (Cr.)
6. After calculating your company's profit for 2014, you discover the following :
   (a) A fixed asset costing ₹ 50,000 has been included in the purchases account.
   (b) Stationery costing ₹ 10,000 has been included as closing stock of raw materials, instead of stock of stationery.
   These two errors have had the effect of :
   A understating gross profit by ₹ 40,000 and understating net profit by ₹ 50,000
   B understating both gross profit and net profit by ₹ 40,000
   C understating gross profit by ₹ 60,000 and understating net profit by ₹ 50,000
   D overstating both gross profit and net profit by ₹ 60,000
7. An organisation's year end is 30 September on 1.1.2014. The organization took out a loan of ₹ 1,00,000 with annual interest of 12%. The interest is payable in equal instalments on the first day of April, July, October and January in arrears. How much should be charged to the profit and loss account for the year ended 30 September, 2014 and how much should be accrued on the Balance Sheet ?

	Profit and Loss Account	Balance Sheet
A	₹ 12,000	₹ 3,000
B	₹ 9,000	₹ 3,000
C	₹ 9,000	Nil
D	₹ 3,000	₹ 9,000

8. The trial balance of a business does not agree. The difference has been entered in a suspense account.
   The error was caused by a cheque for ₹ 400 from X being debited to X's account. The correct journal entry is :

	Debit	**Credit**	**With**
A	Bank	Suspense	₹ 400
B	Suspense	X	₹ 400
C	Suspense	X	₹ 800
D	Suspense	Bank	₹ 800

9. A company's trial balance failed to agree and a suspense account was opened for the difference.
   Subsequent checking revealed that discount allowed ₹ 12,500 has been credited to discount received account.
   Which of the following journal entry will correct the errors ?

A	Discount Allowed A/c	Dr.	12,500	
	To Discount Received A/c			12,500
B	Discount Allowed A/c	Dr.	12,500	
	Discount Received A/c	Dr.	12,500	
	To Suspense A/c		25,000	
C	Suspense A/c	Dr.	12,500	
	To Discount Allowed A/c			12,500

PRACTICAL QUESTIONS

1. The Trial Balance as on 31.12.2014 of Moon Light Pvt. Ltd showed a difference and the Trial Balance was made to agree with the help of a Suspense Account. The following errors were detected afterwards. (a) The Sales Day Book was overcast by ₹ 3,000; (b) A sum of ₹ 1,000 received from R. Bose was wrongly credited to B. Bose; (c) A creditor's balance was extracted as ₹ 1,345 instead of ₹ 345; (d) A Sales Bill for ₹ 9,289 was wrongly debited to Customer's Account as ₹ 9,810; (e) The Purchase Day Book was undercast by ₹ 1,000; (f) An invoice of ₹ 2,000 for the purchase of a typewriter was debited to Purchases Account. Pass Journal entries to rectify the above errors.

2. The Trial Balance extracted from a set of books of X showed a difference which was placed in a Suspense Account. Subsequently, the following mistakes were detected:
   (i) A cheque for ₹ 1,000 received from B was dishonoured and returned by the bank had been credited to the Bank Account and debited to Sundry Creditors Account.
   (ii) Several items of furniture sold for ₹ 5,000 had been entered in the Sales Day Book.
   (iii) Goods purchased from Z for ₹ 310 had been posted to the debit of his Account as ₹ 130.
   (iv) ₹ 1,200 for goods sold on credit to A had been omitted to be entered in his account.
   Show the necessary entries in the Journal properly ruled and with suitable narrations to rectify these errors and also indicate the amount of the difference in the Trial Balance.
3. On 31st March 2015, while balancing the books of account of Shri M Singh, they did not agree. The difference in Trial Balance amounting to ₹ 783 was debited to Suspense Account. Later, the following errors were noticed. Give the Journal entries for rectification of errors and prepare the Suspense Account:
   (a) The total of Purchases Day Book for March, 2015 has been undercast by ₹ 300.
   (b) ₹ 220 paid for repairing the Machinery has been debited to Machinery Account.
   (c) The Sales Day Book has been overcast by ₹ 150.
   (d) A sale of ₹ 1,200 to Mr Kapur has been passed through the Purchases Day Book.
   (e) Cash ₹ 117 received from Shri Shankaran though entered in the Cash Book has not been posted to Shri Shankaran Account.
   (f) Goods returned by Mr Charan Singh, ₹ 225 have been entered in the Returns Outward Book. However, Mr Charan Singh's Account is correctly posted.
4. The Trial Balance of Skreen and Co. as on 30th June 2015 shows a difference of ₹ 16,646, the debit side being in excess of the credit side, this difference was placed in 'Suspense' Account while closing the books. The following errors were subsequently noticed:
   (a) Returns Outward Book was undercast by ₹ 1,818 on 28th June, 2015.
   (b) Repairs to Plant and Machinery, amounting to ₹ 2,200 was debited to Plant and Machinery Account on 9th June, 2015.
   (c) Advance of ₹ 2,002 given to one of the suppliers, Mr X on 20th May 2015 was entered correctly in the Cash Book but was posted in his account on the credit side.
   (d) A cheque for ₹ 1,858 deposited in the Bank on 29th May, 2015 was wrongly entered in Cash Book as ₹ 18,458 though the correct amount was posted in the account of the Customer.
   (e) Closing stock as on 30th June, 2014 was ₹ 1,91,400 but the same was wrongly carried forward as ₹ 1,95,000 in the books on 1st July, 2014.
   (f) ₹ 1,368 being the discount allowed by Mr Y on 25th June, 2015 was omitted to be posted in his account.
   Pass rectification entries for the above and draw the 'Suspense' Account.
5. There was an error in the Trial Balance of Mr. Arora on 31st December, 2014 and the difference in the books was carried to Suspense Account. On going through the books, you find that :
   1. ₹ 5,400 received from Mr. Rajiv was posted to the debit of his account.
   2. ₹ 1,000 being purchases returned were posted to the debit of Purchases Account.
   3. Discount of ₹ 2,000 received were posted to the debit of Discount Received Account
   4. ₹ 2,740 paid for repairs to motor car was debited to Motor Car Account as ₹ 1,740.
   5. ₹ 4,000 paid to R. Sanjay was debited to S. Sanjay Account.
   Give Journal entries to rectify the above errors and ascertain the amount transferred to Suspense Account on 31st December, 2014 by showing the Suspense Account, assuming that the Suspense Account is balanced after the above corrections.
6. The Trial Balance of Dilip and Co, showed a difference. On scrutiny of the books, the following errors were detected:
   (a) Total of the debit side of the Stationery Account has been overcast by ₹ 100.
   (b) Sales Account has been totalled in short by ₹ 200.
   (c) One item of purchase of ₹ 50 has been correctly recorded in the Purchases Day Book, but posted to the supplier's account (shown under Sundry Creditors) as ₹ 500.
   (d) Sales Return of ₹ 200 from a customer has not been posted to that account although the Customer's Account has been credited.
   (e) A cheque of ₹ 1,000 issued to a supplier (shown under Sundry Creditors) towards his dues has been debited to the Purchase Account through error.
   (f) A credit sale of ₹ 100 has been credited to the Sales Account and also to the Sundry Debtors Account.
   (i) Show the Journal entries to rectify the errors; (ii) Draw up the Suspense Account as it would appear in the ledger of the firm; (iii) Show also how they affect the profits of the firm.

7. The trial balance of A. Bose did not agree and the difference was carried to a Suspense Account. It was found that :
   (i) A sales invoice for ₹ 1,000 for goods sold on credit to B. Ghosh was entered in the Purchases Book, but in the Ledger, the amount was correctly debited in the Account of B. Ghosh.
   (ii) Goods bought on credit from P. Roy for ₹ 1,500 were wrongly debited to his account at ₹ 5,100.
   (iii) A cash discount of ₹ 50 allowed to S. Gupta remained unposted to his A/c in the Ledger from the Cash Book.
   (iv) The sales book for the month of April was undercast by ₹ 100.
   (v) ₹ 460 paid for repairs to building was debited to Building Account.

   Pass necessary Journal entries to rectify the errors and state what amount was carried to the Suspense Account.
8. The books of A. Vikram did not agree. The accountant put the difference in a Suspense Account. Rectify the following errors and prepare a Suspense Account.
   (a) The total of the Returns Outwards Book, ₹ 200 has not been posted in the Ledger.
   (b) A purchase of ₹ 1,400 from Saran has been entered in the Sales Book. However, Saran's Account has been correctly credited.
   (c) A sale of ₹ 430 to Ramakant has been credited in his account as ₹ 340.
   (d) A sale of ₹ 296 to Krishan has been entered in the Sales Book as ₹ 269.
   (e) Old furniture sold for ₹ 540 has been entered in the Sales Account as ₹ 450.
   (f) Goods taken by the proprietor, ₹ 500 have not been entered in the books at all.
9. Write out the Journal entries to rectify the following errors using a Suspense Account:
   (a) The total of "Discount Allowed" from the Cash Book for the month of December 2014 amounting to ₹ 350 was not posted.
   (b) An amount of ₹ 175 entered in the Sales Return Book has been posted to the debit of Mr. Roberts who returned the goods.
   (c) Bad debts aggregating ₹ 250 were written off during the year in the Sales Ledger but were not adjusted in the General Ledger.
   (d) Goods to the value of ₹ 500 returned by Mr. Smith were entered in the Sales Day Book and posted therefrom to the credit of his account.
   (e) A sale of ₹ 800 made to Mr. Peter was correctly entered in the Sales Day Book but wrongly posted to the debit of Mr. Armstrong as ₹ 80.
10. Rectify the following errors. Calculate the difference in the Trial Balance. Prepare a Suspense Account and find out the effect of these errors on the Net Profit.
   (a) Purchased goods from Mathai ₹ 300, passed through Sales Book. Mathai's account was correctly credited.
   (b) Received a bill of exchange from Arun for ₹ 500, passed it through Sales Book.
   (c) An item of ₹ 150 relating to Prepaid Rent Account was omitted to be brought forward.
   (d) ₹ 500 paid to Mehta Bros. against our acceptance were debited to Malhotra Bros. Account.
   (e) Received final dividend of ₹ 200 from Ajit whose account had already been written off as bad debt, was credited to his newly opened account and was included in the list of creditors.
   (f) Bill received from Janki Das for repairs done to radio ₹ 150 and radio supplied for ₹ 950 was entered in the Invoice Book as ₹ 1,000.
11. Misbal Co has produced a Trial Balance for the year ended March 31, 2015, which does not balance. An examination of the company's books discloses the following errors:
   1. An invoice from J. Smith amounting to ₹ 100, for goods purchased, has been omitted from the Purchases Day Book and posted direct to purchases account in the Nominal Ledger and J. Smith's account in the Purchases Ledger, but has not been included in the Creditors Control Account in the Trial Balance.
   2. The Sales Day Book has been undercast by ₹ 240 and posted to the Debtors Control Account accordingly.
   3. Discount allowed for the month of March amounting to ₹ 489 has not been posted to the Nominal Ledger.
   4. Goods received from Why Ltd on 31 March 2015, costing ₹ 2,410 have been included in stock, but the invoice has not yet been received.
   5. A cheque for ₹ 192 received from J. Jones, a debtor, has been posted direct to Sales Account in the Nominal Ledger.
   6. Sales Account in the Nominal Ledger has been credited with a credit note for ₹ 250 being trade-in allowance given on a company van. This amount had already been taken into account when dealing with the replacement in the Motor Van Account.

   You are required : (a) to give the Journal entries, where necessary, to correct these errors, or if no journal entry is required, state how they will be corrected; (b) to prepare a statement showing the effect the corrections would have on the company's profit for the year, and; (c) to prepare a statement showing the net adjustment to the trial balance.

12. Mr Mehrotra closes his books on 31st March, every year. In August, 2015 he found that his books for the year 2013-14 contained some errors in spite of an agreed Trial Balance. The errors were:
    (a) ₹ 800 paid for purchase of office furniture was posted to the Purchase Account.
    (b) The Sales Book was overcast by ₹ 250.
    (c) ₹ 275 paid for freight on machinery was debited to Freight Account for ₹ 525.
    (d) Closing stock was overcast by ₹ 3,000 by a wrong casting in the inventory.
    (e) An amount of ₹ 700 was received in full settlement from a customer after he was allowed a discount of ₹ 70, but while writing the books, the amount received was entered in the discount column and the discount allowed was entered in the cash column.
    (f) A cheque of ₹ 7,330 received from Mr Rao, after allowing him a discount of ₹ 70 was endorsed to Mr Roy in full settlement, for ₹ 7,500. The cheque was finally dishonoured but no entries for dishonour was passed in the books.

    Give journal entries to rectify the above errors using Suspense Account, where necessary.
13. After the preparation of Profit and Loss Account, the following transactions were overlooked :
    (a) The opening and closing stock were correctly valued amounted to ₹ 40,000 and ₹ 35,000 respectively, but they have both been included in the Trading Account at 20% less.
    (b) ₹ 1,000 received from a customer in respect of a debt previously written off credited to his personal account.
    (c) Goods costing ₹ 1,500 were sent on sale or return basis for ₹ 2,000 which was included in sales, though no information was received from the customers.
    (d) An account of ₹ 5,000 on account of a claim against the merchant was in dispute and it was estimated that ₹ 2,000 would probably have to be paid on this account.
    (e) Actual cash balance in the office cash box is ₹ 8,000 though the books of account shows ₹ 8,500.

    Show the necessary adjusting entries in the merchant's journal.
14. As the trial balance failed to agree, the accountant of X decided to open a Suspense Account. The final accounts were then produced for the year ended 31 December, 2014.

    Further investigations revealed the following :
    1. The Cash Book had been debited with ₹ 125, which was a receipt from C, a customer. C's account in the sales ledger had been debited with ₹ 152.
    2. A general ledger debit balance for Advertising ₹ 34,000 had been correctly transferred to Profit and Loss Account, but incorrectly entered in the trial balance as ₹ 34,400.
    3. I, a creditor of the company who was owed ₹ 2,000, was paid by a personal cheque from J, wife of X. The only ledger entry recording this was a debit in I's account for ₹ 2,000.
    4. The addition of the debit side of the trial balance had been undercast by ₹ 1,000.
    5. Discounts allowed of ₹ 300 had been correctly posted to the personal ledger, but had not been transferred to the Discount Allowed Account.

    (a) Prepare Journal Entries to correct the discrepancies shown in notes 1 to 5 above.
    (b) Show the Suspense Account with the original trial balance difference and all relevant entries required to correct the errors.
    (c) Which, if any, of notes 1 to 5 above did not affect the double-entry book-keeping system of X in any way ?
15. A firm's accountant has agreed a Trial Balance, and drafted the Trading and Profit and Loss Account and the Balance Sheet. You discover the following errors:
    (a) Sales on approval amounting to ₹ 1,000 have been included in the Sales Account; ₹ 750 of these goods were returned. No record of the return was made in the books, but the returned goods were included in stock at their cost price of ₹ 500.
    (b) A cheque for ₹ 2,500 received for a loss of stock sustained by fire has been paid by the proprietor into his private bank account and not recorded in the business books.
    (c) Purchased goods amounting to ₹ 2,000 are included in stock, but the invoice was dated forward, and is not entered for the period under review.
    (d) There were two compensating errors, viz. discounts received were undercast by ₹ 50. Sales Account was overcast by ₹ 50. State the effect of each of these errors, and pass rectifying Journal entries in a summarized form.
16. Chi Knitwear Ltd. is an old fashioned firm with a hand-written set of books. A Trial Balance is extracted at the end of each month, and Profit and Loss Account and Balance Sheets are computed. This month however, the Trial Balance will not balance, the credits exceeding debits by ₹ 1,536.

    You are asked to help and after inspection of the Ledgers discover the following errors:
    (a) A balance of ₹ 87 on a Debtors Account has been omitted from the schedule of debtors, the total of which was entered as debtors in the Trial Balance.
    (b) A small piece of machinery purchased for ₹ 1,200 had been written off to repairs.

(c) The receipts side of the Cash Book had been undercast by ₹ 720.
(d) The total of one page of the Sales Day Book had been carried forward as ₹ 8,154, whereas the correct amount was ₹ 8,514.
(e) A credit note for ₹ 179 received from a supplier had been posted to the wrong side of his account.
(f) An electricity bill in the sum of ₹ 152, not yet accrued for, is discovered in a filing tray.
(g) Mr. Smith whose past debts to the company had been the subject of a provision, at last paid ₹ 731 to clear his account. His personal account has been credited but the cheque has not yet passed through the Cash Book.

Required : (i) Necessary Journal entries for rectification of errors; (ii) Write up the Suspense Account to clear the difference; (iii) State the effect of correcting each error.

17. The Trial Balance of M/s Roy and Smith not having agreed, their book-keeper, in order to close the books places the difference in a Suspense Account. In the next accounting period, he discovers the following:
(a) An item of ₹ 575.33 paid for the purchase of a new typewriter for the Accounts Department has been wrongly passed through the Purchases Book.
(b) An item of ₹ 68.36 in the Sales Day Book has been posted at ₹ 86.36 in the Personal Ledger Account.
(c) An addition in Returns Inwards Day Book has been cast ₹ 23 short.
(d) An item of ₹ 35 appearing in the discount column in the credit side of the Cash Book has been posted to the credit side of the Personal Account as ₹ 53.
(e) A bill of exchange for ₹ 365 accepted by Ranganathan & Co and later discounted with the firm's bankers has been returned by the bankers as dishonoured. On dishonour, this amount has been debited to the Sales Account. Give the correcting entries and also show the Suspense Account.

18. The Trial Balance of S Das & Co, did not tally as on 31st December, 2014. The following errors were detected afterwards. Pass the necessary Journal Entries to rectify the errors and find out the difference in Trial Balance.
(a) ₹ 600 received from Bidhan Nandy on 31.12.2014 was entered in the Cash Book on 2nd January, 2015.
(b) Returns Inward Book was undercast by ₹ 300.
(c) The purchase of typewriter for ₹ 5,000 was entered in the Purchase Day Book.
(d) Wages of workmen engaged in construction of Building amounting to ₹ 500 were debited to Wages Account.
(e) A purchase of ₹ 671 had been posted to the debit of Supplier Account as ₹ 617.
(f) Goods amounting to ₹ 1,000 had been returned by Ramesh and were taken into stock, but no entry was passed for the transaction.
(g) ₹ 4,000 paid for purchase of TV for proprietor's own purpose had been charged to Miscellaneous Expenses Account.
(h) A Sales of ₹ 600 to 'S' was credited to his account by ₹ 60.
(i) A sale of ₹ 2,000 has been passed through Purchase Journal.
(j) ₹ 75 paid for repairs of furniture had been entered in the total column of Petty Cash Book, but not extended in the appropriate analysis column, the total of which has been posted.

Guide to Answers

Multiple choice

1. A 2. C 3. B 4. A 5. D 6. A 7. B 8. C 9. B.

Practical Questions

1. Credit balance of Suspense Account ₹ 4,479.
2. Amount of difference in the Trial Balance is ₹ 760.
3. After rectification there will be no balance in Suspense Account. Total of Suspense Account ₹ 900.
4. After rectification there will be no balance in Suspense Account. Total of Suspense Account ₹ 22,018.
5. Amount transferred to Suspense Account ₹ 15,800.
6. (ii) Dr. ₹ 100; ₹ 200. Cr. ₹ 450; ₹ 200; ₹ 200. (iii) Profit will be increased by items (a); (b); (e). Profit will be decreased by item (d). Net increase in profit ₹ 1,100.
7. Dr. ₹ 2,000; ₹ 6,600; ₹ 50; ₹ 100. Cr. nil. Amount carried to Suspense A/c ₹ 8,750 (Cr.)
8. Dr. ₹ 200; ₹ 27; ₹ 90. Cr. ₹ 2,800; ₹ 770. Amount carried to Suspense A/c ₹ 3,253 (Dr.).
9. Dr. ₹ 350. Cr. ₹ 350; ₹ 250; ₹ 500; ₹ 500; ₹ 720. Amount carried to Suspense A/c ₹ 1,970 (Dr.).
10. Difference in trial balance ₹ 750, Net decrease in profit ₹ 1,050.
11. Profit will be increased by ₹ 691.
12. Net decrease in profit ₹ 1,935.
13. Decrease in profit ₹ 2,500.
15. Profit will be decreased by ₹ 250.
16. Dr. Opening Balance ₹ 1,536; ₹ 360. Cr. ₹ 87; ₹ 720; ₹ 358; ₹ 731. Profit will be increased by ₹ 2,443.
17. Dr. ₹ 18. Cr. ₹ 23; ₹ 88.
18. Difference in Trial Balance — ₹ 4,253.

16

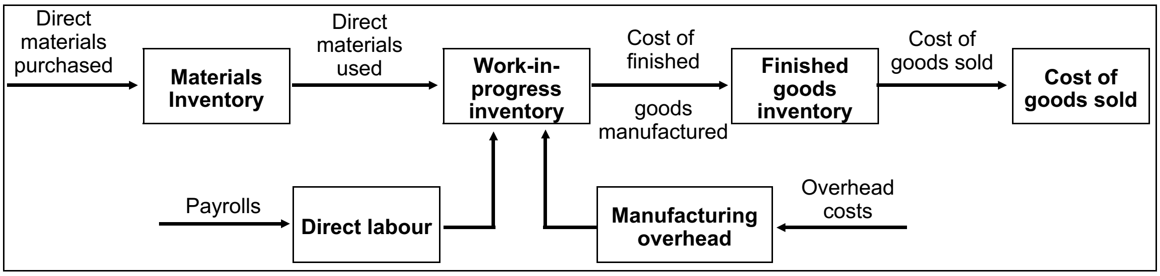
Manufacturing Account and Cost Statement

Introduction

In the Final Accounts chapter, we have seen that the main objective of preparing a Trading Account is to find out the profit from trading, that is the buying and selling of goods. There are many firms which instead of buying saleable products from outside suppliers, make the product themselves. The main objective of such a firm is to make a saleable product and to sell that product at a profit. These firms prepare a Manufacturing Account, in addition to the Trading and Profit and Loss Account, to show separately the cost of goods manufactured during the period.

The Cycle of Production

The production cycle is the sequence of operations which transforms raw materials into finished goods. Each operation will have costs which give rise to expenses. The flow of costs through the manufacturing process is shown as below:



Raw materials are the basic materials that enter into the production of finished goods.
Work-in-Progress are partly completed products that are in the manufacturing process.
Finished goods are the completed products which are ready for sale.

Elements of Cost

In the preparation of a Manufacturing Account, it is necessary to identify all the costs of manufacturing goods. The costs of manufacturing a product consist of three major elements : (a) Materials; (b) Labour; and (c) Expenses.

(a) Materials : Materials are classified as Direct Materials and Indirect Materials.

Direct Materials are those which can be identified with the product, that is, these are directly traceable to an article being manufactured. For example, wood, screws, and the like in a furniture factory.

Indirect Materials are those which do not form a part of the finished product but are necessary for production. For example, sandpaper used in a furniture factory for smoothing surfaces.

Here, we discuss the nature of a few materials. These are :

(i) Raw Materials : The term, raw material is referred to a material that has to be further worked upon for converting into a finished product. The raw materials used in production are treated as *Direct materials*.

(ii) Packing Materials : Primary packing materials are treated as *Direct Materials* where as secondary packing materials are treated as *Indirect Materials***.** Examples of primary packing materials are—bottles and plastic containers, tins, product labels, and the like. Examples of secondary packing materials are—wooden cases, binding wire, string, etc.

(iii) Consumable Materials : These are treated as *Indirect Materials***.** Examples will include cotton waste, grease, lubricating oil, and the like.

(iv) Maintenance Materials : These are required for keeping plant and machinery in working condition. Examples will include gears, bushes and bearings etc. These are treated as *Indirect Materials*.

(b) Labour : Labour is also classified as Direct Labour and Indirect Labour.

Direct Labour is the remuneration paid to production workers who are directly associated with the manufacture of particular articles.

Indirect Labour is the remuneration paid to those workers who are not involved in the actual manufacturing of the product.

Examples will include the remuneration of supervisors, works manager, security staff, and others.

(c) Expenses : Expenses are also classified as Direct Expenses and Indirect Expenses.

Direct Expenses are those which can be directly identified with a particular product other than direct materials and direct labour. Examples are hire charges of special plant, royalties paid on production, etc.

Indirect Expenses are those which cannot be identified with the product such as rent, rates and taxes, etc.

Types of Cost in Manufacturing Account

The total cost of manufacturing are divided into two groups:

(a) **Prime cost** is the aggregate of: (i) Direct Materials; (ii) Direct Labour; and (iii) Direct Expenses.

(b) **Overheads** is the aggregate of: (i) Indirect Materials; (ii) Indirect Labour; and (iii) Indirect Expenses. Overheads are classified into three classes: (i) Factory Overhead; (ii) Administrative Overhead; and (iii) Selling and Distribution Overhead. In Manufacturing Account we only consider the *Factory Overhead***.**

The Format of a Manufacturing Account

In the Manufacturing Account all the elements of production cost, that is, Direct Materials, Direct Labour, Direct Expenses and Factory Overhead are debited. As the Manufacturing Account is concerned with the production cost of goods finished during the year, any opening work-in-progress and closing work-in-progress must be adjusted at the time of preparing the Manufacturing Account of that year. The necessary details required to draw up a Manufacturing Account are shown below.

Dr. Manufacturing Account for the year ended ... Cr.

To Raw materials consumed (Note 1)	***	By Closing Stock of WIP	***
To Direct Labour	***	By Trading Account c/d	***
To Direct Expenses	***	(cost of goods finished and transferred)	
Prime Cost	***		
To Factory overhead (Note 2)	***		
To Opening Stock of W.I.P.	***		
	***		***

Working Notes :

(1) Raw Materials Consumed

Opening stock of raw materials	***
Add: Purchases of raw materials	***
	***
Less: Returns of raw materials	***
Less : Closing stock of raw materials	***
	***
Add: Freight, carriage inward, import duty, excise duty, etc. on materials	***
	***

(2) Factory Overhead

Indirect Materials	Indirect Labour	Indirect Expenses
(i) Secondary packing materials	Wages of :	Factory :
(ii) Maintenance materials	(i) Foreman	(i) Rent
(iii) Stores	(ii) Timekeeper	(ii) Rates
(iv) Grease	(iii) Supervisor	(iii) Taxes
(v) Lubricating oil	(iv) Factory Manager	(iv) Insurance
(vi) Cotton waste	(v) Securitymen	(v) Electricity
		(vi) Lighting
		(vii) Heating
		(viii) Depreciation

Valuation of Stocks in Manufacturing Account

Valuation of manufacturing stock creates problem. At the beginning of the accounting period there will be opening stock of raw materials but at the end of the accounting period there will not only be stocks of raw materials but also stocks of W.I.P. Raw materials will be valued *at cost or market price, whichever is lower*. ***However, it will be a matter to decide what value to place upon work-in-progress. It is common to value the work-in- progress at*** **"***Factory Cost*", that is, at prime cost plus a proportionate factory overhead.

Distinction Between Trading Account and Manufacturing Account

	Trading Accounnt		Manufacturing Account
1.	It shows the gross profit or gross loss.	1.	It shows the cost of production.
2.	It is prepared by all types of businesses.	2.	It is prepared by manufacturers.
3.	It may have a debit balance or a credit balance.	3.	It always has a debit balance.
4.	It is prepared after the Manufacturing Account.	4.	It is prepared before the Trading Account.
5.	The balance of this account is transferred to the Profit and Loss Account.	5.	The balance of this account is transferred to the Trading Account.
6.	It is a part of the Profit and Loss Account	6.	It is a part of the Trading Account.
7.	Any error in the Trading Account will affect the Profit and Loss Account.	7.	Any error in the Manufacturing Account will affect the Trading Account.
8.	It shows the matching of sales and direct costs.	8.	It is not the matching of sales and cost of production.

Key Points to Remember

1. ***Hire charges of special plant, royalty on production and cost of design will be treated as direct expenses. These are to be treated as part of the prime cost.***
2. ***Opening stock of W.I.P. (Work-in-progress) will be debited to Manufacturing Account. Closing stock of W.I.P. will be credited to Manufacturing Account.***
3. ***All indirect expenses relating to factory will be treated as factory overheads. Examples are : (i) Wages and salary of Durwan and security staff. (ii) Salary of works manager, supervisors, factory/ works staff etc. (iii) Depreciation on plant. (iv) Repairs to plant. (v) Repairs to factory shed etc.***
4. ***Opening stock and closing stock of finished goods will be shown in the Trading Account.***
5. ***Bad debts, discount allowed, audit fees etc. will be debited to Profit and Loss Account.***

Illustration 1

The following information is given to you from the books of a manufacturer in respect of the year ended 31st March, 2015.

Particulars	₹	Particulars	₹
Stock of Raw Materials (1.4.2014)	25,000	Electricity and telephone	6,000
Freight — Inward	8,500	Selling expenses	6,000
Freight — Outward	6,000	Miscellaneous expenses	14,000
Wages — Direct	18,000	Stock of raw materials (31.3.2015)	22,000

Wages — Indirect	14,000	Stock of finished goods	
Sales	4,18,000	Opening	30,000
Stationery	1,500	Closing	40,000
Travelling expenses	5,000	Provision for doubtful debts	8,500
Salaries (H.Q.)	26,000	Depreciation on plant	4,000
Factory expenses	26,000	Depreciation on office furniture and equipments	3,000
Interest on loan paid	1,800	Repairs to plant and machinery	4,650
Returns inwards	5,000	Scrap sale	3,700
Returns outwards	3,500	Purchase of raw materials	2,50,000
Power and fuel	8,000	Coal consumed	9,000
Work-in-progress (1.4.2014)	7,000	Bank interest received	2,600
Work-in-progress (31.3.2015)	4,000		

Adjustments necessary for the following :

(i) Finished goods worth ₹ 5,000 was distributed as free samples.
(ii) A loan was obtained on 1st October, 2012 for ₹ 50,000 carrying interest @ 10 p.a.
(iii) Bad debts to be written off ₹ 750 and Provision for Doubtful Debts to be maintained at ₹ 7,000.
(iv) Electricity and telephone to be apportioned as: Factory 3/5th and office 2/5th.
(v) A fire occurred destroying finished goods worth ₹ 15,000. Insurance company admitted a claim of ₹ 12,000 not yet received.
(vi) Stock of stationery in hand (31.3.2015) ₹ 150.

You are required to prepare the Manufacturing Account and Trading Account and Profit and Loss Account for the year ended 31st March, 2015.

Solution

Dr. Manufacturing Account for the year ended 31st March, 2015 Cr.

Particulars	₹	Particulars	₹
To Materials Consumed (Note 1)	2,58,000	By Closing Stock of Work-in-Progress	4,000
To Direct Wages	18,000	By Sale of Scrap	3,700
Prime cost	2,76,000	By Trading Account	3,44,550
To Factory overhead (Note 2)	69,250	(cost of goods manufactured and transferred)	
To Opening Stock of Work-in-Progress	7,000		
	3,52,250		3,52,250

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2015 Cr.

Particulars		₹	Particulars		₹
To Opening stock of finished goods		30,000	By Sales	4,18,000	
To Manufacturing A/c		3,44,550	Less: Returns inwards	5,000	4,13,000
To Gross Profit c/d		98,450	By Goods distributed as free sample		5,000
			By Goods destroyed by fire		15,000
			By Closing stock of finished goods		40,000
		4,73,000			4,73,000
To Salaries		26,000	By Gross Profit b/d		98,450
To Electricity and telephone (2/5 of ₹ 6,000)		2,400	By Bank interest received		2,600
To Stationery (₹ 1,500 — 150)		1,350	By Provision for doubtful debts :		
To Interest on loan	1,800		Old	8,500	
Add: Outstanding interest	700	2,500	New	7,000	1,500
To Travelling expenses		5,000			
To Selling expenses		6,000			
To Bad debts		750			
To Freight outward		6,000			
To Miscellaneous expenses		14,000			
To Loss on fire (₹ 15,000 — ₹ 12,000)		3,000			
To Depreciation on office furniture		3,000			
To Advertisement (free sample)		5,000			
To Net Profit (transferred)		27,550			
		1,02,550			1,02,550

Working Notes :

(1) Materials Consumed	₹	(2) Factory Overhead	₹
Opening stock of raw materials	25,000	Indirect wages	14,000
Add: Purchases of raw materials	2,50,000	Factory expenses	26,000
Add: Freight inward	8,500	Power and fuel	8,000
	2,83,500	Coal consumed	9,000
Less: Return of raw materials	3,500	Electricity and telephone (3/5 of ₹ 6,000)	3,600
	2,80,000	Depreciation on plant	4,000
Less: Closing stock	22,000	Repairs to plant	4,650
	2,58,000		69,250

Illustration 2

Prepare the Manufacturing, Trading and Profit and Loss Account for the year ended on 31.12.2014 and a Balance Sheet as at that date from the following balances extracted from the books of Md. Arif.

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Plant (1.1.2014)	50,000		General expenses :		
Plant bought (1.7.2014)	5,000		Office	1,000	
Purchases	65,000		Factory	400	
Packing and Transport	2,000		Insurance	1,800	
Rent, rates and taxes	3,000		Light and heat	900	
Repairs to plant	1,500		Sales		1,62,200
Salaries — Office	7,500		Stock on 1.1.2014 :		
Advertising	1,700		(a) Raw materials	10,000	
Bad debts	1,200		(b) Finished goods	14,000	
Provision for bad debts		2,000	(c) Work-in-progress	3,000	
Bank charges	200		Factory wages	40,000	
Capital Account		75,000	Debtors	20,000	
Current Account		3,000	Creditors		12,000
Drawings	10,000		Cash in hand	500	
Discount		800	Cash at bank	7,500	
Factory power	7,000				
Furniture	1,800		**TOTAL**	2,55,000	2,55,000

Additional Information :

	₹		₹
1. Stock at 31.12.2014		2. Following liabilities are to be provided :	
Raw materials	7,000	Factory Power	1,000
Work-in-progress	3,500	Rent and rates	600
Finished goods	20,000	Light and heat	300
Packing materials	250	General expenses: Factory	50
3. Insurance prepaid	300	General expenses:Office	100

4. Provide depreciation on Plant @ 10% per annum and on furniture @ 5%; per annum increase bad debts provision by ₹ 1,000.
5. 5/6th of the rent and rates, light and heat and insurance are to be allocated to the factory and 1/6th to office.

Solution

Dr. Manufacturing Account of Md. Arif for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Materials Consumed (Note 1)	68,000	By Work-in-progress (closing)	3,500
To Factory Wages	40,000	By Trading Account (finished goods transferred)	1,27,950
Prime cost	1,08,000		
To Factory overhead (Note 2)	20,450		
To Work-in-progress (opening)	3,000		
	1,31,450		1,31,450

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Stock of finished goods	14,000	By Sales	1,62,200
To Manufacturing A/c	1,27,950	By Closing stock of finished goods	20,000
To Gross Profit c/d	40,250		
	1,82,200		1,82,200
To Salaries	7,500	By Gross Profit b/d	40,250
To Rent and Taxes (Note 3)	600	By Discount received	800
To Light and heat (Note 5)	200		

To Insurance (Note 4)		250		
To General expenses	1,000			
Add: outstanding	100	1,100		
To Depreciation on furniture		90		
To Advertisement		1,700		
To Packing and transport		2,000		
Less: Closing stock of packing materials	250	1,750		
To Bank charges		200		
To Bad debts		1,200		
To Provision for bad debts		1,000		
To Net Profit (transferred)		25,460		
		41,050		41,050

Balance Sheet of Md. Arif as at 31st December, 2014

Liabilities		₹	Assets		₹
Capital Account		75,000	Plant and machinery	50,000	
Current Account			Addition	5,000	
Opening balance	3,000			55,000	
Add: Net Profit	25,460		Less: Depreciation	5,250	49,750
	28,460		Furniture	1,800	
Less: Drawings	10,000	18,460	Less: Depreciation	90	1,710
Trade creditors		12,000	Stock :		
Outstanding expenses :			Raw materials	7,000	
General factory expenses	50		W.I.P.	3,500	
General office expenses	100		Finished goods	20,000	
Factory power	1,000		Packing materials	250	30,750
Light and heat	300		Debtors	20,000	
Rent and taxes	600	2,050	Less: Provision for bad debts	3,000	17,000
			Prepaid insurance		300
			Cash at bank		7,500
			Cash in hand		500
		1,07,510			1,07,510

Working Notes :

(1) Materials Consumed

	₹
Opening stock of raw materials	10,000
Add: Purchases	65,000
	75,000
Less: Closing stock of raw materials	7,000
	68,000

(2) Factory Overhead

		₹
Factory power	7,000	
Add: Outstanding	1,000	8,000
Rent and taxes (Note 3)		3,000
Insurance (Note 4)		1,250
Light and Heat (Note 5)		1,000
Repairs to plant		1,500
General expenses	400	
Add: Outstanding	50	450
Depreciation on plant (Note 6)		5,250
		20,450

(3) Rent and Taxes

	₹
As per trial balance	3,000
Add: Outstanding	600
	3,600
Factory 5/6 = 3,000; Office 1/6 = 600	

(4) Insurance

	₹
As per trial balance	1,800
Less: Prepaid	300
	1,500
Factory 5/6 = ₹ 1,250; Office 1/6 = ₹ 250	

(5) Light and Heat

	₹
As per trial balance	900
Add: Outstanding	300
	1,200
Factory 5/6 = ₹ 1,000; Office 1/6 = ₹ 200	

(6) Depreciation — On ₹ 50,000 @ 10% for 1 year = ₹ 5,000 and On ₹ 5,000 @ 10% for 1/2 year = ₹ 250; Total = ₹ 5,250

Manufacturing Account Showing Manufacturing Profit

When the goods are transferred from the factory to the warehouse at 'Factory Cost', they do not give any indication of the profitability of the factory. The Gross Profit achieved by a business is the result of two processes : (a) The manufacturing process, and (b) The trading process. A better control can be exercised over the activities of the business if the results of these two processes can be segregated. A Manufacturing Account can be prepared to ascertain manufacturing profit. In this case, the manufacturing department is treated as a separate ***profit centre***. If this is decided, manufactured goods are transferred from the factory to the warehouse at a profit in any of the following two ways : (a) at sales price, or (b) at cost price plus a fixed percentage of profit.

When goods are transferred to the warehouse at selling price, such transfer price becomes the selling price for the manufacturing department and the purchase price for the trading department. This helps in deciding whether the manufacturing department is running at a profit or at a loss. If the cost per unit is more than the selling price (prevailing in the market), the department will show a loss and the management is to decide whether to close down the manufacturing department or not.

When it is not possible to get a ready market price for the product being transferred to the trading department, goods are transferred at cost plus a fixed percentage of profit. The percentage of profit that is added with the cost is purely on an arbitrary basis.

In both the above cases, the Manufacturing Account is credited with the 'Transfer price' (i.e. selling price or cost plus certain percentage of profit). Since the credit side becomes heavier (for adding the profit with the cost price of the goods transferred), the balancing figure will show the manufacturing profit and will appear on the debit side. Other items in the Manufacturing Account will appear as usual. The manufacturing profit is really the Gross Profit earned by the manufacturing department.

Elimination of Unrealised Profit in Closing Stock

When the goods are transferred from manufacturing department to the trading department at a profit, and at the year end a part of the stock remains unsold, some amount of unrealised profit remains in the closing stock. Applying the concept of conservatism (anticipate no profit but provide for all possible losses), the unrealised profit on closing stock is removed by passing the following journal entry :

Profit and Loss Account Dr.
To Stock Reserve Account

In the Balance Sheet, closing stock appears at its usual value less stock reserve, that is, strictly at cost.

Illustration 4

Leek and Bean were in partnership as lawnmower manufacturers, Leek being responsible for the factory and Bean for the warehouse. All completed lawnmowers were transferred from the factory to the warehouse, at agreed prices. Profits are to be shared as follows :

Factory—Leek (75%); Bean (25%); Trading—Leek (25%); Bean (75%).

The following trial balance has been extracted from the books on 30th June, 2015 :

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Capital Account — Leek		48,000	Stock at 30th June, 2014 — W.I.P.	3,400	
Capital Account — Bean		49,000	Lawn mowers completed (1,200 at ₹ 40 each)	48,000	
Drawings — Leek	6,000		Sales (1,820 lawn mowers)		1,11,020
Drawings — Bean	5,000		Purchase of raw materials	28,650	
Freehold factory, at cost	42,150		Factory wages	15,020	
Factory plant, at cost	25,750		Warehouse wages	6,030	
Provision for depreciation to 30.6.2014		6,050	Expenses — Factory	12,070	
Delivery vans, at cost	8,050		Expenses — Warehouse	10,020	
Provision for depreciation to 30.6.2014		3,450	Provision for doubtful debts		1,600
Stock at 30th June, 2013 — Raw materials	4,028		Trade debtors and creditors	18,000	6,000
Bank overdraft		7,048	**TOTAL**	2,32,168	2,32,168

1,520 lawn mowers at ₹ 45 each were transferred to the warehouse in 2014; lawn mowers in stock at the end of the year were to be valued at ₹ 45 each. Stock of raw materials was ₹ 3,180 and work in progress was valued at prime cost of ₹ 5,050 at 30th June, 2015. Accrued expenses outstanding as on 30th June, 2015 were : Factory Expenses ₹ 2,090; Factory Wages ₹ 280; Warehouse Expenses ₹ 1,080; Factory Wages nil.

The general provision for bad debts was to be maintained at 10% of the trade debtors. Bad debts for the year to 30 June 2015 have already been written-off against last year's provision.

Provision for depreciation is to be made as follows : Factory plant 10% p.a. on cost; Motor vehicles 20% p.a. on cost.

You are required to prepare : (a) Manufacturing, Trading and Profit and Loss Accounts for the year ended 30 June 2015; and (b) a Balance Sheet as at that date.

Solution

Dr. **Manufacturing Account for the year ended 30th June, 2015** **Cr.**

Particulars		₹	Particulars	₹
To Raw materials consumed		29,498	By Closing W.I.P.	5,050
To Factory wages	15,020		By Value of goods transferred to warehouse (1,520 x ₹ 45)	68,400
Add: Outstanding	280	15,300		
Prime cost		44,798		

To Factory overhead (Note 2)	16,735		
To Opening W.I.P.	3,400		
To Factory Profit c/d	8,517		
	73,450		73,450

Dr. Trading and Profit and Loss Account for the year ended 30th June, 2015 Cr.

Particulars		₹	Particulars	₹
To Opening stock of finished goods		48,000	By Closing Stock of finished goods (₹ 45 x 900)	40,500
To Value of goods transferred to warehouse		68,400	By Sales (1,820 Units)	1,11,020
To Gross Profit c/d		35,120		
		1,51,520		1,51,520
To Depreciation : Motor vehicles		1,610	By Gross Profit b/d	35,120
To Warehouse wages		6,030		
To Warehouse expenses	10,020			
Add: Outstanding	1,080	11,100		
To Provision for bad debts		200		
To Net Trading Profit c/d		16,180		
		35,120		35,120
To Share of Factory Profit			By Factory Profit b/d	8,517
Leek — 75%	6,388		By Net Profit b/d	16,180
Bean — 25%	2,129	8,517		
To Share of Trading Profit				
Leek — 25%	4,045			
Bean — 75%	12,135	16,180		
		24,697		24,697

Balance Sheet of Leek and Bean as at 30th June, 2015

Liabilities		₹	Assets		₹
Capital Account — Leek	48,000		**Fixed Assets**		
Add: Profit (₹ 6,388 + 4,045)	10,433		Freehold factory (at cost)		42,150
	58,433		Factory plant (at cost)	25,750	
Less: Drawings	6,000	52,433	Less: Depreciation to date	8,625	17,125
Capital Account — Bean	49,000		Delivery van (at cost)	8,050	
Add: Profit (₹ 2,129 + 12,135)	14,264		Less: Depreciation to date	5,060	2,990
	63,264		**Current Assets**		
Less: Drawings	5,000	58,264	Stock :		
Current Liabilities			Raw materials	3,180	
Creditors	6,000		W.I.P.	5,050	
Bank	7,048		Finished goods	40,500	48,730
Accrued Expenses (₹ 2,090 + 280 + 1,080)	3,450	16,498	Debtors	18,000	
			Less: Provision for bad debt	1,800	16,200
		1,27,195			1,27,195

Cost Statement/Cost Sheet

It is a statement prepared to show the different components of total cost, total output and profit of a given period of time. Cost sheet is a memorandum statement and is not a part of the double entry system. However, data relating to direct material, direct labour and direct expense are collected from financial accounts. Overheads are added in a cost sheet on the basis of predetermined rates. The profits disclosed by Cost Sheet and financial accounts generally differ due to difference in stock valuation and under/over absorption of overheads and it is explained by means of a reconciliation statement. A specimen of a cost sheet is given below.

Cost Sheet for the year ...

Direct materials consumed	***
Direct labour	***
Direct expenses	***
Prime cost	***
Factory overhead (say, 20% of the prime cost)	***
Factory cost/works cost	***
Add: Opening stock of W.I.P.	***
Less: Closing stock of W.I.P.	***
Works cost of finished goods	***
Administrative overhead (say 10% of works cost)	***

Cost of production	***
Add: Opening stock of finished goods	***
Less: Closing stock of finished goods	***
Cost of goods sold	***
Selling and Distribution overhead (say ₹ 5 per unit sold)	***
Cost of sales	***
Profit	***
Sales	***

Illustration 6

The following extract of information relates to a commodity for the year ended 31st March, 2015:

	₹		
Stock on 1.4.2014	₹	Raw materials purchased	30,000
Raw materials	5,000	Direct wages	25,000
Finished products (1,000 tonnes)	4,000	Rent, rates and insurance of works	10,000
Work-in-progress	1,200	Carriage inwards	360
Stock on 31.3.2015		Cost of factory supervision	2,000
Raw materials	5,560	Sales of finished products	75,000
Finished products (2,000 tonnes)	8,000	Advertisement and selling overhead amount to 25 paise per tonne sold,	
Work-in-progress	4,000	16,000 tonnes were produced during the year.	

Prepare Cost Sheet.

Solution **Cost Sheet for the year ended 31st March, 2015**

	₹
Raw materials consumed (Note 1)	29,800
Direct wages	25,000
Prime cost	54,800
Factory overhead (Note 2)	12,000
Factory cost/works cost	66,800
Add: Opening stock of W.I.P.	1,200
	68,000
Less: Closing stock of W.I.P.	4,000
Works cost of finished goods	64,000
Administrative overhead	nil
Cost of production	64,000
Add: Opening stock of finished goods	4,000
	68,000
Less: Closing stock of finished goods	8,000
Cost of goods sold	60,000
Selling and Distribution overhead ₹ (0.25 x 15,000)	3,750
Cost of sales	63,750
Profit (balancing figure)	11,250
Sales	75,000

Working Notes :

(1) Materials Consumed	₹	**(2) Factory Overhead**	₹
Opening stock of raw materials	5,000	Rent, rates and insurance	10,000
Add: Purchases	30,000	Cost of factory supervision	2,000
	35,000		12,000
Less: Closing stock of raw materials	5,560	**(3) Sales**	(tonnes)
	29,440	Opening stock	1,000
Add: Carriage inward	360	Production	16,000
	29,800		17,000
		Less: Closing stock	2,000
			15,000

Illustration 7

The following figures for the month of April 2015, were extracted from the records of a factory:

Opening stock of finished goods (5,000 units)	45,000	Administrative overhead	Re 1 per unit
Purchases of raw materials	2,57,100	Selling and Distribution overhead	10% of Sales
Direct wages	1,05,000	Closing stock of finished goods (10,000 units)	?
Factory overhead	100% of Direct wages	Sales (45,000 units)	6,60,000

Prepare a Cost Sheet for the month of April, 2015, assuming that sales are made on the basis of FIFO principle.

Solution **Cost Sheet for the month of April, 2015**

Purchase of raw materials	2,57,100
Direct wages	1,05,000
Prime cost	3,62,100
Factory overhead (100% of Direct wages)	1,05,000
Factory cost/works cost	4,67,100
Administrative overhead (Re 1 x 50,000) (Note 1)	50,000
Cost of production	5,17,100
Add: Opening stock of finished goods	45,000
	5,62,100
Less: Closing stock of finished goods (Note 2)	1,03,420
Cost of goods sold	4,58,680
Selling and Distribution overhead (10% of ₹ 6,60,000)	66,000
Cost of sales	5,24,680
Profit (balancing figure)	1,35,320
Sales	6,60,000

Working Notes :

(1) Production

	(Units)
Closing stock	10,000
Sales	45,000
	55,000
Less: Opening stock	5,000
	50,000

Administrative overhead is recovered on the basis of no. of units produced

(2) Value of Closing Stock

No. of units sold—45,000 on FIFO basis. It means that 5,000 units from Opening Stock and 40,000 units from current production. Closing stock represents only from current production. Therefore, the value will be : 5,17,100 / 50,000 x 10,000 = ₹ 1,03,420.

Valuation of Work-in-Progress

The cost of work-in-progress consists of raw materials consumed, direct labour and a proportionate part of the factory overheads. If the work-in-progress is valued at prime cost, it is necessary to have an adjustment for the work-in-progress. It should be made at the stage of calculating the prime cost. With the aggregate value of raw materials consumed and direct labour, value of opening work-in-progress at prime cost is to be added and value of closing work-in-progress at prime cost is to be subtracted. The resultant figure will be the value of prime cost.

Illustration 8

A company manufactures refrigerators and the following details are furnished in respect of its factory operations for the year ended 31.12.2015 (all figures in rupees) :

Work-in-progress on 1.1.2015 :			Stock of raw materials on 1.1.2015	2,25,000
At prime cost	51,000		Purchase of raw materials	4,77,000
Add: Manufacturing cost	15,000	66,000	Direct labour	1,71,000
Work-in-progress on 31.12.2015 :			Manufacturing costs	84,000
At prime cost	45,000		Stock of raw materials on 31.12.2015	2,04,000
Add: Manufacturing cost	9,000	54,000		

On the basis of above data, prepare a statement showing the cost of production.

Solution **Cost Sheet for the month of April, 2015**

Raw materils consumed (Note 1)	4,78,000
Direct labour	1,71,000
Value of work-in-progress at prime cost on 1.1.2015	6,69,000
	51,000
Value of Work-in-Progress at Prime Cost on 31.12.2015	7,20,000
	(45,000)
Prime cost	6,75,000
Value of work-in-progress on 1.1.2015 (Manufacturing Cost)	15,000
Manufacturing costs	84,000
	7,74,000
Less: Value of work-in-progress on 31.12.2015 (Manufacturing Cost)	(9,000)
Cost of production	7,65,000

Working Note : (1) Raw materials consumed : Opening stock of raw materials ₹ 2,25,000; *Add* : Purchases ₹ 4,77,000; Total = ₹ 7,02,000; *Less*: Closing stock of raw materials ₹ 2,04,000; Total raw materials consumed ₹ 4,98,000.

Key Points

- The **production cycle** is the sequence of operations which transforms raw materials into finished goods.
- **Direct Materials** are those which can be identified with the product, that is, these are directly traceable to an article being manufactured.
- **Direct Labour** is the remuneration paid to production workers who are directly associated with the manufacture of particular articles.
- **Direct Expenses** are those which can be directly identified with a particular product other than direct materials and direct labour.
- **Prime cost** is the aggregate of: (i) Direct Materials; (ii) Direct Labour; and (iii) Direct Expenses.
- **Overheads** is the aggregate of: (i) Indirect Materials; (ii) Indirect Labour; and (iii) Indirect Expenses.

THEORETICAL QUESTIONS

1. What do you mean by Manufacturing Account ? Why is it prepared ?
2. What do you mean by Direct Materials, Direct Labour and Direct Expenses ? Give suitable examples.
3. What is a Cost Sheet ? Why is it prepared ?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below :

1. Primary packing materials are
   A treated as indirect materials and included in the factory overhead
   B treated as indirect materials and included in the selling and distribution overhead
   C treated as direct materials and included in prime cost
   D treated as indirect materials and included in the administrative overhead
2. Direct materials are those which
   A cannot be identified with the product
   B are directly not traceable to an article being manufactured
   C are very costly materials used in the production of an article
   D can be identified with the product
3. Which of the following is not an example of direct expenses ?
   A royalties paid on production
   B hire charge of special plant
   C rent and taxes of the factory
   D designing cost
4. Which of the following is an example of direct material ?
   A cotton waste
   B binding wire
   C lubricating oil
   D screws in a furniture factory
5. Direct labour cost is the remuneration paid to a
   A supervisor
   B production worker
   C security staff
   D works manager
6. Which of the following expense is not an item of factory overhead ?
   A insurance of the factory
   B time keeper's salary
   C freight on raw materials
   D stores

7. Prime cost is the aggregate of
   A direct materials consumed + direct labour
   B direct materials purchased + direct labour + direct expense
   C direct materials consumed + direct labour + direct expenses
   D direct materials consumed + direct labour + factory overhead
8. Generally work-in-progress is valued at
   A prime cost
   B factory cost
   C factory cost + administrative overhead
   D prime cost + variable factory overhead
9. Secondary packing materials is treated as
   A direct expenses
   B factory overhead
   C selling overhead
   D distribution overhead
10. Which of the following is an item of overhead ?
   A audit fees
   B bad debts
   C discount allowed
   D delivery van expenses

PRACTICAL QUESTIONS

Manufacturing Account

1. From the following list of balances, prepare Manufacturing Account, Trading Account and Profit and Loss Account for the year ended 31.12.2014. Prepare also a Balance Sheet as on that date.
   Stock on 1.1.2014 : Raw Materials ₹ 30,000, Work-in-Progress ₹ 20,000, Finished Goods ₹ 1,50,000. Purchase of Materials ₹ 3,00,000, Carriage Inwards ₹ 11,000, Wages ₹ 2,00,000, Works Manager's Salary ₹ 56,000, Factory Expenses ₹ 59,000. Sales ₹ 7,34,000, Discount (Cr) ₹ 11,000, Office Expenses ₹ 1,24,000, Advertisement, etc. ₹ 30,000, Carriage Outward ₹ 6,000, Discount (Dr) ₹ 10,000, Cash-in-hand and at Bank ₹ 62,000, Sundry Debtors ₹ 2,50,000, Plant and Machinery ₹ 2,00,000, Land and Buildings ₹ 1,15,000, Sundry Creditors ₹ 4,70,000, Loan @ 5% (Cr.) ₹ 48,000, Drawings ₹ 60,000, Provision for Doubtful Debts ₹ 10,000, Capital ₹ 4,10,000. Additional information available is as follows :
   (a) Stock on 31.12.2014 : Raw Materials ₹ 40,000; Work-in-Progress 45,000; Finished Goods 2,80,000.
   (b) Outstanding Expenses : Wages ₹ 6,000 ; Office Salary ₹ 3,000 and Interest on Loan for the whole year.
   (c) Depreciate : Land and Building @ 2% p.a. and Plant and Machinery @ 5% p.a.
   (d) Provision for doubtful debt is to be raised to 5% on Sundry Debtors.
2. From the following information relating to the business of Lutfur Rahman, prepare a full Manufacturing Account and also prepare Trading, Profit and Loss Account and Balance Sheet for the year ended 30th September, 2014:

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Purchases	18,61,000		Sales staff — salary and commission	1,79,900	
Sales		41,54,500	Royalties	1,89,000	
Opening Stock:			Production wages :		
Raw materials	1,42,100		Direct	4,34,700	
W.I.P.	73,800		Indirect	2,69,800	
Finished goods	88,500		Administrative salaries	1,43,300	
Debtors / Creditors	1,89,600	2,01,600	Drawings	1,10,000	
Discount allowed	66,800		Land and Building	24,50,000	
Discount received		89,400	Plant and machinery at cost	12,50,000	
Bank and cash	2,49,400		Vehicles	6,25,000	
General factory expenses	2,10,100		Depreciation upto date		
Rent and rates	41,200		Vehicle		2,11,000
Light and heat	96,300		Plant and machinery		3,33,000
Factory power	1,56,500		Capital		38,50,000
Insurance	12,500		**TOTAL**	88,39,500	88,39,500

Notes at 30th September, 2014 :

1. Stock of : Raw Materials ₹ 1,68,100, Work-in-progress ₹ 82,500 and Finished Goods ₹ 1,03,400.
2. Light and heat, rent and rates, insurance are to be apportioned : Factory 3/5ths, Administration 2/5ths.
3. Depreciation provisions are to be applied to cost on the basis of : Plant and Machinery 10%, Vehicles 20%.

3. Prepare Manufacturing, Trading and Profit and Loss Account for the year ended 31st December, 2014 and Balance Sheet as at that date of Shri S. Singh, manufacturer, from the following Trial Balance and information:

Trial Balance as at 31st December, 2014

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Advertising	1,660		Purchases	67,336	
Bad debts	1,210		Packing and transport	2,170	
Bad debts provision		2,000	Rent and rates	2,972	
Bank charges	240		Repair to plant	1,570	
Capital Account of Sri S. Singh		70,000	Salaries — Office	7,380	
Current Account of Sri S. Singh		3,246	Sales		1,58,348
Drawings Account of Sri S. Singh	16,000		Stock on 1.1.2014:		
Discount		824	(a) Raw materials	10,460	
Factory power	7,228		(b) Finished goods	14,760	
Furniture	1,800		(c) Work-in-progress	3,340	
General expenses — Factory	410		Wages — Factory	41,400	
General expenses — Office	692		Debtors	21,120	
Insurance	1,804		Creditors		12,300
Light and heat	964		Cash at bank	7,852	
Plant and machinery (1.1.2014)	30,000		Cash in hand	350	
Plant and machinery bought (30.6.2014)	4,000		**TOTAL**	2,46,718	2,46,718

1. Stock at 31st December, 2014 was : Raw materials ₹ 7,120; W.I.P. ₹ 3,480; Finished goods ₹ 19,300; Packing materials ₹ 250.
2. The following liabilities are to be provided for : Factory power ₹ 1,124; Rent and rates ₹ 772; Light and heat ₹ 320; General expenses : Factory ₹ 50; Office ₹ 80.
3. Prepaid Insurance ₹ 340.
4. Increase bad debt provision by ₹ 1,000.
5. Provide depreciation at 10% p.a on Plant and Machinery and 5% p.a. on furniture.
6. 5/6th of Rent and rates, Light and heat, and Insurance are to be allotted to the factory and 1/6th to the office.

Cost Statement / Cost Sheet

4. From the following particulars you are required to prepare a statement showing the total cost of production and cost per unit produced.
Stock on 1.1.2014 : Raw materials ₹ 28,000; Work-in-progress ₹ 15,200;
Stock on 31.12.2014 : Raw materials ₹ 36,800; Work-in-progress ₹ 11,640;
Raw materials purchases ₹ 88,000; Carriage on the purchase of raw materials ₹ 3,120; Direct wages ₹ 30,000; Manufacturing expenses ₹ 14,800; No. of units produced in the year 180.

5. The following are the figures relating to the production of a commodity for the month of March, 2015:

Particulars	₹	Particulars	₹
Stock on 1.3.2015—Raw materials	75,000	Works overheads	2,000
Stock on 1.3.2015—Finished goods	75,000	Office and administrative overheads	3,000
Work-in-progress on 1.3.2015	5,000	Selling expenses	2,000
Work-in-progress on 31.3.2015	3,000	Sales	1,77,000
Stock on 31.3.2015—Raw materials	50,000	Purchase of raw materials	1,00,000
Stock on 31.3.2015—Finished goods	53,000	Direct wages	5,000

Prepare a statement showing Prime Cost, Total Cost and Net Profit for the month.

6. A manufacturing concern requires a statement showing the results of its production for the month of September, 2014. The cost records give the following information :

Particulars	₹	Particulars	₹
Stock on 1.9.2014—Raw materials	1,00,000	Sales	2,84,000
Stock on 1.9.2014—Finished goods	71,500	Direct wages	70,000
Stock on 30.9.2014—Raw materials	1,23,500	Indirect wages	2,500
Stock on 30.9.2014—Finished goods	42,000	Works charges	37,000
Purchase of materials	88,000	Administrative expenses	13,000
Work-in-progress on 1.9.2014	31,000	Selling and distributing expenses	15,000
Work-in-progress on 30.9.2014	34,500		

You are asked to prepare a cost sheet showing: (a) Prime cost; (b) Works cost; (c) Cost of production; (d) Cost of goods sold; (e) Cost of sales; and (f) Profit.

Guide to Answers

Multiple Choice

1. C 2. D 3. C 4. D 5. B 6. C 7. C 8. B 9. B 10. D

Practical Questions

1. **Prime cost ₹ 5,07,000; Cost of finished goods ₹ 6,07,000.**
2. **Prime cost ₹ 24,58,700; Cost of finished goods ₹ 34,26,400.**
3. **Materials consumed ₹ 70,676; Prime cost ₹ 1,12,076; Cost of finished goods — ₹ 1,30.928; G.D. ₹ 31,960; Net Profit ₹ 17, 430; Balance Sheet total ₹ 89,322.**
4. **Total cost of production ₹ 1,30,680; Cost per unit ₹ 726.**
5. **Prime cost ₹ 1,30,000; Total cost 1,61,000 ; Profit ₹ 16,000.**
6. **Prime cost ₹ 1,34,500 ; Works cost 1,74,000; Works cost of finished goods ₹ 1,70,500 ; Cost of production ₹ 1,83,500; Cost of goods sold ₹ 2,13,000; Cost of sales ₹ 2,28,000; Profit ₹ 56,000.**

17

Consignment Accounts

Introduction

Business organisations sometimes market their goods through agents as an alternative to selling goods themselves. Consignment is a kind of business expansion without actually opening a branch in a new potential market. In consignment, a manufacturer or wholesaler despatches goods to an agent who has a better knowledge of the local market, for the purpose of sale. The person sending the goods is called the ***consignor*** and the agent who receives the goods is called the ***consignee***. The consignee markets the product within his own periphery and receives commission at a stipulated rate on the total sales. He is also entitled to recover such expenses which he incurs in connection with the consignment. The consignee does not only market the product but discharges the function of sales promotion also. If he fails to perform this function, he may well be replaced by another. On the other hand, if the consignee finds that the business is not remunerative enough for him, he may well give it up and may not be interested to renew the contract for consignment. Consignment accounts are the accounts recording the transactions relating to the goods sent on consignment.

Economics of Consignment

Consignment flourishes because of its inherent economies. ***First***, it is cost saving. It dispenses with the need of branch opening at distant place or places with heavy cost implications. ***Secondly***, the manufacturer may not have the capacity to open branches while he intends to tap distant markets. Consignment fulfils both the needs. Consignment facilitates expansion without much initial and on-going costs. In short, it is the simplest and more economical way of territorial expansion and, as such, a mode of growth for manufacturing companies.

Distinction Between Sale and Consignment

	Sale		Consignment
(a)	In case of a sale, property in goods is transferred to the buyer along with the transfer of goods.	(a)	In case of a consignment, goods remain the property of the consignor until the time they are sold by the consignee.
(b)	Goods once sold cannot be returned to the seller except when they are defective or the seller agrees to take those back.	(b)	Unsold goods of consignment are the property of the consignor and can be returned to him.

(c)	When goods are sold on credit, the buyer becomes the debtor of the seller. The relationship between the buyer and seller is that of debtor and creditor.	(c)	When goods are sold on credit, the buyer becomes the debtor of the consignor. The relationship between the consignor and the consignee is that of a principal and an agent.
(d)	When goods are lost after delivery to the buyer, it is the buyer who will bear the loss.	(d)	When goods are lost on consignment, it is the consignor who will bear the loss.

Procedure for Consignment Transactions

The consignor sends goods to the consignee along with a ***Proforma Invoice***. An invoice is a document sent by a seller to a buyer giving details of goods or services sold, their price and terms of payments. A proforma invoice is a document to show what the invoice would be. It is not a demand for payment. It is a memorandum invoice and serves as a guide to the consignee in respect of (1) description of the goods and (2) minimum selling price to be realised. In the case of foreign consignments, the 'Proforma Invoice' serves as a prime document for customs clearance.

When goods are sent to the consignee the consignor makes a record of the consignment giving full details of the goods, their cost prices and the expenses incurred.

After receiving goods, the consignee tries to sell them at the best possible price. ***It should be noted that mere receipt of the goods does not make the consignee a debtor of the consignor***. He becomes indebted to the consignor when he sells the goods and realizes the money. The consignee may have to spend some money in respect of the consignment such as unloading charges, godown rent and the like for which he is entitled to be reimbursed. It is the duty of the consignee to remit the proceeds of sales after deducting his expenses in respect of the consignment and his own commission, to the consignor. The details of sale proceeds, expenses and commission are contained in an accompanying statement known as **'*Account Sales*.'**

An ***Account Sales*** is a statement which is periodically rendered by the consignee to the consignor, showing the details about the goods sold, price realized, his own commission, and the expenses incurred in connection with the sale.

Illustrative Example

On 15th November 2014, Kapil & Co of Chandigarh consigned 250 bicycles to Arun & Co Calcutta. On 31st December 2014, Arun forwarded an Account Sales, with a bank draft for the balance, showing the following transactions:

1. 200 bicycles sold @ ₹ 600 each and 50 @ ₹ 560 each.
2. Unloading charges ₹ 500.
3. Storage and Insurance ₹ 1,000.
4. Commission on Sales @ 10%.

You are required to prepare the Account Sales.

Arun & Co **35, Park Street, Calcutta 700 016** **31st December, 2014**		
Account Sales of 250 bicycles sold by order and for account of Kapil & Co.		
Gross Proceeds	₹	₹
200 @ ₹ 600 each	1,20,000	
50 @ ₹ 560 each	28,000	1,48,000
Less: Charges		
Unloading charges	500	
Storage & Insurance	1,000	
Commission @ 10% on ₹ 1,48,000	14,800	16,300
Net proceeds		1,31,700
Bank draft enclosed, ₹ 1,31,700 (Rupees one lakh thirty one thousand seven hundred only)	E. & O. E.	
	(Signed) Arun & Co Calcutta	

Entries in the Books of the Consignor

The primary objective for preparing the Consignment Account is to ascertain the profit or loss on each consignment separately. For that, the consignor prepares a ***Consignment Account*** for each consignment. This special account is always named with either the consignee or the place, for example 'Consignment to Arun & Co Account' or 'Consignment to Calcutta Account'—just to distinguish one consignment from another. Consignment account is a ***Nominal Account***. In fact, it is a combined Trading and Profit and Loss Account related solely to the consignment. This account is debited with : (1) opening stock on consignment (if any); (2) cost of goods sent on consignment; (3) expenses incurred by the consignor, such as freight, insurance for sending goods; (4) expenses incurred by the consignee such as unloading charges, godown rent and the like; and (5) consignee's commission on sales. This account is credited with : (1) gross sales proceeds; and (2) closing stock (if any). The balance of this account represents profit or loss which is transferred to ***'Profit & Loss on Consignment Account'***. At the year end, the balance of the Profit and Loss on Consignment Account is transferred to the General Profit and Loss Account.

The secondary objective of the consignor is to ascertain the amount due from the consignee. For this purpose, he opens a personal account of the consignee. The Consignee Account is debited with gross sales proceeds and credited with: (1) advance made by him (if any); (2) expenses incurred by him in respect of the consignment; and (3) his own commission on sales. The balance shows the amount due from the consignee.

The consignor may price the goods sent on consignment either at 'cost price' or at a higher price which is called 'invoice price'. The accounting procedure in the two cases is slightly different. Therefore, we discuss them separately.

Cost Price Method

Journal entries are as under:

1. For sending goods to the consignee

Consignment to ... Account	Dr.	[cost price]
To Goods Sent on Consignment Account		[cost price]

2. For payment of expenses by the consignor

Consignment to ... Account	Dr.	
To Cash or Bank Account		[If paid]
To Creditors for Expenses Account		[If unpaid]

3. For receipts of advance from the consignee

(a) When payment is received in cash or Bank Draft

Cash or Bank Account	Dr.
To Consignee Account	

(b) When a bill is accepted by the consignee

Bills Receivable Account	Dr.
To Consignee Account	

4. When Account Sales is received from the consignee

Immediately after receiving the Account Sales, the consignor passes the following entries:

(a) For sale of goods by the consignee

Consignee Account	Dr. [Gross sales proceeds]
To Consignment to ... Account	

(b) For expenses incurred by the consignee

Consignment to ....Account	Dr.
To Consignee Account	

(c) For the commission of the consignee

Consignment to ... Account	Dr.
To Consignee Account	

(d) For receiving remittance from the consignee
Cash or Bank Account Dr.
To Consignee Account

5. If the consignee completes the sales before the end of the consignor's accounting year, the consignor closes the Consignment Account by passing the following entry :

(a) When there is a profit on consignment
Consignment to ... Account Dr.
To Profit and Loss on Consignment Account

(b) When there is a loss on consignment
Profit and Loss on Consignment Account Dr.
To Consignment to ... Account

The students should note that a transfer to the Profit and Loss Account would close the Consignment Account but, it is not possible to wait until the Profit and Loss Account is prepared at the end of the accounting year. To overcome this hardship, the profit or loss on consignment is transferred to a special account called 'Profit and Loss on Consignment Account.' This account will also serve the purpose of combining the profits and losses of all consignments in the accounting year. At the end of the year it is transferred to the Profit and Loss Account.

6. At the end of the financial year, the Goods Sent on Consignment Account is closed by passing the following entry:

(a) If the consignor is a manufacturer
Goods Sent on Consignment Account Dr.
To Trading Account

(b) If the consignor is a wholesaler
Goods Sent on Consignment Account Dr.
To Purchase Account

The above adjustment entry should be passed to find out the correct profit of 'General Profit and Loss Account'. We know that every manufacturer prepares Manufacturing Account and the total cost of goods produced is transferred to Trading Account by debiting Trading Account and crediting Manufacturing Account. Now, if any goods have been sent on consignment, out of those goods, the Trading Account must be credited with the cost of goods sent on consignment. If this is not done, the general profit will be understated. Similarly, when the consignor is a wholesaler, whatever he purchases he debits his Purchases Account. Now if any goods that have been sent on consignment out of these goods, ***the Purchases Account must be reduced to that extent*** and the adjusted purchases should be debited to General Trading Account. If this adjustment is not done, the general profit will be understated.

Illustration 1

On 1st March, 2014 Kamal of Calcutta sends 1,000 boxes of tea to Bimal of Bombay on consignment basis. Each box costs ₹ 500. Kamal pays railway freight ₹ 1,000 and insurance ₹ 2,000 and draws upon Bimal a bill for ₹ 2,00,000 for 3 months which was duly accepted and returned.

On 30th September, 2014 Bimal forwards an Account Sales to Kamal showing that 500 boxes have been sold @ ₹ 560 each while 300 boxes were sold @ ₹ 550 each and the remaining boxes were sold @ ₹ 540 each. The expenses incurred by Bimal consisted of carriage charges ₹ 500; and godown rent ₹ 3,500. Bimal is entitled to a commission @ 5% on gross sales proceeds. He encloses a cheque for the balance due to Kamal.

Show how these transactions would be recorded in the books of Kamal, assuming that the bill of exchange was met on its due date. Also assume that Kamal closes the books on 31st December.

Solution

In the books of Kamal
Journal

Date	Particulars		Dr. ₹.	Cr. ₹.
2014 Mar. 1	Consignment to Bimal A/c To Goods sent on Consignment A/c (Being goods sent on consignment to Bombay)	Dr.	5,00,000	5,00,000

	*Consignment to Bimal A/c To Cash A/c (Being freight ₹ 1,000 and insurance ₹ 2,000 paid for sending goods)	Dr.	3,000	3,000
	Bills Receivable A/c To Bimal A/c (Being a bill drawn on Bimal for 3 months)	Dr.	2,00,000	2,00,000
June 4	*Bank A/c To Bills Receivable A/c (Being the bill met at maturity)	Dr.	2,00,000	2,00,000
Sept 30	Bimal A/c To Consignment to Bimal A/c (Being goods sold by Bimal)	Dr.	5,53,000	5,53,000
	Consignment to Bimal A/c To Bimal A/c (Being expenses paid by Bimal in respect of consignment)	Dr.	4,000	4,000
	Consignment to Bimal A/c To Bimal A/c (Being commission charged by Bimal @ 5% on ₹ 5,53,000)	Dr.	27,650	27,650
	*Bank A/c To Bimal A/c (Being a cheque received for the balance due)	Dr.	3,21,350	3,21,350
	Consignment to Bimal A/c To Profit & Loss on Consignment A/c (Being profit on consignment transferred to Profit and Loss on Consignment Account)	Dr.	18,350	18,350
Dec 31	Profit & Loss on Consignment A/c To Profit & Loss A/c (Being transferred to Profit and Loss Account)	Dr.	18,350	18,350
	Goods sent on Consignment A/c To Purchases A/c (Being the adjustment for goods sent on consignment)	Dr.	5,00,000	5,00,000

*These entries should be recorded in the Cash Book.

Ledger

Dr. Consignment to Bimal Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Mar 1	To Goods sent on Consignment A/c	5,00,000	Sept 30	By Bimal A/c (Sales)	5,53,000
	To Cash A/c (Expenses)	3,000			
Sept 30	To Bimal A/c				
	Carriage	500			
	Godown Rent	3,500			
	Commission	27,650			
	To Profit & Loss on Consignment A/c transfer	18,350			
		5,53,000			5,53,000

Dr. Goods sent on Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Dec 31	To Purchases A/c	5,00,000	Mar 1	By Consignment to Bimal A/c	5,00,000

Dr. Bimal Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Sept 30	To Consignment to Bimal A/c	5,53,000	Mar 1	By Bills Receivable A/c	2,00,000
			Sept 30	By Consignment to Bimal A/c	31,650
				By Bank A/c	3,21,350
		5,53,000			5,53,000

Dr. Profit & Loss on Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Dec 31	To Profit & Loss A/c	18,350	Sept 30	By Consignment to Bimal A/c	18,350

Dr. **Bills Receivable Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Mar 1	To Bimal A/c	2,00,000	2014 June 4	By Bank A/c	2,00,000

Dr. **Purchases Account (inclusive)** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
			2014 Dec 31	By Goods sent on Consignment A/c	5,00,000

Profit & Loss Account for the year ended 31st December, 2014 [Extract]

Particulars	₹	Particulars	₹
		By Profit & Loss on consignment A/c	18,350

Incomplete Consignment and Valuation of Closing Stock

It is not necessary that all consignments should be completed during the accounting year. There may be certain consignments which are incomplete when the consignor's accounting year comes to an end. Under such a situation, the consignee will be required to submit an Account Sales stating sales, expenses and commission upto the ***last date*** of the accounting year. After receiving the Account Sales, the unsold stock with the consignee should be valued. The stock so valued should be credited to the Consignment Account. The entry is:

Stock on Consignment Account Dr.
    To Consignment to ... Account

In the Balance Sheet, this stock is shown as an asset. In the ***next accounting year***, this stock is transferred to Consignment Account. The following entry is passed:

Consignment to .... Account Dr.
    To Stock on Consignment Account

Valuation of Unsold Stock

Now, we discuss the principles and procedures for valuation of consignment stock. We know that stock should be valued at ***cost or market price, whichever is lower***. This, principle applies to consignment stock as well.

The main problem is to ascertain 'cost price' and 'market price.' ***'Cost' includes all expenditure incurred in bringing the goods to a saleable condition and all expenses incurred for sending goods upto the consignee's place. These include freight, carriage, export or import duties, insurance on goods sent, loading and unloading charges, and the like. It should be noted that the expenses may be incurred either by the consignor or by the consignee. All the above expenditures which are included in the cost are popularly known as Non-Recurring Expenditures***. The expenditure incurred after the goods have reached the consignee's place should be ignored for the valuation of stock on consignment. These include godown rent, carriage on sales, establishment expenses, insurance for godown or any other selling expenses.

In the examination, the following format should be followed for valuation of consignment stock :

Valuation of Closing Stock

Particulars	₹.	₹.
Cost price of goods sent		*****
Add : *Consignor's Expenses*	****	
Freight	****	
Carriage	****	
Loading & Unloading charges	****	
Insurance on goods sent	****	
Export & Import duties	****	
Dock dues etc.	****	*****
Add : *Consignee's Expenses*	****	
Cartage	****	
Landing charges	****	
Unloading Expenses	****	*****
Total Cost		*****

$$\text{The cost of unsold goods} = \frac{Total\ \ Cost}{Total\ \ quantity} \text{ x } Unsold\ \ quantity$$

Alternatively,

Valuation of Closing Stock

Particulars	₹.	₹.
Cost price of goods unsold		*****
Add : Proportionate non recurring Expenses by:		
Consignor	****	
Consignee	****	*****

At the end of the accounting year, if some part of the goods are still in transit, the expenses of the consignee are generally not taken into consideration for the valuation of stock in transit

Here, ***'Market Price'*** refers to ***Net Realizable Value (NRV). Applying the concept of conservatism, all other possible expenses to be incurred in selling those goods are to be provided for, which will include the amount of commission payable to the consignee.***

After computing the ***'Cost Price'*** and ***'Market Price'*** in the above manner, the smaller one should be taken as the value of stock on consignment. ***In the examination problem, if there is no indication regarding market price, we should assume that market price is more than the cost price and valuation should be done accordingly.***

Illustration 2

On 30th September, 2014, Dey's Medical of Calcutta sends 500 cases of medicine costing ₹ 1,000 per case to Medicine Corner of Delhi on consignment basis. Dey's Medical incurred the following expenses: packing expense @ ₹ 20 per case (paid in cash); insurance premium ₹ 2,000 (paid by cheque); freight ₹ 10,000 (paid in cash); forwarding agent's expenses ₹ 1,000 (due).

On 31st December, 2014, Medicine Corner forwards an Account Sales to Dey's Medical showing that 200 cases have been sold @ ₹ 1,250 per case while 250 cases were sold @ ₹ 1,200 per case and the 50 cases remained unsold. Medicine Corner paid the following expenses : cartage ₹ 2,000; unloading ₹ 1,000 and ₹ 2,000 as godown rent. Account Sales accompanying an account payee cheque for ₹ 4,00,000.

Under the agreement Medicine Corner was to receive 5% commission on sales.

You are required to show: (1) Consignment to Delhi Account; (2) Medicine Corner Account; (3) Stock on Consignment Account; and (4) Goods sent on Consignment Account in the Ledger of Dey's Medical and Balance Sheet.

Solution

In the books of Dey's Medical

Dr. Consignment to Delhi Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014	To Goods Sent on Consignment A/c	5,00,000	2014	By Medicine Corner A/c	
Sept 30	To Cash A/c		Dec 31	200 @ ₹ 1,250	2,50,000
	Packing	10,000		250 @ ₹ 1,200	3,00,000
	Freight	10,000	"	By Stock on Consignment A/c (Note 1)	52,600
	To Bank A/c				
	Insurance premium	2,000			
	To Creditors for Expenses A/c				
	Forwarding Agent's expenses	1,000			
Dec 31	Medicine Corner A/c				
	Cartage	2,000			
	Unloading	1,000			
	Godown Rent	2,000			
	Commission	27,500			
"	To Profit & Loss on Consignment A/c	47,100			
		6,02,600			6,02,600

Dr. Medicine Corner Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014	To Consignment to Delhi A/c	5,50,000	2014	By Bank A/c	4,00,000
Dec 31			Dec 31	By Consignment to Delhi A/c	32,500
			"	By Balance c/d	1,17,500
		5,50,000			5,50,000

Dr. **Stock on Consignment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Consignment to Delhi A/c	52,600	2014 Dec 31	By Balance c/d	52,600

Dr. **Goods sent on Consignment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec 31	To Trading A/c	5,00,000	2014 Sept 30	By Consignment to Delhi A/c	5,00,000

Balance Sheet of Dey's Medical as at 31st December, 2014 [Extract]

Liabilities	₹	Assets	₹
		Medicine Corner	1,17,500
		Stock on consignment	52,600

Working Notes :

(1) Valuation of Closing Stock

	₹
Cost price : 500 cases @ ₹ 1,000 per case	5,00,000
Consignor's Expenses	
Packing (₹ 10,000) + Freight (₹ 10,000) + Insurance (₹ 2,000) + Forwarding Agent's Expenses (₹ 1,000)	23,000
Consignee's Expenses	
Cartage (₹ 2,000) + Unloading (₹ 1,000)	3,000
Total cost :	5,26,000

$$\text{Value of unsold stock} = \frac{5,26,000}{500} \times 50 = ₹\ 52,000.$$

Illustration 3

On 1st January, 2014 Chatterjee Bros of Calcutta shipped to Shanton Bros of Tokyo 400 musical instruments at the rate of ₹ 350 each. Chatterjee Bros incurred the following expenses on the consignment: cartage ₹ 150, freight ₹ 1,950 and Insurance ₹ 2,500.

The charges incurred by Shanton Bros were landing charges ₹ 450; storage ₹ 1,500 and ₹ 1,250 as fire insurance premium on stock.

On 31st December, 2014, an Account Sales was received from Shanton Bros disclosing that 350 instruments were sold out at ₹ 950 per instrument. Towards the close of the year, suddenly a new type of instrument appeared in the market and there was no possiblity of selling the balance of the goods at a high price. The market price fell down to ₹ 250 per instrument. In the Account Sales, besides their expenses Shanton Bros., charged commission at 15% on the gross sale proceeds. The unsold goods were held by them. A bank draft for the amount due was sent along with the Account Sales.

You are required to prepare:

(1) Consignment to Tokyo Account; (2) Shanton Bros Personal Account; and (3) Goods Sent on Consignment Account in the Ledger of Chatterjee Bros.

Solution

In the books of Chatterjee Bros

Dr. **Consignment to Tokyo Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014	To Goods sent on Consignment A/c	1,40,000	2014	By Shanton Bros A/c	
Jan 1	To Cash A/c		Dec 31	350 @ ₹ 950 each	3,32,500
	Cartage	150	"	By Stock on Consignment A/c (Note 1)	10,625
	Freight	1,950			
	Insurance	2,500			
Dec. 31	To Shanton Bros A/c				
	Landing charges	450			
	Storage	1,500			
	Insurance	1,250			
	Commission	49,875			
"	To Profit & Loss on Consignment A/c	1,45,450			
		3,43,125			3,43,125

Dr. Shanton Bros Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec 31	To Consignment to Tokyo A/c	3,32,500	2014 Dec 31	By Consignment to Tokyo A/c	53,075
				By Bank A/c (Balance)	2,79,425
		3,32,500			3,32,500

Dr. Goods sent on Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec 31	To Purchases A/c	1,40,000	2014 Jan 1	By Consignment to Tokyo A/c	1,40,000

Valuation of Closing Stock

Particulars	₹
Cost price : 400 instruments @ ₹ 350 each	1,40,000
Consignor's Expenses	
Cartage (₹ 150) + Freight (₹ 1,950) + Insurance (₹ 2,500)	4,600
Consignee's Expenses	
Landing charges	450
Total cost	1,45,050

(a) Cost price of 50 instruments = $\frac{1,45,050}{400} \times 50$ = ₹ 18,131.25.

(b) Market Price of an instrument (₹ 250 × 50) = ₹ 12,500; Less: Commission @ 15% — 1,875 = ₹ 10,625;
Therefore, the value of closing stock = ₹ 10,625

Entries in the Books of the Consignee

The following entries are to be made in connection with the consignment:

1. For goods received on Consignment

No entry is made in the books of the consignee because he holds these goods on behalf and on account of the consignor. He may, however, record the details of the goods received in a separate book, called the Consignment Inward Book.

2. For advance made to the consignor

(a) When payment is made by cash or bank draft

Consignor Account Dr.
To Cash or Bank Account

(b) When a bill of exchange is accepted

Consignor Account Dr.
To Bills Payable Account

3. For Payment of Expenses in respect of the consignment

Consignor Account Dr.
To Cash or Bank Account

(4) For Sale of goods

(a) When goods are sold for cash

Cash or Bank Account Dr.
To Consignor Account

(b) When goods are sold on credit

[*See 'Credit Sales and Del credere Commission'*]

5. For Commission

The calculation of actual commission will depend on the agreement between the consignor and the consignee. The entry to be passed:

Consignor Account Dr.
To Commission Received Account

6. For sending a remittance

Consignor Account Dr.

To Cash or Bank Account

On the last date of the accounting year, if there is any balance (Debit/Credit) in the Consignor Account, it should be shown in the Balance Sheet under Sundry Debtors or Sundry Creditors, depending upon the nature of the balance.

The student should note that the consignee will not make any entry in respect of stock on consignment. Similarly, he will not ascertain any profit or loss in respect of goods sold by him on behalf of the consignor. The commission received should be transferred to his Profit and Loss Account at the year end.

Illustration 4

Taking the particulars from ***Illustration 2***, the entries in the books of consignee would be as under :

Solution **In the books of Medicine Corner**

Journal

Date	Particulars		Dr. ₹.	Cr. ₹.
2014 Mar. 1	*Dey's Medical A/c To Cash A/c (Being expenses incurred in respect of consignment)	Dr.	5,000	5,000
?	*Cash A/c To Dey's Medical A/c (Being goods sold for cash on behalf of Dey's Medical, Calcutta)	Dr.	5,50,000	5,50,000
?	Dey's Medical A/c To Commission Received A/c (Being commission on goods sold on behalf of the consignor)	Dr.	27,500	27,500
Dec 31	*Dey's Medical A/c To Bank A/c (Being remittance by cheque)	Dr.	4,00,000	4,00,000
	Commission Received A/c To Profit & Loss A/c (Being commission received, transferred to Profit & Loss A/c)	Dr.	27,500	27,500

*These entries should be recorded in the Cash Book.

Ledger

Dr. **Dey's Medical Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Mar. 1	To Cash A/c	5,000	?	By Cash A/c	5,50,000
Dec 31	To Commission Received A/c	27,500			
"	To Bank A/c	4,00,000			
"	To Balance c/d	1,17,500			
		5,50,000			5,50,000

Dr. **Commission Received Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Dec. 31	To Profit & Loss A/c	27,500	Dec. 31	By Dey's Medical A/c	27,500

Illustration 5

Auto Agencies have sold the following goods on behalf of different parties for which they have incurred some expenses and are entitled to commission and reimbursement of expenses.

Parties	Stock in hand	Goods received	Goods sold	Expenses	Remittances	Commission
Life Light (₹)	8,000	20,000	24,000	600	20,000	10%
Silac (₹)	12,000	30,000	26,000	400	22,000	6%
Akriti (₹)	12,000	36,000	44,000	800	40,000	5%

Prepare the Consignors' Accounts in the books of Auto Agencies.

Solution **In the books of Auto Agencies**

Dr. **Consignors' Accounts** **Cr.**

Particulars	Life Light	Silac	Akriti	Particulars	Life Light	Silac	Akriti
To Bank A/c - expenses	600	400	800	By Bank A/c - sales	24,000	26,000	44,000
To Commission Received A/c	2,400	1,560	2,200				
To Bank A/c - remittances	20,000	22,000	40,000				
To Balance c/d (amount due)	1,000	2,040	1,000				
	24,000	26,000	44,000		24,000	26,000	44,000

Credit Sales and Del Credere Commission

It is not necessary that all the goods are to be sold by the consignee in cash. He may require to sell some part of the goods on credit. When goods are sold on credit, the problem of bad debt arises.

Whether the bad debts loss will be borne by the consignor or the consignee depends upon the fact whether del credere commission is given to the consignee or not.

Remember: (1) The consignor will bear the bad debts loss if no del credere commission is given to the consignee. (2) The consignee will bear the bad debts loss if del credere commission is given to him.

Del Credere Commission is an additional commission paid to a consignee who guarantees the payment in case of credit sale. Where the consignee gets del credere commission, he indemnifies the consignor for all bad debts. To the consignor, it is a ***form of credit insurance.*** **Like ordinary commission, del credere commission is also paid, generally, at a predetermined percentage of the Gross Sales Proceeds. However, there may be a separate agreement between the parties for calculation of the del credere commission.**

Accounting Entries for Credit Sales where no Del Credere Commission is given

In the books of the consignor

1. For Credit Sales

Consignment Debtors Account Dr.
To Consignment to . . . Account

2. For Collections from Debtors

Bank or Cash Account Dr.(collected by consignor)
Consignee Account Dr. (collected by consignee)
To Consignment Debtors Account

3. For Bad Debts / Discount Allowed

Bad Debts /Discount Allowed Account Dr.
To Consignment Debtors Account

4. For Closing Bad Debts / Discount Allowed Account

Consignment to... Account Dr.
To Bad Debts /Discount Allowed Account

Entries (3) and (4) can be clubbed and the following entry can be passed :

Consignment to . . . Account Dr.
To Consignment Debtors Account

In the books of the Consignee

1. For credit sales *No Entry*

2. For Collections from Debtors

Cash or Bank Account Dr.
To Consignor's Account

3. For Bad Debts *No Entry*

Accounting Entries for Credit Sales where del credere commission is given

In the books of the consignor

1. For Credit Sales

Consignee Account Dr.
To Consignment to ... Account

2. For Bad Debts *No Entry*

3. For Commission (Ordinary + del credere)

Consignment to... Account Dr.
To Consignee Account

In the books of the Consignee

1. For Credit Sales

Consignment Debtors Account Dr.
To Consignor Account

2. For Collections from Debtors

Bank Account Dr.
To Consignment Debtors Account

3. For Bad Debts

Bad Debts Account Dr.
To Consignment Debtors Account

4. For Closing Bad Debts

Bad debts arising out of credit sale on consignment are adjusted against the commission received. The net balance of the commission received account is transferred to the Profit and Loss Account at the year end.

(i) Commission Received Account Dr.
To Bad Debts Account

(ii) Commission Received Account Dr.
To Profit and Loss Account

Illustration 6

(a) On 1st November, 2014, C of Calcutta sends goods costing ₹ 1,00,000 to D of Delhi on consignment basis. C paid ₹ 5,000 as railway freight and ₹ 2,000 as insurance. On 31st December, 2014, an Account Sales was received from D disclosing that the entire quantity of goods were sold for ₹ 1,50,000 — out of which, ₹ 30,000 was sold on credit. A customer who purchased goods for ₹ 5,000 failed to pay and the debt proved bad. All other debts were collected by D in full. As per agreement, D is allowed a commission @ 10% on sales. D sends the amount due to C by a cheque.

Prepare necessary ledger accounts in the books of C and D.

(b) Will your answer be different, if in the above Illustration, the consignee is given a del credere commission of 5% on sales (in addition to ordinary commission)—other things remaining the same?

Solution (a)

In the books of C

Dr. Consignment to D Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Nov 1	To Goods Sent on Consignment A/c	1,00,000	2014 Dec 31	By D A/c (Cash Sales)	1,20,000
	To Cash A/c			By Consignment Debtors A/c (Credit Sales)	30,000
	Railway Freight	5,000			
	Insurance	2,000			
Dec 31	To D A/c (Commission @ 10%)	15,000			
"	To Consignment Debtors A/c (Bad Debts)	5,000			
"	To Profit & Loss on Consignment A/c	23,000			
		1,50,000			1,50,000

Dr. D Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec 31	To Consignment to D A/c	1,20,000	2014 Dec 31	By Consignment to D A/c	15,000
	To Consignment Debtors A/c	25,000		By Bank A/c	1,30,000
		1,45,000			1,45,000

Dr. Consignment Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec 31	To Consignment to D A/c	30,000	2014 Dec. 31	By D A/c (Cash Collected)	25,000
				By Consignment to D A/c (Bad Debt)	5,000
		30,000			30,000

Dr. Goods Sent on Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Purchases A/c	1,00,000	2014 Nov. 1	By Consignment to D A/c	1,00,000

In the Books of D

Dr. C Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec 31	To Commission Received A/c	15,000	2014 Dec. 31	By Bank A/c (cash sales)	1,20,000
	To Bank A/c	1,30,000		By Bank A/c (collection from debtors)	25,000
		1,45,000			1,45,000

Dr. Commission Received Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Profit & Loss A/c	15,000	2014 Dec. 31	By C A/c	15,000

Solution (b)

In the Books of C

Dr. Consignment to D Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Nov 1	To Goods Sent on Consignment A/c	1,00,000	2014	By D A/c (Sales)	1,50,000
	To Cash A/c				
	Railway Freight	5,000			
	Insurance	2,000			
Dec 31	To D A/c				
	Ordinary commission	15,000			
	Del Credere commission	7,500			
"	To Profit & Loss on Consignment A/c	20,500			
		1,50,000			1,50,000

Dr. D Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec 31	To Consignment to D A/c	1,50,000	2014 Dec 31	By Consignment to D A/c	
				Ordinary commission	15,000
				Del Credere commission	7,500
				By Bank A/c	1,27,500
		1,50,000			1,50,000

Dr. Goods Sent on Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Purchases A/c	1,00,000	2014 Nov. 1	By Consignment to D A/c	1,00,000

In the Books of D

Dr. C Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec 31	To Commission Received A/c		2014 Dec. 31	By Bank A/c (Cash Sales)	1,20,000
	Ordinary commission	15,000		By Consignment Debtors A/c	30,000
	Del Credere commission	7,500			
	To Bank A/c	1,27,500			
		1,50,000			1,50,000

Dr. Consignment Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To C A/c	30,000	2014 Dec. 31	By Bank A/c (collection)	25,000
				By Commission Received A/c (Bad Debts)	5,000
		30,000			30,000

Dr. Commission Received Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec 31	To Consignment Debtors A/c	5,000	2014 Dec 31	By C A/c	22,500
	To Profit & Loss A/c	17,500			
		22,500			22,500

Illustration 7

Somali of Mumbai consigned 100 units of a commodity to Mohua of Kolkata. The goods were invoiced at ₹ 300 so as to yield a profit of 50% on cost. Somali incurred ₹ 2,000 on freight and insurance. Mohua incurred ₹ 1,000 on Salesmen's salary and ₹ 1,600 on godown rent. Mohua sold 50 units for cash at ₹ 320 per unit and 20 units on credit at ₹ 350 per unit. She retained her commission @ 6 per cent (including 1 per cent for the del credere arrangements) and remitted the balance due. Mohua informed that 10 units were damaged on account of bad packing and that she would be able to sell them only for ₹ 160 per unit. A debtor for ₹ 2,000 to whom the goods were sold by Mohua became insolvent and only 50 paise in a rupee was recovered.

Show necessary ledger accounts in the books of Mohua.

Solution

In the Books of Mohua

Dr. Somali Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Commission Received A/c :			By Bank A/c (cash sales)	16,000
	Ordinary commission	1,150		By Consignment Debtors A/c	7,000
	Del credere commission	230			
	To Bank A/c (Expenses)	2,600			
	To Bank (Final remittance)	19,020			
		23,000			23,000

Dr. Consignment Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Somali A/c	7,000		By Bank A/c	6,000
				By Discount Received A/c (Bad Debts)	1,000
		7,000			7,000

Dr. Commission Received Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Consignment Debtors A/c (Bad Debts)	1,000		By Somali A/c	1,380
	To Profit and Loss A/c	380			
		1,380			1,380

Treatment of Discount on Bills in Consignment Account

A consignor may draw a bill on the consignee as an advance on the goods sent to the consignee. After acceptance, the consignor may discount the bill with his banker. ***The discounting charges, however, should not be charged to the Consignment Account*** because it is purely a financial expense. This discounting charge is transferred to the General Profit and Loss Account of the consignor.

Advance Made by the Consignee

An advance is a payment on account. When the consignee makes an advance to the consignor, the advance is adjusted against the amount due from the consignee. The problem of adjusting the advance arises when only a part of the goods are sold. The portion of the advance to be adjusted against the amount due depends on the *nature of the advance* made by the consignee. The consignee may make an advance which is to be *adjusted against the future payment* or the advance may be made by the consignee *as a security of the goods* received on behalf of the consignor. Accounting entries are made according to situations.

When an Advance is *Not Given* as a Security

In the books of the Consignor

(i) For advance received from the Consignee

Cash / Bank / Bills Receivable Account Dr.

To Advance Against Consignment Account

(ii) For adjustment at the end of the period

Advance Against Consignment Account Dr. [Full amount]

To Consignee Account

In the books of the Consignee

(i) For advance given to Consignor
Advance Against Consignment Account Dr.
To Cash / Bank / Bills Receivable Account

(ii) For adjustment at the end of the period
Consignor Account Dr. [Full amount]
To Advance Against Consignment Account

It should be noted that when an advance is not given as a security, the entire amount of advance is to be adjusted against the amount due—even when a part of the goods are sold.

Illustration 8

Arun of Calcutta sent goods costing ₹ 75,000 to Barun of Bombay on consignment basis. Arun paid ₹ 3,000 on various accounts for sending the goods. Barun paid ₹ 1,800 as railway charges and ₹ 750 as godown rent. The consignee sent a bank draft for ₹ 45,000 as advance against the consignment. 4/5ths of the goods were sold at ₹ 87,000. A customer who purchased goods for ₹ 500 failed to pay for which the debt proved bad. The Account Sales sent by the consignee showed that he charged 10 per cent as ordinary commission and 2.5 per cent as Del Credere commission.

You are required to give in the books of Arun :

(1) Consignment Account; (2) Barun Personal Account; (3) Advance against Consignment Account.

Solution

In the Books of Arun

Dr. Consignment to Bombay Account Cr.

Date	Particulars		₹	Date	Particulars	₹
	To Goods sent on Consignment A/c		75,000		By Barun A/c (sale proceeds)	87,000
	To Bank A/c — expenses		3,000		By Stock on Consignment A/c	
	To Barun A/c — expenses				1/5th of (₹ 75,000 + 3,000 + 1,800)	15,960
	Railway charges	1,800				
	Godown rent	750	2,550			
	To Barun A/c — commission					
	Ordinary @ 10%	8,700				
	Del Credere @ 2-$^1/_2$%	2,175	10,875			
	To Profit and Loss on Consignment A/c		11,535			
			1,02,960			1,02,960

Dr. Barun Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Bombay A/c	87,000		By Consignment to Bombay A/c (expenses)	2,550
				By Consignment to Bombay A/c (comm.)	10,875
				By Advance Against Consignment A/c	45,000
				By Balance c/d (amount due)	28,575
		87,000			87,000

Dr. Advance Against Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Barun A/c	45,000		By Bank A/c	45,000

When an Advance is *Given* as a Security of the Goods

In the books of the Consignor

(i) For advance received from the Consignee
Cash / Bank / Bills Receivable Account Dr.
To Advance Against Consignment Account

(ii) For adjustment at the end of the period
Advance Against Consignment Account Dr. [Proportionate amount]
To Consignee Account

In the books of the Consignee

(i) For advance given to Consignor

Advance Against Consignment Account Dr.
To Cash / Bank / Bills Receivable Account

(ii) For adjustment at the end of the period

Consignor Account Dr. [Proportionate amount]
To Advance Against Consignment Account

It should be noted that in this case a proportionate adjustment of advance is to be made against the amount due. For example, if the consignee receives 100 units of goods and makes an advance of ₹ 10,000. At the year end, if 80 units are sold, only ₹ 8,000 of the advance can be adjusted against the amount due.

Illustration 9

Gavaskar of Bombay sent 100 TV sets to Kapil of Chandigarh on consignment basis. The cost price of each set is ₹ 5,000. Gavaskar paid ₹ 100 for cartage, ₹ 1,500 for railway freight and ₹ 400 for insurance premium.

He drew a bill, payable after two months for ₹ 50,000, which was accepted by Kapil, by way of security against the consignment. He then discounted the bill for ₹ 49,900.

Kapil paid ₹ 600 as godown rent and ₹ 400 as sundry expenses. He sold 90 sets @ ₹ 5,400 per set. But he could not realize the sale proceeds of 5 sets from the customers. He was entitled to receive 4% ordinary commission and 1% del credere commission. The net amount due from Kapil was received in time.

Prepare the Consignment Account, Kapil Account and Advance Against Consignment Account in the books of Gavaskar.

Solution

In the books of Gavaskar

Dr. Consignment to Kapil Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c	5,00,000		By Kapil A/c	4,86,000
	To Cash A/c			By Stock on Consignment A/c (Note 1)	50,200
	Cartage	100			
	Railway Freight	1,500			
	Insurance	400			
	To Kapil A/c				
	Godown Rent	600			
	Sundry Expenses	400			
	Commission	24,300			
	To Profit & Loss on Consignment A/c	8,900			
		5,36,200			5,36,200

Dr. Kapil Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Kapil A/c	4,86,000		By Consignment to Kapil A/c	25,300
				By Advance against Consignment A/c	45,000
				By Bank A/c	4,15,700
		4,86,000			4,86,000

Dr. Advance against Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Kapil A/c (9/10)	45,000		By Bills Receivable A/c	50,000
	To Balance c/d	5,000			
		50,000			50,000

Working Note : (1) Valuation of Closing Stock

Cost price : 100 TV sets @ ₹ 5,000 each	5,00,000	
Add: non recurring expenses (₹ 100 + ₹ 1,500 + ₹ 400)	2,000	Value of Unsold TV = $\frac{5,02,000}{100}$ x 10 = ₹ 50,200
Value of goods sent	5,02,000	

Tutorial Notes:

(1) Sundry expenses should not be considered for valuation of closing stock.
(2) Discount on bill should not be charged to Consignment Account because it is purely a financial expense.
(3) When del credere commission is given to the consignee, the consignor has nothing to do with the bad debts.

Loss of Goods on Consignment

It is possible that a portion of the consignment stock may be stolen or otherwise lost (may be in transit or in the consignee's godown). The consignor will have to bear the loss, but not the consignee. There may also be some inevitable normal losses. In accounting for consignment, losses are classified as *normal and abnormal*. Therefore, in the books of the consignor, accounting treatment for normal and abnormal losses are different.

Accounting for normal losses

Normal losses are inevitable or unavoidable. These may arise due to natural causes like breaking in bulk, evaporation, leakage, drying, etc. No effort can prevent these losses.

Normal loss is treated by ignoring the loss. It means that the value of remaining stock absorbs this loss. Therefore, when there is some normal loss, the value of the remaining goods are artificially inflated to cover the normal loss. For example, a consignment of 100 units costing @ ₹ 0.95 is sent. Due to normal loss, the consignee receives 95 units. The value of stock will become ₹ 1 per unit (instead of the actual price of ₹. 0.95 per unit).

Therefore, when there is no stock remaining unsold, there will be no treatment for normal loss. But where there is some stock remaining unsold, the value of the stock on consignment will be ascertained by applying the following formula:

$$\frac{\textit{Value of the goods received by the consignee}}{\textit{Net quantity received (after normal loss) by the consignee (in units)}} \times \textit{Unsold goods (in units)}$$

Illustration 10

A informed you of the following particulars of his transactions relating to goods consigned to B for the year ended 31.12.2014. Goods sent (10,000 kgs)—₹ 1,00,000; A's expenses—₹ 10,000; B's expenses—freight and insurance—₹ 2,000; selling—₹ 5,000; Sold (8,000 kgs)—₹ 1,12,000; Loss due to natural wastage 100 kgs; Commission @ 5% on gross sales.You are asked to prepare the Consignment Account only with the detailed calculation of unsold stock in the books of A.

Solution

In the Books of A

Dr. Consignment to B Account Cr.

Date	Particulars		₹	Date	Particulars	₹
2014	To Goods sent on Consignment A/c		1,00,000	2014	By B A/c - sale proceeds	1,12,000
?	To Bank A/c - expenses		10,000	Dec. 31	By Stock on Consignment A/c (Note 1)	21,495
Dec. 31	To B A/c - expenses					
	Freight and Insurance	2,000				
	Selling	5,000	7,000			
"	To B A/c - commission @ 5% on ₹ 1,12,000		5,600			
"	To Profit and Loss on Consignment A/c		10,895			
			1,33,495			1,33,495

Working Note: (1) Ascertainment of the value of Stock: We know, when there is a normal loss, it is treated by ignoring the loss, i.e. the value of the remaining goods are artificially inflated. It means remaining goods absorb the normal loss. Therefore, in such a case, closing stock is to be ascertained by applying the following formula :

$$\frac{\text{Value of Goods Sent}}{\text{Quantity received by the Consignee after normal loss}} \times \text{Stock in hand}$$

$$= \frac{1{,}00{,}000 + 10{,}000 + 2{,}000}{10{,}000 - 100} \times 1{,}900 = ₹\ 21{,}495 \text{ (approx.)}$$

Accounting for abnormal losses

Abnormal losses in consignment may arise owing to reasons such as, theft, fire and the like. Again, these may occur either in transit or at the consignee's place. Normal loss is unavoidable but abnormal loss can be avoided. To ascertain the true profit on consignment, abnormal losses are eliminated from the Consignment Account. Therefore, abnormal losses should be charged to the General Profit And Loss Account and Consignment Account should be given due credit for the value of goods lost abnormally. Abnormal losses can be dealt with in two different ways as under:

Method I

(a) When the goods are not insured:

Profit and Loss Account Dr.
To Consignment Account

(b) When the goods are fully insured:

Insurance Claim Account Dr.
To Consignment Account

(c) When the value of goods lost is more than the amount admitted by the insurance company:

Insurance Claim Account Dr. (claim admitted)
Profit and Loss Account Dr. (claim not admitted)
To Consignment Account (value of goods lost)

Method II

Under this method, the whole amount of abnormal loss is transferred to a special account called Abnormal Loss Account by passing the following entry:

Abnormal Loss Account Dr.
To Consignment Account

Now, for closing the Abnormal Loss Account, the following entries are made according to the situation:

(a) When the goods are not insured:

Profit and Loss Account Dr.
To Abnormal Loss Account

(b) When the goods are fully insured:

Insurance Claim Account Dr.
To Abnormal Loss Account

(c) When the value of goods lost is more than the amount admitted by the insurance company:

Insurance Claim Account Dr.
Profit and Loss Account Dr.
To Abnormal Loss Account

The following entry is to be passed under both methods, when the actual claim is received from the insurance company:

Bank Account Dr.
To Insurance Claim Account

Valuation of Abnormal Loss

Particulars	₹.	₹.	
Cost price of goods sent		*****	Value of abnormal loss = $\frac{\textit{Total Cost}}{\textit{Total Quantity}}$ x *Quantity Lost*
Add : Non-recurring expenses upto the point of loss (consignor's + consignee's)		*****	
Total Cost just before loss		*****	

Illustration 11

Romesh of Calcutta consigned 100 packets of medicine, each costing ₹ 500, to his agent Md. Arif of Ahmedabad. He paid ₹ 1,000 towards freight and insurance. 10 packets were destroyed in transit. The consignee took delivery of the remaining packets and spent ₹ 500 as godown rent, ₹ 2,000 as clearing charges and ₹ 500 as selling expenses. The consignee sold 80 packets @ ₹ 600 each.

You are required to calculate the cost of damage and cost of goods in hand at the end.

Solution

Valuation of goods lost in transit	₹	Valuation of goods in hand at the end	₹
Cost of 100 packets @ ₹ 500 each	50,000	Cost of 100 packets just before lost in transit	51,000
Add: Non-recurring expenses up to accident	1,000	Less: Value of 10 packets lost in transit	5,100
Cost of 100 packets just before loss in transit	51,000	Cost of 90 packets after loss in transit	45,900
Therefore, Value of 10 packets = ₹ 51,000 / 100 x 10 =	5,100	Add: Non-recurring exp. after accident (cledaring charges)	2,000
		Total cost of 90 packets	47,900
		Therefore, Value of 10 packets = ₹ 47,900 / 90 x 10 =	5,322

Illustration 12

100 cycles, costing ₹ 150 each were consigned to the agent at Jaipur. Expenses incurred on sending them were ₹ 1,000. On the way, 5 cycles were damaged due to bad handling and insurance claim of ₹ 700 was accepted. Consignee took delivery of the rest and incurred direct expenses of ₹ 285 and indirect expenses of ₹ 150. He sold 80 cycles at ₹ 200 per cycle. Prepare Consignment Account when consignee gets 5% commission on gross sales. also show how abnormal loss and stock at the end is to be calculated.

Solution

In the Books of ...

Dr. Consignment to Jaipur Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c	15,000		By Abnormal Loss A/c (Note 1)	800
	To Cash A/c (Expenses)	1,000		By Consignee A/c (Sales)	16,000
	To Consignee A/c :			By Stock on Consignment A/c (Note 2)	2,445
	Direct expenses	285			
	Indirect expenses	150			
	To Consignee A/c (Commission @ 5%)	800			
	To Profit or Loss on Consignment A/c	2,010			
		19,245			19,245

Working Notes :

(1) Valuation of goods lost in transit	₹	(2) Valuation of goods in hand at the end	₹
Cost of 100 cycles @ ₹ 150 each	15,000	Cost of 100 cycles just before loss in transit	16,000
Add: Non-recurring expenses	1,000	Less: Value of 5 cycles lost in transit	800
Cost of 100 cycles just before lost in transit	16,000	Cost of 95 cycles	15,200
Therefore, value of 5 cycles = ₹ 16,000 / 100 x 5	800	Add: Direct expenses	285
		Total cost of 95 cycles	15,485
		Value of 15 cycles = ₹ 15,485 / 95 x 15	2,445

Illustration 13

Arup consigned 2,000 kg of fine Basmati rice @ ₹ 10 per kg to Sintu. He paid freight ₹ 3,000, dock charges ₹ 2,500 and insurance ₹ 1,500. 800 kg. rice was destroyed in transit due to an accident. Claim admitted by the insurance company was ₹ 4,500. Sintu sold in cash and on credit 1,000 kg. rice @ ₹ 15 per kg. He incurred the following expenses :

Clearing charges ₹ 2,000; Carrying charges ₹ 1,000; Godown rent ₹ 1,200 and Selling expenses ₹ 1,500.

Sintu received commission @ 10% on sales. ₹ 2,000 could not be realised from a debtor.

Show the Consignment Account and determine profit or loss from consignment.

Solution

In the Books of Arup

Dr. Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c	20,000		By Accidental Loss A/c (Note 1)	10,800
	To Bank A/c (Expenses) :			By Sintu A/c (Sales)	15,000
	Freight	3,000		By Stock on Consignment A/c (Note 2)	3,200
	Dock charges	2,500		By Profit and Loss on Consignment A/c	7,200
	Insurance	1,500			
	To Sintu A/c :				
	Commission @ 10%	1,500			
	Bad Debts	2,000			
	Clearing Charges	2,000			
	Carrying Charges	1,000			
	Godown Rent	1,200			
	Selling Expenses	1,500			
		36,200			36,200

Working Notes :

(1) Valuation of goods lost in transit	₹	(2) Valuation of goods in hand at the end	₹
Cost of 2,000 kg rice @ ₹ 10	20,000	Cost of 2,000 kg rice just before loss in transit	27,000
Add: Non-recurring expenses	7,000	Less: Value of 800 kg lost in transit	10,800
Cost of 2,000 kg rice just before loss in transit	27,000	Cost of 1,200 kg after loss in transit	16,200
Value of 800 kg = ₹ 27,000 / 2,000 x 800	10,800	Add: Non-recurring expenses :	
		Clearing charges	2,000
		Carrying charges	1,000
		Total cost of 1,200 kg	19,200
		Value of 200 kg = ₹ 19,200 / 1,200 x 200	3,200

Normal and Abnormal Losses Simultaneously

Illustration 14

(a) A consigned to B 5,000 kg. of tea costing ₹ 40 per kg. A incurred ₹ 3,000 on freight and ₹ 2,000 on insurance. 500 kg of tea were lost in transit. The insurance company admitted the claim for ₹ 15,000. After receiving the goods, B spent ₹ 1,000 on carriage, ₹ 500 on selling and ₹ 500 on godown rent, B was allowed a commission of 5% on sales. 3,000 kg of tea were sold at ₹ 64 per kg. 25 kg of tea were lost due to breakage of a chest which was considered to be normal. Prepare necessary Ledger Accounts in the books of A and B.

(b) Will your answer be different, if in the above example, abnormal loss of 500 kg took place in the consignee's godown by theft—other things remaining the same?

Solution (a)

In the Books of A

Consignment to B Account

Dr. | **Cr.**

Date	Particulars		₹	Date	Particulars	₹
	To Goods sent on Consignment A/c		2,00,000		By Abnormal Loss A/c (Note 1)	20,500
	To Bank A/c - expenses:				By B A/c (sale proceeds) (3000 x ₹ 64)	1,92,000
	Freight	3,000			By Stock on Consignment A/c (Note 2)	61,142
	Insurance	2,000	5,000			
	To B A/c (expenses)					
	Carriage	1,000				
	Selling	500				
	Godown rent	500	2,000			
	To B A/c - commission (5% on ₹ 1,92,000)		9,600			
	To Profit and Loss on Consignment A/c		57,042			
			2,73,642			2,73,642

B Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to B A/c	1,92,000		By Consignment to B A/c - expenses	2,000
				By Consignment to B A/c - commission	9,600
				By Balance c/d (amount due)	1,80,400
		1,92,000			1,92,000

Abnormal Loss Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to B A/c	20,500		By Insurance Company A/c (claim admitted)	15,000
				By Profit and Loss A/c	5,500
		20,500			20,500

Goods sent on Consignment Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Trading A/c - transfer	2,00,000		By Consignment to B A/c	2,00,000

In the Books of B

A Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Bank A/c (expenses)			By Bank A/c (sale proceeds)	1,92,000
	Cartage	1,000			
	Selling	500			
	Godown rent	500			
	To Commission A/c	9,600			
	To Balance c/d (balance due)	1,80,400			
		1,92,000			1,92,000

Working Notes:

1. Calculation of Abnormal Loss

	₹
Cost of 5,000 kgs @ ₹ 40 per kg.	2,00,000
Add: Expenses prior to the loss (₹ 3,000 + 2,000)	5,000
Value of 5,000 kgs	2,05,000

Therefore, value of 500 kg. is
₹ 20,500 (₹ 2,05,000 x 500 ÷ 5,000).

2. **Calculation of Stock on Consignment**

	₹
Value of 5,000 kgs (Note 1)	2,05,000
Less: Abnormal loss of 500 kgs (Note 1)	20,500
Value of the goods received by the consignee	1,84,500
Add: Non-recurring expenses of the consignee (Cartage)	1,000
Total value of the goods sent to the consignee	1,85,500

The consignee received 4,475 kgs (5,000 kgs – 500 kgs abnormal loss – 25 kgs normal loss). Out of that 3,000 kgs sold by him. Therefore, stock in hand is 1,475 kgs (4,475 – 3,000).
Thus, ₹ 1,85,500 / 4,475 x 1,475 = ₹ **61,142**.

Solution (b)

When the abnormal loss of 500 kgs takes place in the consignee's godown (other things remaining the same) the value of abnormal loss and stock on consignment will be different — which are calculated as under:

Ascertainment of Abnormal Loss and Unsold Stock	₹
Value of the goods received by the consignee	2,05,000
Add: Proportionate expenses of the consignee (cartage)	1,000
	2,06,000

The consignee received 4,975 units (5,000 kgs – 25 kgs normal loss)

Therefore, Value of Abnormal Loss = $\frac{2,06,000}{4,975} \times 500$ = ₹ 20,704 (approx.)

Value of Unsold Stock = $\frac{2,06,000}{4,975} \times 1,475$ = ₹ 61,075 (approx.). Profit on consignment will be ₹ 57,179.

Illustration 15

On 1st January, 2015 ITC Ltd. of Calcutta consigned 10,000 kg of Sunflower Oil, costing ₹ 40 per kg to Dinesh & Co. of Delhi. ITC Ltd. paid ₹ 40,000 as freight and insurance. 200 kg of oil were lost on 15.1.2015 in transit. The insurance claim was settled for ₹ 7,500 and was paid to the consignor directly. Dinesh & Co. took delivery of the consignment on 29th January 2015, and accepted a bill drawn upon them by ITC Ltd. for ₹ 2,00,000 for 2 months. On 31st March, 2015 an Account Sales was received from Dinesh & Co. containing the following information:

(i) 8,000 kg were sold @ ₹ 55 per kg.; (ii) Unloading charges ₹ 9,500; (iii) Godown rent ₹ 1,250; (iv) Printing & Advertisement ₹ 10,000; and (v) 200 kg were lost due to leakage which is considered as normal. Dinesh & Co. is entitled to a commission @ 5% on sales. They paid the amount due in respect of the consignment on 31st March itself.

You are required to show: (i) Consignment to Delhi Account; (ii) Dinesh & Co. Account; and (iii) the Loss in Transit Account in the Books of ITC Ltd.

Solution

In the books of ITC Ltd

Dr. Consignment to Delhi Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Goods Sent on Consignment A/c	4,00,000	15.1.2015	By Loss in transit A/c (Note 1)	8,800
	To Cash A/c (Freight & Insurance)	40,000	31.3.2015	By Dinesh & Co A/c (Sales)	4,40,000
31.3.2015	To Dinesh & Co A/c		31.3.2015	By Stock on Consignment A/c (Note 2)	73,450
	Unloading	9,500			
	Godown Rent	1,250			
	Printing & Advertisement	10,000			
31.3.2015	To Dinesh & Co A/c (commission @ 5%)	22,000			
31.3.2015	To Profit & Loss on Consignment A/c	39,500			
		5,22,250			5,22,250

Dr. Dinesh & Co. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Consignment to Delhi A/c	4,40,000	29.1.2015	By Bills Receivable A/c	2,00,000
			31.3.2015	By Consignment to Delhi A/c	20,750
			31.3.2015	By Consignment to Delhi A/c	22,000
			31.3.2015	By Bank A/c	1,97,250
		4,40,000			4,40,000

Dr. Loss in Transit Account Cr.

Date	Particulars	₹	Date	Particulars	₹
15.1.2015	To Consignment to Delhi A/c	8,800	?	By Bank A/c (claim received)	7,500
			31.3.2015	By Profit & Loss A/c	1,300
		8,800			8,800

Working Notes :

(1) Valuation of goods lost in transit	₹	**(2) Valuation of goods in hand at the end**	₹
Cost of 10,000 kg oil @ ₹ 40 per kg	4,00,000	Total cost of 10,000 kg oil	4,40,000
Add: Freight & Insurance upto accident	40,000	Less: Cost of goods destroyed	8,800
Total cost of 10,000 kg oil	4,40,000	Cost of 9,800 kg (10,000 — 200)	4,31,200
Value of 200 kg = ₹ (4,40,000 / 10,000) x 200	8,800	Add: Unloading charges	9,500
		Total cost of 9,800 kg	4,40,700
		Less: Normal Loss 200 kg	—
		Total cost of 9,600 kg	4,40,700
		Therefore, Value of 1,600 Kg. (4,40,700 / 9,600) x 1,600 = ₹ 73,450.	

General Illustrations

Illustration 16

X, whose accounting year ends on 31st May each year, consigned 100 cases of medicine costing ₹ 3,000 each to Y of Madras on 1.4.2015. he paid ₹ 5,000 towards freight and insurance. 15 cases were damaged in transit and on 30.5.2015, the consignor received ₹ 10,000 on account of the damaged cases from the insurance company. Y took delivery of the goods on 10.4.2015 and immediately accepted a bill drawn on him for ₹ 2,00,000 for 60 days.

On 30.5.2015, the consignee reported that : (i) 75 cases were sold at ₹ 4,500 per case; and (ii) he incurred the following expenses : Godown rent ₹ 4,000; Clearing charges ₹ 8,500; Carriage outwards ₹ 3,000. He is entitled to a commission of 10% on the sale proceeds.

Assuming that Y remits the balance by bank draft on 30.5.2015, show the Ledger Accounts in the books of X and the personal account of X in the books of Y.

Solution

In the books of X

Dr. Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015 April 1	To Goods Sent on Consignment A/c	3,00,000	2015 ?	By Abnormal Loss A/c (Note 1)	45,750
	To Bank A/c (freight and insurance)	5,000	May 30	By Y A/c (Sales)	3,37,500
May 30	To Y A/c		"	By Stock on Consignment A/c (Note 2)	31,500
	Godown rent	4,000			
	Clearing charges	8,500			
	Carriage outwards	3,000			
	Commission - 10%	33,750			
"	To Profit & Loss on Consignment A/c	60,500			
		4,14,750			4,14,750

Dr. Abnormal Loss Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
?	To Consignment A/c	45,750	May 5	By Bank A/c (Insurance claim)	10,000
			May 31	By Profit & Loss A/c	35,750
		45,750			45,750

Dr. Y Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
May 30	To Consignment A/c	3,37,500	Apr. 4	By Bills Receivable A/c	2,00,000
			May 30	By Consignment A/c (expenses and comm.)	49,250
			"	By Bank A/c (remittances)	88,250
		3,37,500			3,37,500

Dr. Bills Receivable Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Apr. 4	To Y A/c	2,00,000	June 7	By Bank Receivable A/c	2,00,000

Dr. Goods Sent on Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
May 30	To Purchases A/c	3,00,000	April 1	By Consignment A/c	3,00,000

In the books of Y

Dr. X Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Apr. 4	To Bills Payable A/c	2,00,000	?	By Bank A/c	3,37,500
?	To Bank A/c (expenses)	15,500			
May 30	To Commission Received A/c	33,750			
"	To Bank A/c (remittances)	88,250			
		3,37,500			3,37,500

Working Notes :

(1) Valuation of Goods Damaged in Transit	₹	(2) Valuation of Closing Stock	₹
Cost of 100 cases @ ₹ 3,000	3,00,000	Total cost of 100 cases	3,05,000
Add: Freight & Insurance upto accident	5,000	Less: Cost of goods damaged	45,750
Total cost of 100 cases	3,05,000	Cost of 85 cases (100 – 15)	2,59,250
Value of 15 cases	45,750	Add: Clearing charges	8,500
		Total Value of 85 cases	2,67,750
		Value of 10 cases	31,500

Illustration 17

Ramesh consigned 2,000 metric tonne of chemicals at a cost of ₹ 800 per metric tonne to John. Ramesh paid freight and insurance charges of ₹ 20,000. Of the above, 500 metric tonne of chemicals were destroyed by fire during transit. John cleared the balance of 1,500 metric tonne of chemicals and sold 1,000 metric tonne at an average price of ₹ 1,000 per metric tonne John incurred the following expenses : Godown rent ₹ 5,000; Insurance ₹ 3,000; and Clearing charges ₹ 4,500. Insurance claim received against fire ₹ 4,00,000 after admitting the salvage value of stock destroyed by fire at ₹ 10,000. John was entitled to a commission of 10% on sale proceeds. John sends the balance to Ramesh after adjusting his commission and expenses out of the sales proceeds.

Prepare a Consignment Account and John's Account in the books of Ramesh.

Solution **In the books of Ramesh**

Dr. **Consignment to John Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c	16,00,000		By Abnormal Loss A/c (Note 1)	3,95,000
	To Bank A/c (Freight and Insurance)	20,000		By John A/c (Sales)	10,00,000
	To John A/c (Total Expenses)	12,500		By Stock on Consignment A/c (Note 2)	4,16,500
	To John A/c (Commission)	1,00,000			
	To Profit & Loss on Consignment A/c	79,000			
		18,11,500			18,11,500

Dr. **John Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to John A/c	10,00,000		By Consignment to John A/c (Expenses)	12,500
				By Consignment to John A/c (Commission)	1,00,000
				By Bank A/c (Final payment)	8,87,500
		10,00,000			10,00,000

Working Notes :

(1) Valuation of Abnormal Loss	₹	(2) Value of Closing Stock	₹
Cost of goods sent (2,000 mt.)	16,00,000	Total cost of goods sent (2,000 mt.)	16,20,000
Add: Non-recurring expenses upto the accident	20,000	Less: Abnormal Loss	4,05,000
Total cost of goods sent (2,000 mt.)	16,20,000	Value of the goods received by John	12,15,000
Therefore, value of abnormal loss (₹ 16,20,000 / 2,000 x 500)	4,05,000	Add: Non-recurring expenses of John (clearing charges)	4,500
Less: Salvage Value	10,000	Total cost of goods received by John (1,500 mt.)	12,19,500
Actual value of Abnormal Loss	3,95,000	Therefore, value of closing stock (₹ 12,19,500 / 1,500 x 500)	4,06,500
		Add: Salvage value of damaged stock	10,000
			4,16,500

Illustration 18

Messrs Goswami Brothers were appointed agents by Sunrise Limited in 2001. You are given the following particulars relating to the year 2014-15 :

(i) Cost of goods despatched by the Company on consignment ₹ 7,50,000.

(ii) Goods fully destroyed in transit (original cost) ₹ 50,000.

(iii) Expenses incurred by the company towards : Freight ₹ 2,500; Insurance ₹ 1,500.

(iv) Expenses incurred by Goswami Brothers :
Landing and clearing ₹ 1,500; Godown rent ₹ 1,000; Transport charges ₹ 1,000; Advertisement ₹ 800; Insurance ₹ 800.

(v) Advance remitted by the Agent ₹ 1,50,000.

(vi) Bills payable accepted ₹ 25,000.

(vii) Goods destroyed by fire (at original cost) in Agent's godown ₹ 35,000.

(viii) Bad debts ₹ 3,000.

(ix) Unsold stock with Agent at the close of the year (at original cost) ₹ 50,000.
(x) Insurance claim recovered by the consignor towards loss in transit ₹ 48,000.
(xi) Insurance claim recovered by the consignee towards loss by fire ₹ 35,000.

All sales were affected by the Agent at 25% on original cost. He is entitled to a commission of 10% on gross sales.

You are required to show the Consignor's Account (Sunrise Ltd.) as would appear in the books of Goswami Brothers.

Solution

In the books of Goswami Brothers

Dr. Sunrise Ltd. Account Cr.

Date	Particulars		₹	Date	Particulars	₹
	To Bank A/c (Advance)		1,50,000		By Bank A/c - Sales (Note 1)	7,68,750
	To Bills Payable A/c		25,000		By Bank A/c - Insurance claim	35,000
	To Bank A/c - expenses :					
	Landing and clearing	1,500				
	Godown rent	1,000				
	Transport charges	1,000				
	Advertisements	800				
	Insurance	800	5,100			
	To Commission A/c		76,875			
	To Balance c/d - amount due		5,46,775			
			8,03,750			8,03,750

Working Note : (1) Calculation of Sale Proceeds

Particulars		₹	
Cost of the goods sent		7,50,000	
Less : Goods lost-in-transit	50,000		Sales were made at 25% of original cost. Therefore, sales are
Goods lost-in-godown	35,000		= ₹ 6,15,000 + 25% of ₹ 6,15,000 = ₹ **7,68,750**.
Unsold stock	50,000	1,35,000	
Cost of goods sold		6,15,000	

Illustration 19

A of Calcutta sent on Consignment basis goods to B of Bombay at an invoice price of ₹ 29,675 and paid for freight ₹ 762, cartage ₹ 231 and insurance ₹ 700. Half the goods were sold by the agents for ₹ 17,500 subject to an agent's commission of ₹ 875, storage expenses of ₹ 200 and other selling expenses of ₹ 350. One-fourth of the consignment was lost in a fire and a claim of ₹ 5,000 recovered.

Draw up the necessary accounts in the books of A and ascertain the profit or loss assuming the closing stock to be one-fourth of the consignment. The agent reported that rest of the goods were also damaged and would need ₹ 700 for repairs.

Solution

In the books of A

Dr. Consignment to Bombay Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c	29,675		By B A/c (sale proceeds)	17,500
	To Bank A/c			By Abnormal Loss A/c	7,842
	Freight	762		By Stock on Consignment A/c	7,842
	Cartage	231		By Profit & Loss on Consignment A/c	309
	Insurance	700			
	To B A/c				
	Storage	200			
	Selling expenses	350			
	Commission	875			
	To Provision for repairs A/c	700			
		33,493			33,493

Dr. B Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Bombay A/c	17,500		By Consignment to Bombay A/c	1,425
				By Balance c/d	16,075
		17,500			17,500

Dr. Goods Sent on Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Trading A/c (transfer)	29,675		By Consignment to Bombay A/c	29,675

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

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Bombay A/c	7,842		By Bank A/c (claim)	5,000
				By Profit & Loss A/c	2,842
		7,842			7,842

Tutorial Note: : To repair the damaged stock, an expense of ₹ 700 will be incurred. Therefore, we would make a provision of that amount by debiting 'Consignment Account' and crediting 'Provision for Repairs Account'—applying the concept of conservatism, 'anticipate no profit but provide for all possible losses.' In the Balance Sheet, the stock will appear as :

Stock on Consignment	₹ 7,842
Less: Provision for Repairs	₹ 700
	₹ 7,142

When the actual expenses will be incurred, we will pass the following entry:

Provision for Repairs Account	Dr.	700	
To Cash Account			700

Illustration 20

Star Mills Ltd. Surat, sends regular consignments of yarn to X who is the selling agent of the Mill and is entitled to a commission of 10 paise per kg of yarn sold. This includes del credere commission. The following further information is furnished to you:

On 1st July, 2014, stock of yarn with the agent 20,000 kg costing ₹ 50,000.

During the year ended 30th June, 2015 :

Total quantity of yarn consigned 1,60,000 kg. at ₹ 3 per kg

Total quantity of yarn sold 1,50,000 kg at ₹ 3.75 per kg including the opening stock of 20,000 kg.

Total remittances by the agent ₹ 5,10,000.

Railway freight paid by the agent ₹ 40,000.

Of the sales made, X could not collect ₹ 11,000 due to the insolvency of the customer.

5,000 kg of yarn were damaged in transit by the railway for which the agent recovered ₹ 6,000. The damaged goods were sold at the rate of ₹ 1.50 per kg. Show the following Ledger Accounts in the books of Star Mills Ltd for the year ended 30th June, 2015: (a) Consignment Account; (b) Goods Damaged in Transit Account; and (c) X Account.

[I.C.W.A. (Inter) — Adapted]

Solution

In the books of Star Mills Ltd

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

Date	Particulars	₹	Date	Particulars	₹
1.7.2014	To Stock on Consignment A/c	50,000	30.6.2015	By X A/c (sales)	5,62,500
	To Goods Sent on Consignment A/c	4,80,000	"	By Goods Damaged in Transit A/c	16,250
30.6.2015	To X A/c		"	By Stock on Consignment A/c	81,250
	Railway freight	40,000			
	Commission	15,000			
"	To Profit & Loss on Consignment A/c	75,000			
		6,60,000			6,60,000

Dr. **Goods Damaged in Transit Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
30.6.2015	To Consignment A/c	16,250	30.6.2015	By X A/c (amount recovered from Railway)	6,000
"	To X A/c (commission)	500	"	By X A/c (sale of damaged goods)	7,500
			"	By Profit & Loss A/c (Abnormal loss)	3,250
		16,750			16,750

Dr. **X Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
30.6.2015	To Consignment A/c	5,62,500	30.6.2015	By Consignment A/c	40,000
"	To Goods Damaged in Transit A/c	6,000	"	By Consignment A/c (commission)	15,000
"	To Goods Damaged in Transit A/c	7,500	"	By Goods Damaged in Transit A/c	500
			"	By Bank A/c (Remittance)	5,10,000
			"	By Balance c/d	10,500
		5,76,000			5,76,000

Working Notes : Valuation of Goods Damaged in Transit	₹
Cost of goods sent	4,80,000
Add: Railway freight	40,000
Total cost of 1,60,000 kg	5,20,000

Therefore, 1. The value of 5,000 kg damaged goods = (₹ 5,20,000 / 1,60,000) x 5,000 = ₹ 16,250;

2. The value of closing stock (25,000 kg) = (₹ 5,20,000 / 1,60,000) x 25,000 = ₹ 81,250.

Illustration 21

A consigned to B on 1st January, 2015, 500 bales of cotton costing ₹ 100 per bale. Freight charges incurred in the consignment were ₹ 5,000. A drew a bill on B for ₹ 50,000 payable on 30th June, 2015 which B accepted. The bill was discounted by A with his banker on 31st January, 2015 at 12% p.a.

B rendered Account Sales to A on 31st March, 2015 showing sales of 300 bales for ₹ 80,000 and selling expenses of ₹ 5,000. B's commission was 10%. On this date, B remitted to A net amount due to him.

On 31st May, 2015 B sold the balance stock for ₹ 30,000 after incurring expenses of ₹ 4,000. He remitted ₹ 20,000 to A, the balance being treated as commission earned by him. On 30th June, 2015 the bill accepted by B was dishonoured by him and the amount due to the bank was paid off by A along with incidental charges of ₹ 200.

Pass journal entries in the books of A (including bank transactions).

Solution

In the books of A

Journal

Date	Particulars		Dr. ₹.	Cr. ₹.
2015 Jan 1	Consignment to B A/c To Goods Sent on Consignment A/c (Being 500 bales of cotton sent to B on consignment @ ₹ 100 per bale as per proforma invoice No ...)	Dr.	50,000	50,000
	Consignment to B A/c To Bank A/c (Being freight charges incurred on the consignment to B)	Dr.	5,000	5,000
	Bills Receivable A/c To B A/c (Being a bills drawn on B for 6 months)	Dr.	50,000	50,000
Jan 31	Bank A/c Discount on Bills A/c To Bills Receivable A/c (Being bills receivable of B discounted @ 12% p.a. for 5 months)	Dr. Dr.	47,500 2,500	50,000
Mar 31	B A/c To Consignment to B A/c (Being sale of 300 bales of cotton as per Account Sales)	Dr.	80,000	80,000
	Consignment to B A/c To B A/c (Being expenses incurred by B ₹ 5,000 and commission payable to him ₹ 8,000 as per Account Sales)	Dr.	13,000	13,000
	Bank A/c To B A/c (Being the amount received from B in settlement of sales to date after adjusting bill receivable expenses and commission)	Dr.	17,000	17,000
May 31	B A/c To Consignment to B A/c (Being sale of remaining goods as per Account Sales)	Dr.	30,000	30,000
	Consignment A/c (see note) To B A/c ₹ (4000 + 6000) (Being expenses and commission payable to B)	Dr.	10,000	10,000
	Bank A/c To B A/c (Being the amount received from B in full settlement)	Dr.	20,000	20,000
	Consignment to B A/c To Profit & Loss on Consignment A/c (Being the profit on consignment transferred)	Dr.	32,000	32,000
June 30	B A/c To Bank A/c (Being the bill accepted by B dishonoured and incidental charges ₹ 200 paid)	Dr.	50,200	50,200

Note: Total sales ₹ 30,000 and expenses ₹ 4,000. So net proceeds = (₹ 30,000 – 4,000) = ₹ 26,000, but the amount sent by B is ₹ 20,000. The balance of ₹ 6,000 should be treated as commission.

Illustration 22

Sri Mehta of Bombay consigns 1,000 cases of goods costing ₹ 100 each to Sri Sundaram of Madras. Sri Mehta pays the following expenses in connection with the consignment: carriage ₹ 1,000; freight ₹ 3,000; and loading charges ₹ 1,000.

Sri Sundaram sells 700 cases at ₹ 140 per case and incurs the following expenses : clearing charges ₹ 850; warehousing and storage ₹ 1,700; and packing and selling expenses ₹ 600. It is found that 50 cases have been lost in transit and 100 cases are still in transit. Sri Sundaram is entitled to a commission of 10% on gross sales. Draw up Consignment Account and Sundaram Account in the books of Mehta.

Solution

In the books of Mehta

Dr. Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c	1,00,000		By Sundaram A/c (sales)	98,000
	To Cash A/c			By Abnormal Loss A/c	5,250
	Carriage	1,000		By Stock on Consignment A/c	15,900
	Freight	3,000		By Stock in Transit A/c	10,500
	Loading charges	1,000			
	To Sundaram A/c				
	Clearing charges	850			
	Warehousing & storage	1,700			
	Packing and selling	600			
	Commission	9,800			
	To Profit & Loss on Consignment A/c	11,700			
		1,29,650			1,29,650

Dr. Sundaram Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Consignment A/c	98,000		By Consignment A/c (expenses)	3,150
				By Consignment A/c (commission)	9,800
				By Balance c/d	85,050
		98,000			98,000

Working Notes :

(1) Valuation of Abnormal Loss	₹	(3) Valuation of Closing Stock	₹
Cost of 1,000 cases @ ₹ 100 each	1,00,000	Total cost of 1,000 cases	1,05,000
Add: Non recurring expenses upto accident	5,000	Less : Cost of 50 cases lost in transit	5,250
Total cost of 1,000 cases	1,05,000		99,750
Therefore, value of 50 cases = ₹ (1,05,000 / 1,000) x 50 =	5,250	Less: Cost of 100 cases still in transit	10,500
(2) Valuation of Stock in Transit	₹	Cost of 850 cases	89,250
Total cost of 1,000 cases (as above)	1,05,000	Add: Non recurring expenses of consignee (clearing charge)	850
Therefore, value of 100 cases (₹ 1,05,000 / 1,000) x 100 =	10,500	Total cost of 850 cases	90,100
		Therefore, value of 150 cases = (₹ 90,100 / 850) x 150 =	15,900

Overriding Commission

It is an extra commission which, in addition, to the ordinary commission is allowed by the consignor to the consignee. This commission is normally granted in case sales exceed a specified amount. It can also be an incentive to the consignee for creating market for a new product.

Illustration 23

On 1.10.2013, S Mittal of Faridabad sent on consignment to S Bros of Kolkata 100 boxes of goods costing ₹ 1,200 each and incurred ₹ 4,600 as freight, ₹ 300 as cartage and ₹ 600 as insurance in consigning the goods.

S Bros accepted a bill on 12.10.2013 at 3 months for 60% of the normal selling price of goods and S Mittal discounted the bill on 15.11.2013 at a discount of 12% p.a. The normal selling price was cost plus 45%.

S Bros had incurred ₹ 1,500 as unloading charges, ₹ 700 as godown rent and ₹ 1,600 as selling expenses. He was entitled to a commission @ 6% on normal selling price plus 20% of any surplus over and above the normal selling price.

He reported that 3/5th of the goods received had been sold for ₹ 1,16,400 and 10 boxes of goods were damaged on account of bad packing which would be sold only for ₹ 725 per box. It was found that 10 boxes of goods were still in transit on 31.12.2013 when the accounts of the consignor were closed. The amount due to S Mittal was remitted by a bank draft. Prepare necessary accounts in the books of S Mittal.

Solution

In the books of S Mittal

Dr. Consignment to Kolkata Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013			2013		
Oct. 1	To Goods Sent on Consignment A/c	1,20,000	Dec. 31	By S Bros A/c (Sale proceeds)	1,16,400
	To Bank A/c (Expenses) :			By Goods in Transit A/c (Note 1)	12,550
	Freight	4,600		By Stock on Consignment A/c (Note 2) :	
	Cartage	300		Good boxes	33,063
	Insurance	600		Damaged boxes	6,815

Dec. 31	To S Bros A/c :				
	Unloading charges	1,500			
	Godown rent	700			
	Selling expenses	1,600			
	Commission (Note 3)	10,126			
	To Profit and Loss on Consignment A/c	29,402			
		1,68,828			1,68,828

Dr. **S Brothers Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013			2013		
Dec. 31	To Consignment to Kolkata A/c	1,16,400	Oct. 12	By Bills Receivable A/c (Note 5)	1,04,400
"	To Balance c/d (Note 4)	31,494	Dec. 31	By Consignment to Kolkata A/c :	
				Unloading charges	1,500
				Godown rent	700
				Selling expenses	1,600
				Commission	10,126
			"	By Bank A/c	29,568
		1,47,894			1,47,894

Dr. **Goods Sent on Consignment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013			2013		
Dec. 31	To Purchases A/c (Transfer)	1,20,000	Oct. 1	By Consignment to Kolkata A/c	1,20,000
		1,20,000			1,20,000

Dr. **Goods in Transit Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013			2013		
Dec. 31	To Consignment to Kolkata A/c	12,550	Dec. 31	By Balance c/d	12,550
		12,550			12,550

Dr. **Stock on Consignment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013			2013		
Dec. 31	To Consignment to Kolkata A/c :		Dec. 31	By Balance c/d	39,878
	Good boxes	33,063			
	Damaged boxes	6,815			
		39,878			39,878

Working Notes :

(1) Calculation of Goods in Transit

	₹
Cost price of 10 boxes	12,000
Add: Proportionate expenses of the consignor (₹ 5,500 × 10 / 100)	550
Value of goods in transit	12,550

(2) Out of 100 boxes sent, 10 boxes are still in transit at the year end. Therefore, number of boxes received by the consignee is 100 – 10 = 90 boxes. The consignee sold 3/5th of 90 boxes = 54 boxes. Therefore, boxes in hand is calculated as :

damaged boxes	10 boxes
good boxes (36 – 10)	26 boxes
	36 boxes

Calculation of Stock on Consignment (good boxes)

	₹
Cost of 26 boxes (26 × ₹ 1,200)	31,200
Add: Proportionate expenses of the consignor (₹ 5,500 / 100 × 26)	1,430
Add: Proportionate non-recurring expenses of the consignee (₹ 1,500 / 90 × 26)	433
Value of stock on consignment (good boxes)	33,063

Calculation of Stock on Consignment (damaged boxes)

Sales value of 10 boxes (10 × ₹ 725)	7,250
Less: Ordinary commission payable (6% on ₹ 7,250)	435
Value of stock on consignment (damaged boxes)	6,815

(3) Calculation of Commission

Normal selling price per unit = Cost price + 45% of cost price = ₹ 1,200 + 45% of ₹ 1,200 = ₹ 1,740

Ordinary commission (6% on 54 × ₹ 1,740)	5,638
Special commission [20% on (₹ 1,16,400 – 54 × 1,740)]	4,488
	10,126

(4) It is assumed that the bill was drawn as an advance against the security of the goods sent. Therefore, the advance will be adjusted proportionately, which is calculated as under :

60% of (26 × ₹ 1,740 + 10 × ₹ 725) = ₹ 31,494.

(5) Amount of the bill = 60% of (₹ 1,740 × 100) = ₹ 1,04,400.

(6) Discounting charges of the bill is a financial charge. It should be debited in the Profit and Loss Account.

Illustration 24

X of Calcutta sent 80 machines to Y of Bombay on 1st January, 2014 on the following terms:

1. All the machines were to be sold 25% above the cost price of ₹ 20,000 each. Any deficit in selling price was to be borne by Y and 50% of the surplus selling price was to be retained by him.
2. Y would get 3% commission and 2% Del Credere commission on all sales. X incurred transport charges of ₹ 80,000. Y sent Account Sales on 31st December, 2014 as: (i) 20 machines sold for ₹ 24,000 each; (ii) 40 machines sold for ₹ 30,000 each; (iii) 5 machines sold for ₹ 25,000 each. (iv) Unloading charges ₹ 8,000; and (v) Selling expenses ₹ 5,000. Y sent a bank draft for the net amount due to X along with the Account Sales.

On 30th June, 2015 Y sent a further Account Sales as: (a) 5 machines sold for ₹ 22,000 each; (b) 10 machines sold for ₹ 40,000 each and sent a bank draft for the amount due.

X closed its books on 31st December each year. Prepare Ledger Accounts in the books of X.

Solution

In the books of X

Dr. Consignment to Bombay Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Goods Sent on Consignment A/c	16,00,000	31.12.2014	By Y A/c (sales)	18,05,000
"	To Bank A/c (transport charges)	80,000	"	By Stock on Consignment A/c (Note 3)	3,16,500
31.12.2014	To Y A/c : Unloading	8,000			
	Selling expenses	5,000			
	Commission (Note 2)	1,70,250			
"	To Profit & Loss on Consignment A/c	2,58,250			
		21,21,500			21,21,500
1.1.2015	To Stock on Consignment A/c	3,16,500	30.6.2015	By Y A/c (sales)	5,10,000
"	To Y A/c (commission) (Note 2)	85,500			
"	To Profit & Loss on Consignment A/c	1,08,000			
		5,10,000			5,10,000

Dr. Y Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Consignment to Bombay A/c	18,05,000	31.12.2014	By Consignment to Bombay A/c	13,000
			"	By Consignment to Bombay A/c	1,70,250
			"	By Bank A/c	16,21,750
		18,05,000			18,05,000
30.6.2015	To Consignment to Bombay A/c	5,10,000	30.6.2015	By Consignment to Bombay A/c	85,500
			"	By Bank A/c	4,24,500
		5,10,000			5,10,000

Working Notes :

(1) Minimum selling price = Cost + 25% Profit on cost = ₹ 20,000 + 5,000 = ₹ 25,000

(2) Calculation of Commission

	₹
2014 5% on Sales proceeds of ₹ 18,05,000	90,250
50% of surplus realization : 40 × (₹ 30,000 – ₹ 25,000)	1,00,000
	1,90,250
Less: Deficit in selling price : 20 × (₹ 25,000 – 24,000)	20,000
	1,70,250
2015 5% on Sales proceeds of ₹ 5,10,000	25,500
50% of surplus realization : 10 × (₹ 40,000 – 25,000)	75,000
	1,00,500
Less: Deficit in selling price : 5 × (25,000 – 22,000)	15,000
	85,500

(3) Valuation of Closing Stock

Particulars	₹.	
Cost price of 80 machines	16,00,000	Therefore, value of closing stock
Add : Non-recurring expenses (₹ 80,000 + ₹ 8,000)	88,000	= ₹ 16,88,000 / 80 x 15 = ₹ 3,16,500.
Total Cost	16,88,000	

Illustration 25

X of Calcutta sent on15th January, 2015, a consignment of 500 bicycles costing ₹ 100 each to Y of Bombay Expenses of ₹ 700 were met by the consignor. Y of Bombay spent ₹ 1,500 for clearance and the selling expenses were ₹ 10 per bicycle.

Y sold on 4th April, 2015, 300 bicycles @ ₹ 160 each and again on 20th June, 2015, 150 bicycles @ ₹ 172 each.

Y was entitled to a commission of ₹ 25 per bicycle sold plus one-fourth of the amount by which gross sale proceeds, less total commission thereon, exceeded a sum calculated @ ₹ 125 per bicycle sold. Y sent the amount due to X on 30th June, 2015. You are to show necessary accounts in the books of X.

Solution

In the books of X

Dr. Consignment to Y Account Cr.

Date	Particulars	₹	Date	Particulars	₹
15.1.2015	To Goods Sent on Consignment A/c	50,000	30.6.2015	By Y A/c (sales)	73,800
"	To Bank A/c (expenses)	700	"	By Consignment Stock A/c	5,220
30.6.2015	To Y A/c				
	Clearance	1,500			
	Selling expenses	4,500			
	Commission (Note 1)	12,510			
"	To Profit & Loss on Consignment A/c	9,810			
		79,020			79,020

Dr. Y Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.6.2015	To Consignment to Y A/c	73,800	30.6.2015	By Consignment to Y A/c	6,000
			"	By Consignment to Y A/c	12,510
			"	By Bank A/c	55,290
		73,800			73,800

Working Notes: (1) Calculation of Commission

Let total commission payable to Y = X

x = [(450 x 25) + 1/4 {(73,800 – x) – (450 x 125)}]

or x = 11,250 + 1/4 (73,800 – 56,250 – x)

or x = 11,250 + 1/4 (17,550 – x)

or x = 11,250 + 4,387.5 – 1/4x or x+1/4x = 15,637.5 or 5x = 62,550 or x = ₹ 12,510.

(2) Valuation of Closing Stock

	₹
Cost @ ₹ 100 =	50,000
Add: Non recurring exp (700 + 1,500)	2,200
Cost of 500 bicycles	52,200
Therefore, cost of 50 bicycles	5,220

Return of Goods from the Consignee

Owing to wrong policy, it is quite possible that some part of the goods may be returned by the consignee to the consignor. When goods are returned, the consignor passes the following entry:

Goods Sent on Consignment Account Dr.
To Consignment to ... Account

When goods are returned, there will definitely be some expenses. These expenses will be paid either by the consignor or by the consignee. ***The problem arises whether the expenses incurred should be charged to the Consignment Account or not.***

Some accountants say that since the expense are related to the consignment, it should be charged to the Consignment Account. Others argue that the expenses on returning the goods are not expenses for the consignment, rather it is a policy cost, so it should be charged to General Profit and Loss Account in place of Consignment Account.

In examinations, the expenses on returning the goods are generally charged to the Consignment Account.

The consignor passes the following entry:

Consignment to ... Account Dr.
To Cash/Bank Account [when paid by consignor]
To Consignee Account [when paid by the consignee]

Illustration 26

On 1.4.2014 Mr Doshi of Darjeeling consigned 2,000 kg of tea costing ₹ 60 per kg. to Mr. Naik of Nagpur. Mr Doshi incurred the following expenses: Freight ₹ 2,000; insurance ₹ 400 and sundry expenses ₹ 600.

During the year ended 31.3.2015, Mr. Naik incurred the following expenses: Freight ₹ 600; godown rent ₹ 500 and carriage to godown ₹ 1,000. On 1.12.2014 Mr. Naik sold 1,200 kg of tea for cash at a profit of 25% on sales. On 15.12.2014, Mr. Naik returned 150 kg. of tea, which were of poor quality to Mr. Doshi and paid returned freight and carriage charges of ₹ 250. Out of the remaining tea, 200 kg being partially damaged were valued at 30% less than cost. Mr. Naik charged his commission at 5% and the balance so far due from him to Mr. Doshi on 31.3.2015. Mr Doshi closes his books every year on 31st March.

You are required to prepare the following accounts in the books of Mr Doshi:

(a) Consignment to Nagpur Account; (b) Goods Sent on Consignment Account; (c) Personal Account of Mr Naik.

Solution

In the books of Mr Doshi

Dr. Consignment to Nagpur Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Goods Sent on Consignment A/c	1,20,000	1.12.2014	By Naik A/c (Sales)	96,000
"	To Bank A/c		15.12.2014	By Goods Sent on Consignment A/c	9,000
	Freight	2,000		By Abnormal Loss A/c (Note 1)	4,420
	Insurance	400	31.3.2015	By Stock on Consignment A/c	
	Sundry expenses	600		Good units	27,900
15.12.2014	To Mr Naik A/c (Freight & carriage return)	250		Damaged units	7,980
31.3.2015	To Mr Naik A/c				
	Freight	600			
	Godown rent	500			
	Carriage to godown	1,000			
	Commission	4,800			
"	To Profit & Loss on Consignment A/c	15,150			
		1,45,300			1,45,300

Dr. Mr Naik Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.12.2014	To Consignment to Nagpur A/c	96,000	31.12.2014	By Consignment to Nagpur A/c	250
			31.3.2015	By Consignment to Nagpur A/c	6,900
			"	By Bank A/c (remittance)	88,850
		96,000			96,000

Dr. Goods Sent on Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
15.12.2014	To Consignment to Nagpur A/c	9,000	1.4.2015	By Consignment to Nagpur A/c	1,20,000
31.3.2015	To Trading A/c	1,11,000			
		1,20,000			1,20,000

Working Notes :

(1) Valuation of Abnormal Loss		₹	(2) Valuation of Closing Stock	₹
Cost of 200 kg @ ₹ 60 per kg		12,000	Cost of 450 kg @ ₹ 60 per kg	27,000
Add: 1/10 (2,000 + 400 + 600 + 1,000) non recurring exp.		400	Add: Proportionate non recurring exp. (4,000 / 2,000) x 450	900
		12,400	(i) Value of good quality tea	27,900
Less: Estimated value			(ii) Value of damaged quality tea	7,980
Cost	12,000		Value of closing stock	35,880
Less: 30%	3,600			
	8,400			
Less: Commission @ 5%	420	7,980		
Abnormal Loss		4,420		

Invoice Price Method

Sometimes, the consignor may prefer to send goods to the consignee at a higher price than the cost price and, accordingly, prepares the 'Proforma Invoice' by adding some profit on cost or on sales. For example, C of Calcutta consigned 100 cases of goods to D of Delhi on 1st January, 2015. The cost per case is ₹ 500. The Proforma Invoice was made to show a 20% profit on cost.

Here, Proforma Invoice will be prepared @ ₹ 600 (₹ 500 + 20% of 500) per case and the Consignment Account will be debited with ₹ 60,000 though the actual cost of goods is ₹ 50,000.

The goods are charged to the consignee not at cost but at higher price with a view

(i) to keep the profit on consignment secret;

(ii) to give incentive to the consignee to realize the highest possible price; and

(iii) to make him charge a uniform price.

The method of preparation of accounts is the same as in the *cost price method*, except for a few adjustments which are explained below. ***Journal Entries*** are as under:

1. For sending goods to the consignee

Consignment to .... Account	Dr.	
To Goods Sent on Consignment Account		(Invoice value of goods sent)

2. For payment of expenses by the consignor

Consignment to ... Account	Dr.	
To Cash/Bank Account		(If paid)
To Creditors for Expenses Account		(If unpaid)

3. For receipts of advance from the consignee

(a) When payment is received in cash or bank draft

Cash or Bank Account	Dr.
To Consignee Account	

(b) When a bill is accepted by the consignee

Bills Receivable Account	Dr.
To Consignee's Account	

4. For Abnormal Loss

Abnormal Loss Account	Dr.
To Consignment to ... Account	

5. For closing Abnormal Loss Account

Insurance Claim Account	Dr. [claim admitted]
Consignment Account	Dr. [loading on goods lost]
Profit and Loss Account	Dr. [balance]
To Abnormal Loss Account	

6. When Account Sales is received from the consignee

Immediately after receiving the Account Sales, the consignor will pass the following entries:

(a) For sale of goods by the consignee

Consignee Account	Dr. (Gross sales Proceeds)
To Consignment to ... Account	

(b) For expenses incurred by the consignee

Consignment to ... Account	Dr.
To Consignee Account	

(c) For commission of the Consignee

Consignment to ... Account	Dr.
To Consignee Account	

(d) For receiving remittance from the consignee

Bank Account	Dr.
To Consignee Account	

7. For bringing down the value of goods sent to its cost

Goods sent on Consignment Account	Dr. (Difference between Invoice value and cost)
To Consignment to ... Account	

8. For stock on consignment

Stock on Consignment Account	Dr. (Proportionate Invoice value plus proportionate
To Consignment to ... Account	non recurring expenses)

9. For adjusting value of Closing Stock

Consignment to ... Account	Dr. (Total loading / Total qty x Unsold qty)
To Stock Reserve Account	

10. The profit should be calculated in the usual manner

(a) For profit on consignment

Consignment to ... Account Dr.
  To Profit and Loss on Consignment Account

(b) For loss on consignment

Profit and Loss on Consignment Account Dr.
  To Consignment to ... Account

11. The balance of the 'Goods sent on Consignment Account' should be transferred to Trading Account (If the consignor is a manufacturer) or to a Purchases Account (if the consignor is a trader).

12. The balance of the 'Stock on Consignment Account' and 'Stock Reserve Account' should be carried down on the respective side of the account. In the Balance Sheet Stock on Consignment Account should be shown on the assets side and Stock Reserve should be shown by way of deduction from stock on consignment.

Balance Sheet as at ....

Liabilities	₹	Assets	₹
		Stock on Consignment Less: Stock Reserve	**** ****

13. At the beginning of the next accounting year, the balance of the Stock on Consignment Account will be transferred to the debit side of the Consignment Account and the Stock Reserve will be transferred to the credit side of the Consignment Account.

Illustration 27

Tilak of Tatanagar consigned goods costing ₹ 2,00,000 to his agent Pulak of Patna. The invoice was made pro-forma so as to show a profit of 25% on cost. Tilak paid freight and insurance ₹ 4,000. Pulak sold part of the consignment for ₹ 1,76,000 at a uniform price of 10% over invoice price and spent ₹ 6,000 as warehousing charges and ₹ 2,000 as selling expenses. Pulak is entitled to a commission of 5% on sales and 20% of the net profit after charging commission on sales. Draw up the Consignment Account in the books of Tilak.

Solution

In the books of Tilak

Dr. **Consignment to Patna Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c (Note 1)	2,50,000		By Goods Sent on Consignment A/c	50,000
	To Bank A/c (freight and insurance)	4,000		By Pulak A/c (Sale proceeds)	1,76,000
	To Pulak A/c :			By Stock on Consignment A/c (Note 2)	91,440
	Warehousing Charges	6,000			
	Selling Expenses	2,000			
	Commission (5% on ₹ 1,76,000)	8,800			
	To Stock Reserve A/c (Note 3)	18,000			
	To Profit c/d	28,640			
		3,17,440			3,17,440
	To Pulak A/c (Share of Profit — 20% on ₹ 28,640)	5,728		By Profit b/d	28,640
	To Profit and Loss on Consignment A/c	22,912			
		28,640			28,640

Working Notes :

1. Invoice price = Cost price + 25% profit on cost (loading) = ₹ 2,00,000 + ₹ 50,000 = ₹ 2,50,000.

2. Valuation of Stock on Consignment

	₹
Invoice price of the goods sent	2,50,000
Less: Invoice price of the goods sold (₹ 1,76,000 / 110 × 100)	1,60,000
Invoice price of the stock on consignment	90,000
Add: Proporationate non-recurring expenses (₹ 4,000 × 90,000 / 2,50,000) — Freight and Insurance	1,440
	91,440

3. Loading on Stock on Consignment = ₹ 90,000 × 25 / 125 = ₹ 18,000.

Illustration 28

On 1st January, 2014 Seth Bros. of Kandla consigned 200 cycles to Panigrahi & Sons of Paradeep. Each cycle costing ₹ 800. The goods were charged at a proforma invoice price to show a 25% profit on cost. On the same date, the consignor paid ₹ 4,000 as freight and insurance. On 30th April, the consignee sent a bank draft for ₹ 1,00,000 to the consignor as advance. On 31st December, 2014 the consignee sent an Account Sale informing that 180 cycles have been sold for ₹ 1,200 each. They have incurred the following expenses in respect of the consignment: (i) Unloading charges ₹ 1,000; (ii) Cycle fitting charges ₹ 2,000; and (iii) Godown rent ₹ 4,200. With the Account Sale the consignee sent a remittance for the balance due to the consignor after deducting commission of 5% on gross sale proceeds.

You are required to show necessary Ledger Accounts in the books of Seth Bros and Seth Bros Account in the books of Panigrahi & sons.

Solution

In the books of Seth Bros

Dr. Consignment to Paradeep Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Goods Sent on Consignment A/c	2,00,000	31.12.2014	By Panigrahi & Sons A/c (sale proceeds)	2,16,000
"	To Bank A/c (freight & insurance)	4,000	"	By Goods Sent on Consignment A/c (loading)	40,000
31.12.2014	To Panigrahi & Sons A/c		"	By Stock on Consignment A/c (Note 5)	20,700
	Unloading charges	1,000			
	Cycle Fitting charges	2,000			
	Godown rent	4,200			
	Commission @ 5%	10,800			
"	To Stock Reserve A/c	4,000			
"	To Profit & Loss on Consignment A/c	50,700			
		2,76,700			2,76,700

Dr. Goods Sent on Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Consignment to Paradeep A/c	40,000	1.1.2014	By Consignment to Paradeep A/c	2,00,000
	To Trading A/c	1,60,000			
		2,00,000			2,00,000

Dr. Stock on Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Consignment to Paradeep A/c	20,700	31.12.2014	By Balance c/d	20,700
1.1.2015	To Balance b/d	20,700	1.1.2015	By Consignment to Paradeep A/c	20,700

Dr. Panigrahi & Sons Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Consignment to Paradeep A/c	2,16,000	31.12.2014	By Advance Against Consignment A/c	1,00,000
			"	By Consignment to Paradeep A/c	18,000
			"	By Bank A/c (final payment)	98,000
		2,16,000			2,16,000

Dr. Stock Reserve Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Balance c/d	4,000	31.12.2014	By Consignment to Paradeep A/c	4,000
1.1.2015	To Consignment to Paradeep A/c	4,000	1.1.2015	By Balance b/d	4,000

Dr. Advance Against Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Panigrahi & Sons A/c	1,00,000	30.4.2014	By Bank A/c	1,00,000

Working Notes :

1. Invoice Price = Cost price + 25% profit on cost = ₹ 800 + ₹ 200 = ₹ 1,000;

2. Loading per cycle = Invoice price – Cost price = ₹ 1,000 – 800 = ₹ 200;

3. Total Loading = 200 x 200 = ₹ 40,000;

4. Loading on Unsold stock = (₹ 40,000 / 200) x 20 = ₹ 4,000;

5. Valuation of Closing Stock

	₹
Invoice price of goods sent	2,00,000
Add: Freight & insurance : 4,000 + Unloading charges : 1,000 + Fitting charges : 2,000	7,000
Value of 200 cycles at Invoice price	2,07,000

Therefore, value of 20 unsold cycles = ₹ 20,700.

6. Advance of ₹ 1,00,000 has not been treated as security on goods sent.

In the books of Panigrahi & Sons

Dr. Seth Bros Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Bank A/c		2014 ?	By Bank A/c (sales)	2,16,000
	Unloading charges	1,000			
	Fitting charges	2,000			
	Godown rent	4,200			
	To Commission Received A/c	10,800			
31.12.2014	To Advance Against Consignment A/c	1,00,000			
	To Bank A/c (final payment)	98,000			
		2,16,000			2,16,000

Dr. Advance Against Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.4.2014	To Bank A/c	1,00,000	31.12.2014	By Seth Bros. A/c	1,00,000

Invoice Price—Memorandum Column Method

When goods are sent at a proforma invoice price this method may be used for writing up the Consignment Account and Goods sent on Consignment Account. This method is a modification of the cost price method. Under this method, Consignment Account is provided with an additional column in which memorandum entries in respect of invoice value of goods consigned, amount of sales and value of unsold stock are recorded. This memorandum column is meant only for information and the profit or loss on consignment will not be affected. *The solution of the previous illustration under this method is given below:*

Dr. Consignment to Paradeep Account Cr.

Date	Particulars	Memo	Amount	Date	Particulars	Memo	Amount
1.1.2014	To Goods Sent on Consignment A/c	2,00,000	1,60,000	31.12.2014	By Panigrahi & Sons A/c	2,16,000	2,16,000
	To Bank A/c (freight)	4,000	4,000		By Stock A/c	20,700	16,700
31.12.2014	To Panigrahi & Sons A/c						
	Unloading	1,000	1,000				
	Fitting charges	2,000	2,000				
	Godown rent	4,200	4,200				
	Commission	10,800	10,800				
	To Profit & Loss on Consignment A/c	14,700	50,700				
		2,36,700	2,32,700			2,36,700	2,32,700

Dr. Goods Sent on Consignment Account Cr.

Date	Particulars	Memo	Amount	Date	Particulars	Memo	Amount
31.12.2014	To Purchases A/c	2,00,000	1,60,000	1.1.2014	By Consignment to Paradeep A/c	2,00,000	1,60,000

It should be noted that the memo column may be added and balanced but the profit or loss disclosed by that column is immaterial. The actual profit or loss will be disclosed by amount column of the Consignment Account. Other accounts will appear as usual, so these accounts have not been shown.

Illustration 29

Goods at an invoice value of ₹ 1,32,000 were consigned by Choudhury & Co. of Calcutta to their agent Gupta & Co. of Allahabad at a proforma invoice of 20% profit on cost.

Freight paid by the consignor amounted to ₹ 5,000. Gupta & Co. was allowed 5% ordinary commission and 3% del credere commission on gross sales. They were also allowed 5% of the net profits as extra commission after charging such commission. Allahabad expenses were : landing and clearing charges ₹ 1,020, godown insurance premium ₹ 2,500.

3/4th of the goods were sold at 25% profit on sales, 1/10th of the balance of goods were destroyed by fire and a claim for ₹ 8,500 was settled by the insurance company.

Prepare Consignment Account, Gupta & Co. Account, Stock Destroyed Account and Consignment Stock Account in the books of Choudhury & Co.

Solution

In the books of Choudhury & Co.

Dr. Consignment to Allahabad Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c	1,32,000		By Goods Sent on Consignment A/c (loading)	22,000
	To Bank A/c (freight)	5,000		By Gupta & Co. A/c (sales)	1,10,000
	To Gupta & Co. A/c :			By Stock Destroyed A/c (invoice price)	3,450
	Landing charges	1,020		By Consignment Stock A/c	31,055
	Godown insurance premium	2,500			
	Commission (8% on ₹ 1,10,000)	8,800			
	To Stock Destroyed A/c (loading)	550			
	To Gupta & Co. A/c (extra commission)	556			
	To Stock Reserve A/c	4,950			
	To Profit & Loss on Consignment A/c	11,129			
		1,66,505			1,66,505

Dr. Gupta & Co. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Consignment Stock A/c	1,10,000		By Consignment to Allahabad A/c	12,320
				By Consignment to Allahabad A/c	556
				By Balance c/d	97,124
		1,10,000			1,10,000

Dr. Stock Destroyed Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Allahabad A/c (I.P.)	3,450		By Consignment to Allahabad A/c (loading)	550
	To Profit & Loss A/c	5,600		By Insurance Company A/c (Note 6)	8,500
		9,050			9,050

Dr. Consignment Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Allahabad A/c	31,055		By Balance c/d	31,055

Working Notes : (1) Loading on Goods Sent	₹	**(2) Calculation of Sales**	
Invoice price of goods sent	1,32,000	Cost price of goods sent (₹ 1,32,000 – 22,000)	1,10,000
Loading is 1/5th on cost, or, 1/6th of invoice price, i.e. **22,000**		Sales = ₹ 1,10,000 x 3/4 x 4/3 = **1,10,000**	
(3) Valuation of Goods Destroyed and Closing stock	₹	**(4) Calculation of Loading on Stock Destroyed and Unsold Stock**	
Invoice price of goods sent	1,32,000	Total loading	32,000
Add: Consignor's expenses	5,000	Loading on stock destroyed = 1/40 x ₹ 22,000	550
Consinee's expenses (Non-recurring)	1,020	Loading on unsold stock = 9/40 x ₹ 22,000	4,950
	1,38,020	**(5) Extra Commission**	
3/4th of the goods are sold. Therefore, balance remains 1/4th Goods destroyed 1/4 x 1/10 = 1/40		Profit before special commission = ₹ 11,685. Therefore extra commission is = 5/105 x ₹ 11,685	556
Invoice price of goods destroyed = 1/40 x ₹ 1,38,200	3,450	**(6)** In practice, insurance company compensates the policy-holder to the extent of actual loss. Actual loss is ₹ 2,900 but in the question, it is given that claim admitted by the insurance company is ₹ 8,500, which in our opinion is not correct.	
Closing stock 1/4 x 9/10 = 9/40 Invoice price of unsold stock = 9/40x ₹ 1,38,020	31,055		

Illustration 30

Calcutta Ayurvedic Ltd. produces a bottle of "Draksharista" at a cost of ₹ 10. They appointed Madras Medical Stores of Madras as their agent on the terms that the agent would get commission @ 10% on invoice price of goods sold and also an extra commission at 25% on any excess amount realised over invoice price.

On 1.7.2014, Calcutta Ayurvedic Ltd. sent 50 boxes of "Draksharista" each box containing 50 bottles at invoice price showing a profit of $33^1/_3$% on such invoice price. They spent ₹ 3,000 for freight and ₹ 2,000 for insurance. 5 boxes were completely destroyed in transit and insurance claim of ₹ 2,300 was realised from the insurance company. The agent took delivery of the remaining goods and spent ₹ 2,000 for duty and ₹ 1,000 for freight to carry the goods to the rented godown. He also sent a Bill of Exchange for ₹ 20,000 payable after 2 months to the consignor as advance.

At the end of the year, the agent reported that 40 boxes were sold at ₹ 18 per bottle and 1 box of goods was lost due to bad packaging. This would be treated as normal loss. The agent remitted a bank draft for the net amount after deducting his commission, advance money, godown rent ₹ 800 and selling expense ₹ 200.

On 1.1.2015, Calcutta Ayurvedic Ltd. discounted the bill of ₹ 20,000 for ₹ 19,800. On 1.3.2015, bank informed that the bill was dishonoured. Calcutta Ayurvedic Ltd. demanded the entire amount along with an additional amount of ₹ 200 as interest. The Madras agent sent a bank draft for the amount on 15.3.2015.

You are asked to show the following Ledger Accounts in the books of the consignor : (a) Consignment to Madras Account; (b) Madras Medical Stores Account; (c) Consignment Stock Account; (d) Consignment Stock Destroyed Account; (e) Consignment Stock Reserve Account.

Solution

In the books of Calcutta Ayurvedic Limited

Dr. Consignment to Madras Account Cr.

Date	Particulars		₹	Date	Particulars	₹
2014 July 1	To Goods Sent on Consignment A/c		37,500	2014 July 1	By Goods Sent on Consignment A/c (Loading)	12,500
?	To Cash A/c :			?	By Consignment Stock Destroyed A/c (Note 2)	4,250
	Freight	3,000		Dec. 31	By Madras Medical Stores A/c (Sales)	36,000
	Insurance	2,000	5,000	"	By Consignment Stock A/c (Note 4)	3,750
Dec. 31	To Madras Medical Stores A/c :					
	Duty	2,000				
	Freight	1,000				
	Godown rent	800				
	Selling	200				
	Commission (Note 1)	4,500	8,500			
"	To Consignment Stock Destroyed A/c (Note 3)		1,250			
"	To Consignment Stock Reserve A/c (Note 5)		1,023			
"	To Profit & Loss on Consignment A/c		3,227			
			56,500			56,500

Dr. Madras Medical Stores Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Consignment to Madras A/c	36,000	2014 Dec. 31	By Advance against Consignment A/c	20,000
			"	By Consignment to Madras A/c (exp. + comm.)	8,500
			"	By Bank A/c (remittance)	7,500
		36,000			36,000
2015 Mar. 1	To Bank A/c (bill dishonoured)	20,000	2015 Mar. 15	By Bank A/c (final remittance)	20,200
	To Interest Received A/c	200			
		20,200			20,200

Dr. Consignment Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Consignment to Madras A/c	3,750	2014 Dec. 31	By Balance c/d	3,750

Dr. Consignment Stock Destroyed Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 ?	To Consignment to Madras A/c (Invoice price)	4,250	2014 ?	By Consignment to Madras A/c (loading)	1,250
			?	By Bank A/c (insurance claim)	2,300
				By Profit & Loss A/c (abnormal loss)	700
		4,250			4,250

Dr. Consignment Stock Reserve Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Balance c/d	1,023	2014 Dec. 31	By Consignment to Madras A/c	1,023

Dr. Advance Against Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Madras Medical Stores A/c	20,000	2014 July 1	By Bills Receivable A/c	20,000

Working Notes :

(1) Calculation of Commission	₹	**(2) Valuation of Abnormal Loss at Invoice Price**	₹
Sales at invoice price (40 x 50 x ₹ 15)	30,000	Invoice price of the goods sent	37,500
Ordinary commission (10% on ₹ 30,000)	3,000	Add : Expenses of the consignor	5,000
Extra commission 25% of ₹ (36,000 – 30,000)	1,500	Invoice price of 50 boxes	42,500
Total commission	4,500	Value of abnormal loss — 5 boxes (₹ 42,500 / 50 x 5)	4,250
(3) Loading on Abnormal Loss	₹	**(4) Valuation of Closing Stock at Invoice Price**	₹
Total loading on goods sent	12,500	Value of the goods sent at invoice price (Note 2)	42,500
Loading on abnormal loss 12,500 / 50 x 5	1,250	Less: Value of abnormal loss at invoice price	4,250

(5) Loading on Closing Stock	₹	Invoice price of 45 boxes	38,250
Total loading	12,500	Add: Expenses of the consignee (non-recurring)	3,000
Less: Loading on abnormal loss	1,250	Total value of the goods at invoice price (44 boxes)	41,250
	11,250	Value of closing stock 41,250 / 44 x 4	3,750
Loading on closing stock 11,250 / 44 x 4	1,023		

Illustration 31

The Account Sales of 1,200 transistor sets received from and sold on account of and the risk of Sri U. Chopra, Kolkata.

Particulars		₹	₹
1,200 Transistor sets @ ₹ 1,200			14,40,000
Less : Expenses :	₹		
Unloading expenses	3,000		
Selling Expenses	4,000		
Transport Charges	6,100		
Godown Rent	6,000		
Advertisements	2,000	21,100	
Less: Commission :			
5% Ordinary Commission	72,000		
1% Del Credere Commission	14,400	86,400	1,07,500
			13,32,500
Less : Advance sent on 10.1.2015			2,50,000
			10,82,500
Bank draft enclosed; Stock in hand (31.3.2015) — 100 sets			E. & O. E.
Dated, Madras, the 26th April, 2015			S. Raman

On further information you come to know that :

(i) Bad Debts amounted to ₹ 2,400 against 2 sets;

(ii) 20% above the invoice price is the sale price which is equal to cost plus 50%;

(iii) Chopra incurred forwarding expenses @ ₹ 10 per set; and

(iv) During transit 10 sets became fully damaged and Chopra recovered from insurance the full amount of the original cost.

You are required to prepare the Consignment Account, Goods Sent on Consignment Account and Loss in Transit Account in the books of Chopra.

Solution

In the books of Mr. Chopra

Dr. Consignment to Madras Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c (Note 1)	13,10,000		By Goods Sent on Consignment A/c - loading	2,62,000
	To Bank A/c — forwarding expenses	13,100		By Loss in Transit A/c	10,100
	To S. Raman A/c — expenses :			By S. Raman A/c	14,40,000
	Unloading expenses 3,000			By Stock on Consignment A/c	1,01,230
	Selling expenses 4,000			100 x ₹ 1,000 1,00,000	
	Transport charges 6,100			100 x ₹ 10 1,000	
	Godown rent 6,000			3,000 / 1,300 230	
	Advertisements 2,000	21,100		1,01,230	
	To S. Raman A/c - Commission: ₹				
	5% Ordinary 72,000				
	1% Del Credere 14,400	86,400			
	To Loss in Transit A/c - Loading (₹ 200 x 10)	2,000			
	To Stock Reserve A/c (₹ 200 x 100)	20,000			
	To Profit & Loss on Consignment A/c	3,60,730			
		18,13,330			18,13,330

Dr. Goods Sent on Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Madras A/c	2,62,000		By Consignment to Madras A/c	13,10,000
	To Purchases A/c - transfer	10,48,000			
		13,10,000			13,10,000

Dr. **Loss in Transit Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Madras A/c	10,100		By Consignment to Madras A/c (Loading)	2,000
				By Bank A/c - Insurance claim (Note 2)	8,000
				By Profit and Loss A/c	100
		10,100			10,100

Working Notes :

(1) Sale price of each set is ₹ 1,200 (₹ 14,40,000 ÷ 1,200). Therefore, invoice price of each set is ₹ 1,000 (₹ 1,200 × 100 ÷ 120). Invoice price of (1,200 + 100 + 10) 1,310 sets is 1,310 × ₹ 1,000 = ₹ 13,10,000. Cost plus 50% = Selling price. Therefore, cost price of each transistor = ₹ 1,200 / 150 x 100 = ₹ 800. Loading per set = ₹ 1,000 – ₹ 800 = ₹ 200.

(2) It is assumed that the original cost does not include forwarding expenses of ₹ 10 per set.
The original cost will be 10 x ₹ 800 = ₹ 8000

Illustration 32

Rahim of Bombay consigned to Raju of Madras goods to be sold at invoice price which represents 125% of cost. Raju is entitled to a commission of 10% on sales at invoice price and 25% of any excess realised over invoice price. The expenses on freight and insurance incurred by Rahim were ₹ 10,000. The account sales received by Rahim shows that Raju effected sales aggregating to ₹ 1,00,000 in respect of 75% of the consignment. His selling expenses to be reimbursed were ₹ 8,000, 10% of the consignment goods of the value of ₹ 12,500 were destroyed by fire at the Madras godown and the insurance company paid ₹ 12,000 net of salvage. Raju remitted the balance in favour of Rahim. Prepare the Consignment Account and the account of Raju in the books of Rahim along with necessary working.

[C.A. (Foundation) — Adapted]

Solution

In the books of Rahim

Dr. **Consignment to Madras Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c (Note 1)	1,25,000		By Goods Sent on Consignment A/c (Loading)	25,000
	To Bank A/c (freight & insurance)	10,000		By Raju A/c (Sales)	1,00,000
	To Raju A/c (Expenses — selling)	8,000		By Abnormal Loss A/c (Note 2)	13,500
	To Raju A/c — Commission (Note 4)	10,938		By Stock on Consignment A/c (Note 3)	20,250
	To Stock Reserve A/c (Note 5)	3,750		By Profit and Loss on Consignment A/c	1,438
	To Abnormal Loss A/c (Note 6)	2,500			
		1,60,188			1,60,188

Dr. **Raju Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Madras A/c — Sales	1,00,000		By Consignment to Madras A/c (Selling Exp.)	8,000
				By Consignment to Madras A/c (Commission)	10,938
				By Bank A/c (Final payment)	81,062
		1,00,000			1,00,000

Working Notes :

(1) The value of 10% of the goods destroyed by fire is ₹ 12,500.
Therefore, the invoice value of the goods sent is ₹ 12,500 / 10% = ₹ 1,25,000.

(2) Valuation of Abnormal Loss	₹
Value of stock lost by fire	12,500
Add: Proportionate expenses upto fire (10% of ₹ 10,000)	1,000
Value of abnormal loss at invoice price	13,500

(3) Valuation of Stock on Consignment	₹
Invoice value of unsold stock (15% of ₹ 1,25,000)	18,750
Add: Proportionate non-recurring expenses (15% of ₹ 10,000)	1,500
	20,250

(4) Calculation of Commission	₹
Sale proceeds (75% of Consignment)	1,00,000
Less: Invoice value of sale proceeds (75% of ₹ 1,25,000)	93,750
Excess sale proceeds received over invoice price	6,250
Therefore, commission is :	
(1) @ 10% on sales in invoice price	9,375
(2) @ 25% on excess sale proceeds	1,563
	10,938

(5) Calculation of Stock Reserve	₹
Total loading on goods sent	25,000
Therefore, loading on closing stock is 15% of ₹ 25,000	3,750

(6) Loading on Abnormal Loss	₹
Total loading on goods sent	25,000
Therefore, loading on goods lost by fire (10%)	2,500

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

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Madras A/c	13,500		By Bank A/c — claim received	12,000
	To Profit and Loss A/c	1,000		By Consignment to Madras A/c (Loading)	2,500
		14,500			14,500

Illustration 33

Tanya Motors of Delhi purchased 50 used Maruti cars for ₹ 50,00,000. Out of these, 30 cars were sent on consignment to Hari Motors of Kanpur at a selling price of ₹ 1,20,000 per car. The consignor paid ₹ 60,000 in sending the cars to Kanpur. Hari Motors sold 25 cars for ₹ 33,00,000. Hari Motors incurred ₹ 30,000 as the selling expenses. Out of the remaining 5 cars, Hari Motors kept one car for their personal use at an agreed price of ₹ 1,25,000. 2 cars got damaged and were sold for ₹ 2,00,000 only. Owing to fall in market price of old cars, the value of remaining cars in stock be reduced by 10%. Tanya Motors sold 20 cars at Delhi for ₹ 25,00,000. Hari Motors is entitled to 5% commission on sales.

Prepare the Consignment Account, Trading and Profit and Loss Account of Tanya Motors and the account of Tanya Motors in the books of the consignee, Hari Motors.

[C.A. (PE-1) — Adapted]

Solution

In the books of Tanya Motors

Dr. Consignment to Kanpur Account Cr.

Date	Particulars	₹	Date	Particulars		₹
	To Goods Sent on Consignment A/c	36,00,000		By Goods Sent on Cosignment A/c (Loading)		6,00,000
	To Bank A/c (expenses)	60,000		By Hari Motors A/c (sale proceeds) :		
	To Hari Motor A/c :			25 good cars	33,00,000	
	Selling expenses	30,000		1 car taken over	1,25,000	
	Commission (5% on ₹ 36,25,000)	1,81,250		2 damaged cars	2,00,000	36,25,000
	To Stock Reserve A/c (Note 1)	73,000		By Stock on Consignment A/c (Note 1)		2,44,000
	To Profit and Loss on Consignment A/c	5,24,750				
		44,69,000				44,69,000

Dr. Trading, and Profit and Loss Account for the year ended . . . Cr.

Particulars	₹	Particulars	₹
To Purchases A/c (₹ 50,00,000 – 30,00,000)	20,00,000	By Sales A/c	25,00,000
To Gross Profit c/d	5,00,000		
	25,00,000		25,00,000
To Net Profit	10,24,750	By Gross Profit b/d	5,00,000
		By Profit and Loss on Consignment A/c	5,24,750
	10,24,750		10,24,750

In the books of Hari Motors

Dr. Tanya Motors Account Cr.

Date	Particulars	₹	Date	Particulars		₹
	To Bank A/c (Selling expenses)	30,000		By Cash A/c (Sale proceeds) :		
	To Commission Received A/c	1,81,250		25 good cars	33,00,000	
	To Balance c/d	34,13,750		2 damaged cars	2,00,000	35,00,000
				By Drawings A/c (car taken over)		1,25,000
		36,25,000				36,25,000

Working Note :

(1) Valuation of Stock on Consignment and Stock Reserve

		₹
Invoice price of 2 cars (₹ 1,20,000 × 2)		2,40,000
Add: Proportionate non-recurring expenses (₹ 60,000 / 30 × 2)		4,000
Value of Stock at Invoice price		2,44,000
Less: Net realisable value of stock :		
Market price (₹ 90,000* × 2)	1,80,000	
Less: 5% Commission**	9,000	1,71,000
Stock Reserve		73,000

* Original cost = ₹ 1,00,000 less 10% = ₹ 90,000.

** Applying the concept of conservatism, all other possible expenses to be incurred in selling those goods are to be provided for, which will include the commission payable to the consignee.

Illustration 34

P of Calcutta consigned goods costing ₹ 45,000 to Q of Delhi. The invoice was made so as to show a profit of 33-$^{1}/_{3}$% on cost. P paid ₹ 300 as carriage and ₹ 1,200 as freight and insurance. Goods costing ₹ 5,000 were destroyed in transit and the insurance company admitted the full claim.

In Delhi Q paid ₹ 240 as carriage and ₹ 600 as godown rent. Two-thirds of the goods received by Q were sold by him. Q sent a cheque to P for the sale proceeds after deducting the expenses incurred by him and the commission due to him — ordinary 5% and del credere $2^1/_2$%.

Show the Consignment Account and Q Account in P's Ledger.

Solution

In the books of P

Dr. Consignment to Delhi Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c	60,000		By Q A/c (sales) (Note 2)	35,556
	To Bank A/c			By Abnormal Loss A/c (invoice price)	6,833
	Carriage	300		By Goods Sent on Consignment A/c (loading)	15,000
	Freight and Insurance	1,200		By Stock on Consignment A/c (Note 3)	18,302
	To Q A/c				
	Carriage	240			
	Godown Rent	600			
	Commission	2,667			
	To Abnormal Loss A/c (loading) (Note 5)	1,667			
	To Stock Reserve A/c (loading)	4,444			
	To Profit & Loss on Consignment A/c	4,573			
		75,691			75,691

Dr. Q Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Delhi A/c	35,556		By Consignmet to Delhi A/c	3,507
				By Bank A/c (balance received)	32,049
		35,556			35,556

Working Notes :

(1) Valuation of Abnormal Loss	₹
Invoice price of goods sent	60,000
Add: Expenses of consignor prior to loss	1,500
Value of goods sent at invoice price	61,500
Value of Abnormal Loss : (61,500 / 45,000) x 5,000	6,833

(2) Calculation of Sale Proceeds	₹
Cost price of goods sent	45,000
Less: Cost of goods lost	5,000
Cost of goods reached to Consignee	40,000
Add: Loading — 33-1/3% of 40,000	13,333
Invoice price of goods received	53,333
Sales : 2/3 (₹ 53,333)	35,556

(3) Valuation of Stock on Consignment	
Invoice price of goods sent	60,000
Add: Expenses of consignor	1,500
	61,500
Less: Abnormal loss (Note 1)	6,833
	54,667
Add: Expenses of the consignee after loss (non-recurring)	240
Total value of goods at invoice price	54,907
Value of unsold goods (1/3rd of goods received)	18,302

(4) Loading on Goods Lost

$$= \frac{Rs\ 15{,}000}{Rs\ 45{,}000} \times Rs\ 5{,}000 = ₹\ \mathbf{1{,}667}$$

(5) Loading on Unsold Stock	
1/3 (₹ 15,000 — ₹ 1,667)	4,444

Dr. Abnormal Loss Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Delhi A/c	6,833		By Consignment to Delhi A/c (loading)	1,667
				By Insurance Co A/c (claim admitted)	5,166
		6,833			6,833

Illustration 35

On 1st July, 2014, M of Madras consigned goods to the value of ₹ 50,000 to P of Patna. This was made by adding 25% on the cost. M paid ₹ 2,500 for freight and ₹ 1,500 for insurance. During transit 1/10th of the goods was totally destroyed by fire and a sum of ₹ 2,400 was realised from the insurance company.

On arrival of the goods, P paid ₹ 1,800 as carriage to godown. During the year ended 30th June, 2015, P paid ₹ 3,600 for godown rent and ₹ 1,900 for selling expenses. 1/9th of the remaining goods were again destroyed by fire in godown and nothing was recovered from the insurance company. Upto 30th June, 2015, P sold half of the original goods for ₹ 30,000 and charged a commission of 5% on sales. On 30th June, 2015, P sent a bank draft to M for the amount so far due from him. You are required to prepare Consignment Account in the books of M of Madras for the year ended 30th June, 2015.

Solution

In the books of M

Dr. Consignment to Patna Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.7.2014	To Goods Sent on Consignment A/c	50,000	1.7.2014	By Goods Sent on Consignment A/c (loading)	10,000
	To Bank A/c :			By Abnormal Loss A/c (during transit : Note 1)	5,400
	Freight	2,500	30.6.2015	By P A/c (Sales)	30,000
	Insurance	1,500	30.6.2015	By Abnormal Loss A/c (in godown : Note 2)	5,600
	To Abnormal Loss A/c (loading : Note 1)	1,000	30.6.2015	By Stock on Consignment A/c (Note 3)	16,800
30.6.2015	To P A/c :				
	Carriage	1,800			
	Godown rent	3,600			
	Selling expenses	1,900			
	Commission	1,500			
30.6.2015	To Abnormal Loss A/c (loading : Note 2)	1,000			
30.6.2015	To Stock Reserve A/c (loading : Note 3)	3,000			
		67,800			67,800

Working Notes :

(1) Valuation of Abnormal Loss in Transit

	₹
Invoice price of goods sent	50,000
Add: Expenses of the consignor prior to loss (₹ 2,500 + 1,500)	4,000
Value of goods sent at invoice price	54,000

Value of abnormal loss at invoice price = 1/10th of ₹ 54,000 = ₹ 5,400.

The insurance claim received will not affect the Consignment Account. It will be shown in the Abnormal Loss Account. The difference between the cost and insurance claim received will be transferred to Profit and Loss Account.

Loading on Abnormal Loss in Transit

Total loading = ₹ (50,000 – 40,000) = ₹ 10,000.

Loading on abnormal loss = 10% on ₹ 10,000 = ₹ **1,000**.

(2) Valuation of Abnormal Loss in Godown

	₹
Value of goods sent at invoice price (Note 1)	54,000
Less: Abnormal loss in transit (Note 1)	5,400
Value of goods received by the consignee	48,600
Add: Expenses of consignee (non-recurring) prior to loss	1,800
Value of goods prior to loss	50,400

Value of abnormal loss at invoice price = 1/9th of ₹ 50,400 = ₹ **5,600**.

Loading on Abnormal Loss in Godown

	₹
Total loading	10,000
Less: Loading on abnormal loss in transit	1,000
Loading on goods received by the consignee	9,000

Loading on abnormal loss in godown = 1/9th of ₹ 9,000 = ₹ **1,000**.

(3) Valuation of Stock on Consignment

Let, the consignor sent 100 units. 10% lost in transit. Therefore, consignee received 90 units. Out of that 1/2 of the original goods sold, i.e., 50 units. Destroyed in transit 10 units (1/9th of 90 units). Therefore, stock in hand [100 – (10 + 10 + 50)] = **30 units**.

Valuation of stock at invoice price = ₹ 50,400 / 90 × 30 = ₹ **16,800**.

Stock reserve = ₹ 10,000 / 100 × 30 = ₹ **3,000**.

Illustration 36

Modern Breweries of Bombay consigned 5000 litres of liquor to Saha Brothers of Calcutta on 1st February, 2015. The goods are charged at a Proforma Invoice value of ₹ 2,00,000 including profit of 20% on invoice. Modern Breweries paid ₹ 5,000 as freight and insurance charges.

During transit 200 litres were destroyed for which the insurance company paid directly to the consignor ₹ 5,000 in full settlement of the claim.

On 25th February, Saha Brothers paid for carriage and clearing charges ₹ 3,100 and sent to the consignor a bank draft for ₹ 40,000 as security. Other expenses paid by the consignee were godown rent ₹ 1,200 and salesman's salary ₹ 900. Saha Brothers were entitled to a commission of 4% plus 2% del credere on sales.

On 31st March, 2015 Saha Brothers reported that 4,000 litres were sold at ₹ 1,65,000 and 50 litres were lost due to evaporation. A customer who bought liquor for ₹ 1,500 was able to pay 40% of the amount due from him.

Assuming that Saha Brothers paid the amount by a bank draft, show the Consignment Account and Saha Bros Account, Advance Against Consignment Account in the books of Modern Breweries.

On the date of closing the accounts, market price of liquor was ₹ 33.50 per litre.

Solution

In the books of Modern Breweries Ltd

Dr. Consignment to Calcutta Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.2.2015	To Goods Sent on Consignment A/c	2,00,000	25.2.2015	By Goods Sent on Consignment A/c	40,000
"	To Cash A/c (freight & insurance)	5,000	"	By Abnormal Loss A/c (invoice price)	8,200
31.3.2015	To Saha Bros A/c		31.3.2015	By Saha Bros A/c (sales)	1,65,000
	Carriage	3,100	"	By Stock on Consignment A/c (Note 2)	31,563
	Godown rent	1,200			
	Salesman salary	900			
	Ordinary commission	6,600			
	Del credere commission	3,300			
"	To Abnormal Loss A/c (loading)	1,600			
"	To Stock Reserve A/c	7,946			
"	To Profit & Loss on Consignment A/c	15,117			
		2,44,763			2,44,763

Dr. Saha Bros Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Consignment to Calcutta A/c	1,65,000	31.3.2015	By Advance Against Consignment A/c	34,000
			"	By Consignment to Calcutta A/c (Expenses)	5,200
			"	By Consignment to Calcutta A/c (Commission)	9,900
			"	By Bank A/c (balance paid)	1,15,900
		1,65,000			1,65,000

Dr. Advance Against Consignment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Saha Bros. A/c	34,000	25.2.2015	By Bank A/c	40,000
"	To Balance c/d (Note 6)	6,000			
		40,000			40,000

Working Notes :

(1) Valuation of Abnormal Loss	₹	**(2) Valuation of Closing Stock**		₹
Invoice price of 5,000 litres	2,00,000	Value of 5,000 litres at invoice price		2,05,000
Add: Freight & insurance before accident	5,000	Less: Value of 200 litres at invoice price		8,200
Value of 5,000 litres at invoice price	2,05,000	Value of 4,800 litres at invoice price		1,96,800
Value of 200 litres (₹ 2,05,000 / 5,000) x 200	8,200	Add: Carriage & clearance paid by consignee		3,100
(3) Loading on Goods Sent		Value of (4,800 – 50) = 4,750 litres at invoice price		1,99,900
1/5 (₹ 2,00,000)	40,000	Value of 750 litres (₹1,99,900 / 4,750) x 750		31,563
(4) Loading on Abnormal Loss		Less: Market price (₹ 33.5 x 750)	25,125	
(40,000 / 5,000) x 200	1,600	Less: Commission @ 6%	1,508	23,617
		Stock Reserve		7,946

(5) Liquor in Stock	₹
Sent out (in litres)	5,000
Lost in transit	200
	4,800
Less: Normal loss	50
	4,750
Less: Sold	4,000
Closing Stock	750

(6) Adjustment for Security

Security for 5,000 litres is ₹ 40,000.

So, security for 750 litres = ₹ 6,000.

Correction of Errors

We know that goods sent on consignment is not a sale but sometimes it is recorded as sales in the consignor's books by debiting the Consignee Account and crediting the Sales Account. For correction, the following entry should be passed:

When goods were sent at cost price

	Entries already passed		Correcting Entries
(1)	**For Goods sent** (a) Consignee A/c Dr. (cost price) To Sales/Goods A/c	(1)	**For Goods sent** (a) Sales/Goods A/c Dr. (cost price) To Consignee A/c
			(b) Consignment A/c Dr. (cost price) To Goods Sent on Consignment A/c

	OR (b) Consignee A/c Dr. (cost price) To Goods Sent on Consignment A/c		OR (b) Consignment A/c Dr . (cost price) To Consignee A/c
(2)	**For Goods sold by consignee** Bank A/c Dr. To Consignee A/c	(2)	**For Goods sold by consignee** Consignee A/c Dr. To Consignment A/c
(3)	**For closing stock** Nil	(3)	**For closing stock** Stock on Consignment A/c Dr. To Consignment A/c

When goods were sent at invoice price

	Entries already passed		Correcting Entries
(1)	**For Goods sent** (a) Consignee A/c Dr. (invoice price) To Sales A/c OR (b) Consignee A/c Dr. (invoice price) To Goods Sent on Consignment A/c	(1)	**For Goods sent** (a) Sales A/c Dr. (invoice price) To Consignee A/c (b) Consignment A/c Dr. (invoice price) To Goods Sent on Consignment A/c OR (b) Consignment A/c Dr. (invoice price) To Consignee A/c
(2)	**For Goods sold by consignee** Bank A/c Dr. (sales value) To Consignee A/c	(2)	**For Goods sold by consignee** Consignee A/c Dr. (sales value) To Consignment A/c
(3)	**For closing stock** Nil	(3)	**For closing stock** Stock on Consignment A/c Dr. (invoice price) To Consignment A/c
		(4)	**For Loading on Goods sent** Goods Sent on Consignment A/c Dr. To Consignment A/c
		(5)	**For Loading on Unsold goods** Consignment A/c Dr. To Stock Reserve

Illustration 37

In the Sales Ledger of XY Goods Co, the following account appears :

Dr. **Ram** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 May 10	To Goods To Expenses	12,000 720	2015 July 5 July 31	By Cash By Balance c/d	5,000 7,720
		12,720			12,720

Upon enquiry you find that the debit to Ram of ₹ 12,000 represented goods costing ₹ 10,000 delivered to him on the understanding that he will try to sell them in his own make, or otherwise return them. For this he is to be allowed a commission of 10 per cent on all sales effected, out of which he is to defray the expenses that he may incur.

On 31st July, 2015 when XY Goods Co make up their annual accounts, it is learnt that Ram has sold half the goods at the prices at which they were invoiced to him but is doubtful about his ability to sell the remaining. He, therefore, proposes to offer his customers a special trade discount of 20 per cent and to waive any further sales commission. To this, XY Goods Co agreed and took this information into account when closing their books. You are required: (a) to show the necessary corrective entries in the firm's journal; (b) to set out the account of Ram as it will appear when the Journal entries have been posted; and (c) to state clearly the resultant profit or loss on the matter.

Solution : In the above question, the goods sent on consignment to Ram has been wrongly treated as Sales. In order to set the accounts right, the following correcting entries will have to be passed in the books of the Company.

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

Date	Particulars		₹	₹
2015 July 31	Goods (Sales) A/c Consignment to Ram A/c To Ram A/c (Being cancellation of wrong entry and expenses on consignment charged to Consignment A/c)	Dr. Dr.	12,000 720	 12,720
	Consignment to Ram A/c To Goods Sent on Consignment A/c (Being the invoice price of goods sent to Ram on consignment)	Dr.	12,000	 12,000

Ram A/c To Consignment to Ram A/c (Being goods sold by Ram)	Dr.	6,000	6,000
Consignment to Ram A/c To Ram A/c (Being commission payable to Ram)	Dr.	600	600
Goods Sent on Consignment A/c To Consignment A/c (Being loading on goods sent to Ram)	Dr.	2,000	2,000
Stock on Consignment A/c To Consignment A/c (Being value of stock at invoice price)	Dr.	6,360	6,360
Consignment A/c To Stock Reserve A/c (Being required reserve on stock)	Dr.	1,560	1,560
Profit & Loss on Consignment A/c To Consignment to Ram A/c (Being loss on consignment transferred)	Dr.	520	520
Goods Sent on Consignment A/c To Purchases A/c (Being the adjustment to goods sent on consignment)	Dr.	10,000	10,000

Dr. Ram Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.7.2015	To Balance c/d	7,720	31.7.2015	By Goods A/c (sales)	12,000
"	To Consignment to Ram A/c (sales)	6,000	"	By Consignment to Ram A/c	720
			"	By Consignment to Ram A/c	600
			"	By Balance c/d	400
		13,720			13,720

Dr. Consignment to Ram Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.7.2015	To Goods Sent on Consignment A/c	12,000	31.7.2015	By Ram A/c	6,000
"	To Ram A/c (expenses)	720	"	By Goods Sent on Consignment A/c	2,000
"	To Ram A/c (commission)	600	"	By Stock on Consignment A/c	6,360
"	To Stock Reserve A/c	1,560	"	By Profit & Loss on Consignment A/c	520
		14,880			14,880

Working Notes : **Valuation of Closing Stock**	₹		₹
Invoice price of goods sent	12,000	Value of 1/2 goods	6,360
Add: Expenses	720	Less: Market value (₹ 6,000 – ₹ 1,200)	4,800
Value of goods at invoice price	12,720	Stock Reserve	1,560

Illustration 38

Nripesh consigns goods to Dharani, his agent at Dhanbad, at cost price of ₹ 40,000. Nripesh's accountant, at the end of the year, drew up the agent's account as under (all figures in rupees) :

Dr. Dharani Account Cr.

To Goods	40,000	By Cash	25,000
To Cash — freight and insurance	3,000	By Balance c/d	19,300
To Profit and Loss A/c	1,300		
	44,300		44,300

Dharani sold part of the goods for ₹ 45,000, which exceeded by ₹ 9,000 over invoice price. He collected ₹ 38,000 after allowing discount of ₹ 2,000 to customers, bad debts came to ₹ 1,000 and his expenses ₹ 800 (including ₹ 200 for unloading and cartage). Dharani was entitled to a commission of 5% on cash collected.

From the above information, draw up the following accounts in the books of Nripesh :

(a) Consignment Account; (b) Consignment Debtors Account; (c) Dharani Account.

Solution

In the books of Nripesh

Dr. Consignment to Dhanbad Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goods Sent on Consignment A/c	40,000		By Consignment Debtors A/c	45,000
	To Dharani A/c :			By Stock on Consignment A/c (Note 1)	4,320
	Freight and Insurance	3,000			

	Unloading and Cartage	200			
	Other Expenses	600			
	Commission (5% on ₹ 38,000)	1,900			
	To Consignment Debtors A/c :				
	Discount Allowed	2,000			
	Bad Debts	1,000			
	To Profit and Loss on Consignment A/c	620			
		49,320			49,320

Dr. Consignment Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Consignment to Dhanbad A/c	45,000		By Dharani A/c (cash collected)	38,000
				By Consignment to Dhanbad A/c :	
				Discount Allowed	2,000
				Bad Debts	1,000
				By Balance c/d	4,000
		45,000			45,000

Dr. Dharani Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d (Note 3)	19,300		By Goods A/c (Note 2)	40,000
	To Consignment Debtors A/c	38,000		By Profit and Loss A/c (Note 2)	1,300
				By Consignment to Dhanbad A/c :	
				Freight and Insurance	3,000
				Unloading and Cartage	200
				Other Expenses	600
				Commission	1,900
				By Balance c/d	10,300
		57,300			57,300

Working Notes :

(1) Calculation of Stock on Consignment

Here, invoice price means the price indicated in the proforma invoice which is nothing but **cost price**.	₹
Cost of goods sent	40,000
Less: Cost of goods sold ₹ (45,000 – 9,000)	36,000
Cost of stock on consignment	4,000
Add: Proportionate non-recurring expenses (₹ 3,000 + 200) / 40,000 × 4,000	320
Value of stock on consignment	4,320

(2) Goods and profit debited to Dharani have been reversed.

(3) Dharani account starts with the balance given in the question.

Key Points

- The person sending the goods is called the ***consignor*** and the agent who receives the goods is called the ***consignee***.
- An ***Account Sales*** is a statement which is periodically rendered by the consignee to the consignor, showing the details about the goods sold, price realized, his own commission, and the expenses incurred in connection with the sale.
- The primary objective for preparing the Consignment Account is to ascertain the profit or loss on each consignment separately.
- ***Del Credere Commission*** is an additional commission paid to a consignee who guarantees the payment in case of credit sale. Where the consignee gets del credere commission, he indemnifies the consignor for all bad debts.

THEORETICAL QUESTIONS

1. What is a Consignment Account? Distinguish between sale and consignment.
2. What is an Account Sales? Prepare an Account Sales with assumed data.
3. What is del credere commission? Why is it given to the consignee?
4. What are non-recurring expenses? Give some examples.
5. What is a Proforma Invoice? Prepare a Proforma Invoice with assumed figures.
6. State the procedure of valuation of closing stock on consignment.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below.

1. Consignee becomes a debtor of the consignor when
   A the goods are despatched
   B the goods are received
   C the goods are sold.
2. An account sales is a statement which shows the details about the
   A goods received
   B goods sold
   C goods lying unsold.
3. Del credere commission is given when the consignee
   A sells all the goods on credit
   B gets no ordinary commission
   C bears the loss of bad debts.
4. No journal entry is required to be passed when there is
   A normal loss
   B abnormal loss in transit
   C abnormal loss in consignee's godown.
5. Del credere commission that is given to the consignee is to cover
   A normal loss
   B abnormal loss
   C loss of bad debts.
6. Del credere commission is calculated on
   A total sales
   B cash sales
   C credit sales.
7. Consignee account is in the nature of
   A personal account
   B real account
   C nominal account.

PRACTICAL QUESTIONS

Cost Price Method

1. C of Calcutta sent 100 bicycles to B of Mumbai to be sold on consignment basis on 1.1.2014. The cost of each bicycle was ₹ 800, C incurred ₹ 500 for freight, ₹ 750 for cooli charges and ₹ 850 for insurance premium.

   On 31.12.2014, C received on Account Sales from B, which showed that he sold 80 bicycles @ ₹ 1,200 each and after deducting his commission and expenses amounting to ₹ 20,000, he sent the balance amount by a draft with the Account Sales. According to contract, B is entitled to get ordinary commission @ 10% and del credere commission @ 5% on sale proceeds. Show important Ledger Accounts in the books of both the parties.
2. On 1st January, 2014 Sadhan Sen of Sodepur sent 1,000 units of silk goods to Biren Bose of Berhampur .The goods cost ₹ 75,000 to Sadhan and these were sent on consignment basis. Sadhan had to incur an expenditure of ₹ 1,500 on the goods. On the due date, the goods reached the destination and Biren had to spend on the goods ₹ 1,000 on various accounts.

   On 30th September, 2014 an Account Sales was received by Sadhan showing that 750 units were sold at ₹ 150 each. Biren charged 5% ordinary commission and $7^1/_2$% del credere commission. The consignee sent with the Account Sales a sight draft for ₹ 90,000 only.

   You are required to prepare the Account Sales and the necessary Journal entries and Ledger accounts in the books of both the parties.
3. On 1st January, 2015, C of Calcutta sends 1,000 boxes of clothing to M of Madras on consignment basis. The goods in each box cost ₹ 200. C pays railway freight and insurance ₹ 500 and draws upon M a bill for ₹ 10,000 which is duly accepted.

   On 2nd April, 2015, M forwards an Account Sales to C showing that 500 boxes have been sold at ₹ 250 per box while 300 boxes were sold at ₹ 260 per box and 200 boxes remained in stock unsold. The expenses incurred by M consisted of carriage ₹ 100 and other charges ₹ 2,000. M is entitled to a commission @ 5% on the gross sale proceeds. He encloses a cheque for the balance due to C.

Show the Consignment Account and M Account in the books of C.

4. On 1.1.2015, Amar Mills of Calcutta consigned 5,000 Kg of oil to Vijay Stores of Madras. Each Kg of oil costs ₹ 8. Amar Mills paid ₹ 50 as carriage, ₹ 250 as freight and ₹ 200 as insurance. During transit, 500 Kg were accidentally destroyed for which the Insurance company paid directly to consignor ₹ 2,500 in full settlement of the claim. On 1.4.2015, Vijay Stores of Madras reported that 3,500 Kg of oil were sold @ ₹ 9.50 per Kg. and expenses being: Godown rent ₹ 500 and salesman's salary ₹ 750. Vijay Stores is entitled to a 5% commission on sales. Vijay Stores also reported a loss of 20 Kg due to leakage. Show (i) Consignment to Madras Account; (ii) Vijay Stores Account; (iii) Consignment Stock Account in the books of the consignor.

5. Karnath sold goods on behalf of Vijay Sales Corporation on consignment basis. On January 1, 2014, he had with him a stock of ₹ 20,000 on consignment.

   Karnath had instructions to sell the goods at cost plus 25% and was entitled to a commission of 4% on sales, in addition to 1% del credere commission on total sales for guaranteeing collection of all the sale proceeds.

   During the year ended 31st December, 2014, cash sales were ₹ 1,20,000, credit sales ₹ 1,05,000 and Karnath's expenses relating to the consignment ₹ 3,000 being salaries and insurance. Bad debts were ₹ 3,000 and goods sent on consignment ₹ 2,00,000.

   From the above, prepare Consignment Account in the books of Vijay Sales Corporation, and important ledger accounts in the books of Karnath.

6. On 1st July, 2014, Sengupta of Calcutta sent 150 cases of goods at a cost of ₹ 750 per case to Kapoor of Bombay on consignment basis and paid ₹ 1,900 for insurance premium, ₹ 3,500 for freight and ₹ 2,600 for dock charges. On arrival of the goods, Kapoor sent a bank draft for ₹ 10,000 to Sengupta on 30th July, 2014 and paid ₹ 2,500 for clearing charges, ₹ 870 for cartage and ₹ 750 for godown rent. 5 cases were damaged in transit and a sum of ₹ 3,500 was realized by way of compensation from the insurance company. Up to 31st December, 2014, 100 cases were sold for ₹ 1,05,000 incurring a bad debt of ₹ 1,150. Kapoor was entitled to a commission of 5% on the gross sales with further 2% as del credere commission. The amount due to Sengupta up to 31st December, 2014 was remitted by a bank draft.

   Show (a) Consignment Account; (b) Kapoor Account; and (c) Consignment Stock Account in the books of Sengupta.

7. Raja of Calcutta consigned on 1st April, 2014 to Praja of Burdwan 50 TV sets at ₹ 6,000 per set. Raja incurred the following expenses on the consignment : Freight ₹ 1,000; Insurance and other charges ₹ 500. The consignee paid ₹ 980 as non-recurring and ₹ 1,000 as recurring expenses. On the way a set was damaged in full for which the insurance company admitted ₹ 5,600. Praja sent an Account Sales on 1st December, 2014 indicating that 45 sets had been sold at ₹ 6,800 per set. The Account Sales was accompanied by the necessary bank draft deducting commission @ 5% and del credere commission @ $2^1/_2$%.

   Assuming Raja closes his books on 31st December, 2014 give the ledger accounts to record the above transactions.

8. Naresh consigns 1,000 bats costing ₹ 500 each to Swaroop for sales and incurs ₹ 4,000 towards freight and ₹ 1,000 for insurance. Swaroop was able to take delivery of 900 bats only and 100 bats were destroyed in transit. The insurance company admitted the claim and paid the same. Swaroop will be entitled to a commission of 5% on sales and 2% del credere commission on credit sales only. He will be entitled for additional commission of 25% of the excess if the sale price exceeds the cost price by more than 20%. Swaroop has spent ₹ 2,000 towards sales expenses. The sales are as follows : 500 bats at ₹ 600 per bat cash; 200 bats at ₹ 700 per bat credit

   Consignment debtors paid their dues except one customer to whom 4 bats were sold for ₹ 2,800 could pay only ₹ 800.

   Show the Consignment Account, the Consignment Debtors Account, Swaroop Account and commission calculation

   [C.A.(Entrance) —Adapted]

9. Ramesh Oil Mills, Bombay, consigned 40,000 kg of castor oil in 10 kg tins to B N Chatterjee, Calcutta, on 1st April, 2015. The cost of oil was ₹ 2 per kg. The consignors paid ₹ 10,000 as freight and insurance. During transit 50 tins were totally destroyed for which the insurance company paid directly to the consignor, ₹ 900 in full settlement of the claim. B N Chatterjee took delivery of the consignment on 10th April, and accepted a bill drawn on him by the Ramesh Oil Mills for ₹ 20,000 for three months. On June 30, 2015 B N Chatterjee reported that 35,000 kg were sold @ ₹ 3 per kg. The expenses were as follows: Godown rent ₹ 400; advertisement ₹ 2,000; and salaries of salesmen ₹ 4,000.

   B N Chatterjee charged a commission of 3% plus 3% del credere commission. He sold ₹ 19,000 worth of oil, the remaining stock, to X & Co who were declared bankrupt after two months and only 50 paise per rupee were realised from them.

   Show accounts in the books of both the parties assuming that the consignee paid the amount due by bank draft.

10. On July 1, 2014 A had consigned to B goods costing ₹ 50,000, on which A paid freight and insurance amounting to ₹ 2,500. On September 30, 2014, B's first Account Sales was received, showing that he had effected sales for ₹ 32,000 of which ₹ 30,000 had been received in cash. His expenses to date were ₹ 2,000 and commission 5% on gross sales. On receipt of the Account Sales the Consignment Account was balanced off, stock being valued at ₹ 28,000. A further Account Sales was received on December 31, 2014 showing that the balance of the goods had been sold for ₹ 36,000 and the cash collected. Debtors had also paid their dues less discount of 3%. The expenses of B were ₹ 2,500. The rate of his commission was the same as before.
    Write up the Consignment Account and B Account up to December 31, in the books of A assuming that B remitted the balance due with each Account Sales.
11. M/s Abubacker and Sons, Madras, sent to their agents, M/s Chinnadurai and Bros in Ceylon on February 12, 2015 a consignment of hides and skins costing ₹ 24,000. They incurred ₹ 1,200 on freight and packing and ₹ 300 towards insurance. They drew a bill on the agent for ₹ 20,000 at three months' sight. It was accepted by the agent and returned on February 20. A commission at 5% and a del credere commission at 1% was agreed to be payable on sales to the agent. It was found that due to faulty packing, goods invoiced at ₹ 2,200 were damaged and the claim was not admitted by the insurer.
    However, these damaged goods were sold by the consignor as scrap for ₹ 1,250. Half of the goods on consignment were sold for cash on March 7 for ₹ 14,600 and the balance on March 12, 2015 on credit for ₹ 18,200. The agent incurred landing and storage expenses of ₹ 600 and ₹ 800 respectively in connection with these sales. Deducting his commission and expenses, he remitted the balance by draft on March 15, 2015 which was received in Madras on March 18. Show the Consignment Account and the Consignee Account as they would appear in the books of M/s. Abubacker and Sons.
12. Oil India Ltd of Bombay consigned 1,000 barrels of Lubricant oil costing ₹ 800 per barrel to Central Oil Company, Calcutta, on 1st Jan 2015. Oil India Ltd paid ₹ 50,000 as freight and insurance. 25 barrels were destroyed on 7.1.2015 in transit. The insurance claim was settled at ₹ 15,000 and was paid directly to the consignor.
    Central Oil Co took delivery of the consignment on 19th Jan 2015 and accepted a bill drawn upon them by Oil India Ltd for ₹ 5,00,000 for 3 months on 31st March, 2015. Central Oil Co reported as follows:
    (i) 750 barrels were sold at ₹ 1,200 per barrel.
    (ii) Other expenses: unloading ₹ 2,500; wages of salesman ₹ 50,000; printing ₹ 21,300; and godown rent ₹ 10,000.
    (iii) 25 barrels of oil were lost due to leakage which is considered to be a normal loss.
    Central Oil Co is entitled to a commission of 5% on all the sales effected by them. Central Oil Co paid the amount due in respect of the consignment on 31st March itself.
    Show the Consignment Account, the account of Central Oil Co. and the loss in transit account as they will appear in the books of Oil India Ltd.
13. Rahim of Calcutta consigned 100 cases of medicine. Costing ₹ 1,000 per case to Karim of Kanpur on 1.1.2015. The goods were to be sold at 25% above cost. Any deficiency in the selling price was to be borne by Karim. Karim was, however, entitled to a special commission @ 25% of any surplus price realised. Karim was further entitled to an ordinary commission of 5% and del credere commission of $2^1/_2$% on all sales.
    Rahim incurred the following expenses:
    Packing charges ₹ 6,000; loading charges ₹ 1,000; lorry charges ₹ 12,000; and railway freight ₹ 21,000
    The cases were received by Karim on 15.1.2015. The Account Sales received from Karim on 30.6.2015 revealed the following: 40 cases sold on 21.3.2015 @ ₹ 1,500 per case, 30 cases sold on 24.5.2015 @ ₹ 1,200 per cases, 10 cases sold on 30.6.2015 @ ₹ 1,300, 5 cases were stolen by a dishonest employee.
    A compensation of ₹ 2,000 was realised from him. Karim incurred unloading charges of ₹ 2,000 and warehouse rent ₹ 3,000. Karim enclosed a bank draft for the balance due. Write up necessary accounts in the books of Rahim.
14. X consigned goods costing ₹ 1,60,000 to A. The terms of the consignment were:
    (a) Consignee to get commission of 5% on cash sales and 4% on credit sales.
    (b) Any goods taken by consignee himself or goods lost through consignee's negligence, shall be valued at original cost plus $12^1/_2$% and no commission will be allowed on them.
    The expenses incurred by the consignor were: Carriage and freight ₹ 6,720 and insurance ₹ 3,440. The consignor received ₹ 50,000 as advance against the consignment. Account Sales together with a draft for the balance due was received by the consignor showing the following position:
    Goods costing ₹ 1,28,000 were sold for cash at ₹ 1,40,000 and on credit at ₹ 1,08,000. Goods costing ₹ 8,000 were taken by A and goods costing ₹ 4,000 were lost through A's negligence. The expenses incurred by A were: advertisement ₹ 1,720; and other selling expenses ₹ 1,080.
    Show the ledger accounts in the books of X.

15. Mr Krishna Murty requests you to prepare a Consignment Account for the year ended 30.6.2015 and for this purpose gives you the following information to ascertain the profit earned on consignment.
    (i) Agent's commission @ 5% on gross sales ₹ 20,000.
    (ii) Cost of goods fully damaged in transit (insurance claim recovered ₹ 18,000).
    (iii) Expenses incurred by the agent : godown rent ₹ 400; landing and clearing ₹ 1,000; advertisements ₹ 200; transport charges ₹ 900; selling expenses ₹ 1,000.
    (iv) Freight expenses incurred by Krishna Murty ₹ 2,000.
    (v) Cost of unsold stock lying with the agent at the end of the year ₹ 60,000.

    All sales were effected by the agent at a profit of 25% on cost.
16. B of Bombay consigned 400 packages of coffee to K of Kanpur. The cost of each package was ₹ 300. A sum of ₹ 2,000 was paid towards freight and insurance by B. In the transit, 60 packages were damaged. However, the consignor received ₹ 400 for the damaged packages from the insurance company.

    The consignee accepted a Bill of Exchange for ₹ 60,000 for 60 days as an advance to B of Bombay. The operating statement from the consignment disclosed the following information :

    (a) 280 packages were sold @ ₹ 360 per package.

    (b) The damaged packages were sold @ ₹ 100 per package.

    (c) He also paid ₹ 1,400 towards godown rent, ₹ 1,000 for carriage outward and ₹ 3,400 towards clearing charges.

    The consignee is entitled to a commission of 10% on the sale proceeds.

    At the end of the consignment period, K of Kanpur sent a bank draft to B of Bombay You are required to prepare the necessary accounts on the books of consignor B of Bombay.
17. On 1.4.2015, X of Delhi consigned 550 tins of oil to Y of Calcutta. Each tin contains 1.5 Kg of oil. The cost is ₹ 21 per kg. This is to be sold at $33^1/_3$% above cost. Y is to be paid 3% ordinary and 2% del credere commission on sales on the basis of the price specified above.
    Any deficiency in the selling price is to be fully borne by Y, while only 50% of any surplus price realised may be retained by him. X incurred freight and insurance ₹ 3,300. 20 tins were stolen in transit and the insurance company paid ₹ 5,500 in final settlement. Y accepted a bill for 3 months for ₹ 40,000 which was discounted by X for ₹ 39,600. Y sent an account sales which showed that 50 tins were sold @ ₹ 29 per Kg, 200 Kg @ ₹ 32 per kg and from the remaining tins 3,750 Kg of oil were sold @ ₹ 34 per Kg.
    Y paid ₹ 4,270 on clearing charges and ₹ 1,200 as selling expenses. 50 Kg of oil were lost due to leakage which was considered as normal loss. Y collected entire sale proceeds except ₹ 400 which became irrecoverable.
    Prepare the Ledger Account in the books of X.
18. Reema consigns goods to Sunita to be sold at above invoice price, Sunita is to get commission of 5% on sales at invoice price, plus 25% of any surplus price realised. Reema received from Sunita on advance of 75% of the invoice price; the accounts being settled by Bank Drafts immediately on sales.

    During the year Reema consigned to Sunita goods worth ₹ 3,60,000, the invoice price of which was ₹ 5,00,000. This includes freight, sales by Sunita during the year amounted to ₹ 4,30,000, goods unsold on 31.3.12015 with Sunita were of invoice price of ₹ 1,50,000 (cost including freight ₹ 1,00,000). Reema had received from Sunita by bank draft during the year ₹ 90,000, certain remittances being in transit on 31.3.2015.

    Show the Consignment to Sunita Account and Consingee's (Sunita) Account in the books of Reema.

Invoice Price Method

19. A of Bombay sent goods on consignment basis, to B of Calcutta at an invoice price of 25% on cost which was to be sold for general commission of 10% on gross sales plus a special commission of 25% on excess of sale proceeds less all commission over the invoice price. A sent 100 boxes of tea at an invoice price of ₹ 500 per box and incurred ₹ 1,000 as freight, ₹ 500 as insurance and ₹ 300 as general expenses. B paid the following expenses: Clearing charges ₹ 400; carriage ₹ 200; godown rent ₹ 600; insurance ₹ 300 and miscellaneous selling expenses ₹ 200.
    It was found that 10 boxes were lost in transit and another 10 boxes were still in transit. Insurance claim in respect of goods lost was settled at ₹ 3,500. B sold 50 boxes for ₹ 35,000 and sent a bank draft for the amount due.
    You are required to show the necessary ledger accounts in the books of A (Calculations are to be shown separately).
20. Mr Achut of Bombay consigned 100 units of a commodity to Mr. Rao of Delhi. The goods were invoiced at ₹ 150 so as to yield a profit of 50 per cent on cost. Mr.Achut incurred ₹ 1,000 on freight and insurance. Mr. Rao incurred ₹ 500 on freight and ₹ 800 on rent. Before December 31, 2014, he sold 50 units for cash at ₹ 160 per unit, 20 units for ₹ 175 on credit. He retained his commission at 5% and 1% for the del credere arrangements and remitted the balance on December 31, 2014. Mr. Rao noticed that 10 units were damaged on account of bad packing and he

could sell them only for ₹ 80 per unit. A debtor for ₹ 1,000 to whom the goods were sold by Mr Rao became insolvent and only 50 paise in a rupee was recovered. Mr Rao sent an Account Sales on March 31, 2015 detailing the transactions for the quarter ended on that date and he remitted the balance due. Make necessary ledger accounts in the books of Achut and Mr Rao assuming that Mr Achut closes his books every 31st March.

21. X of Delhi purchased 10,000 meters of cloth for ₹ 2,00,000 of which 5,000 meters were sent on consignment to Y of Agra at the selling price of ₹ 30 per meter. X paid ₹ 5,000 for freight and ₹ 500 for packing etc.

    Y sold 4,000 meters at ₹ 40 per meter and incurred ₹ 2,000 as selling expenses. Y is entitled to a commission of 5% on total sale proceeds plus a further 20 per cent on any surplus price realised over ₹ 30 per meter. 3,000 meters were sold at Delhi at ₹ 30 per meter less ₹ 3,000 for expenses and commission. Owing to a fall in the market price, the stock of cloth in hand is to be reduced by 10 per cent. Prepare the Consignment Account and the Trading and Profit and Loss Account in the books of X and his Account in the books of Y.

22. On 1st December, 2014, 100 radio sets were sent on consignment by Kolay & Co of Bombay to Paul & Co of Calcutta at a Proforma Invoice price of ₹ 1,800 each (including a profit of 20% on cost). Kolay & Co paid freight, insurance and other charges amounting to ₹ 8,000. 2 radio sets were totally damaged in transit and as such were thrown away. Paul & Co incurred an expenditure of ₹ 980 for loading and unloading of the consignment and took delivery of the remaining radio sets and sent a cheque for ₹ 90,000 as security against the goods to Kolay & Co. On 31st December, 2014, Paul & Co sent an Account Sales showing that 90 radio sets were sold at 10% above their proforma invoice price and expenses incurred in connection with sales amounted to ₹ 2,208.

    Paul & Co was entitled to an ordinary commission of 5% and del credere commission of 1% on sales. Paul & Co could not realize ₹ 500 from a customer to whom a radio set was sold on credit and accordingly that became a bad debt. Along with the Account Sales Paul & Co sent a bank draft to Kolay & Co for the net amount due.

    You are required to show the Consignment Account and the Consignee Account and Advance Against Consignment Account in the books of the consignor.

23. Rama consigned goods to Ravindran, his agent at New Delhi at cost price of ₹ 40,000. Rama's accountant, at the end of the year, drew up the agent's account as under:

Dr. **Ravindran** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Goods To Profit & Loss A/c	40,000 3,300		By Cash By Balance c/d	24,000 19,300
		43,300			43,300

Ravindran sold the goods for ₹ 45,000, which exceeded by ₹ 9,000 their invoice value. He collected ₹ 38,000 after allowing discount of ₹ 2,000 to customers. Bad debts come to ₹ 1,000 and his expenses to ₹ 800. Ravindran was entitled to a 5% commission on cash collected. Balance of stock is to be valued at invoice prices. From the above information, draw the accounts of Ravindran, Consignment and Consignment Debtors in the books of Rama.

24. On 1st September, 2014 goods which cost to X ₹ 33,000 were consigned by him to his agent Y at a proforma invoice price which was 20% over cost. X paid insurance and freight charges amounting to ₹ 1,250. Y was allowed 3,000 per annum towards establishment cost, 5% commission on gross sales and 3% del credere commission. He was also allowed 5% extra commission on the profit on such consignment sales after charging such commission. Y incurred expenses of ₹ 255 as landing charges. 3/4th of the goods were sold at $33^1/_3$% profit on cost, half of which were on credit; half of the remaining goods were damaged and a claim on insurance company was made for ₹ 4,400 which was settled at a discount of 10%. You are required to prepare a Consignment Account and an Abnormal Loss Account in the books of X for the year ended 31st December, 2014.

25. Roy Brothers of Calcutta sent goods costing ₹ 60,000 to Patel Brothers of Bombay on 10th September, 2013, on consignment basis. The invoice price was made by adding 25% of the cost. Roy Brothers of Calcutta paid the following expenses in connection with the despatch of goods : Packing ₹ 350, carriage ₹ 550 and other expenses ₹ 960.

    On 25th September 2013, after receiving the goods Patel Brothers paid ₹ 850 as freight and ₹ 450 as carriage for taking goods to their godown and forwarded a three months' bill for ₹ 15,000 to Roy Brothers.

    On 31st December, 2013 Patel Brothers sent an Account Sales to Roy Brothers. Roy Brothers of Calcutta came to know from the Account Sales that Patel Brothers had sold half of the goods at ₹ 40,000 in cash and ₹ 20,000 on credit out of which ₹ 7,000 had already been collected by Patel Brothers. The expenses deducted by Patel Brothers also include ₹ 450 for fire insurance. Patel Brothers were entitled to an ordinary commission of 5% and del credere commission of $2^1/_2$% on gross sales.

    On April 30, 2014 a second Account Sales was sent by Patel Brothers. It showed that half of the remaining goods were sold by Patel Brothers at ₹ 15,000 in cash and ₹ 10,000 on credit. Their expenses during the period were ₹ 250 for fire insurance and ₹ 150 for other expenses. The remaining goods could not be sold and were brought back by Roy Brothers on 31st August 2014, at a further cost of ₹ 1,000. These goods were damaged on the way and were valued at 40% below their cost price. Patel Brothers remitted with each Account Sales the balance due from them and Roy Brothers close their books of accounts on 31st December each year. Patel Brothers were able to collect all that was due from the debtors till 31st December, 2014 except ₹ 1,500 from a debtor, which was treated as bad debt.

Draw up the Consignment Account, Patel Brothers' Personal Account and Goods sent on Consignment Account in the books of Roy Brothers of Calcutta.

Guide to Answers

Multiple Choice

1. C 2. B 3. C 4. A 5. C 6. A 7. A.

Practical Questions

1. **Loss on Consignment ₹ 4,080; Stock ₹ 16,420; Amount received ₹ 61,600.**
2. **Profit ₹ 40,062; Stock ₹ 19,125; Amount due ₹ 7,437.**
3. **Profit ₹ 30,370; Stock ₹ 40,120; Final Payment ₹ 1,80,750.**
4. **Profit on Consignment ₹ 1,860; Stock on Consignment ₹ 7,973; Balance due ₹ 30,337; Abnormal Loss ₹ 1,550.**
5. **Profit on Consignment ₹ 30,750; Value of Stock on Consignment ₹ 40,000.**
6. **Profit on Consignment ₹ 14,243; Abnormal Loss ₹ 4,017; Stock on consignment ₹ 37,196.**
7. **Profit ₹ 9,800; Stock ₹ 24,200; Abnormal Loss ₹ 6,030; Final Payment ₹ 2,81,070.**
8. **Profit ₹ 54,700; Stock ₹ 1,01,000; Abnormal Loss ₹ 50,500; Commission (₹ 22,000 + ₹ 2,800 + ₹ 5,000) ₹ 29,800.**
9. **Profit ₹ 21,285; Abnormal Loss ₹ 1,125; Final Payment received ₹ 90,160.**
10. **Profit (₹ 3,900 + ₹ 3,640) = ₹ 7,540; Payment (₹ 26,400 + 31,700).**
11. **Profit ₹ 6,325; Abnormal Loss ₹ 2,393 (₹ 2,200 + ₹ 138 + ₹ 55).**
12. **Profit ₹ 1,17,450; Abnormal Loss ₹ 21,250; Stock (8,31,250 / 950) x 200 = ₹ 1,75,000.**
13. **Loss ₹ 16,900; Commission (8,175 + 2,625 – 1,500) = ₹ 9,300; Goods stolen ₹ 7,100; Stock on Consignment ₹ 21,300.**
14. **Profit ₹ 98,490; Stock ₹ 21,270; Goods lost ₹ 4,500; Goods taken over ₹ 9,000; Commission ₹ 11,320.**
15. **Profit on consignment ₹ 55,200; Stock on consignment ₹ 60,600; Abnormal Loss charged to Profit and Loss Account ₹ 2,100.**
16. **Profit on consignment ₹ 120; Abnormal Loss ₹ 12,500; Stock on consignment ₹ 18,900.**
17. **Profit on consignment ₹ 50,315; Stock on consignment ₹ 8,830; Abnormal Loss ₹ 920.**
18. **Profit on consignment ₹ 1,32,500.**
19. **Profit ₹ 7,825; Abnormal Loss ₹ 5,180 (Invoice price); Loading on Abnormal Loss ₹ 1,000; Stock ₹ 20,945; (₹ 5,180 + ₹ 15,765); Stock Reserve (total) ₹ 4,000. Final Payment ₹ 28,500.**
20. **Profit ₹ 1,960; Stock (Good units) ₹ 3,300 (invoice price); Damaged Stock ₹ 752 (₹ 800 – ₹ 48) at cost; Stock Reserve on good units ₹ 1,000; Abnormal Loss charged to P/L 398 (₹ 1,150 – 752).**
21. **Profit on Consignment ₹ 53,600; Gross Profit ₹ 26,000; Net Profit ₹ 76,600; Stock Reserve ₹ 14,000.**
22. **Profit on Consignment ₹ 22,200; Stock on Consignment ₹ 15,120; Amount received from Pal & Co ₹ 81,520.**
23. **Profit on Consignment ₹ 3,300; Stock on Consignment ₹ 4,000; Balance due from Consignment Debtors ₹ 4,000.**
24. **Profit on Consignment ₹ 3,315; Stock on Consignment ₹ 5,138; Abnormal Loss at invoice price ₹ 5,138; Profit before extra commission ₹ 3,481. Extra commission ₹ 166.**
25. **Profit on consignment for the year 2013 ₹ 23,470. Value of unsold stock on 31.12.2013 ₹ 39,080; Stock reserve ₹ 7,500. Loss for the year 2014 ₹ 855 (charging expenses for goods returned); Value of returned goods ₹ 9,000.**

18

Joint Venture Accounts

Introduction

A joint venture is the combination of two or more persons into a single activity. It is a form of partnership which is limited to a specific venture. It may seem to be exactly the same as partnership, with the exception that it is one of a business that is to be terminated. Since the business is to be concluded after completion of the venture, a firm name is not generally used. There are many reasons for a joint venture. A joint venture is undertaken when different persons have mutual advantages in tackling a particular business venture together. For example, an individual may be in a particular advantageous position to buy goods exceptionally cheap, but lacks capital. An associate might agree to provide the capital to finance the whole project.

When the respective advantages of the parties are pooled together, the persons can undertake a joint venture for mutual profit.

Features of a Joint Venture

1. It is a specific partnership.
2. It does not entail a continuing partnership since termination is certain.
3. The business is dissolved after the venture is terminated.
4. Many accounting concepts are not applicable such as the going concern concept.
5. Ascertainment of income is relatively simple.
6. All the assets are ultimately received in cash and all liabilities are paid in cash.
7. It does not use a firm name generally.

Difference between Partnership and Joint Venture

	Partnership		Joint Venture
1.	It is a going concern.	1.	It is a terminable venture.
2.	It always has a name.	2.	It may not bear a name.
3.	Persons carrying on business are called partners.	3.	Persons carrying on business are called co-venturers.
4.	Profits are ascertained at regular intervals, i.e., annually.	4.	The profits are ascertained for each venture separately.

Methods of Keeping Accounts

Joint venture accounts can be kept in the manner that will suit the co-venturers in a particular case. The important methods are as follows:

1. ***When a separate set of books is kept for the Joint Venture.***
2. ***When no separate set of books is kept for the Joint Venture.***

1. A Separate Set of Books is Kept

When the size of the venture is large and the duration of the venture is protracted, then a complete separate set of books of account may be maintained under the double-entry system for recording all joint venture transactions. Under this system, the following accounts are commonly maintained in the ledger :

(i) Joint Bank Account: For better financial control, a Joint Bank Account is opened specially for the venture. The co-venturers operate this account jointly. This account is just like a cash book—all cash deposited into the bank is debited and all withdrawals are credited. Generally, capital contribution of the venturers and sale proceeds are deposited in this account. Similarly, all major payments are made from this account. It is finally closed by payment to the co-venturers.

(ii) Co-venturers' Accounts: This account records the transactions between the venture and the co-venturers. Since these are the capital accounts of the co-venturers, they are credited for what they contribute to the venture and debited for any withdrawals from the venture. The co-venturers' contribution towards the joint venture by way of cash, goods or services is credited to these accounts. Goods and sale proceeds taken over by co-venturers are debited to these accounts. The profit or loss on venture is credited or debited respectively in these accounts and ultimately closed off by cash payment from the joint bank balance.

(iii) Joint Venture Account: It is in the nature of a Trading and Profit and Loss Account and it is prepared to ascertain the profit or loss on joint venture. Goods purchased, goods supplied by the co-venturers, expenses incurred etc. are debited to this account and sale proceeds, unsold stock and the like are credited to it. The final balance represents profit or loss on the venture which is transferred to the Co-venturers' Accounts in the profit sharing ratio. It is interesting to note that no separate accounts for purchases, sales and expenses are maintained; all these are directly entered in the Joint Venture Account.

Among the three accounts, Joint Venture Account is closed first of all, transferring the profit or loss to the Co-venturers' Accounts. Thereafter, Joint Bank Account and Co-venturers' Accounts are closed simultaneously, ensuring that the resultant claim of the venturers are equal to the available joint bank balance.

Accounting Entries in Books of Joint Venture

1. For cash contribution by the venturers

Joint Bank Account Dr.
  To Co-venturers' Accounts

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2. For goods purchased out of Joint Bank Account

Joint Venture Account Dr.
  To Joint Bank Account

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3. For goods purchased on credit

Joint Venture Account Dr.
  To Creditors Account

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4. For goods supplied by the co-venturers

Joint Venture Account Dr.
  To Co-venturers' Accounts

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5. For expenses (paid from joint bank)

Joint Venture Account Dr.
  To Joint Bank Account

6. For expenses (paid by co-venturers)
Joint Venture Account Dr.
To Co-venturers' Accounts

7. For goods sold in cash
Joint Bank Account Dr.
To Joint Venture Account

8. For goods sold by the co-venturer who kept the sale proceeds for own purpose
Co-venturers' Accounts Dr.
To Joint Venture Account

9. For goods sold on credit
Sundry Debtors Account Dr.
To Joint Venture Account

10. For goods taken over by the co-venturers
Co-venturers' Accounts Dr.
To Joint Venture Account

11. For collection from debtors
Joint Bank Account Dr.
To Sundry Debtors Account

12. For bad debt
Joint Venture Account Dr.
To Sundry Debtors Account

13. For payment to creditors
Creditors Account Dr.
To Joint Bank Account

14. For commission payable to any managing venturer
Joint Venture Account Dr.
To Co-venturers' Accounts

15. After passing the above entries, the balance of the Joint Venture Account will show the profit or loss on venture.

(a) If the credit side is greater than the debit side, there is a profit and it should be transferred to the credit side of the Co-venturers' Accounts
Joint Venture Account Dr.
To Co-venturers' Accounts [profit sharing ratio]

(b) If the debit side is greater than the credit side, there is a loss and it should be transferred to the debit side of the Co-venturers' Accounts.
Co-venturers' Accounts Dr.
To Joint Venture Account

16. Now the Joint Bank Account and Co-venturers' Accounts show some balance. The sum total of Co-venturers' Accounts must be equal to the Joint Bank Account balance.

17. For final settlement

(a) If any of the Co-venturers' Account shows debit balance, he will bring in money and the entry is:
Joint Bank Account Dr.
To Co-venturers' Account

(b) Now the credit balance of the other co-venturers will be paid off.
Co-venturers' Accounts Dr.
To Joint Bank Account

Illustration 1

Mono and Anusua entered into a joint venture and agreed to share profits and losses in the ratio of 2 : 3. They opened a Joint Bank Account in which Mono and Anusua contributed ₹ 8,000 and ₹ 10,000 respectively. They purchased 10 condemned television sets at ₹ 1,500 each. They met the reconditioning cost ₹ 3,000 from the Joint Bank Account carriage and other expenses of ₹ 2,000 were borne by Anusua. Anusua received a cheque of ₹ 1,000 from Mono. Nine sets were sold @ ₹ 2,500 each and the rest was taken over by Anusua at cost.

Pass necessary journal entries and prepare Joint Venture Account, Joint Bank Account and close the accounts of the Venture.

Solution **In the books of Joint Venture**

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

Date	Particulars		L.F.	₹	₹
	Joint Bank A/c	Dr.		18,000	
	To Mono A/c				8,000
	To Anusua A/c				10,000
	(Being capital contributed by the venturers)				
	Joint Venture A/c	Dr.		15,000	
	To Joint Bank A/c				15,000
	(Being purchase of 10 TV sets @ ₹ 1,500 each)				
	Joint Venture A/c	Dr.		3,000	
	To Joint Bank A/c				3,000
	(Being reconditioning expenses paid)				
	Joint Venture A/c	Dr.		2,000	
	To Anusua A/c				2,000
	(Being carriage paid by Anusua)				
	Anusua A/c	Dr.		1,000	
	To Mono A/c				1,000
	(Being cash received by Anusua from Mono)				
	Joint Bank A/c	Dr.		22,500	
	To Joint Venture A/c				22,500
	(Being sale of 9 TV sets @ ₹ 2,500 each)				
	Anusua A/c	Dr.		2,000	
	To Joint Venture A/c				2,000
	(Being the remaining TV set taken over by Anusua at cost)				
	Joint Venture A/c	Dr.		4,500	
	To Mono A/c				1,800
	To Anusua A/c				2,700
	(Being profit of venture transferred to Capital A/c of Mono & Anusua in the ratio 2 : 3)				
	Mono A/c	Dr.		10,800	
	Anusua A/c	Dr.		11,700	
	To Joint Bank A/c				22,500
	(Being the final settlement between the co-venturers)				

Dr. **Joint Venture Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Joint Bank A/c (10 x 1,500)	15,000		By Joint Bank A/c (Sale Proceeds)	22,500
	To Joint Bank A/c (Reconditioning cost)	3,000		By Co-venturers' A/cs : Anusua	2,000
	To Co-venturers' A/cs : Anusua (Carriage)	2,000		Unsold set taken over at cost by Anusua	
	To Co-venturers' A/cs — Profit			(₹ 15,000 + 3,000 + 2,000) /10	
	Mono — 2/5th	1,800			
	Anusua — 3/5th	2,700			
		24,500			24,500

Dr. **Joint Bank Account** **Cr.**

Date	Particulars		₹	Date	Particulars		₹
	To Co-venturers' A/cs :				By Joint Venture A/c		15,000
	Mono	8,000			By Joint Venture A/c		3,000
	Anusua	10,000	18,000		By Co-venturers' A/cs :		
	To Joint Venture A/c		22,500		Mono	10,800	
					Anusua	11,700	22,500
			40,500				40,500

Dr. **Co-venturers' Accounts** **Cr.**

Date	Particulars	Mono	Anusua	Date	Particulars	Mono	Anusua
	To Mono A/c	—	1,000		By Joint Bank A/c	8,000	10,000
	To Joint Venture A/c	—	2,000		By Joint Venture A/c	—	2,000
	To Joint Bank A/c	10,800	11,700		By Anusua A/c	1,000	—
					By Joint Venture A/c	1,800	2,700
		10,800	14,700			10,800	14,700

Illustration 2

Ram and Ravan are carrying on a business as contractors. They jointly take up the work of constructing a building for Mr Bose at an agreed price of ₹ 5,00,000 and ₹ 3,00,000 payable in cash and ₹ 2,00,000 payable in fully paid shares of a company. A bank account is opened in which Ram and Ravan paid ₹ 3,00,000 and ₹ 75,000 respectively. The following costs were incurred in completing the construction : a) Salary paid, ₹ 1,00,000; b) Materials purchased, ₹ 2,00,000; c) Materials supplied by Ram from the stock of his own business,₹ 50,000; d) Engineer's fees paid by Ravan, ₹ 10,000. The contract price was duly received. The accounts of the venture were closed; Ram taking up all the shares at an agreed valuation of ₹ 1,70,000 and Ravan taking up the unused stock of materials at ₹ 15,000. Prepare necessary accounts in the Ledger of the venture assuming that a separate set of books are maintained for this purpose and that the net result of the same is shared by Ram and Ravan in the ratio of 3:2.

Solution

Ledger of the Venture

Dr. **Joint Venture Account** **Cr.**

Date	Particulars	₹	₹	Date	Particulars	₹	₹
	To Joint Bank A/c :				By Joint Bank A/c (Cash received)		3,00,000
	Salary	1,00,000			By Co-venturers' A/cs :		
	Materials Purchased	2,00,000	3,00,000		Ram (Shares taken over)	1,70,000	
	To Co-venturers' A/cs :				Ravan (Materials taken over)	15,000	1,85,000
	Ram (Materials)	50,000					
	Ravan (Fees)	10,000	60,000				
	To Co-venturers' A/cs — Share of Profit						
	Ram 3/5th	75,000					
	Ravan 2/5th	50,000	1,25,000				
			4,85,000				4,85,000

Dr. **Joint Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Co-venturers' A/cs :			By Joint Venture A/c	3,00,000
	Ram	3,00,000		By Co-venturers' A/cs :	
	Ravan	75,000		Ram	2,55,000
	To Joint Venture A/c	3,00,000		Ravan	1,20,000
		6,75,000			6,75,000

Dr. **Co-venturers' Accounts** **Cr.**

Date	Particulars	Ram	Ravan	Date	Particulars	Ram	Ravan
	To Joint Venture a/c	1,70,000	15,000		By Joint Bank A/c	3,00,000	75,000
	To Joint Bank A/c	2,55,000	1,20,000		By Joint Venture A/c (Expenses)	50,000	10,000
					By Joint Venture A/c (Profit)	75,000	50,000
		4,25,000	1,35,000			4,25,000	1,35,000

Illustration 3

S D and S G entered into a joint venture to construct a building for a new company. Profits and losses were to be shared in the ratio of 3:2. S D invested ₹ 2,00,000 and S G₹ 1,00,000. The money was deposited to a joint bank account with arrangement of overdraft. S D also supplied materials valued ₹ 35,000 and S G paid the architect's fees ₹ 15,000. S G also supplied a machine valued ₹ 25,000. Building materials valued ₹ 4,00,000 and wages of ₹ 1,00,000 were met from the Joint Bank Account.

On completion of the construction, the company paid ₹ 8,00,000 out of which ₹ 4,00,000 was in cash (deposited into Joint Bank Account) and the balance of ₹ 4,00,000 was in fully paid shares of ₹ 10 each. These shares were sold at ₹ 9.50 each and the proceeds taken by S D and S G in the ratio of 3:1. The machine supplied by S G was taken back by him at an agreed value of ₹ 15,000.Bank charged interest ₹ 1,000 for the overdraft.

Prepare necessary Ledger Accounts.

Solution **In the books of M/s S.D. and S.G.**

Dr. **Joint Venture Account** **Cr.**

Date	Particulars	₹	₹	Date	Particulars	₹	₹
	To Co-venturers' A/cs :				By New Company A/c		8,00,000
	S.D. (Materials)	35,000			By Co-venturers' A/cs :		
	S.G. (Architect's fees)	15,000	50,000		S.G. (Machine taken over)		15,000
	To Co-venturers' A/cs :						
	S.G. (Machine supplied)		25,000				
	To Joint Bank A/c :						
	Building Materials	4,00,000					
	Wages	1,00,000	5,00,000				
	To Share in New Company A/c (Loss on Sale of Shares)		20,000				
	To Interest on Overdraft A/c		1,000				
	To Co-venturers' A/cs — Share of Profit						
	S.D. 3/5th	1,31,400					
	S.G. 2/5th	87,600	2,19,000				
			8,15,000				8,15,000

Dr. **Shares in New Company Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To New Company A/c	4,00,000		By Co-venturers' A/cs (₹ 2,85,000 + ₹ 95,000)	3,80,000
				By Joint Venture A/c (Loss on Shares)	20,000
		4,00,000			4,00,000

Dr. **Joint Bank Account** **Cr.**

Date	Particulars	₹	₹	Date	Particulars	₹	₹
	To Co-venturers' A/cs :				By Joint Venture A/c :		
	S.D.	2,00,000			Building Materials	4,00,000	
	S.G.	1,00,000	3,00,000		Wages	1,00,000	5,00,000
	To New Company A/c		4,00,000		By Interest on Overdraft A/c		1,000
					By Co-venturers' A/cs:		
					S.D.	81,400	
					S.G.	1,17,600	1,99,000
			9,00,000				9,00,000

Dr. **Co-venturers' Accounts** **Cr.**

Date	Particulars	S.D.	S.G..	Date	Particulars	S.D.	S.G.
	To Shares in New Company A/c	2,85,000	95,000		By Joint Bank A/c	2,00,000	1,00,000
	To Joint Bank A/c	81,400	1,17,600		By Joint Venture A/c	35,000	15,000
	To Joint Venture A/c		15,000		By Joint Venture A/c		25,000
					By Joint Venture A/c	1,31,400	87,600
		3,66,400	2,27,600			3,66,400	2,27,600

Dr. **New Company Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Joint Venture A/c	8,00,000		By Joint Bank A/c	4,00,000
				By Shares in New Company A/c	4,00,000
		8,00,000			8,00,000

Illustration 4

A and B entered into a joint venture on 1.10.1993 for sale of specified goods paying ₹ 60,000 and ₹ 40,000 respectively in a Joint Bank Account—sharing profits and losses in the ratio of 3 : 5. It was agreed that Joint Bank Account is to be used for purchases and sales and each venturer is to meet his joint venture expenses out of private funds. Each venturer is to charge a commission @ 5% on sales made by him. The transactions for the period ended 31.3.1994 were as follows :

A purchased goods costing ₹ 40,000 and expenses in connection thereof amounted to ₹ 6,000. He sold 90% of these goods at 30% over the cost price and selling expenses amounted to ₹ 2,500. B purchased goods costing ₹ 50,000 and expenses in connection thereof amounted to ₹ 6,500. He sold 80% of these goods at 25% over the cost price and selling expenses amounted ₹ 3,000. 1/5th of the remaining goods purchased by A was destroyed by fire on 28th February, 1994 and the insurance company paid a claim for ₹ 2,000. Write up Joint Venture Account, Joint Bank Account and Venturers' Accounts.

Solution **Ledger of the Venture**

Dr. **Joint Venture Account** **Cr.**

Date	Particulars	₹	₹	Date	Particulars	₹	₹
	To Joint Bank A/c :				By Joint Bank A/c (Note 1)		
	Goods purchased by A	40,000			Sales made by A	53,820	
	Goods purchased by B	50,000	90,000		Sales made by B	56,500	1,10,320

	To Venturers' A/cs :				By Joint Bank A/c (insurance claim)		2,000
	Expenses incurred by A	8,500		31.3.1994	By Closing Stock (Note 2)		14,980
	Expenses incurred by B	9,500	18,000				
	To Venturers' A/cs (Commission) :						
	A — @ 5% on ₹ 53,820	2,691					
	B — @ 5% on ₹ 56,500	2,825	5,516				
31.3.1994	To Venturers' A/cs—share of profit:						
	A — 3/8th of ₹ 13,784	5,169					
	B — 5/8th of ₹ 13,784	8,615	13,784				
			1,27,300				1,27,300

Dr. **Joint Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.10.1993	To Venturers' A/cs :			By Joint Venture A/c	90,000
	A — ₹ 60,000; B — ₹ 40,000	1,00,000	31.3.1994	By Balance c/d	1,22,320
	To Joint Venture A/c (Sale proceeds)	1,10,320			
	To Joint Venture A/c (Insurance claim)	2,000			
		2,12,320			2,12,320

Dr. **Venturers' Accounts** **Cr.**

Date	Particulars	A	B	Date	Particulars	A	B
	To Balance c/d	76,360	60,940		By Joint Bank A/c	60,000	40,000
					By Joint Venture A/c	8,500	9,500
					By Joint Venture A/c (Commission)	2,691	2,825
					By Joint Venture A/c (Profit)	5,169	8,615
		76,360	60,940			76,360	60,940

Working Notes : (1) Calculation of Sales	₹	**(2) Valuation of Closing Stock**	₹
A — *Cost of goods sold : 90% of ₹ (40,000 + 6,000)	41,400	A — 10% of ₹ (40,000 + 6,000)	4,600
Add : 30% of ₹ 41,400	12,420	Less : Goods lost by fire (1/5th)	920
	53,820		3,680
B — *Cost of goods sold : 80% of ₹ (50,000 + 6,500)	45,200	B — 20% of ₹ (50,000 + 6,500)	11,300
Add : 25% of ₹ 45,200	11,300	**Total** ₹ 3,680 + 11,300	14,980
	56,500		

* Cost includes purchase price and expenses in connection thereof.

(3) No entry is required for stock destroyed. Only insurance claim received is credited to Joint Venture Account as an income.

Tutorial Note : It is clear from the question that the final settlement was not effected by A and B on 31st March, 1994. Therefore, the value of closing stock and balances on other accounts are to be carried forward to the next period.

Illustration 5

Ujjal and Sajjal started a joint venture to construct five flats in a building sharing profits and losses in the ratio of 3:2. The contract price of each flat was ₹ 90,000. Ujjal contributed ₹ 2,00,000 and Sajjal ₹ 1,40,000 and a bank account was opened in their names. Cost of raw material, wages and other expenses amounting to ₹ 2,90,000, ₹ 35,000 and ₹ 5,000 respectively, and the architect's fee which was 2% of the contract price, were met from the Joint Bank Account. Ujjal supplied further raw materials costing ₹ 15,000 and Sajjal supplied a machine costing ₹ 5,000. Ujjal paid ₹ 3,000 for transport charges.

Sajjal is entitled to a commission of 1% on the cost of raw materials used. Four of the flats were disposed off at the contract price but the fifth one was not according to specification and hence could not be disposed off. This flat was taken by Ujjal at the cost of construction plus 5% profit. The unused raw materials and the machine were taken by Sajjal at ₹ 5,000 and ₹ 1,000 respectively.

Prepare Joint Venture Account, Joint Bank Account, Ujjal Account and Sajjal Account to close the venture.

Solution **In the books of M/s Ujjal and Sajjal**

Dr. **Joint Venture Account** **Cr.**

Date	Particulars	₹	₹	Date	Particulars	₹	₹
	To Joint Bank A/c :				By Joint Bank A/c		3,60,000
	Materials	2,90,000			By Co-venturers' A/cs (Note 2) :		
	Wages	35,000			Ujjal — Unsold flat taken over		74,760
	Other Expenses	5,000			By Co-venturers' A/cs :		
	Architect's Fees	9,000	3,39,000		Sajjal — Stock taken over	5,000	
	To Co-venturers' A/cs :				Machine taken over	1,000	6,000
	Ujjal — Raw materials	15,000					
	Sajjal — Machine	5,000	20,000				

	To Co-venturers' A/cs :						
	Ujjal — Transportation charges	3,000					
	Sajjal — Commission (Note 1)	3,000	6,000				
	To Co-venturers' A/cs — Share of Profit						
	Ujjal — 3/5th	45,456					
	Sajjal — 2/5th	30,304	75,760				
			4,40,760				4,40,760

Dr. **Joint Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Co-venturers' A/cs :			By Joint Venture A/c	3,39,000
	Ujjal : ₹ 2,00,000; Sajjal : ₹ 1,40,000	3,40,000		By Co-venturers' A/cs :	
	To Joint Venture A/c	3,60,000		Ujjal : ₹ 1,88,696; Sajjal — ₹ 1,72,304	3,61,000
		7,00,000			7,00,000

Dr. **Co-venturers' Accounts** **Cr.**

Date	Particulars	Ujjal	Sajjal	Date	Particulars	Ujjal	Sajjal
	To Joint Venture A/c	74,760			By Joint Bank A/c	2,00,000	1,40,000
	To Joint Venture A/c		6,000		By Joint Venture A/c	15,000	5,000
	To Joint Bank A/c	1,88,696	1,72,304		By Joint Venture A/c	3,000	3,000
					By Joint Venture A/c	45,456	30,304
		2,63,456	1,78,304			2,63,456	1,78,304

Working Notes : (1) Materials Consumed	₹	**(2) Valuation of Unsold flat**	₹
Materials purchased	2,90,000	Materials consumed	3,00,000
Add: Materials supplied by Ujjal	15,000	Wages	35,000
	3,05,000	Other Expenses	5,000
Less: Unsold materials taken over by Sajjal	5,000	Architects' Fees	9,000
	3,00,000	Depreciation (5,000 — 1,000)	4,000
Therefore, commission @ 1%	3,000	Transport charges	3,000
		Cost of construction of 5 flats	3,56,000
		Therefore, cost of one flat	71,200
		Add: Profit (5% of 71,200)	3,560
			74,760

Illustration 6

Gavaskar and Biswanath jointly underwrite and place on the market 50,000 shares of Bombay Machineries Ltd of ₹ 10 each. It was agreed with the company that they would be allotted 2,000 shares as fully-paid towards their remuneration. Their profit sharing ratio is 3:2. Applications were received from the public only for 45,000 shares. Gavaskar paid ₹ 4,000 for postage and advertisement in addition to 60% of the amount required to take up the short subscription. Biswanath financed the balance amount. These are accounted for through the Joint Bank Account. All the shares including those allotted for remuneration were sold. Gavaskar sold 3,000 shares for ₹ 35,000 and Biswanath sold the balance shares for ₹ 48,000. Biswanath incurred expenses ₹ 2,000. Sales proceeds were retained individually. Show necessary accounts in the books of the co-venturers, which were started separately for the purpose. The *inter se* account was settled through the Joint Bank Account.

Solution **In the books of M/s Gavaskar and Biswanath**

Dr. **Joint Venture Account** **Cr.**

Date	Particulars		₹	Date	Particulars	₹
	To Joint Bank A/c (5,000 shares)		50,000		By Gavaskar A/c (Sale of 3,000 shares)	35,000
	To Joint Bank A/c (Postage & Advertisement)		4,000		By Biswanath A/c (Sale proceeds)	48,000
	To Joint Bank A/c (Expenses)		2,000			
	To Co-venturers' A/cs — Share of Profit					
	Gavaskar 3/5th	16,200				
	Biswanath 2/5th	10,800	27,000			
			83,000			83,000

Dr. **Joint Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Gavaskar A/c (60% of ₹ 50,000 + ₹ 4,000)	34,000		By Joint Venture A/c (Postage and Advertisement)	4,000
	To Biswanath A/c (40% of ₹ 50,000 + ₹ 2,000)	22,000		By Joint Venture A/c (Expenses)	2,000
	To Biswanath A/c	15,200		By Joint Venture A/c (Purchases)	50,000
				By Gavaskar A/c	15,200
		71,200			71,200

Dr. **Co-venturers' Accounts** **Cr.**

Date	Particulars	Gavaskar	Biswanath	Date	Particulars	Gavaskar	Biswanath
	To Joint Venture A/c	35,000	48,000		By Joint Bank A/c	34,000	22,000
	To Joint Bank A/c	15,200	—		By Joint Venture A/c (Profit)	16,200	10,800
					By Joint Bank A/c	—	15,200
		50,200	48,000			50,200	48,000

Illustration 7

X and Y entered into a joint venture to act as underwriters of a newly formed company which issued 30,000 shares of ₹ 10 each. The extent of underwriting was 80%. They opened a joint bank account by contributing ₹ 35,000 each. Public subscribed for 22,000 shares and the underwriters duly discharged their obligations in consideration of a commission of 5% which they received by cheque. Miscellaneous expenses amounting to ₹ 1,500 were met out of the Joint Bank Account. X took 1,500 shares at ₹ 9 per share and Y took 1,600 shares at ₹ 9.50 per share. The rest of the shares were sold at ₹ 12 per share, brokerage being Re 0.50 per share. Profits on joint venture are to be shared equally. You are required to prepare the Joint Venture Account, Joint Bank Account and the Personal Accounts of X and Y.

Solution

In the books of M/s XY

Dr. **Joint Venture Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Joint Bank A/c (Purchases of 6,400 shares)	64,000		By Joint Bank A/c (Commission) (Note 2)	12,000
	To Joint Bank A/c (Expenses)	1,500		By Co-venturers' A/cs — Shares taken over	
	To Co-venturers' A/cs — Share of Profit			X — 1,500 x ₹ 9.00	13,500
	X — 1/2	6,575		Y — 1,600 x ₹ 9.50	15,200
	Y — 1/2	6,575		To Joint Bank A/c (Sales Proceeds) (Note 3)	37,950
		78,650			78,650

Dr. **Joint Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Co-venturers' A/cs :			By Joint Venture A/c	64,000
	X	35,000		By Joint Venture A/c (Expenses)	1,500
	Y	35,000		By Co-venturers' A/cs :	
	To Joint Venture A/c (Commission)	12,000		X	28,075
	To Joint Venture A/c	37,950		Y	26,375
		1,19,950			1,19,950

Dr. **Co-venturers' Accounts** **Cr.**

Date	Particulars	X	Y	Date	Particulars	X	Y
	To Joint Venture A/c	13,500	15,200		By Joint Bank A/c	35,000	35,000
	To Joint Bank A/c (final settlement)	28,075	26,375		By Joint Venture A/c (Profit)	6,575	6,575
		41,575	41,575			41,575	41,575

Working Notes: **(1)** Since the extent of underwriting was 80%, the venturers had to purchase 80% of 8,000 shares (30,000 – 22,000), i.e. 6,400 shares; **(2)** Commission received was 5% on (80% of 30,000 shares of ₹ 10 each), i.e, 5% on ₹ 2,40,000 = 12,000; **(3) Sale proceeds of shares are calculated as under:**

			₹
Shares purchased	6,400 shares	Sale proceeds of 3,300 shares @ ₹ 12 per share	39,600
Less: Shares taken over (1,500 + 1,600)	3,100 shares	Less: Brokerage @ Re 0.50 per share	1,650
Shares sold	3,300 shares		37,950

2. No Separate Set of Books is kept

When the size of the venture is small and co-venturers are residing at distant places, each co-venturer may record joint venture transactions in his own books of account without inaugurating a complete set of double-entry books for the venture. In such a case, two variations are possible : *(a) when each co-venturer maintains a complete record of all the joint venture transactions; and (b) when each co-venturer maintains a record of his own transactions only.*

(a) When each co-venturer maintains a complete record of all the Joint Venture transactions

In such a case, each co-venturer will record in his own books of account all transactions (own + co-venturers') relating to the joint venture. Each co-venturer will open in his ledger the following two accounts:

(i) Joint Venture Account: It is a nominal account and may be treated as a special Profit and Loss Account which discloses profit or loss on venture. It is prepared in the same manner as illustrated previously. One's own share of profit or loss is transferred to the Profit & Loss Account whereas the co-venturers' share of profit is transferred to their respective personal accounts.

(ii) Personal Accounts of Co-venturers: These accounts are credited with cash, goods and services supplied by the co-venturers and debited with goods, sales proceeds taken over, remittance, and the like. Share of profit or loss is credited or debited respectively to these accounts. The balances of these accounts are shown in the Balance Sheet (if it has not been settled). Under this system, each co-venturer will send from time to time a statement of the transactions entered into by him to his co-venturer who will accordingly make appropriate entries in his own books of account.

Accounting Entries

1. For purchase of goods for the venture
Joint Venture Account Dr.
    To Cash/Bank Account

2. For supply of goods from own stock
Joint Venture Account Dr.
    To Purchases Account

3. For expenses in respect of joint venture
Joint Venture Account Dr.
    To Cash/Bank Account

4. For cash received from co-venturers
Cash/Bank Account Dr.
    To Co-venturers' Accounts

5. For supply of goods by the co-venturers
Joint venture Account Dr.
    To Co-venturers' Accounts

6. For any expenses paid by the co-venturers
Joint Venture Account Dr.
    To Co-venturers' Accounts

7. For goods sold
Cash/Bank Account Dr.
    To Joint Venture Account

8. For goods sold by the co-venturer
Co-venturer's Account Dr.
    To Joint Venture Account

9. For goods taken over by the co-venturer for his business/personal use
Co-venturers' Accounts Dr.
    To Joint Venture Account

10. For goods taken over for business
Purchases Account Dr.
    To Joint Venture Account

11. For goods taken over for own use
Drawings Account Dr.
    To Joint Venture Account

12. Sometimes a bill of exchange may be drawn by one venturer on the other for accommodation of funds. When the bill is discounted, the discount on the bill is debited to the Joint Venture Account.

13. Joint Venture Account is finally balanced to find out the trading result. The profit is distributed by closing the Joint Venture Account, as follows:
Joint Venture Account Dr.
    To Profit and Loss Account (own share of profit)
    To Co-venturers' Accounts (co-venturers' share of profit)

14. For loss, the above entry will be reversed.

15. Account with co-venturer will be settled through appropriate remittance.

Illustration 8

M and N enter into a joint venture for the purchase and sale of second-hand motor cars, agreeing to share profits and losses in the ratio of 3:2. On January 15, 2015, M bought five cars for ₹ 43,000 and on January 20, he paid tax and insurance ₹ 1,600. On January 31, 2015, he sold these cars for ₹ 58,000, out of which he remitted ₹ 11,000 to N and the balance deposited into his own bank account. On January 31, 2015, N bought three cars for ₹ 36,000 and he paid tax and insurance ₹ 1,400 and repair charges amounting to ₹ 2,000. He sold one car on February 2, 2015 for ₹ 14,000 which he paid into his own bank account. M then took over the other cars at a valuation of ₹ 26,000, and the venture was closed on February 10, 2015. Pass necessary journal entries in the books of M and as well as in the books of N.

Solution

In the books of M

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 Jan. 15	Joint Venture A/c	Dr.		43,000	
	To Bank A/c				43,000
	(Being purchase of 5 second-hand motor cars)				
Jan. 20	Joint Venture A/c	Dr.		1,600	
	To Bank A/c				1,600
	(Being tax and insurance paid)				
Jan. 31	Bank A/c	Dr.		47,000	
	N A/c	Dr.		11,000	
	To Joint Venture A/c				58,000
	(Being sale of cars for ₹ 58,000,of which ₹ 11,000 remitted to N and the balance deposited into bank)				
Jan. 31	Joint Venture A/c	Dr.		36,000	
	To N A/c				36,000
	(Being purchase of three cars for ₹ 36,000)				
Jan. 31	Joint Venture A/c	Dr.		3,400	
	To N A/c				3,400
	(Being tax and insurance of ₹ 1,400 and repairing of ₹ 2,000 paid by N)				
Feb. 2	N A/c	Dr.		14,000	
	To Joint Venture A/c				14,000
	(Being sale of one car by N)				
Feb. 10	Purchases A/c*	Dr.		26,000	
	To Joint Venture A/c				26,000
	(Being two cars taken over for ₹ 26,000 for business)				
Feb. 10	Joint Venture A/c	Dr.		14,000	
	To Profit & Loss A/c (own share of profit)				8,400
	To N A/c (Co-venturer's share of profit)				5,600
	(Being profit on venture credited to P & L A/c and N A/c in the ratio 3:2)				
	N A/c	Dr.		20,000	
	To Bank A/c				20,000
	(Being final settlement with N)				

In the books of N

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 Jan. 15	Joint Venture A/c	Dr.		43,000	
	To M A/c				43,000
	(Being cars purchased by M for ₹ 43,000)				
Jan. 20	Joint Venture A/c	Dr.		1,600	
	To M A/c				1,600
	(Being tax and insurance paid by M)				
Jan. 31	Bank A/c	Dr.		11,000	
	M A/c	Dr.		47,000	
	To Joint Venture A/c				58,000
	(Being sale of cars for ₹ 58,000 by M and received ₹ 11,000 from that)				
Jan. 31	Joint Venture A/c	Dr.		36,000	
	To Bank A/c				36,000
	(Being purchase of three cars for ₹ 36,000)				

Jan. 31	Joint Venture A/c Dr. To Bank A/c (Being tax and insurance of ₹ 1,400 and repairing of ₹ 2,000 paid by cheque)		3,400	3,400
Feb. 2	Bank A/c Dr. To Joint Venture A/c (Being sale of one car)		14,000	14,000
Feb. 10	M A/c Dr. To Joint Venture A/c (Being two cars taken over for ₹ 26,000 for business by M)		26,000	26,000
Feb. 10	Joint Venture A/c Dr. To Profit & Loss A/c (own share of profit) To M A/c (co-Venturer's share of profit) (Being profit on venture credited to P & L A/c and M A/c in the ratio 2:3)		14,000	5,600 8,400
	Bank A/c Dr. To M A/c (Being final settlement with M)		20,000	20,000

*It has been assumed that the venturers deal in motor cars, otherwise Motor Car A/c would have been debited in place of Purchases A/c.

Illustration 9

A and B enter into a joint venture to take a building contract for ₹ 2,40,000. They provide the following information regarding the expenditure incurred by them :

	A	B
Materials	68,000	50,000
Cement	13,000	17,000
Wages		27,000
Architect's fee	10,000	
Licence fees		5,000
Plant		20,000

Plant was valued at ₹ 10,000 at the end of the contract and B agreed to take it at that value. Contract amount of ₹ 2,40,000 was received by A. Show: (i) Joint Venture Account and B Account in the books of A; and (ii) Joint Venture Account and A Account in the books of B.

Solution

In the books of A

Dr. Joint Venture Account Cr.

Date	Particulars	₹	₹	Date	Particulars	₹	₹
	To Bank A/c				By Bank A/c (contract price)		2,40,000
	Materials	68,000			By B A/c (Plant taken over)		10,000
	Cement	13,000					
	Architect's fee	10,000	91,000				
	To B A/c						
	Materials	50,000					
	Cement	17,000					
	Wages	27,000					
	Licence fees	5,000					
	Plant	20,000	1,19,000				
	To B A/c (Share of profit)		20,000				
	To Profit & Loss A/c (Share of profit)		20,000				
			2,50,000				2,50,000

Dr. B Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Joint Venture A/c	10,000		By Joint Venture A/c (expenses)	1,19,000
	To Balance c/d	1,29,000		By Joint Venture A/c (profit)	20,000
		1,39,000			1,39,000

In the books of B

Dr. Joint Venture Account Cr.

Date	Particulars	₹	₹	Date	Particulars	₹	₹
	To Bank A/c				By A A/c (contract price)		2,40,000
	Materials	50,000			By Plant A/c (taken over)		10,000
	Cement	17,000					
	Wages	27,000					
	Licence fees	5,000					
	Plant	20,000	1,19,000				

	To A A/c						
	Materials	68,000					
	Cement	13,000					
	Architects' fees	10,000	91,000				
	To A A/c (share of profit)		20,000				
	To Profit & Loss A/c (share of profit)		20,000				
			2,50,000				2,50,000

Dr. **A Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Joint Venture A/c (contract price)	2,40,000		By Joint Venture A/c (expenses)	91,000
				By Joint Venture A/c (profit)	20,000
				By Balance c/d	1,29,000
		2,40,000			2,40,000

Illustration 10

X and Y entered into a joint venture for purchase and sale of jute. They agreed to share profits in the proportion of 2:1.

The following transactions took place in between them: (i) On January 1, 2015, X purchased 1,400 bales of jute at ₹ 55 per bale, the brokerage being ₹ 2 per bale; (ii) On February 1, 2015, Y purchased 1,200 bales of jute at ₹ 62 per bale, the brokerage being ₹ 2 per bale;. (iii) On March 9, 2015 Y sold 700 bales of jute at ₹ 70 per bale (the brokerage being Re 1 per bale) and took the proceeds to himself; and (iv) On April 1, 2015, X sold 1,600 bales of jute at ₹ 66 per bale (brokerage being Re 1 per bale) and took the proceeds to himself. The balance of unsold stock was to be divided between the partners in proportion to their profit-sharing ratio and the goods being valued at cost to the partners concerned. The venture was closed. Show the accounts as they would appear in books of X.

Solution

In the books of X

Dr. **Joint Venture Account** **Cr.**

Date	Particulars	₹	₹	Date	Particulars	₹	₹
1.1.2015	To Bank A/c			9.3.2015	By Y A/c (Sales)		49,000
	Purchase of Jute	77,000		1.4.2015	By Bank A/c (Sales Proceeds)		1,05,600
	Brokerage on Purchase	2,800	79,800		By Purchases A/c (Note 1)		12,046
1.2.2015	To Y A/c				By Y A/c (Unsold goods taken over)		
	Purchases of Jute	74,400			(Note 1)		6,023
	Brokerage on Purchases	2,400	76,800				
9.3.2015	To Y A/c (Brokerage on Sales)		700				
1.4.2015	To Cash A/c (Brokerage on Sales)		1,600				
	To P & L A/c (Share of profit)		9,179				
	To Y A/c (Share of profit)		4,590				
			1,72,669				1,72,669

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

Date	Particulars	₹	Date	Particulars	₹
9.3.2015	To Joint Venture A/c (Sales)	49,000	1.2.2015	By Joint Venture A/c :	
	To Joint Venture A/c (Unsold goods taken over)	6,023		Purchase of Jute	74,400
1.4.2015	To Balance c/d	27,067		Brokerage	2,400
			9.3.2015	By Joint Venture A/c (Brokerage)	700
			1.4.2015	By Joint Venture A/c (share of profit)	4,590
		82,090			82,090

Working Notes :

(1) Total bales of jute purchased (1,400 + 1,200) = 2,600 Less: Total bales of jute sold (700 + 1,600) = 2,300. Total : 300 unsold. The above unsold bales of jute are taken over by X and Y in the ratio 2:1. Therefore, X takes over 200 bales and Y takes over 100 bales.

		₹
(2) Ascertainment of Cost of bales :	1,400 bales @ ₹ 55 per bale = ₹ 77,000 plus brokerage @ ₹ 2 per bale = 2,800 = Total	79,800
	1,200 bales @ ₹ 62 per bale = ₹ 74,400 plus brokerage @ ₹ 2 per bale = 2,400 = Total	76,800
		1,56,600

Therefore, the cost per bale = ₹ 1,56,600 / 2,600 = ₹ 60.23 (App.).

So, the value of unsold stock taken over by the venturers will be X – 200 x 60.23 each = ₹ 12,046 and Y – 100 x 60.23 each = ₹ 6,023

Abnormal and Normal Losses

Abnormal losses may arise owing to causes such as, theft, fire, and the like. For calculating the profit of the joint venture abnormal losses are ignored. It is ignored on the ground that joint venture account itself represents Trading as well as Profit and Loss Account. However, any insurance claim received is credited to the Joint Venture Account.

Normal losses are inevitable or unavoidable. These may arise due to natural causes like breaking in bulk, evaporation, leakage, drying and the like. No effort can prevent these losses.

When there is no stock remaining unsold, there will be no treatment for normal loss. But where there is some stock remaining unsold, the value of stock on joint venture will be ascertained as follows :

$$\frac{\text{Value of goods purchased}}{\text{Net quantity(after normal loss) in units}} \times \text{Unsold goods (in units)}$$

Illustration 11

X and Y entered into a joint venture agreement to share the profits and losses in the ratio of 2:1. X supplied goods worth ₹ 60,000 to Y incurring expenses amounting to ₹ 2,000 for freight and insurance. During transit goods costing ₹ 5,000 were damaged and a sum of ₹ 3,000 was recovered from the insurance company. Y reported that 90% of the remaining goods were sold at a profit of 30% on their original cost. Towards the end of the venture a fire occurred and as a result the balance stock lying unsold with Y was damaged. The goods were not insured and Y agreed to compensate X by paying in cash 80% of the aggregate of the original cost of such goods plus proportionate expenses incurred by X. Apart from the joint venture share of profits, Y was also entitled under the agreement, to a commission of 5% of the net profits of joint venture after charging such commission. Selling expenses incurred by Y totalled ₹ 1,000. Y had earlier remitted an advance of ₹ 10,000. Y duly paid the balance due to X by draft. You are required to prepare in the Books of X: (1) Joint Venture Account, and (2) Y Account.

Solution

In the books of X

Dr. Joint Venture Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Purchases A/c (Goods supplied)	60,000		By Bank A/c (Insurance claim)	3,000
	To Bank A/c (Expenses)	2,000		By Y A/c (Sales)	64,350
	To Y A/c (Expenses)	1,000		By Y A/c (Compensation for loss)	4,546
	To Y A/c (Commission)	424			
	To Profit & Loss A/c (Share of profit)	5,648			
	To Y A/c (Share of profit)	2,824			
		71,896			71,896

Dr. Y Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Joint Venture A/c (Sales)	64,350		By Bank A/c (Advance)	10,000
	To Joint Venture A/c (Compensation)	4,546		By Joint Venture A/c (Expenses)	1,000
				By Joint Venture A/c (Commission)	424
				By Joint Venture A/c (Profit)	2,824
				By Bank A/c (Final payment)	54,648
		68,896			68,896

Working Notes :

(1) Calculation of Sales Proceeds

	₹
Cost price of the goods sent	60,000
Less: Goods damaged at cost	5,000
	55,000
Less: Cost of goods unsold (10% of ₹ 55,000)	5,500
Cost of goods sold	49,500
Profit (30% of cost)	14,850
Sales Proceeds	64,350

(2) Calculation of Compensation

	₹
Cost of goods damaged by fire (unsold)	5,500
Add: Proportionate Expenses (2,000 / 60,000) x 5,500	183
Total cost	5,683

Y will compensate to the extent of 80%, i.e., 5,683 x .8 = ₹ 4,546 (approx.)

(3) Commission Payable to Y : Profit before charging Y's commission is ₹ 8,896 {₹ 71,896 – (₹ 60,000 + ₹ 2,000 + ₹ 1,000}. Therefore, Y's commission is (5 /105) x ₹ 8,896 = ₹ 424 (approx.).

Illustration 12

John and Ali entered into a joint venture agreeing to share profits and losses in the ratio of 3:2. On 4.1.2015, Ali purchased goods costing ₹ 60,000 and spent ₹ 2,000 as expenses. On the same date he sent to John part of these goods costing ₹ 40,000. On 7.2.2015, John sent ₹ 30,000 to Ali. On 10.2.2015, he purchased goods costing ₹ 50,000 and sent half of the goods to Ali. He paid ₹ 1,000 as carriage. On 24.3.2015, Ali sold most of the goods in his possession for ₹ 55,000 and the remaining goods costing ₹ 3,000 were taken over by him at an agreed valuation of ₹ 4,000. On 18.4.2015, John sold all the goods in his possession for ₹ 75,000 except some damaged goods costing

₹5,000 which it was agreed were to be written off as unsaleable. His selling expenses amounted to ₹ 2,000. On 30.4.2015, the amount required to settle the accounts between John and Ali was paid by the appropriate party. Show the Joint Venture Account and John's Account in the books of Ali.

Solution

In the books of Ali

Dr. Joint Venture Account Cr.

Date	Particulars	₹	₹	Date	Particulars	₹	₹
4.1.2015	To Bank A/c			24.3.2015	By Bank A/c (Sales)		55,000
	Goods purchased	60,000			By Purchases A/c (Goods taken)		4,000
	Expenses	2,000	62,000	18.4.2015	By John A/c (Sales)		75,000
10.2.2015	To John A/c :						
	Goods purchased	50,000					
	Carriage	1,000	51,000				
18.4.2015	To John A/c (Selling expenses)		2,000				
30.4.2015	To Profit & Loss A/c (Sh. of profit)		7,600				
	To John A/c (Share of profit)		11,400				
			1,34,000				1,34,000

Dr. John Account Cr.

Date	Particulars	₹	Date	Particulars	₹
18.4.2015	To Joint Venture A/c (Sales)	75,000	7.2.2015	By Bank A/c (Advance)	30,000
30.4.2015	To Bank A/c (Balance paid)	19,400	10.2.2015	By Joint Venture A/c (Expenses + Purchases)	51,000
				By Joint Venture A/c (Selling Expenses)	2,000
				By Joint Venture A/c (Profit)	11,400
		94,400			94,400

Tutorial Notes : **(1)** No entry is required for transfer of goods by Ali to John and also John to Ali.;
(2) No entry is required for damaged goods for which nothing has been realised.

Illustration 13

Maganbhai of Rajkot and Ramanan of Madras enter into a joint venture deciding to share profits and losses in the ratio of 3:2. Maganbhai purchases 3,000 kg of material A for ₹ 1,50,000 and sends it to Nana of Pune for processing. Maganbhai pays the transport cost amounting to ₹ 6,000. Ramanan purchases 2,000 kg of material B for ₹ 2,00,000 and sends it to Nana of Pune for processing. The transport cost amounting to ₹ 10,000 is paid by Ramanan. Nana does the processing work and manufactures 4,800 units of the finished product C. Nana prepares a 'conversion cost' bill on the joint venture at ₹ 20 per unit. Maganbhai pays this bill. The goods are sent to Banerjee of Calcutta, the transport cost amounting to ₹ 18,000 paid by Maganbhai. Banerjee sells 90% of the goods at ₹ 150 per unit. He takes over the balance goods at ₹ 120 per unit. After deducting his own commission @ 10% of sale proceeds, he remits the amount to Maganbhai. The co-venturers agree to settle the account, after retaining 30% of the profits for taxation on the income of association of persons. You are required to show the ledger accounts in the books of Maganbhai.

Solution

Ledger of Maganbhai

Dr. Joint Venture Account Cr.

Date	Particulars	₹	₹	Date	Particulars	₹	₹
	To Bank A/c :				By Banerjee A/c (Sales)		6,48,000
	Purchases	1,50,000			By Banerjee A/c (Goods taken)		57,600
	Transportation cost	6,000					
	Conversion cost	96,000					
	Transportation cost (Calcutta)	18,000	2,70,000				
	To Ramanan A/c :						
	Purchases	2,00,000					
	Transportation cost	10,000	2,10,000				
	To Banerjee A/c (Commission)		64,800				
	To Net profit c/d		1,60,800				
			7,05,600				7,05,600
	To Provision for Taxation A/c @ 30%		48,240		By Net profit b/d		1,60,800
	To Profit & Loss A/c (Share of profit)		67,536				
	To Ramanan A/c (Share of profit)		45,024				
			1,60,800				1,60,800

Dr. Ramanan Account Cr.

Date	Particulars	₹	₹	Date	Particulars	₹	₹
	To Bank A/c (Balance sent)		2,55,024		By Joint Venture A/c :		
					Purchases	2,00,000	
					Transport	10,000	
					Share of Profit	45,024	2,55,024
			2,55,024				2,55,024

Dr. **Banerjee Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Joint Venture A/c (Sales)	6,48,000		By Joint Venture A/c (Commission)	64,800
	To Joint Venture A/c (Goods taken)	57,600		By Bank A/c (Final payment)	6,40,800
		7,05,600			7,05,600

Tutorial Note: We assume that no commission is payable on the unsold stock taken over by Banerjee and the amount for the provision for taxation lies with Maganbhai.

(b) When each co-venturer maintains a record of his own transactions. [Memorandum Method]

In such a case, each co-venturer records in his books of account those transactions with which he is concerned. He does not record any transactions of his co-venturers. In this method, each co-venturer opens the following two accounts : (i) Joint Venture with ... Account; and (ii) Memorandum Joint Venture Account.

(i) Joint Venture with .... Account: It is in the nature of a personal account. Each co-venturer debits this account with all the payments and supply made by him on behalf of the joint venture such as purchase, expenses, and the like and credits it with all the payments received by him on behalf of the venture. This account is a part of the double-entry system of the venturer concerned. It should be remembered in this context that 'Joint Venture with ... Account' is not a nominal account and does not disclose any profit or loss.

(ii) Memorandum Joint Venture Account: As soon as the venture is completed, each party submits a copy of his account to others. With the help of this information each co-venturer prepares a 'Memorandum Joint Venture Account', which shows profit or loss on venture. This account simply summarizes the expenses and incomes of all the parties in respect of the joint venture for the purpose of ascertaining profit on venture. Since, it is a memorandum account it does not form a part of the double-entry system.

Accounting Entries

1. For goods purchased on account of joint venture

Joint Venture with ... Account Dr.
    To Bank Account

---

2. For expenses incurred on account of joint venture

Joint Venture with ... Account Dr.
    To Bank Account

---

3. For goods sold by him on account of joint venture

Bank Account Dr.
    To Joint Venture with ... Account

---

4. For goods taken over for business/personal use

Purchases Account (business) Dr.
Drawings Account (personal) Dr.
    To Joint Venture with ... Account

---

5. For one's share of profit

Joint Venture with ... Account Dr.
    To Profit & Loss Account

---

6. For final settlement

(a) For paying

Joint Venture with ... Account Dr.
    To Bank Account

(b) For receiving

Bank Account Dr.
    To Joint Venture with ... Account

Tutorial Note : Discount on bill should be treated as expenses of the joint venture.

Illustration 14

A and B entered into a joint venture to purchase and sell crackers during the Diwali season. Profits and losses were to be shared equally between A and B. A was to purchase crackers from Sivakasi and send it to B of Mumbai who would sell it.

On 1.8.2014, A purchased crackers worth ₹ 1,00,000 and incurred the following expenses in sending it to B: (i) forwarding charges ₹ 6,000; and (ii) insurance charges ₹ 2,000.He immediately drew upon B ₹ 1,00,000 for 3 months. The acceptance was discounted @ 18% p.a. B paid the following expenses : (i) cartage charges ₹ 3,000; (ii) commission to agents ₹ 5,000; (iii) rental charges ₹ 4,000.

The whole crackers were disposed of for ₹ 2,00,000. He forwarded a cheque to A for the amount due on 31.10.2014. You are required to prepare the following accounts : (a) Memorandum Joint Venture Account; (b) B in Joint Venture in the books of A; and (c) A in Joint Venture in the books of B.

Solution

Dr. Memorandum Joint Venture Account Cr.

Date	Particulars	₹	₹	Date	Particulars	₹	₹
	To A : Purchases	1,00,000			By B : Sales		2,00,000
	Expenses	8,000					
	Discount on Bill	4,500	1,12,500				
	To B : Expenses		12,000				
	To Share of Profit :						
	A	37,750					
	B	37,750	75,500				
			2,00,000				2,00,000

In the books of A

Dr. B in Joint Venture Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.8.2014	To Bank A/c :		1.8.2014	By Bills Receivable A/c	1,00,000
	Purchases	1,00,000	31.10.2014	By Bank A/c (Final settlement)	50,250
	Forwarding charges	6,000			
	Insurance charges	2,000			
	To Discount on Bill A/c	4,500			
31.10.2014	To Profit & Loss A/c (Share of profit)	37,750			
		1,50,250			1,50,250

In the books of B

Dr. A in Joint Venture Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.8.2014	To Bills Payable A/c	1,00,000	?	By Bank A/c (Sales)	2,00,000
?	To Bank A/c : Cartage charges	3,000			
	Commission to agents	5,000			
	Rental charges	4,000			
31.10.2014	To Profit & Loss A/c (Share of profit)	37,750			
"	To Bank A/c (final settlement)	50,250			
		2,00,000			2,00,000

Illustration 15

Ghosh and Bose enter into a joint venture for guaranteeing the subscription at par of 1,00,000 shares of ₹ 10 each of a joint stock company. They agree to share profits and losses in the ratio of 2:3. The terms with the company are 4.5% commission in cash and 6,000 shares of the company as fully paid-up. The public take up 88,000 of the shares and the remaining share of guaranteed issues are taken up by Ghosh and Bose who provided cash equally. The commission in cash is taken by partners in the ratio of 4:5. The entire shareholding of the joint venture is then sold through brokers, 25% at a price of ₹ 9;. 50% at a price of ₹ 8.75; 15% at a price of ₹ 8.50; and remaining 10% are taken over by them equally at ₹ 8 per share. The sale proceeds of the shares are taken by the partners equally.

Prepare a Joint Venture Memorandum Account and the separate accounts in the books of Ghosh and Bose.

Solution

Dr. Memorandum Joint Venture Account Cr.

Date	Particulars	₹	₹	Date	Particulars	₹	₹
	To Ghosh : Cost of shares		60,000		By Ghosh :		
	To Bose : Cost of shares		60,000		Sales proceeds 1/2	71,100	
					Commission (cash) 4/9	20,000	
					Shares taken over	7,200	98,300

	To Share of profit :				To Bose :		
	Ghosh 2/5th		32,640		Sales proceeds 1/2	71,100	
	Bose 3/5th		48,960		Commission (cash) 5/9	25,000	
					Shares taken over	7,200	1,03,300
			2,01,600				2,01,600

In the books of Ghosh

Dr. Joint Venture with Bose Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Bank A/c : cost of shares	60,000		By Bank A/c (Share of commission)	20,000
	To Profit & Loss A/c (Share of profit)	32,640		By Bank A/c (Share of proceeds)	71,100
	To Balance c/d (Amount due)	5,660		By Shares A/c (Shares taken over)	7,200
		98,300			98,300

In the books of Bose

Dr. Joint Venture with Ghosh Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Bank A/c : Cost of shares	60,000		By Bank A/c (Share of commission)	25,000
	To Profit & Loss A/c (Share of profit)	48,960		By Bank A/c (Share of proceeds)	71,100
				By Shares A/c (Shares taken over)	7,200
				By Balance c/d (Amount due)	5,660
		1,08,960			1,08,960

Working Notes : (1) Since public took up 88,000 shares, the venturers were to take up the balance of shares, i.e. 1,00,000 – 88,000 = 12,000 shares. Secondly, 4.5% commission was given on gross face value of shares, i.e. 4.5% on ₹ 10,00,000 (1,00,000 x ₹ 10) = ₹ 45,000; (2) The venturers were having 18,000 shares with themselves, i.e. 12,000 shares purchased and 6,000 shares given to them as a part of the consideration. Therefore, sale proceeds and unsold shares taken over are calculated as under:

Sale Proceeds		**Sale proceeds taken over** :
25% of 18,000 shares = 4,500 shares @ ₹ 9.00 each =	₹ 40,500	Unsold shares — 10% of 18,000 = 1,800 shares
50% of 18,000 shares = 9,000 shares @ ₹ 8.75 each =	₹ 78,750	Taken over by each of them 1/2 of 1,800 x ₹ 8
15% of 18,000 shares = 2,700 shares @ ₹ 8.50 each =	₹ 22,950	= ₹ 7,200.
Sale Proceeds =	1,42,200	

Illustration 16

A and B decided to work on a joint venture for the sale of electric motors. On 21st May, 2014, A purchased 200 electric motors at ₹ 175 each and despatched 150 electric motors to B incurring ₹ 1,000 as freight and insurance charges, 10 electric motors were damaged in transit. On 1st February, 2015 ₹ 500 was received by A from the insurance company in full settlement of claim. On 15th March, 2015, A sold 50 electric motors at ₹ 225 each. He received ₹ 15,000 from B on 1st April, 2015.

On 25th May, 2014 B took delivery of electric motors and incurred the following expenses : clearing charges ₹ 125; Repair charges for motors damaged in transit ₹ 300; and Godown rent ₹ 600. B sold the electric motors as follows : On 1.2.2015 10 damaged motors at ₹ 170 each; on 15.3.2015, 40 motors at ₹ 200 each; on 1.4.2015, 20 motors at ₹ 315 each; on 3.4.2015, 80 motors at ₹ 250 each. It is agreed that they are entitled to commission at 10% on the respective sales effected by them and that the profits and losses shall be shared by A and B in the ratio of 2 : 1. B remits to A the balance of money due on 30th April, 2015.

Prepare : (1) Joint Venture Account with B Account in the books of A, and (2) Memorandum Joint Venture Account.

Solution

In the books of A

Dr. Joint Venture with B Account Cr.

Date	Particulars	₹	Date	Particulars	₹
21.5.2014	To Bank A/c (Purchases)	35,000	1.2.2015	By Bank A/c (Insurance claim)	500
21.5.2014	To Bank A/c (Freight)	1,000	15.3.2015	By Bank A/c (Sales proceeds)	11,250
	To Commission Received A/c	1,125	1.4.2015	By Bank A/c (Amount received)	15,000
30.4.2015	To Profit & Loss A/c (Share of profit)	4,000	30.4.2015	By Bank A/c (Balance received)	14,375
		41,125			41,125

Dr. Memorandum Joint Venture Account Cr.

Date	Particulars	₹	₹	Date	Particulars	₹	₹
	To A : Cost of Motor	35,000			By A : Sale proceeds		11,250
	Freight & Insurance	1,000			Insurance claim		500
	Commission	1,125	37,125		By B : Sales proceeds		36,000
	To B :						
	Clearing Charges	125					
	Repairs	300					

Date	Particulars	₹	₹	Date	Particulars	₹	₹
	Godown Rent	600					
	Commission	3,600	4,625				
	To Net Profit						
	A : 2/3rd		4,000				
	B : 1/3rd		2,000				
			47,750				47,750

Illustration 17

B of Bombay and C of Calcutta enter into a joint venture to consign scrap iron to A of Agra, to be sold on their risk. They share profits and losses equally. A is entitled to a commission of 10% of the net proceeds after charging such commission. B sends 50 tonnes costing ₹ 4,300 per tonne and pays freight and other expenses of ₹ 30,000. C sends 70 tonnes costing ₹ 5,000 per tonne and pays freight and other expenses ₹ 40,000. All the scrap is sold by A @ ₹ 10,000 per tonne and he pays selling expenses of ₹ 12,000. He remits ₹ 5,00,000 to B and the balance of the net proceeds to C by bank draft. You are required: (a) to show the account in the books of B and C to record their own transactions; and (b) to prepare a Memorandum Joint Venture Account.

Solution

Dr. **Memorandum Joint Venture Account** **Cr.**

Date	Particulars	₹	₹	Date	Particulars	₹	₹
	To B :				By B A/c (Sale proceeds received)		5,00,000
	Purchases	2,15,000			By C A/c (Sale proceeds received)		5,80,000
	Expenses	30,000	2,45,000				
	To C :						
	Purchases	3,50,000					
	Expenses	40,000	3,90,000				
	To Share of Profit						
	B	2,22,500					
	C	2,22,500	4,45,000				
			10,80,000				10,80,000

In the books of B

Dr. **Joint Venture with C Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Bank A/c (Purchases)	2,15,000		By Bank A/c : (Sale proceeds from A)	5,00,000
	To Bank A/c (Expenses)	30,000			
	To Profit & Loss A/c (Share of profit)	2,22,500			
	To Bank A/c (Final settlement)	32,500			
		5,00,000			5,00,000

In the books of C

Dr. **Joint Venture with B Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Bank A/c (Purchases)	3,50,000		By Bank A/c : (Sale proceeds from A)	5,80,000
	To Bank A/c (Expenses)	40,000		By Bank A/c (Final settlement)	32,500
	To Profit & Loss A/c (Share of profit)	2,22,500			
		6,12,500			6,12,500

Working Notes :

	₹
Sale of 120 tonnes @ ₹ 10,000 per ton	12,00,000
Less: Selling Expenses	12,000
Net proceeds before charging commission	11,88,000
Less: A's commission (₹ 11,88,000 / 110) x 10	1,08,000
Net proceeds after charging commission	10,80,000

Illustration 18

Asim and Anup entered in joint venture to buy and sell second hand T.V. sets. They shared profits and losses equally. It was agreed that interest @ 10% p.a. would be provided for the amount invested by the venturers in the venture.

On 1.8.2013 Asim purchased 6 T.V. sets for ₹ 36,000 and paid ₹ 3,300 to the mechanic for repairs. He sold all the T.V. sets for ₹ 47,500 on 15.9.2013.

On 1.9.2013, Anup purchased 3 T.V. sets at a cost of ₹ 18,300 and incurred ₹ 2,100 for repairing. He sold 2 T.V. sets for ₹ 16,400 on 25.11.2013 and the unsold set was taken over by him at cost plus 8%. The venture was closed on 30.11.2013.

Prepare Memorandum Joint Venture Account and the Account of "Joint Venture with Anup" in the books of Asim.

Solution

Dr. Memorandum Joint Venture Account Cr.

Date	Particulars		₹	Date	Particulars		₹
	To Asim : Cost of T.V.Sets	36,000			By Asim (sale proceeds)		47,500
	Repairs	3,300			By Anup :		
	Interest (Note 2)	491	39,791		Sale proceeds	16,400	
	To Anup : Cost of T.V.Sets	18,300			T.V. taken over (Note 1)	7,344	23,744
	Repairs	2,100					
	Interest (Note 2)	510	20,910				
	To Net Profit :						
	Asim	5,272					
	Anup	5,271	10,543				
			71,244				71,244

In the books of Asim

Dr. Joint Venture with Anup Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013			2013		
Aug 1	To Bank A/c (Purchases of T.V.)	36,000	Sep 15	By Bank A/c (Sale Proceeds)	47,500
	To Bank A/c (Repairs)	3,300			
Nov 30	To Interest Received A/c	491			
	To Profit and Loss A/c (Share of Profit)	5,272			
	To Bank A/c (Final Payment)	2,437			
		47,500			47,500

Working Notes :

(1) Calculation of Unsold Stock taken over by Anup

	₹
Cost of 1 T.V. (₹ 18,300 / 3)	6,100
Add: Proportionate repairs cost (₹ 2,100 / 3)	700
	6,800
Add: 8% Profit on ₹ 6,800	544
Value of 1 T.V. taken over by Anup	7,344

(2) Calculation of Interest

Asim invested ₹ 39,300 (₹ 36,000 + 3,300) on 1.8.2013 but received back ₹ 47,500 on 15.9.2013.

Therefore, he is entitled to interest on capital invested on ₹ 39,300 @ 10% p.a. for 1.5 months (1.8.2013 to 15.9.2013). Therefore, interest = ₹ 39,300 × 10% × 1.5 / 12 = ₹ 491.

Anup invested ₹ 20,400 (₹ 18,300 + 2,100) on 1.9.2013 but received back ₹ 16,400 on 25.11.2013.

If interest is calculated to nearest month, he is entitled to interest on capital invested on ₹ 20,400 @ 10% p.a. for 3 months (1.9.2013 to 30.11.2013). Therefore, interest = ₹ 20,400 × 10% × 3/12 = ₹ 510.

Illustration 19

A and B entered into a joint venture as equal partners and guaranteed, as underwriters, the subscription at par of 10,00,000 shares of Re 1 each of Madan Ltd and to pay all expenses upto allotment in consideration of Madan Ltd issuing to them 30,000 other shares of Re 1 each fully paid up and paying ₹ 20,000 in cash.

A introduced cash into the business to meet the following expenses :

Stamp charges and registration fees etc ₹ 5,000;
Advertisement charges ₹ 2,000.

B introduced cash to meet the following expenses :

Printing charges of documents ₹ 4,000;
Solicitor's charges ₹ 2,500; Rent ₹ 500.

Application fell short of 10,00,000 shares by 40,000 shares. A took up those shares on joint account in terms of their agreement with Madan Ltd and himself paid for those shares. Finally, Madan Ltd handed over the shares and the cash to A and B in full payment of the underwriting commission as per agreement. The cash thus received was taken over by B. Out of the total 70,000 shares received by the venturers, 55,000 shares were sold out for ₹ 50,000 and the proceeds were taken up by A and the rest of the shares were taken up by B at an agreed value of ₹ 12,000.

Prepare Memorandum Joint Venture Account including necessary accounts in the books of both the parties assuming that they settled their accounts by payment of cash.

Solution

Dr. **Memorandum Joint Venture Account** **Cr.**

Date	Particulars	₹	₹	Date	Particulars	₹	₹
	To A : Stamp charges, etc.	5,000			By B : Cash Received	20,000	
	Advertisement	2,000			Shares taken over	12,000	
	Cost of 40,000 Shares	40,000	47,000				32,000
	To B : Printing	4,000			By A : Sale Proceeds		50,000
	Solicitor's Charges	2,500					
	Rent	500	7,000				
	To Net Profit : A	14,000					
	B	14,000	28,000				
			82,000				82,000

In the books of A

Dr. **Joint Venture with B Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Bank A/c (Expenses) :			By Bank A/c (Sale proceeds)	50,000
	Stamp charges, etc.	5,000		By Bank A/c (final settlement)	11,000
	Advertisement	2,000			
	Cost of 40,000 shares	40,000			
	To Profit and Loss A/c (Share of Profit)	14,000			
		61,000			61,000

In the books B

Dr. **Joint Venture Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Bank A/c (Expenses) :			By Bank A/c (Cash received)	20,000
	Printing	4,000		By Investments A/c (Shares taken over)	12,000
	Solicitor's charges	2,500			
	Rent	500			
	To Profit and Loss A/c (Share of Profit)	14,000			
	To Bank A/c (Final settlement)	11,000			
		32,000			32,000

Valuation of Unsold Stock

Where accounts are to be prepared before the completion of the venture, stock in hand at the balancing date must be valued. The value of the unsold stock is credited to the Joint Venture Account and debited to the Stock on Joint Venture Account. In the next period, it should be brought down in the debit side of the Joint Venture Account.

The unsold stock should be valued by the principle of 'Cost price or Market Price, whichever is lower'.

The cost price should include:

(i) Cost of unsold goods; and (ii) Proportionate non-recurring expenses such as freight, insurance, carriage inward and the like, but not selling or distribution cost.

Interim Settlement of Accounts and Unsold Stock

Before the completion of the venture, if an interim settlement is desired and there is some unsold stock lying in the hands of either or both the parties, then it may be treated in the following manner.

Method 1: (a) Credit Memorandum Joint Venture Account with unsold stock and bring it down on the debit side as balance in the next period; (b) Divide the unsold stock between the co-venturers in the *profit sharing ratio*; (c) Each co-venturer in his own books will bring down *his share of stock* separately without merging with other dues.

Method 2: (a) Credit Memorandum Joint Venture Account with unsold stock and bring it down on the debit as balance in the next period; (b) *Don't divide the unsold stock between the co-venturers*; (c) Each co-venturer in his own books will bring down the amount of unsold stock that *he has on hand*.

We suggest that the students should follow Method 1 because it reflects the respective interest in the stock.
The following illustration will make the matter more clear (Method 1).

Illustration 20

On 1st January, 2014, Pandey and Parker entered into a joint venture to consign goods to Parekh to be sold on their joint risk. They agreed to share profits and losses in the ratio of 3:2.

On 15th April, 2014, Pandey consigned goods to the value of ₹ 36,000 and incurred expenses amounting to ₹ 3,000. On 31st July, 2014, Parker also consigned goods to the value of ₹ 22,000 and incurred expenses amounting to ₹ 1,800. On 15th Nov. 2014, Parekh sold 80% of the total goods for ₹ 60,000 and remitted the proceeds to Pandey after deducting 5% commission on sales. On 31st Dec., 2014, on which date accounts were prepared, an interim settlement was effected between Pandey and Parker. On 15th August, 2015, Parekh sold the remainder of the total goods for ₹ 8,000 and remitted the proceeds to Parker, less 5% commission on sales. On 31st Oct., 2015, a final settlement was effected between Pandey and Parker.

You are required : (a) to show the accounts in the books of each co-venturer to record his own transactions, and (b) to prepare a Memorandum Joint Venture Account.

Solution

Dr. Memorandum Joint Venture Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Pandey :			By Parekh	
	Goods sent	36,000		Sales	60,000
	Expenses	3,000		By Stock c/d (Note)	12,560
	To Parker :				
	Goods sent	22,000			
	Expenses	1,800			
	To Parekh :				
	Commission	3,000			
	To Net Profit :				
	Pandey — 3/5th	4,056			
	Parker — 2/5th	2,704			
		72,560			72,560
	To Stock b/d	12,560		By Parekh (Sales)	8,000
	To Parekh — Commission	400		By Loss :	
				Pandey — 3/5th	2,976
				Parker — 2/5th	1,984
		12,960			12,960

In the books of Pandey

Dr. Joint Venture with Parker Account Cr.

Date	Particulars	₹	Date	Particulars	₹
15.4.2014	To Bank A/c :		2014	By Bank A/c : (Sales)	57,000
	Goods consigned	36,000		By Stock c/d (Note) (3/5 x 12,560)	7,536
	Expenses	3,000			
31.12.2014	To Profit & Loss A/c (share of profit)	4,056			
	To Bank A/c (Remittance)	21,480			
		64,536			64,536
1.1.2015	To Stock b/d	7,536	2015	By Profit & Loss A/c (Share of loss)	2,976
				By Bank A/c (Remittance)	4,560
		7,536			7,536

In the books of Parker

Dr. Joint Venture with Pandey Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.7.2014	To Bank A/c :		31.12.2014	By Bank (Remittance)	21,480
	Goods consigned	22,000		By Stock c/d (2/5 x 12,560) (Note)	5,024
	Expenses	1,800			
31.12.2014	To Profit & Loss A/c (Share of profit)	2,704			
		26,504			26,504
1.1.2015	To Stock b/d	5,024	15.8.2015	By Bank A/c (Sales)	7,600
	To Bank A/c (Remittance)	4,560		By Profit & Loss A/c (Share of loss)	1,984
		9,584			9,584

Working Note :

	₹
Goods consigned by Pandey	36,000
Goods consigned by Parker	22,000
Expenses (₹ 3,000 + ₹ 1,800)	4,800
	62,800

20% Unsold = (₹ 62,800/ 5) = ₹ 12,560.

Illustration 21

Kapil and Amarnath of Nagpur entered into a joint venture to trade in silk goods in the ratio 2:1. On June 1, 2014, Kapil bought goods worth ₹ 7,200 and handed over half of the goods to Amarnath. On July 1, 2014 Kapil bought another lot of goods costing ₹ 2,400 and paid ₹ 180 as expenses. On September 1, Amarnath purchased goods for ₹ 4,500 and on the same day he sent to Kapil a part of these goods costing ₹ 1,800 and paid ₹ 240 towards expenses. On the same day Kapil remitted ₹ 1,800 to Amarnath. The goods were invariably sold by the venturers at a uniform price of $33^{1}/_{3}$% above cost price excluding expenses. Each of the venturers collected cash proceeds on sales excepting an amount of ₹ 250 owing to Kapil by a customer and this was written off as a loss relating to the venture. In addition, goods costing ₹ 600 in possession of Amarnath were destroyed by fire and an amount of ₹ 500 was realized by him as compensation from the Insurance Company. On December 20, unsold goods costing ₹ 1,500 (at cost) were lying with Kapil. Of these, goods costing ₹ 600 were taken by Kapil for personal use and the balance was purchased by him at an agreed value of ₹ 1,000. Amarnath disposed of all the goods with him on December 31, excepting some damaged goods costing ₹ 300 which were written off as unsaleable.

Prepare a Memorandum Joint Venture Account and the Joint Venture Account as it would appear in the books of Kapil and Amarnath assuming that the final settlement of accounts, between the venturers took place on December 31, 2014.

Solution

Dr. Memorandum Joint Venture Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Kapil :			By Kapil :	
	Cost of goods (₹ 7,200 + ₹ 2,400)	9,600		Sales (Note)	8,400
	Expenses	180		Stock taken over	1,600
	Bad Debts	250		By Amarnath :	
	To Amarnath :			Sales (Note)	7,200
	Cost of goods	4,500		Insurance claim	500
	Expenses	240			
	To Net Profit :				
	Kapil — 2/3rd	1,953			
	Amarnath — 1/3rd	977			
		17,700			17,700

Working Note : **Calculation of Sales by Kapil and Amarnath**

Kapil	₹	Amarnath	₹
Goods purchased	7,200	Goods received from Kapil	3,600
Less: Sent to Amarnath	3,600	Add: Goods purchased	4,500
	3,600		8,100
Add: Further purchase of goods	2,400	Less: Sent to Kapil	1,800
	6,000		6,300
Add: Received from Amarnath	1,800	Less: Stock destroyed by fire	600
	7,800		5,700
Less: Unsold Stock	1,500	Less: Damaged stock (written off)	300
Cost of goods sold	6,300	Cost of goods sold	5,400
Add: Profit 33.33% on cost	2,100	Add: Profit 33.33% on cost	1,800
Sale Proceeds	8,400	Sale Proceeds	7,200

In the books of Kapil

Dr. Joint Venture with Amarnath Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.6.2014	To Bank A/c (Goods purchased)	7,200	20.12.2014	By Sundry Debtors A/c (Sales proceeds)	8,400
1.7.2014	To Bank A/c (Goods purchased)	2,400		By Drawing A/c (Taken over for personal use)	600
1.7.2014	To Bank A/c (Expenses)	180		By Purchases A/c (Taken over for business)	1,000
1.9.2014	To Bank A/c (Remittance)	1,800	31.12.2014	By Bank A/c (Final settlement)	3,783
31.12.2014	To Bad Debts A/c	250			
"	To Profit & Loss A/c (Share of profit)	1,953			
		13,783			13,783

In the books of Amarnath

Dr. Joint Venture with Kapil Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.9.2014	To Bank A/c (Goods purchased)	4,500	1.9.2014	By Bank A/c (Amount received)	1,800
"	To Bank A/c (Expenses)	240	31.12.2014	By Sundry Debtors A/c (Sales Proceeds)	7,200
31.12.2014	To P & L A/c (Share of profit)	977	"	By Bank A/c (Insurance claim)	500
"	To Bank A/c (Final settlement)	3,783			
		9,500			9,500

Illustration 22

Gopal and Gopi, who are share brokers, agreed to enter into a joint venture to underwrite 5,00,000 equity shares of ₹ 10 each of a new flotation of X Ltd. X Ltd. agreed to allot them as fully-paid 4,000 shares in the company in consideration of the underwriting arrangement. The parties were to share profits and losses equally. In connection with the venture, the following expenses were incurred:

Gopal: Printing and stationery ₹ 5,000; postage ₹ 1,000; and advertisement ₹ 3,000.

Gopi : Postage ₹ 750; solicitor's fees ₹ 3,500; and entertainment expense ₹ 4,000.

The public subscription was for 4,80,000 shares only and the underwriters were forced to take up the balance and pay for them, to enable them to do so, the two persons approached the New Bank of India, which on the security of the shares, advanced the required sum on 1st July, 2015 at 15% interest p.a. The underwriters paid for the shares on the same day and were also allotted the 4,000 shares by X Ltd.

The underwriters through the bank unloaded their lot of holdings in the market in equal lots and realized 90% of the face value for the first lot on 30th September and 85% for the second lot on 31st October. The sale proceeds were applied in full to discharge the bank loan and the relative interest on the same date. (The four thousand shares formed part of the second lot). Share transfer fees of ₹ 1,006.25 was met from the Joint Venture Bank Account.

You are required to draw a Memorandum Joint Venture Account, the account of Gopal as appearing in Gopi's books and the account of Gopi as appearing in Gopal's books and as the settlement of account between the parties.

Solution

Dr. Memorandum Joint Venture Account Cr.

Date	Particulars		₹	Date	Particulars		₹
	To Gopal :				By Bank (Sale of shares)		2,10,000
	Printing & Stationery	5,000			By Loss on Venture :		
	Postage	1,000			Gopal — 1/2	8,500	
	Advertisement	3,000	9,000		Gopi — 1/2	8,500	17,000
	To Gopi :						
	Postage	750					
	Fees to Solicitors	3,500					
	Entertainment Expenses	4,000	8,250				
	To Bank loan for 20,000 shares		2,00,000				
	To Bank Interest A/c (Note 2)		8,743.75				
	To Share Transfer fees		1,006.25				
			2,27,000				2,27,000

In the books of Gopal

Dr. Joint Venture with Gopi Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Bank A/c (Total expenses)	9,000		By P&L A/c (Loss on Venture)	8,500
				By Bank A/c (Amount recd. from Joint Bank A/c)	250
				By Bank A/c (Amount recd. from Gopi)	250
		9,000			9,000

In the books of Gopi

Dr. Joint Venture with Gopal Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Bank A/c (Expenses)	8,250		By P & L A/c (Loss on Venture)	8,500
	To Bank A/c (Amount in settlement)	250			
		8,500			8,500

Working Notes :

(1) Sale Proceeds :	₹	(2) Interest :	₹
30.9.2015 12,000 shares @ ₹ 9	1,08,000	On ₹ 2,00,000 @ 15% for 3 months	7,500.00
31.10.2015 12,000 shares @ ₹ 8.50	1,02,000	On ₹ 99,500 @ 15% for 1 month	1,243.75
	2,10,000	[₹ 2,00,000 + ₹ 7,500 — ₹ 1,08,000]	8,743.75

(3) Balance in Joint Bank Account : Sale Proceeds of 24,000 shares = ₹ 2,10,000 Less: (Loan ₹ 2,00,000 + Interest & Transfer Fee ₹ 9,750) = ₹ 2,09,750. Therefore, Balance given to Gopal = ₹ 250.

Conversion of Consignment into Joint Venture

The consignor and the consignee may decide to convert a consignment into a joint venture for their mutual interest. Conversion may be done: (a) from a particular date; and (b) with retrospective effect.

(a) Conversion from a particular date: When a consignment is converted into a joint venture from a particular date, the following steps should be followed:

Step 1 Prepare Consignment Account and Consignee Account in the usual manner upto the date of conversion and determine profit or loss on consignment and consignee's balance upto that date.

Step 2 Open Joint Venture Account and debit it with the stock on consignment (on the date of conversion). Prepare Joint Venture Account in the usual manner.

Step 3 Bring down the balance of the Consignee Account and post all the transactions relating to joint venture in the usual manner. Finally, settle the account of the consignee.

The following illustration will help the students to understand the principles.

Illustration 23

On 1st January, 2015 Menon sent goods to Gupta to be sold on consignment basis @ 5% commission. Goods costing ₹ 6,00,000 were sent and ₹ 50,000 expenses were incurred. Gupta has to incur ₹ 20,000 expenses for landing and 75% of the goods were sold out for ₹ 7,00,000.

Gupta sent the amount due from him with the Account Sales on 31st March, 2015. But he wanted to return the balance goods as he was not agreeable to carry on as a commission agent. He was, however, persuaded to continue on joint venture basis for 1/3rd profit. ₹ 2,50,000 worth of goods were further despatched by Menon.

All goods (except ₹ 25,000 which were taken over by Gupta for the same amount) were sold out for ₹ 6,00,000 before 30th June, 2015. Menon incurred ₹ 25,000 as expenses and Gupta's expenses amounted to ₹ 15,000. The account was settled on 30th June, 2015.

Show necessary accounts in the books of both the parties.

Solution

In the books of Menon

Dr. Consignment to Gupta Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015	To Goods Sent on Consignment A/c	6,00,000	2015	By Gupta A/c (Sales)	7,00,000
Jan. 1	To Bank A/c (Expenses)	50,000	Mar. 31	By Stock on Consignment A/c	1,67,500
Mar. 31	To Gupta A/c (Landing charges)	20,000		(Transferred to Joint Venture)	
	To Gupta A/c (Commission)	35,000			
	To Profit & Loss on Consignment A/c	1,62,500			
		8,67,500			8,67,500

Dr. Joint Venture Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015	To Stock on Consignment A/c	1,67,500	2015	By Gupta A/c (Sales)	6,00,000
April 1	To Purchases A/c (Goods supplied)	2,50,000	June 30	By Gupta A/c (Goods taken over)	25,000
June 30	To Bank A/c (Expenses)	25,000			
	To Gupta A/c (Expenses)	15,000			
	To Profit & Loss A/c (Share of profit)	1,11,667			
	To Gupta A/c (Share of profit)	55,833			
		6,25,000			6,25,000

Dr. **Gupta Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015	To Consignment to Gupta A/c	7,00,000	2015	By Consignment to Gupta A/c :	
Mar. 31			Mar. 31	Landing charges	20,000
				Commission	35,000
				By Bank A/c (Remittance)	6,45,000
		7,00,000			7,00,000
June 30	To Joint Venture A/c (Sales)	6,00,000	June 30	By Joint Venture A/c (Expenses)	15,000
	To Joint Venture A/c (Goods taken over)	25,000		By Joint Venture A/c (Share of profit)	55,833
				By Bank A/c (Remittance)	5,54,167
		6,25,000			6,25,000

In the books of Gupta

Dr. **Joint Venture Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015	To Menon A/c		2015	By Bank A/c (Sales)	6,00,000
April 1	Stock on Consignment	1,67,500	June 30	By Purchases A/c (Goods taken over)	25,000
	Goods sent	2,50,000			
	Expenses	25,000			
	To Bank A/c (Expenses)	15,000			
June 30	To Profit & Loss A/c (Share of profit)	55,833			
	To Menon A/c (Share of profit)	1,11,667			
		6,25,000			6,25,000

Dr. **Menon Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 ?	To Bank A/c (Landing charges)	20,000	2015 ?	By Bank A/c (Sales)	7,00,000
Mar. 31	To Commission Received A/c	35,000			
	To Bank A/c (Remittance)	6,45,000			
		7,00,000			7,00,000
June 30	To Bank A/c (Remittance)	5,54,167	April 1	By Joint Venture A/c (Stock on consignment)	1,67,500
				By Joint Venture A/c (Goods sent)	2,50,000
				By Joint Venture A/c (Expenses)	25,000
				By Joint Venture A/c (Share of profit)	1,11,667
		5,54,167			5,54,167

(b) Conversion with retrospective effect: When a consignment is converted into a joint venture with effect from a previous date, the following steps should be followed:

Step 1 Prepare Consignment Account in the usual manner.

Step 2 Prepare Joint Venture Account (from the same information) assuming that the consignor and the consignee were in joint venture from the very beginning.

Step 3 Determine the amount received by the consignee under consignment.

Step 4 Determine the amount which would have been received by the consignee as a co-venturer.

Step 5 If there is any difference between the two amounts, pass the following adjusting entry:

(a) If the amount received as consignee is more than the amount receivable as co-venturer

Consignee Account Dr.

To Profit and Loss Account

(b) If the amount received as consignee is less than the amount receivable as co-venturer

Profit and Loss Account Dr.

To Consignee Account

Illustration 24

On 1st January, 2015, Singh of Amritsar, a manufacturer of sports goods, sent a consignment of 100 cricket bats to Bose of Calcutta to be sold on a consignment basis at a commission of 20%. The commission is to cover the consignee's expenses but not the freight charges of the goods to Calcutta. The cost of each bat is ₹ 100 but is invoiced to Bose at ₹ 150 each. A case containing 10 cricket bats was lost, against which the consignor lodged a claim and collected from the insurance company ₹ 800.

The consignee paid ₹ 540 as freight charges and spent a further sum of ₹ 400 as sales expenses. Consignor's expenses amounted to ₹ 500. The consignee accepted a bill of exchange drawn by Singh for 3 months (beginning with the date of despatch) for ₹ 10,000 which bill was discounted at 6% p.a. with the bankers. Bose sold 75 bats at ₹ 200 each and on 30th June 2015 remitted the balance due from him.

After making up the accounts on 30th June 2015, the parties decide to convert their relationship to that of a joint venture on the terms that the cost of a bat would be taken at ₹ 150. Singh is to get an interest of 8% p.a. on his investment and Bose to get a commission of 10% on sales. The co-venturers are to share profit and losses equally.

Prepare the necessary accounts in the books of Singh and indicate the adjustment journal entry required on conversion of the terms of despatch. The workings should form a part of your answer.

Solution

In the books of Singh

Dr. Consignment to Calcutta Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015	To Goods Sent on Consignment A/c (100 x 150)	15,000	2015	By Bose A/c (Sales)	15,000
Jan. 1	To Bank A/c (Expenses)	500	June 30	By Abnormal Loss A/c (Note 1)	1,550
June 30	To Bose A/c (Freight charges)	540		By Goods sent on Consignment A/c (Loading)	5,000
	To Abnormal Loss A/c (Loading)	500		By Stock on Consignment A/c	2,415
	To Stock Reserve A/c	750			
	To Bose A/c (Commission)	3,000			
	To Profit & Loss on Consignment A/c	3,675			
		23,965			23,965

Dr. Bose Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015	To Consignment to Calcutta A/c (Sales)	15,000	2015	By Bills Receivables A/c	10,000
June 30			June 30	By Consignment to Calcutta A/c (Freight + Comm.)	3,540
				By Bank A/c (Final settlement)	1,460
		15,000			15,000

Dr. Memorandum Joint Venture Account Cr.

Date	Particulars		₹	Date	Particulars		₹
	To Singh :				By Singh (Insurance claim)		800
	Goods sent		15,000		By Bose (Sales)		15,000
	Expenses		500		By Stock (15 bats)		2,415
	Interest (Note 4)		600		By Loss on Venture :		
	To Bose :				Singh — 1/2		163
	Freight		540		Bose — 1/2		162
	Sales Expenses		400				
	Commission		1,500				
			18,540				18,540

Entries on Conversion

In the books of Singh

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
Jan. 15	Bose A/c (Note 8) Dr.		1,262	
	To Profit & Loss A/c			1,262
	(Being the adjustment for excess amount paid to Bose as per new arrangement ₹ 3,000 – 1,738)			
	Profit & Loss A/c Dr.		375	
	To Stock Reserve A/c			375
	(Being provision for unrealised profit on stock — our share of unrealised profit on unsold stock)			

Working Notes :

(1) Valuation of Abnormal Loss :	₹
Invoice price of 10 bats	1,500
Add: Proportionate non recurring expenses of consignor	50
	1,550

(2) Value of Unsold Stock :	₹
Invoice price of 15 bats	2,250
Add: Proportionate consignor's expenses	75
Add: Proportionate freight (540 / 90) x 15	90
	2,415

(3) It has been assumed that freight was for 90 bats only.

(4) Interest has been calculated for 6 months for ₹ 15,000 only. Assumed to be allowed on investment in goods only.

(5) No stock reserve is required for Joint Venture purpose.

(6) In Joint Venture abnormal loss is not taken into consideration.

(7) Interest on investment has been allowed to Singh, so bill discounting charges should be borne by him.

(8) Amount already received by Bose (commission)		3,000
Less: Amount receivable by Bose under new arrangement		
Commission	1,500	
Expenses (sales)	400	
Loss	(162)	1,738
		1,262

Key Points

- A joint venture is the combination of two or more persons into a single activity. It is a form of partnership which is limited to a specific venture.
- When the size of the venture is large and the duration of the venture is protracted, then a complete separate set of books of account may be maintained under the double-entry system for recording all joint venture transactions.
- When the size of the venture is small and co-venturers are residing at distant places, each co-venturer may record joint venture transactions in his own books of account without inaugurating a complete set of double- entry books for the venture.

THEORETICAL QUESTIONS

1. (a) What do you understand by a joint venture? (b) State its main features.
2. Distinguish between Joint venture and consignment.
3. Explain how joint venture accounts are kept when a complete set of double-entry books is separately maintained for this purpose.
4. (a) What is a joint bank account?
   (b) How are entries regarding joint venture passed when such an account is kept?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below.

1. A memorandum joint venture summarises -
   A assets and liabilities
   B expenses and incomes
   C receipts and payments
   D all transactions
2. Recording of transactions in a separate set of book is made
   A when the size of the business is small
   B when double entry system cannot be followed
   C for better financial control
   D when co-venturers are residing at distant places
3. In a joint venture, valuation of stock is affected -
   A when there is an abnormal loss
   B when insurance claim is received for loss of stock
   C when insurance claim is not received for loss of stock
   D when there is a normal loss
4. For calculating the profit of a joint venture, abnormal losses are :
   A credited to joint venture account
   B ignore
   C debited to abnormal loss account
   D debited to co-venturers' capital account
5. Any insurance claim received for the loss of stock is
   A treated as an income
   B deducted from expenses
   C debited in the bank account only
   D not shown in the books

6. In a joint venture, no distinction is made between normal and abnormal loss when
   A there is some unsold stock
   B there is no unsold stock
   C one venturer withdraws some stock
   D insurance claim is received in respect of goods lost by fire
7. To make final settlement in a joint venture :
   A joint bank account is closed first
   B joint bank account and venturers' accounts are closed
   C joint venture is closed last
   D joint venture account is closed first and the remaining account are closed simultaneously
8. For determining profit / loss of the joint venture -
   A joint venture account is prepared
   B memorandum joint venture account is prepared
   C joint venture account or memorandum joint venture account is prepared
   D joint venture account and memorandum joint venture account is prepared
9. A joint venture will come to an end as soon as
   A income is received and payments are made
   B income is earned and payments are recognised
   C income is earned and payments are made
   D the venture is completed
10. A joint venture is undertaken when the
    A respective advantages of the parties are pooled together
    B termination is uncertain
    C ascertainment of income is simple
    D accounting concepts are not applicable
11. A joint venture is a
    A general partnership
    B specific partnership
    C limited partnership
    D limited liability partnership
12. A joint venture account is a
    A real account
    B personal account
    C nominal account
    D valuation account
13. Which of the following is true ?
    A there will be separate treatment for normal loss
    B there will be separate treatment for abnormal loss
    C there will be separate treatment for both normal and abnormal loss
    D there will be no treatment for normal loss but valuation of unsold stock is affected
14. Which of the following is true ?
    A profit / loss is shown by the ventures equally
    B for distribution of profit on joint venture, a separate account is opened
    C the relationship of the co-ventures is that of partners
    D in a joint venture, generally a balance sheet is prepared
15. Which of the following is true ?
    A joint bank account is just like a cash book
    B joint venture account is just like a trading account
    C joint venture account is just like a profit and loss account
    D joint bank account is closed first of all
16. Which of the following is true ?
    A joint venture account does not record depreciation
    B joint bank account is opened specially for the venture
    C goods taken over by the venturers are not recorded in the venturers' accounts
    D joint venture account and joint bank account are closed simultaneously.

17. Profit / loss in a joint venture is ascertained -
    A any time during an accounting period
    B at the end of the accounting period
    C at the end of the venture
    D at the end of the venture and for each venture separately.
18. In joint venture, many accounting concepts are not applicable. For example,
    (i) money measurement concept
    (ii) going concern
    (iii) entity concept
    A all three are not applicable
    B (i) and (ii) are not applicable
    C (ii) is not applicable
    D (iii) is not applicable
19. Memorandum joint venture account shows :
    A the cash transaction between the co-venturers
    B the amount due to co-venturer
    C profit or loss on joint venture
    D the credit as well as cash transactions between the co-venturers
20. In joint venture, discounting charges of a bill of exchange is
    A treated as financial expenses and charged to profit and loss account
    B treated as joint venture expense and charged to joint venture account
    C treated as personal expenses of the drawee
    D treated as personal expenses of the drawer

PRACTICAL QUESTIONS

A. Separate Set of Books

1. Murari and Mihir entered into a joint venture and agreed to divide the profit as Murari 60% and Mihir 40%. Murari and Mihir contributed ₹ 60,000 and ₹ 40,000 respectively for carrying on transactions relating to the venture. They opened a Joint Account with the above contributions. They purchased three old State Buses for ₹ 80,000. Murari and Mihir personally paid ₹ 15,000 and ₹ 10,000 respectively for repairs and renewals. They purchased few tyres and tubes costing ₹ 18,000. Two buses were sold for ₹ 90,000 and the third one was taken by Mihir at cost price. Show the Joint Venture Account, Joint Bank Account and the Co-venturers Accounts.
2. Ram and Shyam undertook jointly to build a house for a company at an agreed price of ₹ 60,000, payable ₹ 45,000 in cash and the balance in fully paid shares of the new company. A Joint Banking Account was opened in their names into which Ram paid ₹ 15,000 and Shyam paid ₹ 10,000. Profit sharing ratio between Ram and Shyam was 3:2. From the following transactions, prepare Joint Venture Account, Joint Bank Account and the Venturers Personal Account closing the venture: Materials purchased ₹ 20,000; Wages paid ₹ 15,000; Materials supplied from Stock by Ram ₹ 3,000 and Shyam ₹ 2,500 respectively. Architect's fees ₹ 1,000 was paid by Shyam.
   The joint venture was closed by Ram taking up all the shares of the company at an agreed valuation of ₹ 12,000 and Shyam taking up the stock of surplus materials at an agreed valuation of ₹ 1,500. The contract was duly completed and the price was received. Prepare Joint Venture Account, Joint Bank Account and accounts of the venturers.
3. Das, Bose and Gupta undertake to errect a five storied mansion for National Housing Trust Ltd. The contract price is agreed at ₹ 25,00,000 and to be paid in cash ₹ 22,00,000 by four equal instalments and the balance amount in 8% Debentures of the company. They agree to share profit or loss in 2:2:1 ratio. They opened a joint banking account with the cash contributed as stated below: Das ₹ 3,00,000; Bose ₹ 3,75,000 and Gupta ₹ 2,00,000. Das arranges the preparation of building plans, and the like and pays ₹ 32,000 as architects fees. Bose brings a concrete mixer and other implements valued at ₹ 80,000 and Gupta brings a motor lorry valued at ₹ 75,000. They paid in cash for the following items :
   Materials — ₹ 12,26,800; Wages — ₹ 7,33,200; Sundry Expenses — ₹20,000; and Plant — ₹ 60,000
   On completion of the venture the concrete mixer is sold for ₹ 50,000 and thePlant and other implements are sold as scrap for ₹ 10,000. Gupta takes back the motor lorry at ₹ 40,000. Subsequently, Das took over the Debentures issued by the company at a valuation of ₹ 2,80,000.
   Show the necessary ledger accounts for the Joint Venture.

4. Das and Krishnan entered into a joint venture sharing profits and losses in the ratio of 3:2. They opened a Bank Account by depositing ₹ 40,000 each. Das purchased 800 kg of an item @ ₹ 60, and his expenses were ₹ 13,000. Krishnan purchased a second item of 10,000 kg.@ ₹ 2.10 and his expenses were ₹ 11,000. Expenses were met from private sources and purchases were paid from Bank Account. Das sold 600 kgs of the first item @ ₹ 100 and his selling expenses were ₹ 5,500. Krishnan sold 8,000 kgs of the second item @ ₹ 5 and his selling expenses were ₹ 6,000. All the sale proceeds were deposited in the bank account and expenses were met from private sources. Write up necessary accounts in the books of the venture. Also prepare a Balance Sheet of the venture.
5. X and Y enter into a Joint Venture to build a multi-storeyed building. They agree to share the profits and losses equally upto ₹ 50,000 of the profit or loss from the venture. Thereafter, the profit and loss are to be shared in the proportion of X 3/5th and Y 2/5th. X contributes plant and machinery worth ₹ 40,000 and meets registration expenses worth ₹ 10,000. Y contributes the plot on which the building is to be built, valued at ₹ 1,00,000. Other expenses incurred are: Fuel and electricity charges ₹ 40,000; Raw materials ₹ 1,60,000; Labour charges ₹ 75,000; and Advertisement expenses ₹ 5,000. All the above expenses were met from the Bank Account opened for the joint venture. At the end of the venture X agreed to take the Plant and Machinery valued at ₹ 10,000. Y sold off the multi-storeyed building for a total of ₹ 7,20,000 and collected all dues from the buyers except for one flat, valued at ₹ 1,80,000 which he kept for himself in lieu of his expected share of profit.
   The venturers who had agreed to maintain their venture accounts in separate sets of books, ask you to prepare the Joint Venture Account, Joint Bank Account and Venturer's Capital Accounts.

B. No Separate Set of Book

6. A and B entered into a joint venture for the purchase and sale of iron tubes. Profits and losses were to be shared equally. A financed the venture and B undertook the sales on a commission of 10% on the sale proceeds. A purchased goods to the value of ₹ 40,000 less $3^3/_4$% trade discount, paid freight ₹ 1,000 and advanced ₹ 1,800 to B for expenses. B expended for travelling ₹ 200, carriage ₹ 500, rent ₹ 300, advertisement ₹ 700 and sundries ₹ 50. B sold whole of the goods for ₹ 56,000 and paid A ₹ 46,000 on account. It was agreed that A should receive interest of ₹ 5,000. Show how the transactions would be recorded in the ledgers of both the parties.
7. A and B entered into a joint venture for underwriting the subscription at par of the entire share capital of the Copper Mines Ltd., consisting of 1,00,000 equity shares of ₹ 10 each and to pay all expenses upto allotment. The profits were to be shared by them in the ratio 3:2. The consideration in return for this agreement was the allotment of 12,000 other shares of ₹ 10 each to be issued to them as fully paid. A provided the funds for: registration fees ₹ 12,000, advertising expenses ₹ 11,000, expenses on printing and distributing the prospectus ₹ 7,500 and other printing and stationery expenses ₹ 2,000. B contributed payment of office rent ₹ 3,000, legal charges ₹ 13,750, Salary to clerical staff ₹ 9,000 and other petty disbursement ₹ 1,750. The prospectus was issued and application fell short of the issue by 15,000 shares. A took these over on joint account and paid for the same in full. The venturers received the 12,000 fully- paid shares as underwriting commission. They sold their entire holding at ₹ 12.50 less 50 paise brokerage per share. The net proceeds were received by A for ₹ 15,000 shares and B for 12,000 shares.
   Show necessary accounts in the books of both the parties showing the adjustments.
8. A obtained a contract for the manufacture and supply of tubewell strainers for ₹ 1,62,500. He entered into a joint venture with B on the following terms, profit and losses being shared equally: (a) A should provide ₹ 1,50,000 as capital, earning interest at 4 per cent per annum. This amount was paid to B on 1st January, 2015. A should also be entitled to 2% of the contract price as commission; and (b) B should look after the technical and management side of the contract and would get (in addition to his share in the profits) a salary of ₹ 400 per month and ₹ 1,500 for the use of his plant in the joint venture.
   The following payments were made by B :
   Raw materials ₹ 50,000; Upkeep of Machine ₹ 5,000; Wages ₹ 60,000; and Establishment Expenses ₹ 4,500.
   The contract was completed on 30th September, 2015 and A received the contract price. On the same date he received the balance due from B.
   You are required to show in the books of B: Joint Venture Account, A Account and the Cash Account

C. Memorandum Method

9. Shipra of Siliguri and Balaram of Bombay entered into a joint venture with the object of buying and selling tea. Shipra agreed to arrange the purchase and Balaram to effect sales. They agreed to share profits and losses in the ratio of 2:1. Shipra purchased 100 boxes of tea at ₹ 1,500 per box subject to 30% trade discount and paid freight ₹ 3,500 and insurance ₹ 500. Balaram remitted ₹ 45,000 to Shipra towards the joint venture. He took the delivery of the goods at Bombay and paid ₹ 350 for cartage. He sold 95 boxes of tea for ₹ 1,90,000 and kept 5 boxes for himself at an agreed value of ₹ 9,500. His other expenses were godown rent ₹ 150 and insurance charges ₹ 75. They decided to settle their accounts by sending bank draft. Prepare Memorandum Joint Venture Account and the accounts as they would appear in the ledger of each of the two parties.

10. X and Y entered into a joint venture for the purchases and sales of old cars sharing profits and losses in the ratio of 2:3. On the 15th April 2015 X bought 5 cars for ₹ 40,000; paid tax and insurance of ₹ 1,500 on 30th April 2015. He sold all the cars at ₹ 60,000 and remitted cash ₹ 10,000 to Y on account on 5th May. On the 30th April, 2015 Y purchased 3 cars at a price of ₹ 30,000 and paid various charges of ₹ 2,000 on 5th May, 2015. He sold 2 cars at ₹ 21,000 incurring selling expenses of ₹ 1,000. The unsold car was kept by him for personal use at an agreed valuation of ₹ 11,000. Both the venturers are entitled to a commission of 1% on sales. Show Memorandum Joint Venture Account and Joint Venture with Co-venturer Account of X and Y.
11. In March, 2015, A and B enter into a joint venture to buy and sell second hand motor cars. They are to share profits and losses in the ratio of 2:1. On March 16, A buys two cars for ₹ 4,800 and ₹ 7,200 respectively and incurs an expenditure for ₹ 1,800 for repairs. On April 1, he sells one of the cars for ₹ 6,000 and on April 10 the other car for ₹ 9,300. On April 12, he buys another car for ₹ 9,000 and sells it on April 20 for 12,000; this amount was paid to B who sent it to his own bank account. B on March 12, buys a car for ₹ 6,000 and incurs an expenditure of ₹ 600 on it. He sells this car for ₹ 7,500 on March 15, but it is returned by the customer on March 20, who is allowed ₹ 7,200 for it. This car was still unsold on April 30, and A agreed to take it over at a valuation of ₹ 6,750. On April 30, the amount required to settle accounts between A and B is paid by the appropriate party.
    Prepare the Joint Venture Account as it would appear in the books of A; and also a Memorandum Joint Venture Account, showing the net profit or loss resulting from the transaction.
12. David of Bombay and Khosla of Delhi entered into a joint venture for the purpose of buying and selling second-hand motor cars. David to make purchases and Khosla to effect sales. The profit or loss was to be shared equally. Khosla remitted a sum of ₹ 1,50,000 to David towards the venture. David purchased 5 cars for ₹ 1,60,000 and paid ₹ 60,000 for their reconditioning and sent them to Delhi. He also incurred an expense of ₹ 5,000 in transporting the cars to Delhi. Khosla sold 4 cars for ₹ 2,40,000 and retained the fifth car for himself at an agreed value of ₹ 50,000. His expenses were: insurance ₹ 1,000; Garage Rent ₹ 2,000; Brokerage ₹ 2,000; and Sundry Expenses ₹ 400. Each party's ledger contains a record of his own transactions on joint account. Prepare a Statement showing the result of the venture and the Joint Venture Account with David in the books of Khosla as it will finally appear, assuming that the matter was finally settled between the parties.
13. D of Delhi and B of Bombay entered into a joint venture for the purpose of buying and selling second hand typewriters; B agreed to make purchases and D to effect sales. The profit and loss was to be shared equally by D and B. A sum of ₹ 15,000 was remitted by D towards the venture. B purchased 20 old typewriters for ₹ 15,000 and paid ₹ 9,000 for their reconditioning and sent them to Delhi. His other expenses were: buying commission ₹ 1,000; Cartage ₹ 200 and miscellaneous expenses ₹ 100. D took delivery of typewriters and paid ₹ 270 for Octroi and ₹ 100 for Cartage. D sold 12 typewriters at ₹ 2,000 each; 4 typewriters at ₹ 2,100 each and 3 typewriters at ₹ 2,000 each. He retained the remaining typewriter for his personal use at an agreed value of ₹ 1,500. His other expenses were Insurance ₹ 250; Rent ₹ 400; Brokerage ₹ 1,200 and Miscellaneous Expenses ₹ 200. Each party's ledger contains a record of his own transactions on joint account. Prepare a statement showing the result of the venture and the account of the venture in D's Ledger as it will finally appear, assuming that the matter was finally settled between the parties.
14. Arbind of Calcutta and Brown of Bombay entered into a joint venture in regard to a consignment of radio sets to be sent from London for sale in this country and they agreed to share profits equally. On 15th May, 2015, Brown purchased 1,000 sets at ₹ 25,000 per hundred subject to 30% trade discount and paid freight and insurance charges amounting to ₹ 15,000. He also drew a bill of exchange on Arbind payable on sight for ₹ 2,00,000 discounting it with the Chartered Bank for ₹ 1,96,640. Arbind received the consignment on 26th July, 2015 and he paid landing and other charges amounting to ₹ 2,950 and on 31st July, he sold the whole consignment for ₹ 3,10,000 and paid the bill of exchange under discount, the discount amounting to ₹ 550. Arbind paid incidental expenses amounting to ₹ 670 and Brown paid ₹ 745.
    Draw up the Memorandum Joint Venture Account and determine the share of profit of each partner.
15. Adarsh of Delhi and Laxman of Bangalore entered into a joint venture for purchase and sale of one lot of mopeds. The cost of each moped was ₹ 3,600 and the fixed retail selling price ₹ 4,500. The following were the recorded transactions:
    2015 Jan.1: Adarsh purchased 100 mopeds, paying ₹ 72,000 in cash on account. Adarsh raised a loan from A. Bank of ₹ 50,000 at 18% p.a. interest, repayable with interest on 1.3.2015. Adarsh forwarded 80 mopeds to Laxman incurring ₹ 2,880 as forwarding and insurance charges.
    Jan. 7: Laxman received the consignment and paid ₹ 720 as clearing charges.
    Feb. 1: Adarsh sold 5 mopeds for cash; Laxman sold 20 mopeds for cash. Laxman raised a loan of ₹ 1,50,000 from B. Bank repayable with interest at 18% p.a. on 1.3.2015. Laxman telegraphically transferred ₹ 1,50,000 to Adarsh incurring charges of ₹ 50. Adarsh paid the balance due for the mopeds.

Feb.26: Adarsh sold the balance mopeds for cash. Laxman sold balance mopeds for cash. Adarsh paid selling expenses ₹ 5,000. Laxman paid selling expenses ₹ 20,000.

Mar.1: Accounts settled between the venturers and loans repaid, profit being appropriated equally.

You are required to show : (1) The Memorandum Joint Venture Account; (2) Joint Venture with Laxman Account in Adarsh's books; and (3) Joint Venture with Adarsh Account in Laxman's books; You are to assume that each venture recorded only such transactions as concluded by him.

16. On 2.5.2014, P of Patna and C of Calcutta entered into a joint venture to buy and sell dolls. They agree to share profits and losses as 3:2. On 7.6.2014, C purchased 600 dolls at ₹ 52 each and sent 240 dolls to P, incurring ₹ 3,700 as freight and insurance charges. 25 of such dolls were damaged in transit and on 1.7.2014, he recovered a sum of ₹ 250 from the insurance company. On 15.7.2014, P made a remittance of ₹ 7,050 to C. On 26.7.2015, P purchased 300 dolls at ₹ 55 each and sent 100 dolls to C incurring ₹ 1,500 as freight and insurance charges. On 14.8.2014, 18 damaged dolls were taken over by P for personal purposes at an agreed valuation of ₹ 25 each and distributed the remaining damaged dolls, free of cost, amongst their customers. On 1.11.2014 both P and C disposed of all the dolls in their possession at ₹ 60 each. On 30.11.2014, the venture was closed and the accounts were settled by bank through bank draft.

    You are required : (a) to prepare a Memorandum Joint Venture Account, and (b) to show the account in the books of P to record his own transactions.

17. Sakti and Sadhan agree to enter into a joint venture to buy and sell television sets. Profits and losses are to be shared equally. On 5th May, 2015, Sakti purchased three television sets for ₹ 3,000, ₹ 3,500 and ₹ 4,000 respectively. He bought a special cabinet costing ₹ 750, which he fixed for one of the sets. On 31st May, 2015, he sold two of the sets for ₹ 4,000 each, paying the proceeds into his private bank account. On 15th June, 2015, he sold the other set for ₹ 4,500 which amount he paid over to Sadhan who paid it into his bank account. On 6th May, 2015, Sadhan purchased a T.V. set for ₹ 3,000 having incurred expenditure of ₹ 200 on repairing, he sold it on 14th May, 2015, for ₹ 3,800 paying the proceeds into his own bank account. This set developed mechanical trouble and on 26th May, 2015, Sadhan agreed to take the set back at a price of ₹ 2,800 which he paid out of his bank account. The set was still unsold on 30th June, 2015 and it was agreed that Sadhan should take it over for his personal use at a valuation of ₹ 2,600. Sakti incurred ₹ 300 as showroom charges and Sadhan incurred ₹ 225 as travelling and postage charges. You are required to prepare: (a) the account of joint venture with Sakti as it would appear in the books of Sadhan; and (b) Memorandum Joint Venture Account showing the net profit.

18. Ravi and Suresh entered into a joint venture for purchase and sale of electronics goods, sharing profits and losses in the ratio of 3:2. They also agreed to receive 5% commission on their individual sales and the following information was extracted from the records:

    July 1, 2014 Ravi purchased goods worth ₹ 1,90,000 financed to the extent of 90% out of his funds and balance by loan from his uncle Shyam.

    August 1, 2014 Ravi sent goods costing ₹ 1,70,000 to Suresh and paid ₹ 1,410 as freight charges. Suresh paid ₹ 13,410 to Ravi.

    October1,2014 Suresh sold all the goods sent to him. Ravi paid back the loan taken from his uncle, including interest of ₹ 350.

    All sales, by either party, were made at an uniform profit of 40% above cost. On November 30, 2014, they decided to close the venture by transferring the balance of goods unsold, lying with Ravi at a cost of ₹ 9,000 to a wholesale dealer. You are required to prepare the Memorandum Joint Venture Account and Joint Venture with Ravi in the books of Suresh and Joint Venture in the books of Ravi. They further disclosed that goods worth ₹ 4,000 were taken personally by Ravi at an agreed price of ₹ 5,000.

19. A and B enter into a joint venture sharing profits and losses equally. A purchased goods for ₹ 5,000 and B spent ₹ 1,000 for freight on 1st Janaury 2015. On the same day B bought goods worth ₹ 10,000 on credit. Further expenses were incurred as follows: On 1.2.2015 ₹ 1,500 by B; on 1.3.2015 ₹ 500 by A. Sales were made against cash as follows: On 15.1.2015 ₹ 3,000 by A; On 31.1.2015 ₹ 6,000 by B; On 15.2.2015 ₹ 3,000 by A; On 1.3.2015 ₹ 4,000 by B. Creditors for goods were paid as follows: On 1.2.2015 ₹ 5,000 by A; On 1.3.2015 ₹ 5,000 by B. On 31st March, 2015 the balance stock was taken over by B at ₹ 9,000. The accounts between the venturers were settled by cash payment on this date. The venturers are entitled to interest at 12% per annum.

    You are required to prepare: (a) Memorandum Joint Venture Account; and (b) Necessary Ledger Accounts in the books of venturers.

20. A and B entered into a joint venture involving the buying and selling of old railway material. The profit or loss was to be shared equally. The cost of the material purchased was ₹ 42,500 which was paid by A who drew a bill on B at 2 months demand for ₹ 30,000. The bill was discounted by A at a cost of ₹ 240. The transaction relating to the venture was: (a) A paid ₹ 300 for carriage, ₹ 500 for commission on sales, and ₹ 200 travelling expenses; (b) B paid ₹ 100

travelling expenses and ₹ 150 sundry expenses; (c) Sales made by A amounted to ₹ 20,000; and (d) Sales made by B were ₹ 30,000. Goods costing ₹ 1,000 and ₹ 1,500 (being unsold stock) were retained by A and B respectively and these were charged to them at prices to show the same rate of gross profit as that made on the total sales (excluding these sales). A was credited with a sum of ₹ 400 to cover the cost of warehousing and insurance. The expenses in connection with the bill were to be treated as a charge against the venture. You are required: (a) to show the account in the books of each party to record his own transactions; and (b) to prepare a Memorandum Joint Venture Account.

21. Aswin of Madras and Gupta of Delhi entered into a joint venture on 1.4.2014 for the purpose of buying second-hand cars for reconditioning and selling them as airconditioned diesel cars. Aswin agreed to buy second-hand cars and recondition them and fit diesel engines. Gupta agreed to fix airconditioners and sell them at Delhi. They agreed to share the profits and losses equally and settle their accounts at the end of each year.

The following are the details of purchase, sale and expenses incurred by Aswin and Gupta during the year 1.4.2014 to 31.3.2015 :

Particulars	Aswin (₹)	Gupta (₹)	Particulars	Aswin (₹)	Gupta (₹)
Cost of 10 cars	5,00,000	—	Expenses incurred :		
Reconditioning expenditure	45,000	—	Freight — local	10,000	8,000
Cost of 10 diesel engines	30,000	—	Freight — Delhi	30,000	—
Labour charges	18,000	32,000	Rent — Office	10,000	10,000
8 Airconditioners purchased	—	4,00,000	Rent — Garage	12,000	20,000
Buying commission @ 5%	25,000	—	Insurance	16,000	20,000
Selling commission @ 5%	—	60,000	Miscellaneous expenses	6,000	10,000
Sale value of 8 cars	—	12,00,000			

Gupta sent a cheque for ₹ 6,00,000 to Aswin on 1.3.2015. Of the balance of 2 cars, one car was met an accident on the way to garage before reconditioning and the insurance company settled the claim at ₹ 30,000 as a total loss. The old petrol engines were sold @ ₹ 500 per engine and one diesel engine was sold at ₹ 3,000 by Aswin. All of them were sold before 31.3.2015. Aswin retained the balance one car as a non-airconditioned diesel car for his personal use which was priced at the average cost.

Aswin / Gupta settled the balance due to / by them as on 31.3.2015 by sending a crossed cheque as the case may be. Prepare : (a) Memorandum Joint Venture Account; (b) Joint Venture Account with Gupta in the books of Aswin; and (c) Joint Venture Account with Aswin in the books of Gupta.

Guide to Answers

Multiple Choice

1. B 2. C 3. D 4. B 5. A 6. B 7. D 8. C 9. D 10. A

11. B 12. A 13. D 14. C 15. A 16. B 17. D 18. B 19. C 20. B

Practical Questions

1. **Profit ₹ 8,000; Final payment—Murari ₹ 79,800; Mihir ₹ 12,200.**
2. **Profit ₹ 17,000; Final payment—Ram ₹ 16,200; Shyam ₹ 18,800.**
3. **Profit ₹ 3,53,000; Final Payment—Das ₹ 1,93,200; Bose ₹ 5,96,200; Gupta ₹ 3,05,600.**
4. **Profit ₹ 17,150; Valuation Stock—1st item ₹ 15,250; 2nd item ₹ 6,400; Balance Sheet total ₹ 1,32,650; Capital—Das ₹ 68,790; Krishna ₹ 63,860.**
5. **Profit ₹ 4,80,000; X's share ₹ 2,83,000 and Y's share ₹ 1,97,000. The joint bank account was opened only after receiving ₹ 6,03,000 from Y and Creditors for expenses were paid off thereafter.**
6. **Profit ₹ 4,150.**
7. **Profit ₹ 1,14,000; Final payment by B to A ₹ 70,900.**
8. **Profit ₹ 30,150; Amount paid to A ₹ 10,325.**
9. **Profit ₹ 89,925; Final payment ₹ 1,23,950.**
10. **Profit ₹ 16,690; Amount due to Y ₹ 1,224.**
11. **Profit ₹ 4,950; Final payment to be received by A from B ₹ 4,050.**
12. **Profit ₹ 59,600; Final payment to David ₹ 1,04,800.**
13. **Profit ₹ 14,580; Final payment to B ₹ 17,590.**
14. **Profit ₹ 1,12,825.**
15. **Profit ₹ 57,600; Final payment ₹ 1,58,180.**
16. **Profit ₹ 300; Final remittance ₹ 120.**
17. **Profit ₹ 1,125; Final remittance to Sakti ₹ 4,112.**
18. **Profit ₹ 57,650; Sales proceeds received by Ravi ₹ 9,800; Sales by Suresh ₹ 2,38,000; Final settlement ₹ 1,89,630.**
19. **Profit ₹ 6,915; Net interest due to A ₹ 135; Net interest due to B ₹ 50; Final payment by B to A ₹ 8,092.**
20. **Share of Profit : A — ₹ 4,368; B — ₹ 4,367; Balance due ₹ 2,742; Value of Goods taken over ₹ 1,875.**
21. **Share of Profi : Aswin — ₹ 21,856; Gupta — ₹ 21,855; Balance received by Aswin ₹ 18,145.**

19

Bills of Exchange

Introduction

Goods can be sold for cash or on a credit basis. If the customers are asked to pay cash all the times, the amount of sales would be considerably less. A complete refusal to give credit is likely to mean that potential sales would go to competitors. Again, if goods are sold on credit, in future the buyer may refuse to pay, part or whole of the amount due from him. The argument may be any one or more of the following : (i) Goods were defective; or (ii) Goods were not received, and the like. To avoid all these, it is a common practice to make use of a bill of exchange.

Definition of Bill of Exchange

A bill of exchange can be defined as an acknowledgment of debt which also fixes the date of payment. It is a legal document which is drawn up and signed by the seller. It requires the buyer to pay a definite sum on a predetermined future date. Therefore, the seller gets the documentary evidence of the amount due from the buyer and also the terms of payment.

Section 5 of The Negotiable Instruments Act, 1881 defines a bills of exchange as under :

'A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a person to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.

Features of Bill of Exchange

1. It must be drawn on a particular date.
2. It must be in writing.
3. There are three parties to a bills of exchange — the drawer, the drawee, and the payee.
4. It must be signed by the maker (drawer).
5. It must be accepted by the drawee (However, a bill payable on demand is not required to be accepted).
6. It must be an unconditional order to pay.

7. The maker (drawer) must direct a person to pay a certain sum of money.
8. It arises generally out of credit sales or loans.
9. It helps temporary settlement of a debt between a debtor and a creditor without involving cash.
10. It must be properly stamped, based on its value.
11. It is an evidence of a debt.
12. It is an asset for the creditor and a liability for the debtor.
13. A bill of exchange does not pay the amount due from a debtor, but the form of the asset is changed from a debtor to a bill receivable.
14. It is drawn for a certain period as agreed by the parties e.g., for two months; 90 days etc.
15. It can be discounted with the bank or it can be endorsed in favour of a creditor to pay a debt.

Advantages of Bill of Exchange

1. By accepting a bill, the debtor acknowledges the debt and agrees to pay it on a particular date. Therefore, it has advantages over oral promises.
2. It is useful in a court of law as evidence of a debt.
3. A bill fixes the date of payment. Both the parties are aware of the time of receipt or payment of money. Thus, it helps better cash management.
4. If necessary, it can be converted into cash by discounting at the bank, before the date of maturity. Thus, it provides easy liquidity.
5. It can be endorsed to a creditor in payment of a debt, if the creditor is willing to accept it.
6. It can be transferred from one place to another in the same way a cheque is remitted.
7. Foreign bill helps to expand foreign trade.
8. The drawee may pay the bill before the due date and he can avail of the rebate.
9. It facilitates the transfer of funds from one place of business to another place of business without the risk of carrying cash.
10. A bill can be renewed for an extended period. It helps the debtor by providing more time for payment of his debts.

Parties to a Bill of Exchange

There are three parties to a bill of exchange — the drawer, the drawee and the payee.

Drawer : The maker of a bill of exchange is known as the drawer. The signature of the drawer is necessary to complete the instrument.

Drawee : The person on whom the bill is drawn and is thereby directed to pay is known as the drawee. When the drawee signs his acceptance on the bill and delivers the bill to the holder, he becomes the 'acceptor' of the bill. The acceptance of a bill by the drawee signifies his assent to the order of the drawer.

Payee : The person named in the instrument to whom or to whose order the amount of the instrument is directed to be paid is known as payee. The drawer may make the bill payable to himself or may name another person to whom the amount has to be paid.

Specimen of a Bill of Exchange

On 1st January, 2015 C of Calcutta purchases goods from B of Bombay for ₹ 50,000 on credit for which B draws a bill on C for ₹ 50,000 for 3 months. The bill is duly accepted by C. The bill will be drawn as follows:

₹ 50,000 Bombay, 1st January, 2015

Three months after date pay to me or my order the sum of Rupees Fifty Thousand only, for value received.

To,
C
3, Park Street
Kolkata

Revenue Stamp

Accepted
C

Distinction Between Bill of Exchange and Cheque

	Bill of Exchange		Cheque
1.	It is drawn by a creditor.	1.	It is drawn by a debtor.
2.	It requires an acceptance.	2.	It does not require an acceptance.
3.	It can be drawn on any person including a bank.	3.	It is always drawn on a bank.
4.	It is not always payable on demand.	4.	It is always payable on demand.
5.	It is entitled to three days of grace.	5.	It is not entitled to any days of grace.
6.	It cannot be crossed.	6.	It can be crossed.
7.	It requires a stamp.	7.	It does not require a stamp.
8.	Notice of dishonour is usually required.	8.	Notice of dishonour is not required.
9.	It is not payable to the bearer on demand.	9.	It is payable to the bearer on demand.
10.	Upon dishonour, noting may be necessary.	10.	Upon dishonour, it does not require any noting.

Definition of Promissory Note

A promissory note is a written unconditional promise made by one person to another, to pay a specific sum of money either on demand or at a specified future date.

It has been defined by section 4 of The Negotiable Instruments Act, as under :

An Instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or the order of, a certain person or to the bearer of the instrument.

Parties to a Promissory Note

There are two parties to a promissory note:

1. The maker — who signs the note (the debtor) and agrees to pay the amount on the due date; and
2. The payee — to whom the amount is payable (the creditor).

Specimen of a Promissory Note

₹ 10,000

5, Park Street
Kolkata - 700 016
15th April, 2015

Revenue Stamp

Two months after date, I promise to pay Mr. S. Subramanian or order the sum of Rupees Ten Thousand only for value received.

To,
S. Subramanian
5, Patel Nagar
New Delhi 110 008

Sd/-
M. Mukherjee

Features of Promissory Note

1. It must be in writing;
2. It must be signed by the maker of the instrument;
3. It must be an unconditional promise to pay by the maker; and
4. The amount payable must be certain and should be expressed in terms of money only.

Distinction Between Bill of Exchange and Promissory Note

	Bill of Exchange		Promissory Note
1.	It is an unconditional order.	1.	It is an unconditional promise.
2.	It is given by a creditor to a debtor.	2.	It is given by a debtor to a creditor.
3.	There may be three parties—drawer, drawee and payee.	3.	There are two parties — maker and payee.
4.	The drawer and the payee may be the same person.	4.	The maker and the payee cannot be the same person.
5.	The liability of the drawer is secondary and conditional.	5.	The liability of the maker is primary and absolute.
6.	The drawer stands in immediate relation with the acceptor.	6.	The maker stands in immediate relation with the payee.
7.	It requires an acceptance.	7.	It does not require an acceptance.
8.	Notice of dishonour must be given.	8.	Notice of dishonour is not required to be given.
9.	A bill can be accepted conditionally.	9.	A promissory note cannot be made conditionally.
10.	Fixation of stamp is not required for a bill payable on demand (however, in a term bill fixation of stamp is required).	10.	Fixation of stamp is always compulsory.

Types of Bills

There are different types of bills. They can be classified on the basis of when they are due for payment, whether drawn for any consideration or not, whether documents to title of goods accompany them or not.

Basically bills are classified into two categories :

(a) Trade / Commercial Bills

(b) Accommodation Bills.

Trade / Commercial Bills

This bill is drawn by the seller and accepted by the buyer for a certain sum of money. It is essentially a trade related instrument.

Trade / Commercial Bill can be sub-divided into :

(a) Demand Bill

(b) Usuance / Time Bill

(c) Documentary Bill

(d) Clean Bill

(a) ***Demand Bill*** : It is payable 'at site' or 'on presentation' to the drawee. A bill on which no due date is specified is also called a demand bill.

(b) ***Usuance / Time Bill*** : It is payable at a specified later date.

(c) ***Documentary Bill*** : This bill is accompanied by documents. These documents include the invoice and other documents of title such as railway receipts, lorry receipts, etc. Documentary bills can be subdividedinto:

(i) Document against acceptance (D/A) bill

(ii) Document against payment (D/P) bill.

(d) Clean Bill : This bill is not accompanied by any document.

Accommodation Bill

Accommodation bill is that which is drawn and accepted without any consideration. It is drawn for the purpose of arranging temporary finance.

The Working of a Commercial / Trade Bill

The working of a bill of exchange can be explained with the ***following example*** : A sells goods to B for ₹ 5,000 on credit. In order to acknowledge the debt, A (the creditor) writes out a bills of exchange and sends it to B (the debtor). After receiving the bill, B signs his name on the bill with the word 'accepted'. Thereafter, B returns the bill to A and becomes liable to make payment for the bill.

Bills Receivable and Bills Payable

When a bill is written out, it is called 'drawing' of a bill. Since the drawer draws the bill, a bill from the point of view of the drawer is called a Bill Receivable because the money is receivable by him.

On the other hand, the same bill from the point of view of the drawee is called a Bill Payable because the money is payable by him.

Accounting Entries in the Books of Drawer

Bills Receivable Account Dr. [Assets comes in]
To Drawee Account [Giver]

Accounting Entries in the Books of Drawee

Drawer Account Dr. [Receiver]
To Bills Payable Account [Liability Increases]

For example, when A draws a bill for ₹ 5,000 on B which he accepts and returns to A, the accounting entries in the Books of the Drawer (A) and the Drawee (B) will be as under:

In the Books of the Drawer (A)
Journal **Dr.** **Cr.**

Date	Particulars	L.F.	₹	₹
	Bills Receivable A/c Dr. To B A/c (Being a bill drawn on B for ... months)		5,000	5,000

Dr. **B Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Sales A/c	5,000		By Bills Receivable A/c	5,000

Dr. **Bills Receivable Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To B A/c	5,000		By Balance c/d	5,000

A Bill of Exchange does not pay the amount the customer owes, but the form of the asset is changed from a debtor to a bill receivable. Therefore, when a bill is drawn on B, he is no more a debtor for A but he is an acceptor of the bill. Since the account of B is closed, it cannot be included in sundry debtors and hence, cannot find a place in the Balance Sheet. But the Bills Receivable Account has a debit balance of ₹ 5,000. Therefore, if a Balance Sheet is to be prepared now, the bills receivable will appear as a current asset which will find a place immediately below Sundry Debtors.

In the Books of the Drawee (B)
Journal **Dr.** **Cr.**

Date	Particulars	L.F.	₹	₹
	A A/c Dr. To Bills Payable A/c (Being a bill daccepted for ... months)		5,000	5,000

Dr. **A Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Bills Payable	5,000		By Purchases A/c	5,000

Dr. **Bills Payable Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance c/d	5,000		By A A/c	5,000

Now, when we consider the books of B, A is no more a creditor for B but B has incurred a liability to him by accepting the bill. This is because, when a person accepts a bill, his liability towards the drawer is paid off but a new liability against the bill payable is created. Since the money is payable by him, the Bills Payable will find a place in the Balance Sheet under the heading 'Current Liabilities and Provision' just below Sundry Creditors.

Due Date of a Bill of Exchange

The due date of a bill of exchange is the date when the amount of the bill is payable by the drawee. It is also called maturity date.

A bills of exchange may be payable —

1. on demand, or,
2. on a specified day, or,
3. after a specified period.

In the first case, the amount is payable when the demand is made.

In other cases, due date has to be calculated. Any bill of exchange payable otherwise than 'on demand' is entitled to three days of grace. These days of grace were originally allowed as a gratuitous favour to the debtor. But now it has become a legal right. Therefore, while calculating the due date of a bill, in its period, for which it is drawn, three more days are added.

Example: A bill dated January 1, 2014 is made payable four months after date. The due date of the bill will be May 4, 2014.

Calculation of Due Date

Date of drawing of bill	1.1.2014
Period / Tenure (month)	4
	1.5.2014
Days of grace	3
Due date / Maturity date	4.5.2014

A bill payable can be : (a) a certain period after date; or (b) a certain period ***after sight.***

When a bill contains a direction to 'pay three months after date', three months have to be counted from ***the date of drawing of the bill***. But, when the bill contains a direction to 'pay three months after sight', three months have to be counted from ***the date of acceptance***.

While calculating the due date of a bill, the following points should be noted :

1. ***Days of grace is not allowed when the bill is payable 'on demand' or 'on presentment' or 'at sight'.***
2. ***When the period of the bill is stated in days, the calculation of the due date will be in days (which includes the date of payment but excludes the date of transaction).***
   Example: A bill dated January 1, 2014 is payable sixty days after date. The due date of the bill will be March 5, 2014 (30 days of January + 28 days of February + 2 days of March + 3 days of grace).
3. ***When the period of the bill is stated in months, the calculation of due date will be made in terms of calendar months, ignoring the number of days in a month.***
   Example: A bill dated January 1, 2014 is payable three months after date. The due date of the bill will be April 4, 2014 (1.1.2014 + 3 months + 3 days of grace).
4. ***If the due date falls on a day which is a 'public holiday', the due date shall be the preceding business day. The expression 'public holiday' includes Sundays and any other day declared by the Central Government, by notification in the Official Gazette, to be a public holiday.***
   Example: If the due date of a bill is January 26, 2014 (Republic Day), it falls due on January, 25.
5. ***If the month in which the period would terminate has no corresponding day, the period is held to terminate on the last day of such month.***
   Example: (a) A bill dated January 30, 2014 is payable one month after date. The due date of the bill will be March 3, 2014.
   Example: (b) A bill dated July 31, 2014 is payable two months after date. The due date of the bill will be October 3, 2014.

Methods of Dealing with a Bill of Exchange by the Drawer

The drawer, as the holder of an accepted bill, can deal with the bill of exchange in the following ways:

(a) Holding the bill till the date of maturity and then presenting the bill to the drawee for payment
If the drawer of a bill is not in need of immediate cash, he can retain the bill with himself; and present it for payment to the drawee on the due date and receive cash from him. In our previous example, if A presents the bill to B for payment on the due date and B makes the actual payment due on the bill, the bill is said to be honoured and the following entry is passed in the books of A:

In the Books of A
Journal **Dr.** **Cr.**

Date	Particulars		L.F.	₹	₹
	Cash A/c To Bills Receivable A/c (Being the bill drawn on B paid by him)	Dr.		1,000	 1,000

Here, Cash Account is debited because actual cash comes in and Bills Receivable Account is closed by crediting the account because nothing is receivable from B, now.

The ledger accounts will be as under:

Dr. **Bills Receivable Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To B A/c	1,000		By Cash A/c	1,000

Dr. **Cash Account (Inclusive)** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Bills Receivable A/c	1,000			

A bill of exchange should be presented for payment on the due date and at the place named. If no place is indicated, presentation should be made at the drawee's usual place of business during business hours.

(b) Discounting the bill with the banker A drawer can receive payment from the drawee on or after the date of maturity. But he can obtain payment from a banker before its due date by ***discounting the bill***. ***Discounting is a device to convert the bill into cash at its present value***. This is done by selling the bill to the banker — which means that the right to receive the money is given to the banker. The consideration for obtaining money in advance (before the due date) is termed as discount. Therefore, by discounting, the drawer of the bill can get present worth of the bill from the banker — which is the difference between the face value of the bill and the discounting charges. In other words, the banker pays the drawer an amount of cash which is less than the face value (the face value of the bill less discounting charges) — with the hope of recovering the full value of the bill from the drawee at maturity. When a bill is discounted with the banker, the banker requires the payee (who is discounting) to agree to pay the amount of the full value of the bill if the drawee will not pay at maturity. Though this discount is more in the nature of interest (from the point of view of the drawer), it has no connection with cash or trade discount, which is very common in accounting parlance. This discount rate is really an interest rate charged by the bank for holding the bill for the remainder of its life. The amount of the discount is based on current interest rates and the unexpired period of the bill, i.e. the period from the date of discounting to the date of maturity. Discount is calculated as under :

$$\text{Discount} = \textit{Face Value of the Bill} \times \textit{Rate of Interest} \times \frac{\textit{Unexpired days of the bill}}{365}$$

In actual practice, discount is always calculated on the number of days of the unexpired period of the bill, but in the illustrations, discounts have been calculated in months (since the difference in amounts are too small to be of any consequence).

A bill can generally be discounted with the banker when the drawer of the bill has an account with the banker. While discounting a bill, the banker does not make the payment in cash — rather the account of the drawer is credited with the face value of the bill less discounting charges, known as ***proceeds***. If the drawer of the bill sells it to another banker or a bill broker, he receives a cheque for the net amount.

When a bill is discounted, the drawer of the bill debits the Bank Column of the Cash Book with the proceeds of the bill and credits the Bills Receivable Account with the full value (because the right to receive money is transferred to the banker). The difference of the above two figures, i.e. the discount, is transferred to an account called 'Discount on Bills Account', — which is debited. Therefore, the accounting entry in the books of the drawer is as under:

Bank Account Dr.
Discount on Bills Account Dr.
To Bills Receivable Account

At the end of the accounting year, the debit balance of the Discount on Bills Account is transferred to the Profit and Loss Account — treating that as an expense for the period (irrespective of the fact that the drawee makes the payment to the banker or not). On the due date, the banker presents the bill to the drawee for payment (as it is payable to the bearer of the instrument). If the bill is met by the drawee, no entry is required to be passed in the books of the drawer, since the drawer has already accepted payment from the banker.

When a bill is drawn, it becomes a current asset of the drawer (which appears on the Balance Sheet). But when it is discounted, it is no longer an asset of the drawer, and, therefore, disappears from the Balance Sheet.

We suppose, in our example that the bill is drawn by A on 1.1.2015 and it is payable after 3 months. If the bill is discounted by A on 4.1.2015 @ 6% p.a., the amount of the discount will be ₹ 15 (₹ 1,000 x 3/12 x 6/100).

***Accounting entry, in the Books of A (drawer) will be as under*:**

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

Date	Particulars		L.F.	₹	₹
1.1.2015	Bills Receivable A/c	Dr.		1,000	
	To B A/c				1,000
	(Being a bill drawn on B for 3 months)				
4.1.2015	Bank A/c	Dr.		985	
	Discount on Bill A/c	Dr.		15	
	To Bills Receivable A/c				1,000
	(Being the bill discounted with the banker @ 6% p.a.)				

Dr. **Bills Receivable Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To B A/c	1,000	4.1.2015	By Bank A/c	985
			4.1.2015	By Discount on Bills A/c	15
		1,000			1,000

Dr. **Discount on Bills Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
4.1.2015	To Bills Receivable A/c	15	31.12.2015	By Profit & Loss A/c	15

At maturity, the banker presents the bill to the drawee (B) for payment, since the drawer (A) has already obtained payment, no entry is required to be passed in the books (provided B makes the payment to the banker on the due date).

Interest is the price of credit. It is a charge made for the use of money. Interest is the expense for the period during which the money is borrowed. In accounting parlance, the meaning of interest is different depending upon whether the interest is to be paid at the time of maturity or whether it is to be paid in advance. Under the first case, it is called 'Interest' but under the second case, it is customarily known as 'Discount'.

Effects of Discounting a Bill

(1) In the books of the drawer, the balance of the Bills Receivable Account is reduced by the face value of the bill and the Bank Account is increased by its present value (the proceeds).
(2) From the viewpoint of the drawer, the discount paid to the banker is in the nature of interest. It has no connection with cash or trade discount.
(3) The discount is an expense for the drawer and revenue for the banker.
(4) The banker realises the face value of the bill on the due date from the drawee. Therefore, when a discounted bill is honoured, no journal entry is to be passed in the books of the drawer.
(5) The discounting of a bill does not affect the position of the drawee.

Discounted Bills Receivable as a Contingent Liability

Where a firm has discounted bills receivable and, at the end of the accounting period, those have not reached the due date of presentation for payment, there is a contingent liability. Because, if a bill, which has already been discounted with the banker, is dishonoured in the future, the banker will debit the account of the drawer in their books. Because it is a potential obligation of the drawer to pay the maturity value of the bill, if the drawee fails to make payment. For example, X draws a bill for ₹ 10,000 on Y on 1.12.2014 payable after 4 months, i.e. 4.3.2015. The bill is discounted by X for ₹ 9,750. If the year closing of X is 31st December, 2014, there would be a contingent liability amounting to ₹ 10,000. In case of a limited company, preparing accounts in accordance with the Companies Act, the contingent liability should be disclosed in the Balance Sheet in the form of a note which will read as : 'Contingent liability for bills receivable discounted'. If the drawee makes the payment for the bill on the due date, the contingent liability of the drawer is thereby ended.

Proportionate Chargeability of Discount Charges

When the amount of the discounting charge is quite substantial and the date of discounting of the bill and its due date lie in two accounting periods (like in the previous example), then the chargeability of discounting charges should be proportionately shared. In the above example, if the amount of the bill is ₹ 10,00,000 and the amount of the discounting charges is ₹ 1,00,000 the discounting charges to be debited to the Profit and Loss Account for the year ended 31.12.2014 will be ₹ 25,000 (1 month) and the balance will be charged in the next year.

Entries in the Books of Bank

After discounting a bill, the banker holds it in good faith on the assumption that the drawee will pay in due course. The banker recognizes the interest at the point of discounting the bill. At maturity, when the bill is presented and paid by the drawee, the receipt of the cash is being recorded.

Therefore, when the bill is discounted by the bank, they pass the following entries:

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

Date	Particulars		L.F.	₹	₹
	(i) **When the Bill is Discounted**				
	Bills Discounted A/c	Dr.		1,000	
	To Customers A/c				985
	To Discount A/c				15
	(Being the customer's bill discounted)				
	(ii) **When Cash is Collected from Drawee**				
	Cash A/c	Dr.		1,000	
	To Bills Discounted A/c				1,000
	(Being bills receivable collected)				

(c) Endorsing the bill in favour of a third party Endorsement are the words written on the back of a bill of exchange so as to vary the terms of the bill. A bill of exchange can be transferred by the holder to any other party by mere physical delivery. This is because, a bill of exchange is a negotiable instrument, i.e. amount is payable to the bearer of the instrument. The bearer is the person who has legal physical possession of the bill. Negotiability makes a bill of exchange readily transferable and increases its usefulness.

A further use of a bill of exchange by the drawer is to settle a debt that the drawer owes to someone else. This is done by the drawer by transferring the bill of exchange to his creditor in full or part settlement of a debt (the amount will rarely be exactly the same), provided that his creditor is willing to agree to such an arrangement. This is called 'Endorsing a bill'. The drawer (who endorses the bill) is called the ***endorser*** and the creditor (to whom it is endorsed) is called the ***endorsee***.

> ***A creditor who is prepared to take a bill in this way in part payment of a debt will clearly only take it at its discounted value on the day it is taken.***

The drawer of the bill (the original payee) endorses the bill by signing his name on it and passes the bill in favour of his creditor (the new payee) — and a valid title passes.

In this connection, we are to remember that when a bill is negotiated in favour of a third party, it does not mean that it has to be treated as a bill payment by the drawer (endorser). Conversely, the creditor (endorsee) of the bill cannot treat the endorser as drawee. The journal entry in the books of the drawer will be :

Endorsee Account Dr.
    To Bills Receivable Account

In the previous example, we suppose the bill is endorsed by A to C (a creditor, from whom goods have been purchased) in full settlement of a debt of ₹ 1,000.

Generally, a slip of paper is attached to a bill of exchange, known as allonge to provide for additional endorsements because the original bill does not afford sufficient space.

The journal entry in the books of A, will be as under :

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

Date	Particulars	L.F.	₹	₹
	C A/c Dr. To Bills Receivable A/c (Being the bill endorsed in favour of C)		1,000	1,000

At maturity, C will present the bill for payment to B and will realise the amount. No entry is required to be passed in the books of A (provided B does not fail to make payment).

The Ledger Accounts will be as under :

Dr. **Bills Receivable Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To B A/c	1,000		By C A/c	1,000

Dr. **C Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Bills Receivable A/c	1,000		By Purchases A/c	1,000

Journal entries in the books of the endorsee:
***When the bill is endorsed in favour of the endorsee he passes the following entry*:**

Bills Receivable Account Dr.
    To Drawer Account

After receiving the bill, the endorsee can deal with the bill of exchange in the same manner as the drawer, such as (i) he may retain the bill till the date of maturity; (ii) he may discount the bill with his banker; (iii) he may further endorse it in favour of his creditor; and (iv) he may send the bill to banker for collection.

The Journal entries will be on the same lines as we do in the books of the drawer under such circumstances.

Effects of Endorsing a Bill

(1) When a bill of exchange is endorsed, the amount is payable to the endorsee instead of the original holder. The endorsee can again endorse the bill to another party and this process may continue to any extent till the due date of the bill.

(2) Endorsement facility gives a bill of exchange the status of a currency for limited circulation between different parties for settlement of debts.

Types of Endorsement

A bill of exchange may be endorsed in any one of the following ways:

(i) Blank endorsement Here, the holder of the bill endorses the bill by signing his name on it and passes the bill in favour of a third party, who can again endorse it in favour of any other party, just by mere physical delivery. Thus, only the signature of the holder is necessary. For example —

R K Singh.

(ii) Special endorseme Here the holder of the bill writes the name of the endorsee to whom the bill is transferred. The endorsee can transfer the bill in favour of some other party. This type of endorsement looks as follows: 'Pay A K Roy or order'

R K Singh

(iii) Restrictive endorsement In this case, the holder of the bill endorses the bill in favour of a definite person and thereby restricts the right of subsequent re-endorsement. This is expressed as:

'Pay A K Roy only'

R K Singh

(iv) Endorsement Sans Recourse (without recourse) Under this type of endorsement, the holder relieves himself from any liability to all subsequent endorsees in the case of dishonour of a bill. Here, the holder acts in a representative capacity as agents and not as principals. The endorsee of the bill cannot treat the endorser as drawee. Following is the pattern of such endorsement:

'Pay A K Roy or order'

R K Singh
Sans Recourse

(v) Faultive endorsement Here, the endorser of a bill waives some of the rights to which he is entitled. The endorser clearly states the right which is being given up by him while endorsing the bill. Following is the pattern of endorsement:

'Pay A K Roy or order'

Notice of dishonour waives.

R K Singh

A bill of exchange can be endorsed any number of times. In case of a successive endorsement (when the bill is endorsed by more than one person), endorsements are actually made in the order in which they appear, the last named being the holder to receive payment from the drawee.

(d) Sending the bill to the banker for collection Where a person has to receive a large number of bills receivable regularly (in case of big business houses), it becomes difficult to present the various bills to different drawees on different due dates. In such a case, the bills are sent to the banker for collection; thus entrusting the banker to do this job. Everytime, a bill is received from the drawee, it is sent to the banker. An instruction is given to the banker before hand to present the bills to the respective drawees on the due date and to credit the drawer's account when money is received. For this, the drawer opens (in his books) one temporary account called Bills for Collection Account. Whenever a bill is sent to the banker for collection, Bills for Collection Account is debited and Bills Receivable Account is credited. (Here, Bank Account is not debited because money can only be received by the banker after the due date). When the money is actually received by the banker, Bank Account is debited and Bills for Collection Account is credited. Any balance in the Bills for Collection Account shows the amount of uncollected bills lying with the banker. ***These bills must not be confused with the discounted bills — the banker holds these bills as an agent for collection.***

In our example, if A sends the bill to the banker for collection and on the due date, the banker obtains money, the following Journal entries will be passed in the books of A.

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

Date	Particulars		L.F.	₹	₹
	Bills for Collection A/c	Dr.		1,000	
	To Bills Receivable A/c				1,000
	(Being the bill sent to the banker for collection)				
	Bank A/c	Dr.		1,000	
	To Bills for Collection A/c				1,000
	(Being the bill previously sent to the banker for collection, now honoured)				

The Ledger Accounts will be as follows :

Dr. **Bills Receivable Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To B A/c	1,000		By Bills for Collection A/c	1,000

Dr. **Bills for Collection Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Bills Receivable A/c	1,000		By Bank A/c	1,000

Dr. **Bank Account (Inclusive)** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Bills for Collection A/c	1,000			

It should be noted that the bank will not make any accounting entry in the books of account in respect of bills received by the bank for collection. However, the bank enters all particulars of the bills in a Memorandum Book.

When the bank collects money from the drawee then it passes the following entry:

Cash Account Dr.
To Current Account of Customer
To Collection Charges Account
(Being the bill collected on behalf of the customer and the net proceeds credited)

(e) Advance on the security of bills Sometimes an advance can be obtained from the banker by depositing the bill as a security. It should be noted that, in this case, the bills are not discounted, but remain the property of the drawer. Therefore, in the books of the drawer, bills will remain as assets in the Bills Receivable Account. The following Journal entry is passed:

(a) Bank Account Dr.
To Advances on Bills Account

At maturity, when the banker presents the bill for payment and the drawee honours it, the banker is to refund the excess of the amount received over the sum advanced plus the interest charged. When the drawer receives the notification from the banker that the bill (which was previously deposited as a security) has been honoured, the following Journal entries are passed.

(b) Advances on Bills Account Dr.
To Bills Receivable Account
(c) Interest Account Dr. [Interest charged by the bank]
To Advances on Bills Account
(d) Bank Account Dr. [Excess amount received]
To Advances on Bills Account

Entries in the Books of the Drawee

The drawee of the bill is not at all concerned with any of the above transactions. On the due date, the amount of the bill is payable by him to the bearer of the bill. Therefore, at maturity, when the bill is presented to the drawee for payment, either by the drawer or by the bank or by the endorsee — depending on the manner in which the bill is being dealt with by the drawer previously, he (the drawee) will pass the following entry in his books:

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

Date	Particulars	L.F.	₹	₹
4.4.2015	Bills Payable A/c Dr. To Cash A/c (Being the bill met at maturity)		1,000	1,000

Bills Receivable Book and Bills Payable Book

For any organization, where a number of bills are drawn and/or accepted, bills are recorded in special subsidiary books — particulars of all bills receivable in the Bills Receivable Book and particulars of the bills payable in Bills Payable Book. At regular intervals, the amounts of the various bills are added together and posted to their relevant accounts in the main ledger. The total of the Bills Receivable Book is posted to the debit side of the Bills Receivable Account and the total of the the Bills Payable Book is posted to the credit side of the Bills Payable Account. In respect of each the Bill Receivable, the Customer's Account, i.e. the drawee from whom it is received, is credited in the Ledger. Usual Formats of Bills Receivable Book and Bills Payable Book are given below:

Bills Receivable Book

Sl. No.	Bill No.	Name of the acceptor	From whom received	Date of Bill	Term	Date of Maturity	Amount ₹	How dealt with

Bills Payable Book

Sl. No.	Bill No.	Date of Bill	Name of the Drawer	Payee	Term	Date of Maturity	Amount ₹	Remarks

Illustration 1

Record the following transactions in the Bills Receivable and Bills Payable Books of a trader :

2015 Jan. 1 Received from Hari Kumar an acceptance of 2 months for ₹ 1,000.
5 Our acceptance to Ram Prasad at 3 months for ₹ 4,000.
15 Received from Benigopal an acceptance for 4 months for ₹ 2,000.
18 Discounted Hari Kumar's acceptance for ₹ 980.
19 Received from Rajagopal an acceptance for 2 months for ₹ 6,000.
20 Our acceptance to Jadav at 2 months for ₹ 1,500.
21 Renewed our acceptance to Ram Prasad by paying him cash ₹ 2,000 and accepted a fresh bill of ₹ 2,100 at 4 months ₹ 100 being interest charged.
22 Benigopal's acceptance endorsed in favour of Rahman in full settlement of a debt of ₹ 2,250.

Solution

Bills Receivable Book

Sl. No.	Bill No.	Name of the acceptor	From whom received	Date of Bill	Term (Months)	Date of Maturity	Amount ₹	How dealt with
1.		Hari Kumar	Hari Kumar	1.1.2015	2	4.3.2015	1,000	Discounted
2.		Benigopal	Benigopal	15.1.2015	4	18.5.2015	2,000	Endorsed
3.		Rajagopal	Rajagopal	19.1.2015	2	22.3.2015	6,000	

Bills Payable Book

S. No.	Bill No.	Date of Bill	Name of the Drawer	Payee	Term (Months)	Date of Maturity	Amount	Remarks
1.		5.1.2015	Ramprasad	Ramprasad	3	8.4.2015	4,000	Renewed
2.		20.1.2015	Jadav	Jadav	2	23.3.2015	1,500	
3.		21.1.2015	Ramprasad	Ramprasad	4	24.5.2015	2,100	

Illustration 2

On 1.4.2015 A draws a bill on B for ₹ 9,000 for 3 months. B accepts the bill and returns it to A. Pass Journal entries in the books of A in each of the following circumstances, assume that the bill is honoured on the due date:

(i) A retains the bill till the due date; (ii) A discounts the bill for ₹ 8,750; (iii) A endorses the bill in favour of C; and, (iv) A sends the bill to the bank for collection.

Solution

In the books of A

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

Date	Particulars		L.F.	₹	₹
2015 April 1	Bills Receivable A/c	Dr.		9,000	
	To B A/c				9,000
	(Being a bill drawn on B for 3 months)				
	(i) **When the Bill is retained**				
July 4	Cash A/c	Dr.		9,000	
	To Bills Receivable A/c				9,000
	(Being the bill honoured at maturity)				
	(ii) **When the Bill is discounted**				
April 1	Bank A/c	Dr.		8,750	
	Discount on Bills A/c	Dr.		250	
	To Bills Receivable A/c				9,000
	(Being the bill discounted with the banker for ₹ 8,750)				
April 1	(iii) **When the Bill is endorsed**				
	C A/c	Dr.		9,000	
	To Bills Receivable A/c				9,000
	(Being the bill previously drawn on B — now endorsed in favour of C)				
	(iv) **When the Bill is sent to the banker for collection**				
April 1	Bills for collection A/c	Dr.		9,000	
	To Bills Receivable A/c				9,000
	(Being the bill sent to the banker for collection)				
July 4	Bank A/c	Dr.		9,000	
	To Bills for collection A/c				9,000
	(Being the amount realised by bank at maturity)				

Illustration 3

X draws a bill for ₹ 4,000 on Y. Y accepts it and returns it to X. X endorses it over to Z. Z endorses it in favour of A. On the due date, the bill was honoured. Pass entries in the books of all the parties.

Solution

In the books of X
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
?	Bills Receivable A/c	Dr.		4,000	
	To Y A/c				4,000
	(Being the bill drawn on Y)				
?	Z A/c	Dr.		4,000	
	To Bills Receivable A/c				4,000
	(Being the bill endorsed in favour of Z)				

In the books of Y
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
?	X A/c	Dr.		4,000	
	To Bills Payable A/c				4,000
	(Being the bill from X accepted)				
?	Bills Payable A/c	Dr.		4,000	
	To Cash A/c				4,000
	(Being the bill honoured by us on maturity)				

In the books of Z
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
?	Bills Receivable A/c	Dr.		4,000	
	To X A/c				4,000
	(Being the receipt of a bill from X)				
?	A A/c	Dr.		4,000	
	To Bills Receivable A/c				4,000
	(Being the bill endorsed in favour of A)				

In the books of A
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
?	Bills Receivable A/c	Dr.		4,000	
	To Z A/c				4,000
	(Being the receipt of a bill from Z)				
?	Cash A/c	Dr.		4,000	
	To Bills Receivable A/c				4,000
	(Being the amount realised at maturity)				

Illustration 4

A draws a bill on B for ₹ 5,000. B accepts and returns it to A. A endorses the bill in favour of C. C, thereafter, endorses the bill in favour of D. D discounts the bill for ₹ 4,750. Pass Journal entries in the books of all the parties, assuming that the bill is honoured at maturity.

Solution

In the books of A
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
?	Bills Receivable A/c	Dr.		5,000	
	To B A/c				5,000
	(Being the bill from B received)				
?	C A/c	Dr.		5,000	
	To Bills Receivable A/c				5,000
	(Being the bill previously drawn on B, now endorsed in favour of C)				

In the books of B
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
?	A A/c	Dr.		5,000	
	To Bills Payable A/c				5,000
	(Being the acceptance of bill from A)				

?	Bills Payable A/c Dr. To Cash A/c (Being the bill honoured by us on maturity)		5,000	 5,000

In the books of C
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
?	Bills Receivable A/c Dr. To A A/c (Being the receipt of a bill from A)		5,000	 5,000
?	D A/c Dr. To Bills Receivable A/c (Being the bill endorsed in favour of D)		5,000	 5,000

In the books of D
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
?	Bills Receivable A/c Dr. To C A/c (Being the receipt of a bill from C)		5,000	 5,000
?	Bank A/c Dr. Discount on Bills A/c Dr. To Bills Receivable A/c (Being the bill discounted with the banker for ₹ 4,750)		4,750 250	 5,000

In the books of Bank
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
?	Bills Discounted A/c Dr. To Current Account of D To Discount A/c (Being the bill discounted)		5,000	 4,750 250
?	Cash A/c Dr. To Bills Discounted A/c (Being cash collected on maturity of bill)		5,000	 5,000

Illustration 5

On 1.1.2015 A purchased goods from B for ₹ 15,000 on 3 months credit. On 1.4.2015 A endorsed a bill for ₹ 10,000 in favour of B and paid the balance in cash. The due date of the bill is 1.6.2015. Immediately after receipt, B discounted the bill with the banker @ 12% p.a. The bill was honoured on the due date.

In the books of A
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2015 Jan. 1	Purchases A/c Dr. To B A/c (Being the goods purchased on credit)		15,000	 15,000
Apr. 1	Interest A/c (Note 1) Dr. To B A/c (Being the interest charged for the delay in payment)		2012	 2012
"	B A/c Dr. To Bills Receivable A/c To Cash A/c (Being a bill endorsed and the balance paid in cash)		15,200	 10,000 5,200

In the books of B
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2015 Jan. 1	 A A/c Dr. To Sales A/c (Being the goods sold on credit)		 15,000	 15,000

Apr. 1	A A/c Dr. To Interest A/c (Being the interest charged for the delay in payment)		2012	2012
"	Bills Receivable A/c Dr. Cash A/c Dr. To A A/c (Being the receipt of a bill and the balance in cash)		10,000 5,200	15,200
"	Bank A/c Dr. Discount on Bills A/c Dr. To Bills Receivable A/c (Being the bill discounted with the banker @ 12%)		9,800 2012	10,000

Working Note :

(1) Due date for payment is 1.4.2015 but the maturity date of the bill is 1.6.2015. Though two months interest is payable by A to B, the rate of interest will be the rate of discounting of the bill by bank. The interest will be : ₹ 10,000 × 12/100 × 2/12 = ₹ 2012.

Tutorial Note : A creditor who is prepared to take a bill in this way in part payment of the debt will clearly only take it at its discounted value on the day it is taken.

Dishonour of a Bill

When the holder of a bill presents it to the drawee for payment on the due date and the drawee fails to make the payment, the bill is said to be ***dishonoured*** (it may be noted that a bill can also be dishonoured by non-acceptance). When a bill is dishonoured, notice of dishonour must be given to the prior parties to retain their liability. The entry to be passed (either in the books of the drawer or the drawee) will cancel the original entry/entries in regard to the bill, and the original position of debtor and creditor will be restored. It means that the drawer will re-establish the draweee as a debtor and the drawee will re-establish the drawer as a creditor.

Let us assume that A is the drawer, B is the drawee and C is the endorsee.

The entry will be as follows

Situation		In the books of A	In the books of B
(1)	**When 'A' retains the bill till maturity**	B A/c Dr. To Bills Receivable A/c (Being the bill dishonoured at maturity)	Bills Payable A/c Dr. To A A/c (Being the bill dishonoured at maturity)
(2)	**When 'A' discounts the bill with the banker**	B A/c Dr. To Bank A/c (Being the bill previously discounted, now dishonoured.) *Note*: Bank Account will be credited by the full value of the bill.	Bills Payable A/c Dr. To A A/c (Being the bill dishonoured at maturity)
(3)	**When 'A' endorsed the bill in favour of 'C'**	B A/c Dr. To C A/c (Being the bill previously endorsed in favour of 'C', now dishonoured)	Bills Payable A/c Dr. To A A/c (Being the bill dishonoured at maturity)
(4)	**When 'A' sends the bill to the banker for collection**	B A/c Dr. To Bills for collection A/c (Being the bill previously sent to bank for collection, now dishonoured)	Bills Payable A/c Dr. To A A/c (Being the bill dishonoured at maturity)

It should be noted that when a bill is dishonoured:

In the books of the Drawer — Drawee Account is always debited and the person who is holding the bill, is credited.

In the books of Drawee — Drawer Account is always credited and Bills Payable Account is always debited.

Effects of Dishonour of a Bill

(1) When a bill is dishonoured, it becomes valueless and the original position of debtor and creditor is restored between the drawee and the drawer.

(2) Upon its dishonour, the holder of a bill has a right of action against the drawee or any previous endorser.

(3) When an endorser makes the payment to the endorsee, he can sue any previous endorser or the drawer.

(4) Upon dishonour, to avoid confusion and multiplicity of legal actions, generally the drawer takes up the bill and exercises his rights upon the drawee.

(5) Expenses incurred for establishing the fact of dishonour of a bill (noting charges) are generally paid by the holder, but ultimately these are recoverable from the drawee.

Illustration 6

X receives from Y four bills on 1st April 2015 for ₹ 1,000, ₹ 2,000, ₹ 3,000 and ₹ 4,000 respectively for 3 months. The 2nd bill of ₹ 2,000 is endorsed in favour of Z and the 3rd bill of ₹ 3,000 is discounted with the Central Bank of India for ₹ 2,980. The 4th bill for ₹ 4,000 is sent to the banker for collection. Pass the Journal entries in the books of X and Y assuming that (a) the bills have been met at maturity; and (b) the bills have been dishonoured at maturity.

Solution

In the books of X

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 April 1	Bills Receivable A/c To Y A/c (Being four bills drawn on Yfor 3 months for ₹ 1,000; ₹ 2,000; ₹ 3,000 and ₹ 4,000 respectively)	Dr.		10,000	10,000
?	Z A/c To Bills Receivable A/c (Being the 2nd bill endorsed in favour of Z)	Dr.		2,000	2,000
?	Bank A/c Discount on Bills A/c To Bills Receivable A/c (Being the 3rd bill discounted with CBI for ₹ 2,980)	Dr. Dr.		2,980 20	3,000
?	Bills for Collection A/c To Bills Receivable A/c (Being the 4th bill sent to the bank for collection)	Dr.		4,000	4,000
July 4	(a) **When the bills have been met at maturity** (i) *For 1st bill* Bank A/c To Bills Receivable A/c (Being the 1st bill met at maturity)	Dr.		1,000	1,000
	(ii) *For 2nd bill* (There will be no entry in the books of X because the money will be realised by Z)				
	(iii) *For 3rd bill* (There will be no entry in the books of X because the money will be realised by Bank)				
July 4	(iv) *For 4th bill* Bank A/c To Bills for Collection A/c (Being the bill collected by bank on our behalf)	Dr.		4,000	4,000
July 4	(b) **When the bills have been dishonoured at maturity** (i) *For 1st bill* Y A/c To Bills Receivable A/c (Being the bill dishonoured at maturity)	Dr.		1,000	1,000
July 4	(ii) *For 2nd bill* Y A/c To Z A/c (Being the bill dishonoured at maturity)	Dr.		2,000	2,000
July 4	(iii) *For 3rd bill* Y A/c To Bank A/c (Being the bill dishonoured at maturity)	Dr.		3,000	3,000
July 4	(iv) *For 4th bill* Y A/c To Bills for Collection A/c (Being the bill dishonoured at maturity)	Dr.		4,000	4,000

In the books of Y

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 April 1	X A/c To Bills Payable A/c (Being four bills accepted for ₹ 1,000; ₹ 2,000; ₹ 3,000 and ₹ 4,000 respectively for 3 months)	Dr.		10,000	10,000

July 4	(a) **When the bills have been met at maturity** Bills Payable A/c Dr. To Bank A/c (Being all the four bills met at maturity)		10,000	10,000
July 4	(b) **When the bills have been dishonoured at maturity** Bills Payable A/c Dr. To X A/c (Being all the bills dishonoured at maturity)		10,000	10,000

Noting Charges

Noting is the procedure adopted if a bill of exchange has been dishonoured by non-acceptance or by non-payment. As we know, if the holder of the bill presents it to the drawee for payment on the due date but the latter does not pay it off, the bill is said to be dishonoured. In such a case, the holder of the bill may resort to legal action by getting the fact of dishonour noted (a form of disapproval) by a Notary Public (a legal practitioner, usually a solicitor, who is empowered to note a dishonoured bill of exchange). This is done by the holder by referring the matter to the notary public who himself presents the bill for payment to the drawee and testifies that the latter declined to pay it off. This is a legally acceptable evidence of dishonour. Therefore, ***noting of a bill*** means that it is re-presented by the notary public to the drawee to obtain legal proof of dishonour. The Notary Public records particulars of the bill, its re-presentment, and the reasons for non-payment of the bill in a regular and also on a notarial ticket, which is to be attached to the bill. The notary public charges some fees for doing all these — which is called ***noting charges***. Generally, the loss by way of noting charges is to be borne by the drawee because it can legally be recoverable from him. The journal entries are as under:

In the books of the drawer

(a) When the drawer pays for the noting charges

Drawee Account Dr.
To Cash Account

(b) When Bank pays for the noting charges

Drawee Account Dr.
To Bank Account

(c) When the endorsee pays for the noting charges

Drawee Account Dr.
To Endorsee Account

(d) When a bill is sent to the banker for collection and ultimately it proves dishonoured, the bank generally returns the bill to the drawer and the drawer himself pays for the noting charges.

It should be noted that entries for noting charges are similar to the entries for dishonour of a bill. All the time, the Drawee Account is debited (in the hope of recovering it from him) and the person who is paying for it, is credited. The Noting Charges Account is not debited because it is not an expense for the drawer.

In the books of the drawee

For all the above cases, the following entry is passed:

Noting Charges Account Dr.
To Drawer Account

We notice that the drawee has nothing to do with the manner in which the bill has been dealt with by the drawer. Noting charges being an expense for the drawee is debited. The amount is payable to the drawer and is therefore credited.

Illustration 7

On 1st November, 2014, Ranjit accepted a bill for ₹ 500 for four months drawn by Aloke. On 4th November, 2014 Aloke discounted the bill @ 6% p.a. with his banker. At maturity, the bill was dishonoured and the bank charged ₹ 15 as noting charges.

Show necessary Journal Entries in the books of Aloke and Ranjit recording the above transactions.

Solution

In the books of Aloke

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2014 Nov. 1	Bills Receivable A/c	Dr.		500	
	To Ranjit A/c				500
	(Being the bill drawn on Ranjit for 4 months)				
Nov. 4	Bank A/c	Dr.		490	
	Discount on Bills A/c	Dr.		10	
	To Bills Receivable A/c				500
	(Being the bill discounted @ 6% p.a.)				
2015 March 4	Ranjit A/c	Dr.		515	
	To Bank A/c				515
	(Being the bill dishonoured and noting charges paid ₹ 15)				

In the books of Ranjit

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2014 Nov. 1	Aloke A/c	Dr.		500	
	To Bills Payable A/c				500
	(Being the bill accepted for 4 months)				
2015 March 4	Bills Payable A/c	Dr.		500	
	Noting Charges A/c	Dr.		15	
	To Aloke A/c				515
	(Being the bill dishonoured and noting charges paid by Aloke)				

Illustration 8

A draws a bill on B for ₹ 3,000. B accepts and returns it to A. A endorses the bill in favour of C. C, thereafter, endorses the bill in favour of D. D discounts the bill for ₹ 2,750. At maturity, the bill is dishonoured and the banker paid noting charges of ₹ 30. Pass the Journal entries in the books of A, B, C and D.

Solution

In the books of A

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
?	Bills Receivable A/c	Dr.		3,000	
	To B A/c				3,000
	(Being a bill drawn on B)				
?	C A/c	Dr.		3,000	
	To Bills Receivable A/c				3,000
	(Being the bill previously drawn on B, now endorsed in favour of C)				
?	B A/c	Dr.		3,030	
	To C A/c				3,030
	(Being the bill endorsed in favour of C now dishonoured, noting charges being ₹ 30)				

In the books of B

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
?	A A/c	Dr.		3,000	
	To Bills Payable A/c				3,000
	(Being the acceptance of a bill from A)				
?	Bills Payable A/c	Dr.		3,000	
	Noting Charges A/c	Dr.		30	
	To A A/c				3,030
	(Being the bill dishonoured for non payment, noting charges being ₹ 30)				

In the books of C

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
?	Bills Receivable A/c	Dr.		3,000	
	To A A/c				3,000
	(Being the bill from A received)				
?	D A/c	Dr.		3,000	
	To Bills Receivable A/c				3,000
	(Being the bill previously received from A, now endorsed in favour of D)				
?	A A/c	Dr.		3,030	
	To D A/c				3,030
	(Being the bill previously endorsed in favour of D now dishonoured, noting charges being ₹ 30)				

In the books of D
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
?	Bills Receivable A/c	Dr.		3,000	
	To C A/c				3,000
	(Being the bill from C received)				
?	Bank A/c	Dr.		2,750	
	Discount on Bills A/c	Dr.		250	
	To Bills Receivable A/c				3,000
	(Being the bill discounted with the banker for ₹ 2,750)				
?	C A/c	Dr.		3,030	
	To Bank A/c				3,030
	(Being the bill previously received from C now dishonoured, noting charges being ₹ 30)				

Illustration 9

A sells goods for ₹ 10,000 to B on 1st January, 2015 and on the same day draws a bill on B at three months for the amount. The bill is dishonoured on the due date, the noting charges paid being ₹ 25.

B then accepts a fresh bill for ₹ 6,000 at three months by A, and he also pays A in cash ₹ 4,205 together with the amount of interest at 12% p.a. for the further credit granted. The bill is duly met on the due date.

Pass journal entries to record these transactions in the books of A.

In the books of A
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 Jan. 1	B A/c	Dr.		10,000	
	To Sales A/c				10,000
	(Being the goods sold to B on credit)				
"	Bills Receivable A/c	Dr.		10,000	
	To B A/c				10,000
	(Being a bill drawn on B for 3 months)				
Apr. 4	B A/c	Dr.		10,025	
	To Bills Receivable A/c				10,000
	To Bank A/c				25
	(Being the bill dishonoured at maturity — noting charges paid ₹ 25)				
"	B A/c	Dr.		6,000	
	To Bills Receivable A/c				6,000
	(Being a new bill is drawn on B)				
"	B A/c	Dr.		180	
	To Interest Received A/c				180
	(Being interest charged to B for the balance amount @ 12% p.a. for 3 months)				
"	Bank A/c (₹ 4,025 + 180)	Dr.		4,205	
	To B A/c				4,205
	(Being the part payment, noting charges and interest for the balance received from B)				
July 7	Bank A/c	Dr.		6,000	
	To Bills Receivable A/c				6,000
	(Being the bill honoured at maturity)				

Insolvency

Insolvency is the inability to pay one's debts when they fall due. Insolvency arises due to bankruptcy. A person is said to be insolvent when he is unable to pay the amount due by him. An insolvent person may have valuable assets that are not immediately realisable. When a person becomes insolvent, his properties are sold by the liquidator or official receiver, who pays off the creditors proportionately out of the realized money. This payment to the creditors by the official receiver (which is generally less than the amount due) is termed as 'Dividend' and is generally expressed as so many paise in the rupee, e.g. 50 paise in the rupee, which means 50% of the amount due is paid.

Effect of Insolvency of the Drawee

(a) When the drawee of the bill is declared insolvent, any bill of exchange accepted by him should be treated as dishonoured and the entry for dishonour is passed in the books of the drawer.

Drawee Account Dr.
To Bills Receivable Account / Bank Account / Endorsee Account / Bills for Collection Account

(b) When any dividend is received from the official liquidator, the following entry is passed:

Bank Account Dr.
To Drawee Account

(c) The amount ultimately proved irrecoverable should be treated as bad debt and it is written off from the books. The drawee account is closed by passing the following entry:

Bad Debt Account Dr.
To Drawee Account

Generally the last two entries are clubbed as under:

Bank Account Dr.
Bad Debt Account Dr.
To Drawee Account

The drawee, in his books, passes the following entries in regard to the above transactions:

(a) Entry for the dishonour:

Bills Payable Account Dr.
To Drawer Account

(b) Entry for the final dividend

Drawer Account Dr.
To Bank Account

(c) Entry for the unsatisfied balance, i.e. deficiency

Drawer Account Dr.
To Deficiency Account

Here also, the last two entries are clubbed as under:

Drawer Account Dr.
To Bank Account
To Deficiency Account

Illustration 10

On 1st January, 2015, Kuntal sold goods to Subhra valuing ₹ 6,000. On 4th January, 2015 Kuntal received from Subhra ₹ 2,000 and drew a bill receivable 3 months after date for the balance. On the same date, Kuntal endorsed the accepted bill to Aparna for full settlement of a debt of ₹ 4,050. On the due date the bill was dishonoured and Subhra, having become insolvent, paid on 5th May, 2015 — 60% of her acceptance. Give Journal Entries in the books of Kuntal and Subhra.

Solution

In the books of Kuntal
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 Jan. 1	Subhra A/c	Dr.		6,000	
	To Sales A/c				6,000
	(Being goods sold to Subhra on credit)				
Jan. 4	Cash A/c	Dr.		2,000	
	Bills Receivable A/c	Dr.		4,000	
	To Subhra A/c				6,000
	(Being the receipt of cash ₹ 2,000 from Subhra and a bill drawn on her for the balance for 3 months)				
Jan. 4	Aparna A/c	Dr.		4,050	
	To Bills Receivable A/c				4,000
	To Discount Received A/c				50
	(Being the bill endorsed in favour of Aparna in full settlement of a debt of ₹ 4,050)				
April 7	Subhra A/c	Dr.		4,000	
	Discount Received A/c	Dr.		50	
	To Aparna A/c				4,050
	(Being the bill endorsed in favour of Aparna, now dishonoured)				
May 5	Bank A/c	Dr.		2,400	
	Bad Debt A/c	Dr.		1,600	
	To Subhra A/c				4,000
	(Being 60% of Subhra's acceptance received)				

In the books of Subhra

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 Jan. 1	Purchases A/c	Dr.		6,000	
	To Kuntal A/c				6,000
	(Being the purchase of goods on credit)				
Jan. 4	Kuntal A/c	Dr.		6,000	
	To Cash A/c				2,000
	To Bills Payable A/c				4,000
	(Being the payment of cash ₹ 2,000 and acceptance of a bill for the balance for 3 months)				
April 7	Bills Payable A/c	Dr.		4,000	
	To Kuntal A/c				4,000
	(Being the bill dishonoured at maturity)				
May 5	Kuntal A/c	Dr.		4,000	
	To Bank A/c				2,400
	To Deficiency A/c				1,600
	(Being the payment of 60% of dues)				

Illustration 11

On 12.2.2015, X sold goods worth ₹ 6,000 to Y. On 15.2.2015, X drew three bills of exchange worth ₹ 3,000, ₹ 2,000 and ₹ 1,000 payable after three months, two months and one month, respectively. Y accepted all the bills and returned to X immediately. X discounted the first bill on 18.3.2015 @ 10% p.a. with his bank. He endorsed the second bill to Z, on 18.3.2015. He retained the third bill till maturity.

Y met the third bill on the due date but dishonoured the first and the second bills. Noting charges amounting to ₹ 25 for each of these two bills were incurred. Y was declared insolvent and could pay only 50 paise in the rupee on 30.5.2015 in full settlement. Pass the Journal Entries in the books of X.

Solution

In the books of X

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 Feb. 12	Y A/c	Dr.		6,000	
	To Sales A/c				6,000
	(Being goods sold to Y on credit)				
Feb. 15	Bills Receivable A/c	Dr.		6,000	
	To Y A/c				6,000
	(Being 3 bills drawn on Y for ₹ 3,000, ₹ 2,000 and ₹ 1,000 for 3, 2 and 1 month respectively)				
Mar. 18	Bank A/c	Dr.		2,950	
	Discount on Bills A/c (See Note)	Dr.		50	
	To Bills Receivable A/c				3,000
	(Being the bill for ₹ 3,000 discounted @ 10% p.a.)				
Mar. 18	Z A/c	Dr.		2,000	
	To Bills Receivable A/c				2,000
	(Being the bill for ₹ 2,000 endorsed in favour of Z)				
Mar. 18	Bank A/c	Dr.		1,000	
	To Bills Receivable A/c				1,000
	(Being the bill honoured at maturity)				
Apr. 18	Y A/c	Dr.		2,025	
	To Z A/c				2,025
	(Being the bill for ₹ 2,000 dishonoured — noting charges ₹ 25)				
May 18	Y A/c	Dr.		3,025	
	To Bank A/c				3,025
	(Being the bill for ₹ 3,000 dishonoured — noting charges ₹ 25)				
May 30	Bank A/c	Dr.		2,525	
	Bad Debts A/c	Dr.		2,525	
	To Y A/c				5,050
	(Being a final dividend of 50 paise in the rupee is received in full settlement)				

Working Note : 2/12 x 10 / 100 x ₹ 3,000 = ₹ 50.

Renewal of a Bill

When the drawee of the bill, after accepting it, has some apprehension that he may not be able to honour the bill on the due date, he may request the drawer of the bill to cancel the original bill and to draw a fresh bill on him for a further period of time.

If the drawee agrees to such an offer, the drawee gets some extention to pay for the bill at a later date and, thereby, dishonouring of the bill is avoided. This is called renewal of a bill. In such a case, the drawee of a bill becomes liable to pay interest to the drawer for the extended period. The amount of the new bill will include the amount of the interest less the part payment made by the drawee, if any, while requesting the drawer to renew the bill.

The renewal of a bill of exchange should always entail the cancellation of the maturing (old) bill and the making of a new one, and accounting records should show such cancellation and renewal. When a bill is renewed, the following entries are required to be passed in the books of the drawer and the drawee.

Transactions	Drawer's Books	Drawee's Books
(1) Cancelling the original bill	Drawee A/c Dr. To Bills Receivable A/c	Bills Payable A/c Dr. To Drawer A/c
(2) Recording interest for the new period	Drawee A/c Dr. To Interest A/c	Interest A/c Dr. To Drawer A/c
(3) Part payment received / made	Cash/Bank A/c Dr. To Drawee A/c	Drawer A/c Dr. To Bank A/c
(4) New bill drawn / accepted	Bills Receivable A/c Dr. To Drawee A/c	Drawer A/c Dr. To Bills Payable A/c

Effects of Renewal of a Bill

(1) Upon renewal, the indebtedness of the drawee is not restricted to the face value of the bill, but it is increased by an amount equal to the aggregate of interest charges, noting charges, stamp duty, and the like.

(2) The new bill re-establishes the acknowledgement of the debt of the drawee.

Illustration 12

A sells goods to B for ₹ 1,000 and draws a bill on him for the same amount for 3 months. Before the due date, B requests A to cancel the bill, to accept ₹ 300 as part payment and to draw a fresh bill on him for ₹ 720 for a further period of 2 months — ₹ 20 being the interest for the period extended. A agrees to the proposal. The new bill is duly honoured. Pass Journal Entries and other Party's Account in the books of both the parties.

Solution

In the books of A

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
?	B A/c Dr. To Sales A/c (Being the goods sold to B on credit)		1,000	1,000
?	Bills Receivable A/c Dr. To B A/c (Being a bill drawn on B for 3 months)		1,000	1,000
?	B A/c Dr. To Bills Receivable A/c (Being the bill cancelled for renewal)		1,000	1,000
?	Cash A/c Dr. To B A/c (Being the acceptance of a part payment)		300	300
?	B A/c Dr. To Interest A/c (Being the interest charged for the period extended)		20	20
?	Bills Receivable A/c Dr. To B A/c (Being a new bill drawn for the balance plus interest)		720	720
?	Cash A/c Dr. To Bills Receivable A/c (Being the new bill honoured)		720	720

Dr. **B Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Sales A/c	1,000	?	By Bills Receivable A/c	1,000
?	To Bills Receivable A/c	1,000	?	By Cash A/c	300
?	To Interest A/c	20	?	By Bills Receivable A/c	720
		2,020			2,020

In the books of B
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
?	Purchases A/c	Dr.		1,000	
	To A A/c				1,000
	(Being the goods purchased on credit from A)				
?	A A/c	Dr.		1,000	
	To Bills Payable A/c				1,000
	(Being the acceptance of a bill from A)				
?	Bills Payable A/c	Dr.		1,000	
	To A A/c				1,000
	(Being the bill cancelled for renewal)				
?	A A/c	Dr.		300	
	To Cash A/c				300
	(Being a part payment made)				
?	Interest A/c	Dr.		20	
	To A A/c				20
	(Being the interest charged by A for the period extended)				
?	A A/c	Dr.		720	
	To Bills Payable A/c				720
	(Being the acceptance of a new bill for the balance plus interest)				
?	Bills Payable A/c	Dr.		720	
	To Cash A/c				720
	(Being the new bill honoured by payment)				

Dr. A Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Bills Payable A/c	1,000	?	By Purchases A/c	1,000
?	To Cash A/c	300	?	By Bills Payable A/c	1,000
?	To Bills Payable A/c	720	?	By Interest A/c	20
		2,020			2,020

Illustration 13

Shyam sold goods to Ram for ₹ 20,000 on 1.1.2015. On the same date Shyam drew upon Ram a bill for the amount of bill at 2 months and Ram accepted the same. On 4th January 2015, Shyam discounted the bill at his bank @ 12% p.a. On the due date Ram told Shyam that he was not in a position to pay the full amount and requested Shyam to accept ₹ 10,000 in cash and to draw a fresh bill for the remaining amount for 2 months together with interest at 15% p.a. Shyam agreed. The second bill was duly met. Give entries to record the above transactions in the books of Shyam.

Solution

In the books of Shyam
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015	Ram A/c	Dr.		20,000	
Jan. 1	To Sales A/c				20,000
	(Being goods sold to Ram on credit)				
Jan. 1	Bills Receivable A/c	Dr.		20,000	
	To Ram A/c				20,000
	(Being a bill drawn on Ram for 2 months)				
Jan. 4	Bank A/c	Dr.		19,600	
	Discount on Bills A/c	Dr.		400	
	To Bills Receivable A/c				20,000
	(Being the bill discounted with the banker @ 12% p.a.)				
Mar. 4	Ram A/c	Dr.		20,000	
	To Bank A/c				20,000
	(Being the bill previously discounted with the banker, now cancelled for renewal)				
Mar. 4	Ram A/c	Dr.		250	
	To Interest A/c				250
	(Being the interest charged to Ram on account of the bill to be drawn @ 15% p.a. for 2 months)				
Mar. 4	Bank A/c	Dr.		10,000	
	Bills Receivable A/c	Dr.		10,250	
	To Ram A/c				20,250
	(Being part payment of ₹ 10,000 received and a fresh bill drawn on Ram for the balance plus interest)				

May 7	Bank A/c Dr. To Bills Receivable A/c (Being the second bill honoured at maturity)		10,250	10,250

Illustration 14

A bought goods from B on 15th January, 2015 for ₹ 25,000 for which he accepted a bill for 3 months drawn on him for ₹ 20,000 and paid ₹ 5,000 by cheque. On 21.1.2015 B discounted the bill @ 15%. p.a. A, being unable to meet the bill at maturity, requested B to accept ₹ 10,000 in cash and to draw another bill for 3 months for the balance sum plus interest at 16% p.a., and B agreed. But before the maturity of the second bill, A became insolvent and a dividend of 60 paise in the rupee was realized from his estate on 30th November, 2015. Pass the necessary Journal entries in the books of B.

Solution

In the books of B
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2015 Jan. 15	A A/c Dr. To Sales A/c (Being goods sold on credit)		25,000	25,000
Jan. 15	Bank A/c Dr. Bills Receivable A/c Dr. To A A/c (Being a cheque of ₹ 5,000 and a bill of ₹ 20,000 for 3 months received from A)		5,000 20,000	25,000
Jan. 21	Bank A/c Dr. Discount on Bills A/c (See Note) Dr. To Bills Receivable A/c (Being the bill discounted with the banker @ 15% p.a.)		19,285 715	20,000
April 18	A A/c Dr. To Bank A/c (Being the bill dishonoured at maturity)		20,000	20,000
April 18	A A/c Dr. To Interest A/c (Being interest due on ₹ 10,000 for 3 months)		400	400
April 18	Bank A/c Dr. Bills Receivable A/c Dr. To A A/c (Being a part payment of ₹ 10,000 accepted and a fresh bill drawn on A for the balance plus interest)		10,000 10,400	20,400
July 21	A A/c Dr. To Bills Receivable A/c (Being the bill dishonoured at maturity)		10,400	10,400
Nov. 30	Bank A/c Dr. Bad Debts A/c Dr. To A A/c (Being the final dividend received from the estate of A @ 60 paise in a rupee)		6,240 4,160	10,400

Note : Discount = 20,000 x 15/100 x 87/365 = ₹ 715. Days = Jan 10 + Feb 28 + March 31 + April 18 = 87 days.

Illustration 15

On 1.1.2015, A sells goods to B for ₹ 10,000 and draws a bill on him for the same amount for 3 months. B accepts the bill and returns it to A. One month before the due date, B requests A to cancel the bill. Instead, he wants to pay ₹ 3,000 immediately as part payment and to accept a fresh bill for the balance plus interest for a further period of 2 months from the due date of the original bill. A agrees to the proposal. The new bill is honoured on the due date. The rate of interest is 12% p.a. Pass Journal Entries in the books of A.

Solution

In the books of A
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2015 Jan. 1	B A/c Dr. To Sales A/c (Being the goods sold to B on credit)		10,000	10,000
"	Bills Receivable A/c Dr. To B A/c (Being a bill drawn on B for 3 months)		10,000	10,000
Mar. 4	B A/c Dr. To Bills Receivable A/c (Being the bill cancelled for renewal)		10,000	10,000
"	Cash A/c Dr. To B A/c (Being a part payment received)		3,000	3,000

"	B A/c Dr. To Interest A/c (See Note) (Being the interest charged for the balance for the period extended — after adjustment of interest for part payment made before the due date)		110	110
"	Bills Receivable A/c Dr. To B A/c (Being a fresh bill drawn on B for the balance plus interest)		7,110	7,110
June 7	Bank A/c Dr. To Bills Receivable A/c (Being the bill honoured at maturity)		7,110	7,110

Working Note :

B made a cash payment of ₹ 3,000 one month before the due date of the bill. Therefore, he is entitled to get one month's interest on ₹ 3,000. The interest is calculated as under :

Interest for the period extended, i.e. @ 12% p.a. on ₹ 7,000 for 2 months	= ₹ 140
Less: Interest on ₹ 3,000 @ 12% p.a. for 1 month (paid before the due date)	= ₹ 30
Interest to be charged	₹ 110

Illustration 16

On 1.1.2015, A sold goods to the value of ₹ 2,000 to B on credit and drew a bill for 3 months for the same amount which B accepted on the same date. The bill was discounted for ₹ 1,970. On the due date, B notified his inability to meet the bill and requested A to take it up and pay the noting charges of ₹ 15, which A did. The following day B met his obligation with a bill at 2 months for the amount together with interest at 6% p.a and paid cash for noting charges. When the bill became due, B paid ₹ 1,000 and accepted a fresh bill at 3 months for ₹ 1,050. B became insolvent before this last bill became due and a first and final dividend of 25 paise in the rupee was realised from his estate on 1.12.1996.

Pass Journal Entries in the books of A to record the above transactions.

Solution

In the books of A

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2015 Jan. 1	B A/c Dr. To Sales A/c (Being the goods sold to B on credit)		2,000	2,000
"	Bills Receivable A/c Dr. To B A/c (Being a bill drawn on B for 3 months)		2,000	2,000
?	Bank A/c Dr. Discount on Bills A/c Dr. To Bills Receivable A/c (Being the bill discounted for ₹ 1,970)		1,970 30	2,000
Apr. 4	B A/c Dr. To Bank A/c (Being the bill dishonoured at maturity — noting charges ₹ 15 paid by bank)		2,015	2,015
5	Cash A/c Dr. To B A/c (Being the noting charges received in cash)		15	15
"	B A/c Dr. To Interest A/c (Being interest charged for 2 months @ 6% p.a. on ₹ 2,000)		20	20
"	Bills Receivable A/c Dr. To B A/c (Being a fresh bill drawn on B for 2 months)		2,020	2,020
June 8	B A/c Dr. To Bills Receivable A/c (Being the bill dishonoured at maturity)		2,020	2,020
"	Cash A/c Dr. To B A/c (Being the part payment received)		1,000	1,000
"	B A/c Dr. To Interest A/c (Being interest charged for the period extended)		30	30

"	Bills Receivable A/c Dr. To B A/c (Being a further bill drawn on B for 3 months)		1,050	1,050
Sept. 11	B A/c Dr. To Bills Receivable A/c (Being the 3rd bill also dishonoured)		1,050	1,050
Dec. 1	Bank A/c Dr. Bad Debts A/c Dr. To B A/c (Being a first and final dividend received from the estate of B @ 25 paise in a rupee)		262.50 787.50	1,050

Illustration 17

D owes ₹ 6,000 to S. The debt is discharged by D on 1.6.2014 by accepting two bills of exchange drawn on him by S — one for ₹ 4,000 at 2 months and the other for ₹ 2,000 at 3 months. The first bill is endorsed in favour of R, a creditor, in full settlement of his debt for ₹ 4,200. The second bill is discounted with the banker at 15% p.a. on 4th June. Both the bills were dishonoured, the noting charges in each case being ₹ 60. On 5th September, D agreed to accept another bill for the total amount including interest @ 18% p.a. payable after 3 months. On the due date the bill was dishonoured. D was declared insolvent and a final dividend @ 40% was realised from his estate.

Show the Journal Entries in the books of S.

Solution

In the books of S
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2014 June 1	Bills Receivable A/c Dr. To D A/c (Being two bills of ₹ 4,000 and ₹ 2,000 drawn on D for 2 and 3 months respectively)		6,000	6,000
?	R A/c Dr. To Bills Receivable A/c To Discount Received A/c (Being the bill for ₹ 4,000 endorsed in favour of R in full settlement of a debt of ₹ 4,200)		4,200	4,000 2012
June 4	Bank A/c Dr. Discount on Bills A/c Dr. To Bills Receivable A/c (Being the bill for ₹ 2,000 discounted @ 15% p.a.)		1,925 75	2,000
Aug. 4	D A/c Dr. Discount Received A/c Dr. To R A/c (Being the bill for ₹ 4,000 dishonoured at maturity — noting charges ₹ 60)		4,060 2012	4,260
Sept. 4	D A/c Dr. To Bank A/c (Being the bill for ₹ 2,000 dishonoured at maturity — noting charges ₹ 60)		2,060	2,060
Sept. 5	D A/c Dr. To Interest A/c (See Note) (Being the interest charged for the extended period)		336.30	336.30
Sept. 5	Bills Receivable A/c Dr. To D A/c (Being a new bill drawn on D for the balance plus interest)		6,456.30	6,456.30
Dec. 8	D A/c Dr. To Bills Receivable A/c (Being the bill dishonoured at maturity)		6,456.30	6,456.30
?	Bank A/c Dr. Bad Debts A/c Dr. To D A/c (Being a final dividend of 40% received in full settlement)		2,582.52 3,873.78	6,456.30

Working Note: Interest for the extended period (ignoring days) :

₹ 4,060 for 4 months @ 18% p.a. = ₹ 243.60
₹ 2,060 for 3 months @ 18% p.a. = ₹ 92.70
Total interest payable = ₹ 336.30

Illustration 18

In the books of A, there was a balance of ₹ 13,000 due by B on 31st March, 2015 which was written-off as bad debt in closing of the books on that date. On 12th July, 2015 B paid cash ₹ 12,000 in full and final settlement of his dues.

Further transactions took place between A and B as follows :

2015

Aug 4 A sold goods to B valued at ₹ 25,000 which were paid by cheque ₹ 4,000 and a bill of exchange for ₹ 21,000 at one month. A discounted the bill of exchange at the bank for ₹ 20,900.

Sep. 7 B's bill was dishonoured and A was called upon to take it up. This he did by paying noting charges of ₹ 100.

Sep. 8 B met his obligation for ₹ 21,000 with a bill at two months for the same amount, paid cash for noting charges on the old bill and interest of ₹ 2012 on the new bill.

Nov. 11 B met his bill by paying cash ₹ 11,000 and accepted a fresh bill at two months for ₹ 10,400 including interest.

Dec. 11 B having become insolvent paid final dividend of 50 paise in the rupee.

Show journal entries in the books of A and necessary ledger accounts in the books of B.

Solution

In the books of A

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 Mar. 31	Bad Debts A/c	Dr.		13,000	
	To B A/c				13,000
	(Being the amount due from B written off as bad debts)				
Mar. 31	Profit and Loss A/c	Dr.		13,000	
	To Bad Debts A/c				13,000
	(Being the bad debts transferred to Profit and Loss Account)				
July 12	Cash A/c	Dr.		12,000	
	To Bad Debts Recovery A/c				12,000
	(Being the recovery of bad debts from B in full settlement of ₹ 13,000)				
Aug 4	B A/c	Dr.		25,000	
	To Sales A/c				25,000
	(Being the goods sold on credit to B)				
"	Bank A/c	Dr.		4,000	
	Bills Receivable A/c	Dr.		21,000	
	To B A/c				25,000
	(Being the receipt of a cheque for ₹ 4,000 and a bill of ₹ 21,000 from B)				
"	Bank A/c	Dr.		20,900	
	Discount on Bill A/c	Dr.		100	
	To Bills Receivable A/c				21,000
	(Being the bill discounted with the banker for ₹ 20,900)				
Sept. 7	B A/c	Dr.		21,100	
	To Bank A/c				21,100
	(Being the bill dishonoured at maturity and noting charges paid ₹ 100)				
Sept. 8	B A/c	Dr.		2012	
	To Interest A/c				2012
	(Being the interest charged for the dishonoured bill)				
"	Cash A/c	Dr.		300	
	To B A/c				300
	(Being the interest and noting charges paid by B in cash)				
"	Bills Receivable A/c	Dr.		21,000	
	To B A/c				21,000
	(Being a new bill drawn on B for 2 months)				
Nov. 11	B A/c	Dr.		21,000	
	To Bills Receivable A/c				21,000
	(Being the bill cancelled for renewal)				
"	Cash A/c	Dr.		11,000	
	To B A/c				11,000
	(Being a part payment received from B)				
"	B A/c	Dr.		400	
	To Interest A/c				400
	(Being interest charged on B for renewal of the bill)				
"	Bills Receivable A/c	Dr.		10,400	
	To B A/c				10,400
	(Being a new bill drawn on B for 2 months)				
Dec. 11	B A/c	Dr.		10,400	
	To Bills Receivable A/c				10,400
	(Being the bill dishonoured due to insolvency of B)				

"	Bank A/c Dr. Bad Debts A/c Dr. To B A/c (Being 50% of the amount due from B received on final settlement)		5,200 5,200	 10,400

In the books of B

Dr. A Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Mar 31	To Balance c/d	13,000	Mar 31	By Balance b/d	13,000
July 12	To Cash A/c	12,000	Mar 31	By Balance b/d	13,000
	To Discount Received A/c	1,000			
		13,000			13,000
Aug. 4	To Bank A/c	4,000	Aug. 4	By Purchases A/c	25,000
"	To Bills Payable A/c	21,000			
		25,000			25,000
Sept. 8	To Cash A/c (₹ 100 + 2012)	300	Sept. 7	By Bills Payable A/c	21,000
"	To Bills Payable A/c	21,000	"	By Noting Charges A/c	100
			Sept. 8	By Interest A/c	2012
		21,300			21,300
Nov. 11	To Cash A/c	11,000	Nov. 11	By Bills Payable A/c	21,000
"	To Bills Payable A/c	10,400	"	By Interest A/c	400
		21,400			21,400
Dec. 11	To Bank A/c (50% of ₹ 10,400)	5,200	Dec. 11	By Bills Payable A/c	10,400
"	To Deficiency A/c	5,200			
		10,400			10,400

Dr. Bills Payable Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Sept. 7	To A A/c	21,000	Aug. 4	By A A/c	21,000
Nov. 11	To A A/c	21,000	Sept. 8	By A A/c	21,000
Dec. 11	To A A/c	10,400	Nov. 11	By A A/c	10,400
		52,400			52,400

Dr. Discount Received Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Dec. 11	To Profit and Loss A/c	1,000	July 12	By A A/c	1,000
		1,000			1,000

Dr. Noting Charges Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Sept. 7	To A A/c	100	Dec. 11	By Profit and Loss A/c	100
		100			100

Dr. Interest Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Sept. 8	To A A/c	2012	Dec. 11	By Profit and Loss A/c	600
Nov. 11	To A A/c	400			
		600			600

Dr. Deficiency Account Cr.

Date	Particulars	₹	Date	Particulars	₹
			2015		
			Dec. 11	By A A/c	5,200
		5,200			5,200

Retiring a Bill

Retiring a bill is the act of withdrawing a bill of exchange from circulation when it has been paid before the due date. When the drawee of a bill desires to make payment before the due date of the bill and the drawer welcomes it, it is called retiring a bill. In such a case, the drawer is to allow some discount (rebate) because what he was to receive at some time in the future, he receives immediately. The discount (rebate) is an expense for the drawer and a gain for the drawee.

Journal entries are as under :

Drawer's Book		Drawee's Book	
Bank A/c	Dr.	Bills Payable A/c	Dr.
Discount Allowed / Rebate on Bill Retired A/c	Dr.	To Bank A/c	
To Bills Receivable A/c		To Discount Received / Rebate on Bill Retired A/c	
(Being the bill retired before the due date)		(Being the bill retired by us before maturity)	

Effects of Retiring a Bill

(1) Upon retirement, the drawer of the bill gets an early payment, i.e. before the due date.
(2) The 'rebate on bill retired' is an expense for the drawer and a revenue for the drawee.
(3) The rebate is actually calculated at a fixed percentage per annum on the unexpired period of the bill.

Rebate on Bill Retired Account can be used in place of Discount Allowed Account or Discount Received Account. In our all illustrations, we have used Discount Allowed Account and Discount Received Account in place of Rebate on Bill Retired Account.

Illustration 19

On January 1, 2015 Saju accepted a bill, drawn on him by Rinku for ₹ 5,000 payable 4 months after sight, against his dues. Having surplus funds, Saju paid off the bill on 4th February and was allowed a rebate of 6% p.a. Show Journal entries in the books of Saju and Rinku to record these transactions.

Solution

In the books of Saju
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 Jan. 1	Rinku A/c	Dr.		5,000	
	To Bills Payable A/c				5,000
	(Being the bill accepted for four months)				
Feb. 4	Bills Payable A/c	Dr.		5,000	
	To Bank A/c				4,925
	To Discount Received A/c				75
	(Being the bill retired before maturity and discount received @ 6% p.a.)				

In the books of Rinku
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 Jan. 1	Bills Receivable A/c	Dr.		5,000	
	To Saju A/c				5,000
	(Being the bill drawn on Saju for four months)				
Feb. 4	Bank A/c	Dr.		4,925	
	Discount Allowed A/c	Dr.		75	
	To Bills Receivable A/c				5,000
	(Being the bill retired and discount allowed @ 6% p.a.)				

Note : The due date of the bill is 4.5.2015. But the drawee made payment on 4.2.2015. Therefore, he has been allowed a discount for 3 months @ 6% p.a. which is calculated as : ₹ 5,000 × 6/100 × 3/12 = ₹ 75.

Illustration 20

On 1st July, 2015, A sold goods to B priced at ₹ 6,000 subject to a deduction of $16^2/_3$% trade discount and drew a bill on B for 3 months. B accepted the bill and returned it to A. A and B mutually agreed that this bill should be discharged by a cash payment of ₹ 2,000 and a new bill on such a date as would enable the latter to earn a rebate of ₹ 100 @ 10% p.a. The new bill would be accepted for 2 months at 12% p.a. interest. The new bill was met on the due date.

Pass Journal Entries in the books of B.

Solution

In the books of B
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 July 1	Purchases A/c To A A/c (Being the goods purchased on credit for ₹ 6,000 at a trade discount of $16^2/_3$%)	Dr.		5,000	5,000
July 1	A A/c To Bills Payable A/c (Being the acceptance of a bill from A)	Dr.		5,000	5,000
July 23	Bills Payable A/c To A A/c (Being the bill cancelled for renewal)	Dr.		5,000	5,000
July 23	A A/c To Bank A/c (Being a part payment made to A)	Dr.		2,000	2,000
July 23	A A/c To Discount Received A/c (Being discount received for discharging the bill before the due date)	Dr.		100	100
July 23	Interest A/c To A A/c (Being the interest payable @ 12% p.a. on ₹ 2,900 for 2 months)	Dr.		58	58
July 23	A A/c To Bills Payable A/c (Being the acceptance of a new bill for 2 months for the balance plus interest)	Dr.		2,958	2,958
Sept. 26	Bills Payable A/c To Bank A/c (Being the new bill honoured by payment)	Dr.		2,958	2,958

Working Note: **Calculation of the number of days to earn a rebate of ₹ 100**.

Interest @ 10% p.a. for 1 year on ₹ 5,000 is ₹ 500. To earn ₹ 100, the number of days should be 100/500 x 365 = 73 days. Therefore, the bill should be honoured 73 days before the due date, i.e. 23rd July.

Illustration 21

Mr David draws two Bills of Exchange on 1.1.2015 for ₹ 6,000 and ₹ 10,000. The Bills of Exchange for ₹ 6,000 is for two months while the Bills of Exchange for ₹ 10,000 is for three months. These bills are accepted by Mr Thomas. On 4.3.2015 Mr Thomas requests Mr David to renew the first bill with interest at 18% p.a. for a period of two months. Mr David agrees to this proposal. On 20.3.2015 Mr Thomas retires the acceptance for ₹ 10,000, the interest rebate, i.e. discount, being ₹ 100. Before the due date of the renewed bill, Mr Thomas becomes insolvent and only 50 paise in a rupee could be recovered from his estate. You are to give the Journal Entries in the books of Mr David.

Solution

In the books of Mr David
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 Jan. 1	Bills Receivable A/c To Mr Thomas A/c (Being a bill drawn on Mr Thomas for 2 months)	Dr.		6,000	6,000
Jan. 1	Bills Receivable A/c To Mr Thomas A/c (Being a bill drawn on Mr Thomas for 3 months)	Dr.		10,000	10,000
Mar. 4	Mr Thomas A/c To Bills Receivable A/c (Being the first bill cancelled for renewal)	Dr.		6,000	6,000
Mar. 4	Mr Thomas A/c To Interest A/c (Being the interest charged to Mr Thomas on account of the first bill @ 18% p.a. for 2 months)	Dr.		180	180
Mar. 4	Bills Receivable A/c To Mr Thomas A/c (Being a fresh bill drawn on Mr Thomas for the balance due plus interest for 2 months)	Dr.		6,180	6,180
Mar. 20	Bank A/c Discount Allowed A/c To Bills Receivable A/c (Being the second bill of ₹ 10,000 retired and discount allowed ₹ 100)	Dr. Dr.		9,900 100	10,000
May 7	Mr Thomas A/c To Bills Receivable A/c (Being the renewed bill dishonoured)	Dr.		6,180	6,180

?	Profit and Loss Suspense A/c (See Note) Dr. To Provision for Bad Debts A/c (Being the provision created @ 50% of the amount due from Mr Thomas)		3,090	3,090

Tutorial Note : Final amount due from Mr Thomas is ₹ 6,180. Only 50 paise in a rupee could be recovered from his estate. Therefore, a provision for bad debts is to be created for ₹ 3,090 by debiting Profit and Loss Suspense Account and crediting Provision for Bad Debts Account. At the end of the accounting period, Profit and Loss Suspense Account is to be closed by debiting Profit and Loss Account and crediting Profit and Loss Suspense Account. The provision for bad debts is to be shown as a deduction from Sundry Debtors. When money will be received from the liquidator of Mr Thomas, Cash / Bank Account will be debited; Bad Debt Account will be debited and Mr Thomas Account will be credited. Bad Debts Account will be adjusted against the provision for bad debts of ₹ 3,090.

Illustration 22

On 1.1.2015, Ram sold goods to Rahim valuing ₹ 30,000. On 4.1.2015, Ram received from Rahim ₹ 10,000 and drew a bill payable 3 months after date for the balance. On the same date, Ram endorses the accepted bill to Shyam for full settlement of a debt of ₹ 21,000. On the due date, the bill was dishonoured and Rahim having become insolvent, met on 10.5.2015, 75% of his acceptance. Give journal entries in the books of Ram and Rahim.

Solution

In the books of Ram

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2015 Jan. 1	Rahim A/c Dr. To Sales A/c (Being the goods sold to Rahim on credit)		30,000	30,000
4	Cash A/c Dr. To Rahim A/c (Being the part payment of ₹ 10,000 received from Rahim)		10,000	10,000
4	Bills Receivable A/c Dr. To Rahim A/c (Being a bill drawn on Rahim for 3 months for the amount due from him)		20,000	20,000
4	Shyam A/c Dr. To Bills Receivable A/c To Discount Received A/c (Being the bill endorsed in favour of Shyam in full settlement of a debt of ₹ 21,000)		21,000	20,000 1,000
Apr. 7	Rahim A/c Dr. Discount Received A/c Dr. To Shyam A/c (Being the bill previously endorsed in favour of Shyam, now dishonoured)		20,000 1,000	21,000
May 10	Bank A/c Dr. Bad Debts A/c Dr. To Rahim A/c (Being 75% of the amount due from Rahim received)		15,000 5,000	20,000

In the books of Rahim

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2015 Jan. 1	Purchases A/c Dr. To Ram A/c (Being the goods purchased from Ram on credit)		30,000	30,000
4	Ram A/c Dr. To Cash A/c (Being the part payment of ₹ 10,000 made to Ram)		10,000	10,000
4	Ram A/c Dr. To Bills Payable A/c (Being the acceptance of a bill for 3 months for the amount due to him)		20,000	20,000
Apr. 7	Bills Payable A/c Dr. To Ram A/c (Being the bill dishonoured at maturity)		20,000	20,000
May 10	Ram A/c Dr. To Bank A/c To Deficiency A/c (Being the payment of 75% of dues)		20,000	15,000 5,000

Illustration 23

Give Journal entries for the following transactions of A in his books:

(i) K renews his acceptance for ₹ 700 by paying ₹ 530 (₹ 30 being for interest) and by giving a bill for ₹ 2012 for a further period of 2 months.

(ii) A's acceptance to B for ₹ 4,000 was discharged by a cash payment of ₹ 2,000 and an acceptance of a new bill for the balance plus ₹ 30 as interest.

(iii) C's acceptance of ₹ 2,000 which had been discounted with the bank for ₹ 1,900 has been returned by the bank unpaid. The bank has notified that ₹ 20 have been paid as noting charges.

(iv) A's acceptance to D for ₹ 5,000 is discharged by M's acceptance to A for a similar amount.

(v) G retires a bill for ₹ 1,000 drawn on him by A for ₹ 5 discount.

Solution

In the books of A
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
(i)	K A/c	Dr.		700	
	To Bills Receivable A/c				700
	(Being the bill previously drawn on K, now cancelled)				
	K A/c	Dr.		30	
	To Interest A/c				30
	(Being the interest charged to K for renewing the bill for a further period of 2 months)				
	Cash A/c	Dr.		530	
	To K A/c				530
	(Being part payment received from K along with interest)				
	Bills Receivable A/c	Dr.		2012	
	To K A/c				2012
	(Being a fresh bill drawn on K for the balance amount)				
(ii)	Bills Payable A/c	Dr.		4,000	
	To B A/c				4,000
	(Being the bill previously drawn on us, now cancelled)				
	B A/c	Dr.		2,000	
	To Cash A/c				2,000
	(Being part payment made to B)				
	Interest A/c	Dr.		30	
	To B A/c				30
	(Being the interest payable for renewing the bill)				
	B A/c	Dr.		2,030	
	To Bills Payable A/c				2,030
	(Being the acceptance of a fresh bill from B for the balance amount plus interest)				
(iii)	C A/c	Dr.		2,020	
	To Bank A/c				2020
	(Being the bill previously discounted, now dishonoured, noting charges ₹ 20 paid by bank charged to C)				
(iv)	Bills Payable A/c	Dr.		5,000	
	To Bills Receivable A/c				5,000
	(Being our acceptance discharged by M's acceptance for the similar amount))				
(v)	Bank A/c	Dr.		995	
	Discount Allowed A/c	Dr.		5	
	To Bills Receivable A/c				1,000
	(Being the bill previously drawn on G, now retired, discount allowed to him ₹ 5)				

Illustration 24

On 1st September, 2014 Honest Dealers purchased goods valued at ₹ 72,000 from Best Manufacturers. They sold these goods to Nice Consumers for ₹ 1,00,000 who agreed to accept two bills of exchange of equal value payable on 1st March, 2015 for the invoice amount plus interest at 10% per annum. Honest Dealers could only sell one of the Bills on 30th September, 2014 at a discount of 6% p.a. The other bill was, however, endorsed to the suppliers, Best Manufacturers who agreed to take the Bill on 30th September at a discount of 12% p.a. together with a cheque for the balance.

Show by Journal entries how all these transactions should be recorded in the books of Honest Dealers. State also how these bills would appear in their Balance Sheet at 31st December, 2014, indicating clearly any note that should appear there.

Solution

In the books of Honest Dealers
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2014 Sept. 1	Purchases A/c	Dr.		72,000	
	To Best Manufacturers A/c				72,000
	(Being the goods purchased on credit)				
	Nice Consumers A/c	Dr.		1,00,000	
	To Sales A/c				1,00,000
	(Being goods sold on credit)				
	Nice Consumers A/c	Dr.		5,000	
	To Interest A/c				5,000
	(Being the interest charges for ₹ 1 lac @ 10% p.a. for 6 months)				
	Bills Receivable A/c	Dr.		1,05,000	
	To Nice Consumers A/c				1,05,000
	(Being the two bills drawn on Nice Consumers for ₹ 52,500 each payable on 1st March 2015)				
Sept. 30	Bank A/c	Dr.		51,187.50	
	Discount on Bills A/c	Dr.		1,312.50	
	To Bills Receivable A/c				52,500
	(Being one of the two bills discounted @ 6% p.a.)				
	Best Manufacturers A/c	Dr.		72,000	
	Discount on Bills A/c	Dr.		2,625	
	To Bills Receivable A/c				52,500
	To Bank A/c				22,125
	(Being the amount due to Best Manufacturers settled by endorsing the bill at a discount of 12% p.a. and the balance paid by cheque)				

Note : Since the Bills Receivable account is closed, they cannot find a place in the Balance Sheet at 31st December, 2014. Since there is a contingent liability, a note must be given below the Balance Sheet as — 'Contingent liability towards bills discounted ₹ 1,05,000'.

Illustration 25

Ravi accepted on April 1, 2015 a bill for ₹ 10,000 drawn by Kapil at three months. Kapil, on 4th April, discounted the bill with his banker at 6% p.a. Ravi failed to meet the bill on the due date and at his request Kapil agreed to renew the bill for three more months for which he demanded collateral security. Ravi endorsed two of his customers bills for ₹ 7,000 and ₹ 5,400 due on August, 20 and September 20, 2015 respectively as collateral security. Kapil discounted all the three bills at 6% p.a. on 10th July with the bankers; but on the due date the second customers' bill was dishonoured, Ravi became bankrupt on 1st September, 2015 and nothing was realised from his estate.

Pass the necessary Journal Entries and Ravi Account in the books of Kapil.

Solution

In the books of Kapil
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 April 1	Bills Receivable A/c	Dr.		10,000	
	To Ravi A/c				10,000
	(Being a bill drawn on Ravi for 3 months)				
April 4	Bank A/c	Dr.		9,850	
	Discount on Bills A/c	Dr.		150	
	To Bills Receivable A/c				10,000
	(Being the bill discounted with the bank @ 6% p.a.)				
July 4	Ravi A/c	Dr.		10,000	
	To Bank A/c				10,000
	(Being the bill dishonoured at maturity)				
July 4	Bills Receivable A/c	Dr.		10,000	
	To Ravi A/c				10,000
	(Being a new bill drawn for 3 months)				
	Bills Receivable A/c	Dr.		12,400	
	To Ravi A/c				12,400
	(Being two bills endorsed in favour of us by Ravi for ₹ 5,400 and ₹ 7,000 respectively)				
July 10	Bank A/c	Dr.		22,139	
	Discount on Bills A/c	Dr.		261	
	To Bills Receivable A/c				22,400
	(Being the bill discounted with the bank @ 6% p.a.)				

Sept. 1	Ravi A/c Dr. To Bank A/c (Being the new bill dishonoured due to Ravi's insolvency)		10,000	10,000
Sept. 20	Ravi A/c Dr. To Bank A/c (Being the second customer's bill dishonoured at maturity)		5,400	5,400
	Bad Debt A/c Dr. To Ravi A/c (Being the amount written-off as bad debt)		3,000	3,000

Working Note : Calculation of discount : ₹

New bill (due date 7th Oct., 2015) = ₹ 10,000 x 6/100 x 3/12 = 150

1st customer's bill (due date Aug. 20) = ₹ 7,000 x 6/100 x 41/365 = 47 (approx.)

2nd customer's bill (due date Sept. 20) = ₹ 5,400 x 6/100 x 72/365 = 64 (approx.)

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Dr. **Ravi Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2015	To Balance b/f	10,000	1.4.2015	By Bills Receivable A/c	10,000
7.7.2015	To Bank A/c (dishonoured)	10,000	7.7.2015	By Bills Receivable A/c (New bill)	10,000
1.9.2015	To Bank A/c (New bill dishonoured)	10,000	7.7.2015	By Bills Receivable A/c (Customer's Bill)	12,400
20.9.2015	To Bank A/c (2nd customer's bill dishonoured)	5,400	20.9.2015	By Bad Debt A/c	3,000
		35,400			35,400

Illustration 26

Ram draw upon Shyam three bills of exchange of ₹ 10,000, ₹ 8,000 and ₹ 6,000 respectively. A week later the first bill of ₹ 10,000 was cancelled on mutual agreement. Shyam paid ₹ 4,000 in cash and for the balance amount, together with interest of ₹ 600, he accepted a new bill. This new bill was endorsed to Jadu along with a cheque for ₹ 2,000 in full settlement of his claim for ₹ 9,000. The second bill for ₹ 8,000 was discounted by Ram for ₹ 7,750. All the bills were dishonoured at maturity as Shyam became insolvent. However, his estates realised 40 paise per rupee. Noting charges were incurred by Ram ₹ 75 and by Jadu ₹ 50.

Prepare Bills Receivable Account, Shyam Account and Jadu Account in the books of Ram reflecting the above mentioned transactions.

Solution **In the books of Ram**

Dr. **Bills Receivable Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Shyam A/c ₹ (10,000 + 8,000 + 6,000)	24,000		By Shyam A/c	10,000
	To Shyam A/c ₹ (10,000 – 4,000 + 600)	6,600		By Jadu A/c	6,600
				By Bank A/c	7,750
				By Discount on Bills A/c	250
				By Shyam A/c	6,000
		30,600			30,600

Dr. **Shyam Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d (See Note)	24,000		By Bills Receivable A/c	10,000
	To Bills Receivable A/c	10,000		By Bills Receivable A/c	8,000
	To Interest Received A/c	600		By Bills Receivable A/c	6,000
	To Bills Receivable A/c	6,000		By Cash A/c	4,000
	To Bank A/c (Noting charge)	75		By Bills Receivable A/c	6,600
	To Bank A/c (Dishonoured of Discounted Bill)	8,000		By Bank A/c	8,290
	To Jadu A/c (Dishonoured of Endorsed Bill)	6,650		By Bad Debt A/c	12,435
		55,325			55,325

Dr. **Jadu Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Bank A/c	2,000		By Balance b/d	9,000
	To Bills Receivable A/c	6,600		By Shyam A/c	6,650
	To Discount Received A/c	400		By Discount Received A/c	400
	To Balance c/d	7,050			
		16,050			16,050

Working Note : Bills drawn on Shyam for a total amount of ₹ 24,000. It means amount due from him was ₹ 24,000. Therefore, opening balance on Shyam Account will show a debit balance of ₹ 24,000.

Accommodation Bill

An Accommodation Bill is a bill of exchange signed by a party as drawer, drawee, endorser to accommodate another party whose credit is not strong enough to enable him to borrow on his single name. It is drawn for the purpose of arranging temporary finance. Therefore, an Accommodation Bill is a Bill of Exchange which has been drawn on and accepted by a reputable party for the purpose of giving value to the bill so that it can be discounted.

Ordinary bills are drawn for some consideration — known as 'Trade Bills'. But accommodation bills are those which are drawn and accepted without any consideration. Here, the idea is to assist one or both the parties financially. Accommodation bill is also called ***Kite Bill***. 'Kite' is an informal name for an accommodation bill. Kite-flying or Kiting is the discounting of an accommodation bill at a bank, knowing that the person on whom it is drawn will dishonour it, if the required amount is not remitted to him. As no consideration is involved, accommodation bills are not legally enforceable. Though accommodation bills are not bills from a legal point of view, yet they are in practice no way different from an ordinary bill.

What actually happens in the case of an accommodation bill is that one party draws the bill and the other party accepts it. Then, the drawing party gets it discounted from the bank and receives ready cash of which he is in need. The money received is either wholly utilized by the drawer, or by both, the drawer and the acceptor. Before the due date approaches, the required sum of money is sent to the acceptor in order to make him able to honour the bill and the bill is honoured by the acceptor on the due date. Thus, although there is no legal liability, there exists a strong moral understanding between the parties concerned.

Distinction between Trade Bills and Accommodation Bills

	Trade Bills		Accommodation Bills
1.	These bills are drawn and accepted for some consideration.	1.	These bills are drawn and accepted without any consideration.
2.	These bills are acknowledgements of the debts.	2.	These bills are not the acknowledgements of the debts.
3.	These bills may or may not be discounted with the bank.	3.	These bills are always discounted with the bank.
4.	The loss by way of discounting charges is to be borne by the drawer because the drawee is no way benefitted.	4.	The loss by way of discounting charges is to be shared by the drawer and the drawee in the same ratio in which they share the proceeds.
5.	The drawer can resort to legal action when the bill is dishonoured.	5.	Legal action cannot be resorted to when the bill is dishonoured.

Entries in the case of accommodation bills are the same as those discussed above. Accommodation bills are generally drawn and accepted for three different purposes.

(i) When the bill is drawn and accepted only for the accommodation of the drawer

When a person is in need of funds, he draws a bill on a friend who accepts the bill to oblige the drawer. The drawer can then discount the bill with the bank and obtain the needed funds to meet his requirement with the temporary finance. When the bill is about to fall due for payment, the drawer gives the amount of the bill to the acceptor who meets the bill on presentation by the bank.

Illustration 27

A approached his friend B for a loan of ₹ 5,000 and the latter, being unable to find the money, agreed to accept a bill drawn on him at 3 months for accommodation. In due course, the bill was drawn, accepted and discounted with the banker. The bank rate of discounting the customer's bill was 6% p.a. On the due date, A remits the required amount to B and the bill was duly met. Pass the Journal entries in the books of both the parties.

Solution

In the books of A

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	Bills Receivable A/c	Dr.		5,000	
	To B A/c				5,000
	(Being bill drawn on B for 3 months for own accommodation)				
	Bank A/c	Dr.		4,925	
	Discount on Bills A/c	Dr.		75	
	To Bills Receivable A/c				5,000
	(Being the bill discounted with the banker @ 6% p.a.)				
	B A/c	Dr.		5,000	
	To Cash A/c				5,000
	(Being the required amount remitted to B)				

In the books of B
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	A A/c	Dr.		5,000	
	To Bills Payable A/c				5,000
	(Being the acceptance of a bill from A for 3 months for his accommodation)				
	Cash A/c	Dr.		5,000	
	To A A/c				5,000
	(Being the required amount received from A)				
	Bills Payable A/c	Dr.		5,000	
	To Cash A/c				5,000
	(Being the bill honoured by us at maturity)				

Illustration 28

On 1st January, 2015, A for his own accommodation, draws a bill on B for ₹ 5,000 at 3 months. B accepts the bill and returns it to A on the same date. A discounts the bill with the banker @ 12% p.a. on 4.1.2015. On the due date, A fails to provide B with the necessary amount and consequently, he dishonours the bill. The bank pays noting charges of ₹ 30. Pass the necessary Journal Entries in the books of A and B.

Solution

In the books of A
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015	Bills Receivable A/c	Dr.		5,000	
Jan. 1	To B A/c				5,000
	(Being the bill drawn on B for own accommodation)				
Jan. 4	Bank A/c	Dr.		4,850	
	Discount on Bills A/c	Dr.		150	
	To Bills Receivable A/c				5,000
	(Being the bill discounted with the banker @ 12% p.a.)				
April 4	B A/c	Dr.		5,000	
	Noting charges A/c	Dr.		30	
	To Bank A/c				5,030
	(Being the bill dishonoured at maturity and bank paid noting charges ₹ 30)				

In the books of B
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015	A A/c	Dr.		5,000	
Jan 1	To Bills Payable A/c				5,000
	(Being the acceptance of a bill from A for his accommodation)				
April 4	Bills Payable A/c	Dr.		5,000	
	To A A/c				5,000
	(Being the bill dishonoured at maturity owing to A's failure to provide us money)				

(ii) When the bill is drawn and accepted for the accommodation of both the drawer and the drawee

When two persons are in need of funds, one of the parties draws a bill on the other. Here, after the bill is discounted with the banker, the realized cash is shared by the drawer and the drawee in an agreed proportion. The understanding is that the loss by way of discounting charges is also to be shared in the same ratio in which they share the proceeds. Before the due date of the bill, the drawer sends his share of the proceeds to the drawee. The drawee then arranges his share of the proceeds and meets the bill on the due date.

Another way of accommodating both the parties who are in the need of funds is that they draw on each other a bill for similar amounts. Both the parties discount their respective bills with the bankers and at maturity, pay off their acceptances.

Illustration 29

For the mutual accommodation of Hiru and Biru, Hiru accepts a bill drawn on him by Biru for three months for ₹ 3,000 on 1st January, 2015. Biru discounts the bill immediately for ₹ 2,700 and remits 1/3rd of the proceeds to Hiru. Before the bill becomes due, Biru remits the balance due to Hiru to enable him to meet the bill. Hiru meets the bill on the due date. Draw up the Journal entries in the books of Hiru and Biru to record the above transactions

Solution

In the books of Biru
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 Jan. 1	Bills Receivable A/c	Dr.		3,000	
	To Hiru A/c				3,000
	(Being the bill drawn on Hiru for 3 months for mutual accommodation)				
Jan. 1	Bank A/c	Dr.		2,700	
	Discount on Bills A/c	Dr.		300	
	To Bills Receivable A/c				3,000
	(Being the bill discounted with the banker for ₹ 2,700)				
?	Hiru A/c	Dr.		1,000	
	To Bank A/c				900
	To Discount on Bills A/c				100
	(Being the remittance of 1/3rd of the proceeds to Hiru and the discounting charges also being shared in the ratio 2:1)				
April 4	Hiru A/c	Dr.		2,000	
	To Bank A/c				2,000
	(Being the remittance of the balance amount to Hiru)				

In the books of Hiru
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 Jan. 1	Biru A/c	Dr.		3,000	
	To Bills Payable A/c				3,000
	(Being a bill accepted for mutual accommodation)				
?	Bank A/c	Dr.		900	
	Discount on Bills A/c	Dr.		100	
	To Biru A/c				1,000
	(Being the receipt of 1/3rd of proceeds remitted by Biru — discounting charges also being shared in the ratio 2:1)				
?	Bank A/c	Dr.		2,000	
	To Biru A/c				2,000
	(Being the balance of amount remitted by Biru)				
April 4	Bills Payable A/c	Dr.		3,000	
	To Bank A/c				3,000
	(Being the bill honoured on maturity)				

Illustration 30

Rita for mutual accommodation of herself and Mita, drew upon the latter a bill of exchange at three months for ₹ 5,000 on 1.6.2013. Mita accepted the bill and sent it to Rita. Rita discounted the bill on 4.6.2013 at 8% p.a. and remitted half of the proceeds to Mita.

Mita for similar purpose drew a bill on 15.6.2013 at two months on Rita for ₹ 3,000 and Rita accepted it. On 18.6.2013 Mita discounted the bill at 8% p.a. and handed over half of the proceeds to Rita.

At maturity Rita met her acceptance but Mita became insolvent and a dividend of 25 paise in a rupee was received from her estate on 25.10.2013. Pass necessary journal entries in the books of Rita.

Solution

In the books of Rita
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2013 June 1	Bills Receivable A/c	Dr.		5,000	
	To Mita A/c				5,000
	(Being a bill drawn on Mita for mutual accommodation)				
June 4	Bank A/c	Dr.		4,900	
	Discount on Bills A/c	Dr.		100	
	To Bills Receivable A/c				5,000
	(Being the bill discounted with the banker for ₹ 4,900)				
"	Mita A/c	Dr.		2,500	
	To Bank A/c				2,450
	To Discount on Bills A/c				50
	(Being half of the proceeds remitted to Mita — the loss on discount shared equally)				
June 15	Mita A/c	Dr.		3,000	
	To Bills Payable A/c				3,000
	(Being the bill drawn on us by Mita for mutual accommodation)				

June 18	Bank A/c Dr. Discount on Bills A/c Dr. To Mita A/c (Being half of the proceeds rereceived from Mita — the loss on discount shared equally)		1,480 20	 1,500
Aug. 18	Bills Payable A/c Dr. To Bank A/c (Being the bill honoured by us on maturity)		3,000	 3,000
Sep. 4	Mita A/c Dr. To Bank A/c (Being the bill dishonoured at maturity)		5,000	 5,000
Oct. 25	Bank A/c (Note 1) Dr. Bad Debts A/c Dr. To Mita A/c (Being 25% of the amount due from Mita received in full settlement)		1,000 3,000	 4,000

Working Note :

(1) Amount paid by Mita in Final Settlement

		₹
Amount received by her on account of :	1st bill	2,500
	2nd bill	1,500
Amount due from her		4,000

Mita paid 25% of the amount due = 25% of ₹ 4,000 = ₹ **1,000**.

Illustration 31

On 1st July, 2014, G drew a bill for ₹ 80,000 for 3 months on H for mutual accommodation. He accepted the bill of exchange. G had purchased goods worth ₹ 81,000 from J on the same date. G endorsed H's acceptance to J in full settlement. On 1st September, 2014, J purchased goods worth ₹ 90,000 from H. J endorsed the bill of exchange received from G to H and paid ₹ 9,000 in full settlement of the amount due to H.

On 1st October, 2014, H purchased goods worth ₹ 1,00,000 from G. He paid the amount due to G by cheque.

Give the necessary journal entries in the books of H.

Solution

In the books of H

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2014 July 1	 G A/c Dr. To Bills Payable A/c (Being the acceptance of a bill from G for mutual accommodation)		 80,000	 80,000
Sep. 1	J A/c Dr. To Sales A/c (Being the goods sold to J on credit)		90,000	 90,000
?	Bills Receivable A/c Dr. Cash A/c Dr. Discount Allowed A/c Dr. To J A/c (Being a bill of ₹ 80,000 and cash ₹ 9,000 received from J in full settlement of debt)		80,000 9,000 1,000	 90,000
?	Bills Payable A/c Dr. To Bills Receivable A/c (Being the mutual indebtedness cancelled)		80,000	 80,000
Oct. 1	Purchases A/c Dr. To G A/c (Being goods purchased on credit from G)		1,00,000	 1,00,000
?	G A/c (₹ 1,00,000 – 80,000) Dr. To Bank A/c (Being the amount due to G paid off)		20,000	 20,000

Illustration 32

A draws a bill for ₹ 1,200 and B accepts the same for mutual accommodation in the ratio of 4:2. A discounts the bill for ₹ 1,110 and remits 1/3rd of the proceeds to B. Before the due date, B draws another bill for ₹ 1,800 on A in order to provide funds to meet the first bill. The second bill is discounted for ₹ 1,740 by B and a sum of ₹ 360 is remitted to A after meeting the first bill. The second bill is duly met. Show the Journal entries in the books of both A and B.

Solution

In the books of A
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	Bills Receivable A/c	Dr.		1,200	
	To B A/c				1,200
	(Being a bill drawn on B for mutual accommodation)				
	Bank A/c	Dr.		1,110	
	Discount on Bills A/c	Dr.		90	
	To Bills Receivable A/c				1,200
	(Being the bill discounted with the banker for ₹ 1,110)				
	B A/c	Dr.		400	
	To Bank A/c				370
	To Discount on Bills A/c				30
	(Being 1/3rd of the proceeds remitted to B — the loss on discount shared proportionately)				
	B A/c	Dr.		1,800	
	To Bills Payable A/c				1,800
	(Being the bill drawn on us by B)				
	Bank A/c	Dr.		360	
	Discount on Bills A/c (See Note)	Dr.		40	
	To B A/c				400
	(Being the net amount remitted to us by B)				
	Bank A/c	Dr.		600	
	To B A/c				600
	(Being the balance amount of the 2nd bill remitted by B)				
	Bills Payable A/c	Dr.		1,800	
	To Bank A/c				1,800
	(Being the 2nd bill honoured at maturity)				

In the books of B
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	A A/c	Dr.		1,200	
	To Bills Payable A/c				1,200
	(Being a bill drawn on us by A for mutual accommodation)				
	Bank A/c	Dr.		370	
	Discount on Bills A/c	Dr.		30	
	To A A/c				400
	(Being 1/3rd of the proceeds received by us — the loss on discount shared proportionately)				
	Bills Receivable A/c	Dr.		1,800	
	To A A/c				1,800
	(Being the bill drawn on A)				
	Bank A/c	Dr.		1,740	
	Discount on Bills A/c	Dr.		60	
	To Bills Receivable A/c				1,800
	(Being the bill discounted with the banker for ₹ 1,740)				
	A A/c	Dr.		400	
	To Bank A/c				360
	To Discount on Bills A/c				40
	(Being 1/3rd of the proceeds remitted to A — the loss on discount shared proportionately)				
	Bills Payable A/c	Dr.		1,200	
	To Bank A/c				1,200
	(Being the 1st bill honoured at maturity)				
	A A/c	Dr.		600	
	To Bank A/c				600
	(Being the balance amount of the 2nd bill remitted to A)				

Note : Before the due date of the first bill, A was to remit ₹ 800 to B to enable him to honour the bill. But A was not in a position to remit the required amount. He accepted a bill of ₹ 1,800 drawn by B. B discounted the bill for ₹ 1,740 and remitted to A ₹ 360 after adjusting ₹ 800 in respect of the first bill.

Therefore, A enjoyed (₹ 360 + 800) = ₹ 1,160 out of ₹ 1,740. A's share of discount will be : ₹ 60 / 1,740 x ₹ 1,160 = ₹ 40.

Illustration 33

On 1st January, 2015, Vinod drew and Pramod accepted a bill at three months for ₹ 2,000. On 4th January, 2015 Vinod discounted the bill with his bank at 15% p.a. and remitted half the proceeds to Pramod. On 1st February, 2015 Pramod drew and Vinod accepted a bill at four months for ₹ 1,500. On 4th February 2015 Pramod discounted the bill at 15% p.a., with his bank and remitted half the proceeds to Vinod. They agreed to share the discount equally.

At maturity Vinod met his acceptance, but Pramod dishonoured his and Vinod had to pay the bill. Vinod drew and Pramod accepted a new bill at three months for the original bill plus interest at 18% p.a. On 1st July, 2015 Pramod became insolvent and only 50 paise in the rupee was received from him. Record the above transactions in Vinod's Journal.

Solution **In the books of Vinod**

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

Date	Particulars		L.F.	₹	₹
2015	Bills Recievables A/c	Dr.		2,000	
Jan. 1	To Pramod A/c				2,000
	(Being a bill drawn on Pramod for 3 months for mutual accommodation)				
Jan. 4	Bank A/c	Dr.		1,925	
	Discount on Bills A/c	Dr.		75	
	To Bills Recievable A/c				2,000
	(Being the bill discounted with the banker @ 15% p.a.)				
Jan. 4	Pramod A/c	Dr.		1,000	
	To Bank A/c				962.50
	To Discount on Bills A/c				37.50
	(Being 50% of the proceeds of the bill remitted to Pramod)				
Feb. 1	Pramod A/c	Dr.		1,500	
	To Bills Payable A/c				1,500
	(Being the acceptance from Pramod for mutual accommodation)				
Feb. 4	Bank A/c	Dr.		712.50	
	Discount on Bills A/c	Dr.		37.50	
	To Pramod A/c				750
	(Being the receipt of 50% proceeds of the bill from Pramod)				
April 4	Pramod A/c	Dr.		2,000	
	To Bank A/c				2,000
	(Being the bill dishonoured at maturity)				
April 4	Pramod A/c	Dr.		90	
	To Interest A/c				90
	(Being the interest charged on ₹ 2,000 @ 18% p.a. for 3 months)				
April 4	Bills Receivable A/c	Dr.		2,090	
	To Pramod A/c				2,090
	(Being a new bill drawn on Pramod for 3 months)				
June 4	Bills Payable A/c	Dr.		1,500	
	To Bank A/c				1,500
	(Being the bill honoured at maturity)				
July 1	Pramod A/c	Dr.		2,090	
	To Bills Receivable A/c				2,090
	(Being the bill dishonoured on Pramod's insolvency)				
July 1	Bank A/c	Dr.		920	
	Bad Debts A/c	Dr.		920	
	To Pramod A/c				1,840
	(Being 50% of the amount due from Pramod received in full settlement)				

Working Note :

Dr. **Pramod Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
4.1.2015	To Bank A/c	962.50	1.1.2015	By Bills Receivable A/c	2.000.00
4.1.2015	To Discount on Bills A/c	37.50	4.2.2015	By Bank A/c	712.50
1.2.2015	To Bills Payable A/c	1,500.00	4.2.2015	By Discount on Bills A/c	37.50
4.4.2015	To Bank A/c	2,000.00	4.4.2015	By Bills Receivable A/c	2,090.00
4.4.2015	To Interest A/c	90.00	1.7.2015	By Bank A/c (50% of the amount due)	920.00
1.7.2015	To Bills Receivable A/c	2,090.00	1.7.2015	By Bad Debts A/c	920.00
		6,680.00			6,680.00

Illustration 34

Arun and Anand were friends and in need of funds. On 1.1.2015 Arun drew a bill for ₹ 2,00,000 for 3 months on Anand. On 4.1.2015 Arun got the bill discounted at 10% p.a. and remitted half of the proceeds to Anand. On the due date, Arun could not remit his share, instead, he accepted Anand's bill for ₹ 1,20,000 on 4.4.2015 for two months. This bill was discounted by Anand at 12% p.a. Out of this, ₹ 19,600 was paid to Arun after deducting ₹ 400 discounting charges. Due to financial crisis, Arun became insolvent and the bill drawn on him was dishonoured and his estate paid 50%. Days of grace for discounting purposes may be ignored.

Give Journal Entries in the books of Arun and prepare Anand's Account in Arun's books and Arun's Account in the books of Anand.

Solution

In the books of Arun

Journal — **Dr.** **Cr.**

Date	Particulars		L.F.	₹	₹
2015	Bills Receivable A/c	Dr.		2,00,000	
Jan. 1	To Anand A/c				2,00,000
	(Being a bill drawn on Anand for mutual accommodation)				
Jan. 4	Bank A/c	Dr.		1,95,000	
	Discount on Bills A/c	Dr.		5,000	
	To Bills Recievable A/c				2,00,000
	(Being the bill discounted with the banker @ 10% p.a.)				
Jan. 4	Anand A/c	Dr.		1,00,000	
	To Bank A/c				97,500
	To Discount on Bills A/c				2,500
	(Being 50% of the proceeds of the bill remitted to Anand — the loss on discount also shared equally)				
April 4	Anand A/c	Dr.		1,20,000	
	To Bills Payable A/c				1,20,000
	(Being the acceptance from Anand for mutual accommodation)				
April 4	Bank A/c	Dr.		19,600	
	Discount on Bills A/c	Dr.		400	
	To Anand A/c				20,000
	(Being 1/6th of the proceeds received — discounting charges shared proportionately)				
June 7	Bills Payable A/c	Dr.		1,20,000	
	To Anand A/c				1,20,000
	(Being the bill dishonoured by us at maturity)				
?	Anand A/c	Dr.		1,20,000	
	To Bank A/c				60,000
	To Deficiency A/c				60,000
	(Being 50% of the amount due to Anand paid in full settlement)				

Dr. **Anand Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Bank A/c	97,500	1.1.2015	By Bills Receivable A/c	2,00,000
1.1.2015	To Discount on Bills A/c	2,500	4.4.2015	By Bank A/c	19,600
4.4.2015	To Bills Payable A/c	1,20,000	4.4.2015	By Discount on Bills A/c	400
4.4.2015	To Bank A/c	60,000	7.6.2015	By Bills Payable A/c	1,20,000
?	To Deficiency A/c	60,000			
		3,40,000			3,40,000

In the books of Anand

Dr. **Arun Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Bills Payable A/c	2,00,000	4.1.2015	By Bank A/c	97,500
4.4.2015	To Bank A/c	19,600	4.1.2015	By Discount on Bills A/c	2,500
4.4.2015	To Discount on Bills A/c	400	4.4.2015	By Bills Receivable A/c	1,20,000
7.6.2015	To Bank A/c	1,20,000	4.4.2015	By Bank A/c	60,000
			?	By Bad Debts A/c	60,000
		3,40,000			3,40,000

Illustration 35

G and K enter into an accommodation arrangement whereunder the proceeds are to be shared as 2/3 and 1/3 respectively. G draws a bill for ₹ 45,000 on 3rd April, 2015 at 3 months. G gets it discounted for ₹ 44,600 and on 5th April, remits K's share to him. On due date, K pays the bill, though G fails to remit his share. On 18th July, G accepts a bill for ₹ 63,000 drawn on him by K at 3 months, which K discounts on 19th July for ₹ 61,650 and remits ₹ 11,100 to G. Before the maturity of the second bill, G becomes insolvent and only 40% was realised from his estate on 20th October, 2015.

Pass necessary Journal Entries in the books of G and K.

Solution

In the books of G
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 April 3	Bills Receivable A/c	Dr.		45,000	
	To K A/c				45,000
	(Being a bill drawn on K for mutual accommodation)				
"	Bank A/c	Dr.		44,600	
	Discount on Bills A/c	Dr.		400	
	To Bills Receivable A/c				45,000
	(Being the bill discounted with the banker for ₹ 44,600)				
5	K A/c	Dr.		15,000	
	To Bank A/c				14,867
	To Discount on Bills A/c				133
	(Being 1/3rd of the proceeds remitted to K — the loss on discount shared proportionately)				
July 18	K A/c	Dr.		63,000	
	To Bills Payable A/c				63,000
	(Being the acceptance of a bill from K for mutual accommodation)				
19	Bank A/c	Dr.		11,100	
	Discount on Bills A/c	Dr.		900	
	To K A/c				12,000
	(Being 2/3rd of the proceeds of the 2nd bill received from K after deducting the amount due from us on account of 1st bill — discounting charges shared proportionately)				
Oct. 20	Bills Payable A/c	Dr.		63,000	
	To K A/c				63,000
	(Being the bill dishonoured at maturity)				
"	K A/c	Dr.		42,000	
	To Bank A/c				16,800
	To Deficiency A/c				25,200
	(Being 40% of the amount due to K paid in full settlement)				

In the books of K
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2015 April 3	G A/c	Dr.		45,000	
	To Bills Payable A/c				45,000
	(Being the acceptance of a bill from G for mutual accommodation)				
5	Bank A/c	Dr.		14,867	
	Discount on Bills A/c	Dr.		133	
	To G A/c				15,000
	(Being the receipt of 1/3rd of the proceeds, the loss on discount shared proportionately)				
July 6	Bills Payable A/c	Dr.		45,000	
	To Bank A/c				45,000
	(Being the bill honoured by us at maturity)				
18	Bills Receivable A/c	Dr.		63,000	
	To G A/c				63,000
	(Being a bill drawn on G for mutual accommodation)				
19	Bank A/c	Dr.		61,650	
	Discount on Bills A/c	Dr.		1,350	
	To Bills Receivable A/c				63,000
	(Being the bill discounted with the banker for ₹ 61,650)				
"	G A/c	Dr.		12,000	
	To Bank A/c				11,100
	To Discount on Bills A/c				900
	(Being 2/3rd of the proceeds of the 2nd bill remitted to G after deducting the amount due from him on account of the 1st bill — also 2/3rd of the discounting charges charged to him)				
Oct. 20	G A/c	Dr.		63,000	
	To Bank A/c				63,000
	(Being the bill dishonoured at maturity)				
"	Bank A/c	Dr.		16,800	
	Bad Debt A/c	Dr.		25,200	
	To G A/c				42,000
	(Being 40% of the amount due from G received in full settlement)				

Illustration 36

Rita for mutual accommodation of 2 : 1 with Mita draw on the latter two bills of ₹ 9,000 and ₹ 6,000 for 3 months and 4 months respectively on 5th March, 2014. Both the bills were discounted with the bank on 8th March, 2014 @ 12% p.a. interest. On the due date of the first bill, Rita endorsed Sita's acceptance of ₹ 6,200 to Mita in settlement of her share. This bill was discounted by Mita at a charge of ₹ 60. On the due date of the second bill, Mita wanted appropriate share from Rita but the latter was not in a position to give any fund. To settle the problem, Rita issued a promissory note of ₹ 4,000 for 3 months in favour of Mita. Mita discounted it immediately for ₹ 3,920. This promissory note was dishonoured on the due date at a noting charge of ₹ 40. On the same day, Mita collected ₹ 1,690 in cash and drew a new bill for two months for ₹ 2,400. However, on the due date of this bill, Rita became insolvent. On 10th February 2015, Mita received a first dividend of 20% from the estate of Rita and on 10th March 2015, a second and final dividend of 50% from the estate of Rita through official receiver. Show Mita Account and Rita Account in the books of Rita and Mita respectively.

Solution

In the books of Rita

Dr. **Mita Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
8.3.2014	To Bank A/c (Note 5)	4,830	5.3.2014	By Bills Receivable A/c	9,000
"	To Discount on Bills A/c (Note 5)	170	"	By Bills Receivable A/c	6,000
8.6.2014	To Bills Receivable A/c	6,200	8.6.2014	By Interest A/c (Note 1)	2012
8.7.2014	To Bills Payable A/c	4,000	11.10.2014	By Bills Payable A/c	4,000
11.10.2014	To Cash A/c	1,690	"	By Noting Charges A/c	40
"	To Bills Payable A/c	2,400	"	By Interest A/c (Note 2)	50
31.12.2014	To Balance c/d	2,400	14.12.2014	By Bills Payable A/c	2,400
		21,690			21,690
10.2.2015	To Cash A/c	480	1.1.2015	By Balance b/d	2,400
10.3.2015	To Cash A/c	1,200			
"	To Deficiency A/c (Note 3)	720			
		2,400			2,400

In the books of Mita

Dr. **Rita Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
5.3.2014	To Bills Payable A/c	9,000	8.3.2014	By Bank A/c	4,830
"	To Bills Payable A/c	6,000	"	By Discount on Bills A/c	170
8.6.2014	To Interest A/c (Note 1)	2012	8.6.2014	By Bills Receivable A/c	6,200
11.10.2014	To Bank A/c	4,040	8.7.2014	By Bills Receivable A/c	4,000
"	To Interest A/c	50	11.10.2014	By Cash A/c	1,690
14.12.2014	To Bills Receivable A/c	2,400	"	By Bills Receivable A/c	2,400
				By Balance c/d	2,400
		21,690			21,690
1.1.2015	To Balance b/d	2,400	10.2.2015	By Cash A/c	480
			10.3.2015	By Cash A/c	1,200
			"	By Bad Debts A/c (Note 3)	720
		2,400			2,400

Working Notes :

(1) Amount due to Mita in respect of 1st bill was ₹ 6,000 (2/3 of ₹ 9,000). Bill of Sita for ₹ 6,200 was endorsed to Mita in settlement of her share. Therefore, ₹ 2012 will be treated as interest.

(2) Amount due to Mita in respect of 2nd bill was ₹ 4,040 including noting charges of ₹ 40. Cash paid to Mita ₹ 1,690 and a bill for ₹ 2,400 was accepted. Therefore, the difference of ₹ 50 (₹ 1,690 + ₹ 2,400 – ₹ 4,040) will be treated as interest.

(3) Final amount due to Mita is ₹ 2,400. Out of which 20%, i.e. ₹ 480 was paid on 10th February, 1994 as 1st instalment. 2nd instalment equal to 50%, i.e. 1,200 was paid on 10th March. The balance 30%, i.e. ₹ 720 wll be treated as bad debts.

(4) It is assumed that the accounting year for both drawer and the drawee is ending on 31st December every year.

(5) Discounting charges for the first bill is ₹ 270 (₹ 9,000 x 12/100 x 3/12) and that of the second bill is ₹ 240 (₹ 6,000 x 12/100 x 4/12). Therefore, total discounting charges = ₹ 510. Mita's share is 1/3, i.e. 1/3 of ₹ 510 = ₹ 170. Amount remitted to Mita — ₹ 5,000 – ₹ 170 = ₹ 4,830.

(iii) When several bills are drawn and accepted for the accommodation of more than two parties

Here, each party draws one or more bills on the others. The bills are then discounted by the respective parties. The total net proceeds of the bills is then shared by the parties in an agreed ratio — the total discounting charges are also shared by them in the same proportion. Before the due date, in order to enable each party to honour his bill, the required amount is remitted by the others — with the help of which (along with their own share), they honour the accepted bills.

Illustration 37

For mutual accommodation of A, B and C, they draw and accept the following bills:

A draws a bill on B for ₹ 10,000; B draws a bill on C for ₹ 20,000; C draws a bill on A for ₹ 30,000.

All the above bills are discounted at 10% and the proceeds are shared equally.

Assuming all the bills are honoured on the due date, pass Journal entries in the books of A, B and C.

Solution

The aggregate amount of the bills is ₹ 60,000. The bills are discounted at 10%. Therefore, total amount of discount is 10% of ₹ 60,000, i.e. ₹ 6,000.

Each party will g et 1/3rd of the total amount of the bill less 1/3rd of the discounting charges. Therefore, each party will receive ₹ 18,000 (₹ 20,000 – ₹ 2,000) and will pay ₹ 20,000. After discounting the bill, A gets ₹ 9,000 (₹ 10,000 – ₹ 1,000). Therefore, he is to get ₹ 9,000 from C to make his share equal to others. B gets ₹ 18,000 (₹ 20,000 – ₹ 2,000) — exactly what each party is to get. C gets ₹ 27,000 (₹ 30,000 – ₹ 3,000) after discounting the bills. When C sends ₹ 9,000 to A, his share becomes ₹ 18,000 (₹ 27,000 – ₹ 9,000) — which is equal to that of the other parties.

Before the due date, A is to honour a bill of ₹ 30,000. To honour the bill, he is to get ₹ 10,000 from B, because B is to honour a bill of ₹ 10,000, but he has ₹ 20,000 with himself. Therefore, the excess of ₹ 10,000 will be remitted to A. Lastly, C is having with himself exactly what he requires to honour the bill drawn by B on him.

In the books of A
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	Bills Receivable A/c	Dr.		10,000	
	To B A/c				10,000
	(Being a bill drawn on B for mutual accommodation)				
	C A/c	Dr.		30,000	
	To Bills Payable A/c				30,000
	(Being the acceptance of a bill from C for mutual accommodation)				
	Bank A/c	Dr.		9,000	
	Discount on Bills A/c	Dr.		1,000	
	To Bills Receivable A/c				10,000
	(Being the bill discounted with the banker @ 10%)				
	Bank A/c	Dr.		9,000	
	Discount on Bills A/c			1,000	
	To C A/c				10,000
	(Being the receipt of ₹ 9,000 from C to make own share equal to others — discounting charges also equally shared)				
	Bank A/c	Dr.		10,000	
	To B A/c				10,000
	(Being the receipt of ₹ 10,000 to enable us to honour the bill)				
	Bills Payable A/c	Dr.		30,000	
	To Bank A/c				30,000
	(Being the bill honoured at maturity)				
	B A/c	Dr.		20,000	
	To C A/c				20,000
	(Being the required adjustment)				

In the books of B
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	Bills Receivable A/c	Dr.		20,000	
	To C A/c				20,000
	(Being a bill drawn on C for mutual accommodation)				
	A A/c	Dr.		10,000	
	To Bills Payable A/c				10,000
	(Being the acceptance of a bill from A for mutual accommodation)				
	Bank A/c	Dr.		18,000	
	Discount on Bills A/c	Dr.		2,000	
	To Bills Receivable A/c				20,000
	(Being the bill discounted with the banker @ 10%)				
	A A/c	Dr.		10,000	
	To Bank A/c				10,000
	(Being the required amount remitted to A in order to enable him to honour the bill)				

Date	Particulars		L.F.	₹	₹
	Bills Payable A/c To Bank A/c (Being the bill previously accepted, now honoured)	Dr.		10,000	 10,000
	C A/c To A A/c (Being the required adjustment)	Dr.		20,000	 20,000

In the books of C

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	Bills Receivable A/c To A A/c (Being a bill drawn on A for mutual accommodation)	Dr.		30,000	 30,000
	B A/c To Bills Payable A/c (Being the acceptance of a bill from B for mutual accommodation)	Dr.		20,000	 20,000
	Bank A/c Discount on Bills A/c To Bills Receivable A/c (Being the bill discounted with the banker @ 10%)	Dr. Dr.		27,000 3,000	 30,000
	A A/c To Bank A/c To Discount on Bills A/c (Being the required amount remitted to A to make his share equal to ₹ 20,000 — proportionately discounting charges also charged)	Dr.		10,000	 9,000 1,000
	Bills Payable A/c To Bank A/c (Being the bill previously accepted, now honoured)	Dr.		20,000	 20,000
	A A/c To B A/c (Being the required adjustment)	Dr.		20,000	 20,000

Illustration 38

A, B and C, for mutual accommodation, drew and accepted the following bills: A drew on B for ₹ 10,000 and on C ₹ 8,000; B drew on A for ₹ 12,000 and on C ₹ 20,000; C drew on A for ₹ 18,000 and on B ₹ 7,000. All the bills were discounted at 10% and the proceeds were shared equally. Pass Journal entries in the books of all the parties, assuming that all the bills were honoured on the due date.

Solution

The aggregate value of the bills is ₹ 75,000 and the amount of discounting charges is 10% of ₹ 75,000, i.e. ₹ 7,500. Since the proceeds are shared equally, the loss by way of discount is also to be shared equally. Therefore, each party is to receive ₹ 22,500 (₹ 25,000 – ₹ 2,500) and each party is to pay ₹ 25,000 to honour the bills. A gets ₹ 16,200 (₹ 18,000 – ₹ 1,800) after discounting the bills drawn by him. Similarly, B gets ₹ 28,800 (₹ 32,000 – ₹ 3,200), and C gets ₹ 22,500 (₹ 25,000 – ₹ 2,500). Therefore, A is to receive ₹ 6,300 (₹22,500 – ₹ 16,200) from B to make his share equal to that of the other parties. On the due date, A is to honour two bills of ₹ 12,000 and ₹ 18,000, i.e. ₹ 30,000. Therefore, he must get ₹ 5,000 from the other parties. B is to honour bills worth ₹ 17,000 (₹ 10,000 + ₹ 7,000). Therefore, he is to pay ₹ 8,000 to the other parties. Lastly, C is to honour bills worth ₹ 28,000 (₹ 8,000 + ₹ 20,000). Therefore, he is to get ₹ 3,000 from the other parties. From the above, we see that A and C will get from B ₹ 5,000 and ₹ 3,000 respectively to honour the bills.

In the books of A

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	Bills Receivable A/c To B A/c To C A/c (Being bills drawn on B and C for mutual accommodation)	Dr.		18,000	 10,000 8,000
	B A/c C A/c To Bills Payable A/c (Being the acceptance of bills from B and C for mutual accommodation)	Dr. Dr.		12,000 18,000	 30,000
	Bank A/c Discount on Bills A/c To Bills Receivable A/c (Being two bills discounted with the banker @ 10%)	Dr. Dr.		16,200 1,800	 18,000

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Bank A/c Dr. Discount on Bills A/c Dr. To B A/c (Being the receipt of ₹ 6,300 from B to make the share equal to ₹ 25,000 — proportionate discounting charges also accepted)		6,300 700	 7,000
	Bank A/c Dr. To B A/c (Being the receipt of ₹ 5,000 from B in order to honour the bills)		5,000	 5,000
	Bills Payable A/c Dr. To Bank A/c (Being the bills accepted by us honoured by payment)		30,000	 30,000
	B A/c Dr. To C A/c (Being the required adjustment)		10,000	 10,000

In the books of B
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Bills Receivable A/c Dr. To A A/c To C A/c (Being bills drawn on A and C for mutual accommodation)		32,000	 12,000 20,000
	A A/c Dr. C A/c Dr. To Bills Payable A/c (Being the acceptance of bills from A and C for mutual accommodation)		10,000 7,000	 17,000
	Bank A/c Dr. Discount on Bills A/c Dr. To Bills Receivable A/c (Being two bills discounted with the banker @ 10%)		28,800 3,200	 32,000
	A A/c Dr. To Bank A/c To Discount on Bills A/c (Being the remittance of ₹ 6,300 to A to make the share equal to ₹ 25,000 — proportionate discounting charges also charged)		7,000	 6,300 700
	A A/c Dr. C A/c Dr. To Bank A/c (Being the remittance of required amount to A and C to enable them to honour their bills)		5,000 3,000	 8,000
	Bills Payable A/c Dr. To Bank A/c (Being the bill accepted by us, honoured by payment)		17,000	 17,000
	C A/c Dr. To A A/c (Being the required adjustment)		10,000	 10,000

In the books of C
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Bills Receivable A/c Dr. To A A/c To B A/c (Being bills drawn on A and B for mutual accommodation)		25,000	 18,000 7,000
	A A/c Dr. B A/c Dr. To Bills Payable A/c (Being the acceptance of bills from A and B for mutual accommodation)		8,000 20,000	 28,000
	Bank A/c Dr. Discount on Bills A/c Dr. To Bills Receivable A/c (Being two bills discounted with the banker @ 10%)		22,500 2,500	 25,000
	Bank A/c Dr. To B A/c (Being the receipt of ₹ 3,000 from B in order to honour the bill)		3,000	 3,000

Bills Payable A/c Dr. To Bank A/c (Being the bill accepted by us, honoured by payment)		28,000	28,000
A A/c Dr. To B A/c (Being the required adjustment)		10,000	10,000

Key Points

- Section 5 of The Negotiable Instruments Act, 1881 defines a bills of exchange as under : 'A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a person to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.
- There are three parties to a bill of exchange — the drawer, the drawee and the payee.
- A promissory note is a written unconditional promise made by one person to another, to pay a specific sum of money either on demand or at a specified future date.
- Basically bills are classified into two categories : (a) Trade / Commercial Bills and (b) Accommodation Bills.
- When the period of the bill is stated in days, the calculation of the due date will be in days (which includes the date of payment but excludes the date of transaction).
- When the period of the bill is stated in months, the calculation of due date will be made in terms of calendar months, ignoring the number of days in a month.
- When the holder of a bill presents it to the drawee for payment on the due date and the drawee fails to make the payment, the bill is said to be dishonoured.
- Noting is the procedure adopted if a bill of exchange has been dishonoured by non-acceptance or by non-payment.
- The Notary Public records particulars of the bill, its re-presentment, and the reasons for non-payment of the bill in a regular and also on a notarial ticket, which is to be attached to the bill. The notary public charges some fees for doing all these — which is called ***noting charges***.
- Insolvency is the inability to pay one's debts when they fall due. Insolvency arises due to bankruptcy.
- Retiring a bill is the act of withdrawing a bill of exchange from circulation when it has been paid before the due date.
- An Accommodation Bill is a bill of exchange signed by a party as drawer, drawee, endorser to accommodate another party whose credit is not strong enough to enable him to borrow on his single name.

THEORETICAL QUESTIONS

1. Define Bill of Exchange and Promissory Note. Distinguish between a bill of exchange and a promissory note.
2. What are the effects of endorsing a bill ? What are the different types of endorsement ?
3. What are the effects of dishonour of a bill ?
4. Write short notes on : (a) Noting charges; (b) Renewal of a bill; (c) Retiring of a bill.
5. Distinguish between Trade Bills and Accommodation Bills.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below.

1. A bill of exchange must be -
   A in writing
   B signed by the drawee
   C a conditional order to pay
   D an unconditional promise to pay
2. A bill of exchange -
   A requires no acceptance
   B must be accepted
   C can be drawn only on a bank
   D is drawn by a debtor

3. There are three parties to a bill of exchange -
   A the seller, the buyer and the bank
   B the debtor, the creditor and the endorsee
   C the payer, the payee and the bank
   D the drawer, the drawee and the payee
4. A bill of exchange is payable -
   A at any time in the future
   B only on presentation
   C on presentation or at a time in the future
   D only to a bank
5. Noting is a procedure adopted if a bill of exchange has been dishonoured by
   A acceptance
   B non-acceptance
   C non-payment
   D non-acceptance or non-payment
6. Upon retirement, the drawer of the bill
   A requires the payment on the due date
   B does not get the payment
   C receives the payment before the due date
   D receives the payment after the due date
7. The rebate on bill retired is actually calculated at a fixed percentage per annum on the face value of the bill for
   A unexpired period of the bill
   B expired period of the bill
   C tenor of the bill
   D none of the above
8. Upon renewal, the indebtedness of the drawee is not restricted to the -
   A value of the bill
   B face value of the bill
   C discounted value of the bill
   D present value of the bill
9. When a bill of exchange is endorsed the amount is payable to the -
   A original holder
   B bank
   C endorsee
   D notary public
10. The discounting of a bill does not affect the position of the -
   A drawer
   B drawee
   C bank
   D seller
11. Discounted Bills Receivable is shown in the Balance Sheet as a
   A current asset
   B contingent liability
   C liability
   D contingent asset
12. State which of the following is a promissory note.
   A 'Mr Amar, I owe you Rs 100.'
   B 'I promise to pay Rs 5,000 to Y provided he is ready to go with me to kill X.'
   C 'Received from Mr Y Rs 4,000 which I promise to pay on demand.'
   D 'Deposit with me Rs 4,000 to be returned on demand.'

13. The liability of the maker of a promissory note is
    - **A** secondary but absolute
    - **B** secondary and conditional
    - **C** primary and absolute
    - **D** primary but conditional
14. Accommodation bill is also called -
    - **A** trade bill
    - **B** promissory note
    - **C** Kite bill
    - **D** bank note
15. Which of the following is true for accommodation bill ?
    - **A** this bill is the acknowledgment of the debt.
    - **B** this bill is always discounted with bank.
    - **C** this bill is drawn and accepted for consideration.
    - **D** in case of dishonour, legal action can be resorted.
16. Which of the following is true ?
    - **A** a bill of exchange must direct a certain person to receive a certain sum of money.
    - **B** a bill payable on demand is not required to be accepted.
    - **C** a bill of exchange is not one kind of a post-dated cheque.
    - **D** a bill payable on demand is estimated to three days of grace.
17. Which of the following is true ?
    - **A** the person to whom a bill is addressed is the creditor.
    - **B** a bill from the point of view of a creditor is called a bills payable.
    - **C** when the drawer discounts a bill, he credits discount account.
    - **D** refusal by the acceptor to make payment of the bill on the maturity date is called dishonour of the bill.
18. Which of the following is true ?
    - **A** no cancellation entry is required when a bill is renewed.
    - **B** a banker holds discounted bills as an agent for collection.
    - **C** discount at the time of retirement of a bill in a gain for the drawee.
    - **D** the noting charges are ultimately borne by the drawer.
19. Which of the following is true ?
    - **A** a bill of exchange should be presented on the due date and at the place named.
    - **B** a bill can generally be discounted with the banker where the drawee of the bill has an account.
    - **C** a bill of exchange cannot be transferred by the holder to any other party by mere physical delivery.
    - **D** no entry is passed in the books of the drawer in respect of bills sent for collection.
20. Which of the following is true ?
    - **A** noting is not a legally acceptable evidence of dishonour.
    - **B** when a bill is honoured, notice must be given to the prior parties.
    - **C** a renewed bill re-establishes the acknowledgment of the debt of the drawee.
    - **D** upon retirement, the drawer of the bill gets a fixed payment.

PRACTICAL QUESTIONS

Commercial Bills

1. On 1.2.2015, J. Jadav received from K. Kadam three acceptances for ₹ 6,000, ₹ 8,000 and ₹ 10,000 for two, three and four months respectively. The first bill for ₹ 6,000 was endorsed to M. Mehta; the second bill for ₹ 8,000 was held till the due date; and the third bill for ₹ 10,000 was discounted for ₹ 50 discount.
   At maturity all the bills were dishonoured. Give the Journal Entries in the books of J. Jadav and the Ledger Accounts in the books of K. Kadam, in respect of these transactions.

[C.A. (Entrance) — Adapted]

2. Y owed money to S and hence accepted two bills each of ₹ 4,850 of three months duration drawn on him by the latter on July 1,2015. S endorsed one of the bills in favour of H on July 7, 2015. On the same date he discounts the other bill with his bank and received net proceeds of ₹ 4,675. Y failed to meet both the bills on the due date. On 4th October, 2015, the bank debited the account of S with value of the second bill plus their charges of ₹ 20. Y is adjudicated insolvent and his estate paid 60 paise in the rupee on 1st November, 2015.
Show the entries in the books of both Y and S. *[C.A. (Entrance) — Adapted]*
3. Amarnath drew on Parker a bill of exchange for ₹ 1,00,000 on 1st January, 2015 payable after 3 months from 1st January 2015, which Parker accepted. On 4th January, 2015, Amarnath discounted the bill with his bankers at 18% p.a. Parker failed to meet the bill on the due date and the bill was returned to Amarnath with bank charges ₹ 2012 debited to him by the bank. Amarnath claimed the bill value plus bank charges from Parker. However, only 40% of the amount claimed could be recovered by Amarnath on 8th April, 2015 as Parker was declared insolvent. Pass the Journal Entries in the books of Amarnath and Parker for the above transactions. *[C.A. (Entrance) — Adapted]*
4. Patel received from one of his customers a bill at three months for ₹ 16,000. He discounted it on the same day at 10 per cent per annum with his bankers. On the date of maturity, the bill was dishonoured and the bank incurred noting charges of ₹ 80. However, the customer paid him ₹ 2,000 plus noting charges plus interest for three months amounting to ₹ 420 in cash and accepted a fresh bill at three months for ₹ 14,000, being the balance amount due from him. Patel gave the second bill to Mr Narayan, one of his creditors. The second bill was duly honoured on the due date. Record these transactions in the Journal of Patel. *[C.A. Entrance — Adapted]*
5. S. Sen and B. Banerjee have a number of transactions on bills of exchange between them. You are required to show the journal entries in their books in respect of the following transactions :
1.1.2015 Sen draws a bill on Banerjee for ₹ 15,450 payable after a month, inclusive of interest at 3% p.m.
3.1.2015 Sen discounts a bill for ₹ 25,000 drawn on 30.12.2014 with his Bank, discounting charges being 15% p.a. The bill is payable on 3.2.2015.
4.1.2015 Sen endorses the bill for ₹ 15,450 in favour of R. Ram towards account.
1.2.2015 Banerjee pays the bill for ₹ 15,450.
4.2.2015 The bill for ₹, 25,000 is returned by Sen's bankers as unpaid with their charges of ₹ 10.
6. Yashpal owed money to Srinivas and hence accepted two bills each of ₹ 4,850 of three months' duration drawn on him by the latter, on July 1, 2015. Srinivas endorsed one of the bills in favour of Hariram on July 7, 2015. On the same date he discounted the other bills with his bank and received net proceeds of ₹ 4,675. Yashpal failed to meet both the bills on the due date. On 4th October, 2015, the bank debited the account of Srinivas with the value of the second bill plus their charges of ₹ 20. Yashpal is declared insolvent and his estate paid 60 paise in the rupee, on 1st November, 2015. Show the Journal Entries in respect of the above in the books of Yashpal and Srinivas.
7. Sri G sold his diamond ring to Sri K for ₹ 20,000 and received in payment thereof, a three months bill of exchange from him of the bill amount. Thereafter, Sri G, discounted the said bill with his bankers receiving ₹ 19,800. Sri K, was not able to meet the bill on the due date. Sri K, however, agreed to accept a new two months bill for the amount due by him together with interest @ 9% p.a. and discount charges.
Show the Journal Entries and Ledger Accounts in the books of Sri G and Sri K.
8. On 1st January 2015 X owes Y ₹ 10,000 for which Y draws on X two bills for ₹ 4,000 and ₹ 6,000 payable after 3 months and 4 months respectively. Both the bills are drawn on 1st January, 2015. Y discounts both the bills with his bankers on 3rd January, at 12% p.a. Before the due date of the 1st bill, X requests Y to assist him by providing with ₹ 4,000 cash and drawing a 3rd bill on him (X) for the amount plus interest @ 12% p.a. for 3 months. Y agrees to this proposal and pays the money after discounting the third bill with his banker @ 12% p.a. A week before the 2nd bill for ₹ 6,000 falls due, X again asks Y to assist him by providing ₹ 5,000. Y however is not in a position to pay any cash but he arranges with X to draw on him (Y) two bills for ₹ 2,000 and ₹ 3,000 at 2 months and 3 months respectively from the due date of the 2nd bill (₹ 6,000). Y accepts these two bills and X discounts them with his bankers at 12% p.a. and assisted by the proceeds, duly meets the 2nd bill on the due date. Y fails to meet his own acceptances. On 10th June 2015 X becomes bankrupt, before meeting his third bill. On 1st September 2015, a first and final dividend of 50 paise in the rupee is received from X's estate. Pass Journal entries and the account of X in the books of Y.

Accommodation Bills

9. On 1st January, 2015, Ram drew and Shyam accepted a bill at three months for ₹ 4,000. On 4th January, 2015, Ram discounted the bill with his bank at 15% per annum and remitted half the proceeds to Shyam. On 1st February, 2015, Shyam drew and Ram accepted a bill at four months for ₹ 3,000. On 4th February, 2015 Shyam discounted the bill at 15% per annum with his bank and remitted half the proceeds to Ram. They both agreed to share the discount

equally. At maturity, Ram met his acceptance, but Shyam dishonoured his acceptance and Ram had to pay it. Ram drew and Shyam accepted a new bill at three months for the original bill plus interest at 18% per annum. On 1st July, 2015, Shyam became insolvent and only 50 paise in the rupee was received from him. Record the above transactions in Ram's Journal.

10. On 1.7.2015 Salil for mutual accommodation of himself and Sunil drew on the other a bill for ₹ 10,000 payable at 3 months date. The bill was discounted with Central Bank of India at 5% and half of the proceeds were remitted to Sunil on 2.7.2015. On 2.7.2015, Sunil drew a bill on Salil for ₹ 4,000 payable at 3 months date. He discounted the bill with Bank of India at 10% and remitted half of the proceeds to Salil. Sunil became bankrupt on 31.8.2015 and only 25% was received by Salil on 15.9.2015 as the first and final dividend from his estate. Write up the Journal entries in the books of Salil.
11. Mr Dhawlka draws on Mr Agarwal for mutual accommodation of both, a bill of ₹ 9,000 on 1st February, 2015 at 3 months. Mr Dhawlka discounts the bill at 10% p.a. and remits 2/3rd of the proceeds, to Mr Agarwal. On maturity, Mr Dhawlka is unable to send the amount due and therefore Mr Agarwal draws on Mr Dhawlka a bill for ₹ 6,000 at 4 months which is duly accepted by Mr Dhawlka. Mr Agarwal discounts the bill for ₹ 5,400 and remits ₹ 600 to Mr Dhawlka. Before the bill is due for payment Dhawlka becomes insolvent. Later 20% dividend is recovered from his estate. Show the Journal Entries in the book of Mr Agarwal and Agrawal's A/c in the book of Mr Dhawlka.
12. Sudip Ray accepted a three month's bill for ₹ 15,000 drawn by Keshab Bose for mutual accommodation on 1.2.2015. This bill was immediately discounted for ₹ 14,650 and moiety was sent to Sudip Ray. Just before maturity Sudip Ray received a cheque for ₹ 2,500 from K. Bose, and the bill was duly honoured. On 15.4.2015, K. Bose was declared insolvent and only 24 paise in the rupee was received as dividend from his estate. Show the necessary Journal entries and the personal accounts in the books of both the parties.
13. X draws a bill for ₹ 3,000 and Y accepts the same for the mutual accommodation of both of them to the extent of X 2/3 and Y 1/3. X discounts the same for ₹ 2,820 and remits 1/3 of the proceeds to Y. Before the due date, Y draws another bill for ₹ 4,200 on X in order to provide funds to meet the first bill. The second bill is discounted for ₹ 4,080 with the help of which the first bill is met and ₹ 720 are remitted to X. Before the due date of the second bill, X becomes bankrupt and Y receives a dividend of 50 paise in the rupee in full satisfaction. Pass the Journal entries in the books of X and Y.
14. On 1st January, 2014, Pankaj for mutual accommodation of Tony and himself drew upon the latter a three months bill for ₹ 12,000 which was duly accepted. Pankaj discounted the bill at 6% p.a. on 4th January 2014 and remitted 1/2 of the proceeds to Tony.

    On 1st February, 2014, Tony drew and Pankaj accepted a bill at 3 months for ₹ 4,800. On 4th February, 2014, Tony discounted the bill at 6% p.a. and remitted half the proceeds to Pankaj. At maturity Pankaj met his acceptance, but Tony failed to meet his and Pankaj had to take up. Pankaj drew and Tony accepted a new bill at two months on 4th May, 2014, for the amount due to Pankaj plus ₹ 100 as interest. On 1st July, 2014 Tony became insolvent and a first and final dividend of 50 paise in the rupee was received from his estate on 30th September, 2014.

    Pass the necessary Journal Entries in the books of Pankaj.

Guide to Answers

Multiple Choice

1. A 2. B 3. D 4. C 5. D 6. C 7. A 8. B 9. C 10. B
11. B 12. C 13. C 14. C 15. B 16. B 17. D 18. C 19. A 20. C

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Average Due Date and Account Current

Average Due Date

Average is a single figure representing a group of figures. Average due date is a mean date on which a single amount can be paid in lieu of several payments on different dates. When several bills of exchange are drawn by the drawer on the drawee payable on different dates, the drawee should make payments on those different dates to discharge his liability. Both the parties may feel it inconvenient to make/receive payments at different dates. As a solution, a mean date is calculated for a lump sum payment, which may result neither in any loss of interest to the drawer nor any undue advantage to the drawee.

The average due date technique of payment may be used in the following situations:

1. In settlement of contra accounts, that is, X and Y sell goods to each other on different dates.
2. In the settlement of accounts between a principal and an agent.
3. In calculating interest on partners' drawings.
4. In calculating interest on book debts which is realized piecemeal during dissolution of partnership.

Steps for Calculation of Average Due Date

Step 1 Select one of the due dates as the ***base date*** from which calculations are to be made. Any due date may be taken as a base date but preferably we should take the ***first due date*** as the base date.

Step 2 Calculate the number of days (plus or minus) of each of the other due dates from the base date.

Step 3 Multiply the amount of each payment by the respective number of days as calculated under Step 2.

Step 4 Add the amount of each payment and also add the products.

Step 5 Divide the total of the products by the total of the amounts payable. The result will give the number of days which are added to (or subtracted from) the base date and thus, the average due date is found out. If the due date is in a fraction, round it off to the next whole number.

Due Date of a Bill of Exchange

The due date of a bill of exchange is the date when the amount of the bill is payable by the drawee.

A bill of exchange payable ***at sight*** becomes due immediately after the bill is presented for payment.

A bill of exchange, payable at a predeterminable time in the future, becomes due on the expiry of the period of the bill. The time after which the term bill is to be paid is said to be the ***tenure*** of the bill. But it is customary to allow three ***days of grace*** to the drawee to pay the amount in the case of a term bill. Therefore, while calculating the due date of a term bill, in its period, for which it is drawn, three more days are added. For example, a bill is drawn 1.1.2015 for 3 months. The due date of the bill is 4.4.2015.

	Date	Month	Year
Date of drawing of the bill	1	1	2015
Period		3	
	1	4	2015
Days of grace	3	—	—
Due date of the bill	4	4	2015

A bill payable can be : (a) a certain period after date; or (b) a certain period after sight.

When the bill contains a direction to 'pay three months after date', three months have to be counted from the *date of drawing of the bill*. But, when the bill contains a direction to 'pay three months after sight', three months have to be counted from the *date of acceptance of the bill*.

While calculating the due date of a bill, the following points should be noted :

1. ***When the period of the bill is stated in days, the calculation of the due date will be in days (which includes the date of payment but excludes the date of transaction).***
2. ***When the period of the bill is stated in months, the calculation will be made in terms of calendar months, ignoring the number of days in a month. For example, if a bill is drawn on 15th January, 2015, for 3 months, the due date of the bill is 18th April, 2015.***
3. ***If the due date falls on a day which is a public holiday, the due date shall be the preceding business day. And now, if the preceding day is also a public holiday, it will fall due on the day preceding the previous day. For example, if the due date of a bill is 26th January (Republic Day) it falls due on 25th January and if 25th January is also a public holiday, it will fall due on 24th January (provided 24th January is not a public holiday).***
4. ***If the maturity date of a bill of exchange falls on a day which is an 'emergent holiday' declared by the Government as per the Negotiable Instruments Act, 1881, the date of maturity will be next working day.***

Illustration 1

A sold goods to B as follows :

Date of Invoice	Amount (₹)
15.5.2014	40,000
22.5.2014	25,000
29.5.2014	45,000
03.6.2014	32,500
09.6.2014	30,000

The payments were to be made two months from the respective date of invoices.

Calculate the average due date on which a single payment can be made by B to A without loss of interest to either parties.

Solution **Calculation of Average Due Date** **Base Date : 15.07.2014**

Date	Due Date	No. of Days from base date	Amount (₹)	Products
15.5.2014	15.7.2014	0	40,000	0
22.5.2014	22.7.2014	7	25,000	1,75,000
29.5.2014	29.7.2014	14	45,000	6,30,000
03.6.2014	03.8.2014	19	32,500	6,17,500
09.6.2014	09.8.2014	25	30,000	7,50,000
			1,72,500	21,72,500

Average Due Date = Base Date + $\frac{21,72,500}{1,72,500}$ = 15.7.2014 + 13 days (rounded off) = **28.7.2014**.

Illustration 2

A drew upon B several Bills of Exchange due for payment on different due dates as under:

Date	Amount (₹)	Tenure
02.10.2014	600	3 months
20.10.2014	800	2 months
10.11.2014	1,000	3 months
27.11.2014	750	3 months
08.12.2014	900	1 month
16.12.2014	1,200	2 months

Find out Average Due Date, on which payment may be made in one single amount.

Solution **Calculation of Average Due Date** **Base Date : 23.12.2014**

Date	Due Date	No. of Days from base date		Amount (₹)	Products
02.10.2014	05.01.2015*	8 + 5	= 13	600	7,800
20.10.2014	23.12.2014		= 0	800	0
10.11.2014	13.02.2015	8 + 31 + 13	= 52	1,000	52,000
27.11.2014	02.03.2015	8 + 31 + 28 + 2	= 69	750	51,750
08.12.2014	11.01.2015	8 + 11	= 19	900	17,100
16.12.2014	19.02.2015	8 + 31 + 19	= 58	1,200	69,600
				5,250	1,98,250

Average due date = Base date + $\frac{1,98,250}{5,250}$ days = 23.12.2014 + 38 days (rounded off) = **30.01.2015**.

***Note** : 3 days of grace has been added for calculating due dates.

Illustration 3

X owes Y the following sum of money on the due dates stated below :

Amount (₹)	Due Date
1,000	1.1.2014
2,000	1.2.2014
3,000	1.3.2014
4,000	1.4.2014

Calculate the average due date. Base date should be taken as 1.2.2014.

Solution **Calculation of Average Due Date** **Base Date : 01.02.2014**

Due Date	No. of Days from base date	Amount (₹)	Products
01.01.2014	– 31	1,000	– 31,000
01.02.2014	0	2,000	0
01.03.2014	28	3,000	84,000
01.04.2014	(28 + 31) 59	4,000	2,36,000
		10,000	2,89,000

Average Due Date = Base Date + $\frac{2,89,000}{10,000}$ = 1.2.2014 + 29 days (rounded off) = **2.3.2014.**

Illustration 4

Anand sold goods to Balwant as detailed below:

Date of Invoice	Value of goods sold (₹)	Date of Invoice	Value of goods sold (₹)
05.05.2014	3,000	26.05.2014	2,250
12.05.2014	1,500	01.06.2014	2,000
19.05.2014	3,500	03.06.2014	1,000

The payments were agreed to be made by bills payable 90 days from the respective dates of the invoice. However, Balwant wanted to arrange for payment of all the bills to be made on a single date.

Calculate the date on which such a payment could be made without loss of interest to either party.

Solution **Calculation of Average Due Date** **Base Date : 06.08.2014**

Date	Due Date	No. of Days from base date	Amount (₹)	Products
05.05.2014	06.08.2014	0	3,000	0
12.05.2014	13.08.2014	7	1,500	10,500
19.05.2014	20.08.2014	14	3,500	49,000
26.05.2014	27.08.2014	21	2,250	47,250
01.06.2014	02.09.2014	27	2,000	54,000
03.06.2014	04.09.2014	29	1,000	29,000
			13,250	1,89,750

Average due date = Base date + $\frac{1,89,750}{13,250}$ days = 6.8.2014 + 14 days (Rounded off) = **20.08.2014**.

Working Note: **Calculation of Due Date**

Date of Drawing of bill	Period (days)	May	June	July	August	Sept.	Due date with days of grace
05.05.2014	90	26	30	31	3		06.08.2014
12.05.2014	90	19	30	31	10		13.08.2014
19.05.2014	90	12	30	31	17		20.08.2014
26.05.2014	90	5	30	31	24		27.08.2014
01.06.2014	90		29	31	30		02.09.2014
03.06.2014	90		27	31	31	1	04.09.2014

Illustration 5

Calculate average due date from the following information :

Date of the bill	Term	Amount of the bills (₹)
August 10, 2014	3 months	6,000
October 23, 2014	60 days	5,000
December 4, 2014	2 months	4,000
January 14, 2015	60 days	2,000
March 8, 2015	2 months	3,000

Solution **Calculation of Average Due Date** **Base Date : 13.11.2014**

Date	Due Date	No. of Days from base date		Amount (₹)	Products
10.8.2014	13.11.2014		= 0	6,000	0
23.10.2014	24.12.2014	17 + 24	= 41	5,000	2,05,000
04.12.2014	07.2.2015	17 + 31 + 31 + 7	= 86	4,000	3,44,000
14.1.2015	18.3.2015	17 + 31 + 31 + 28 + 18	= 125	2,000	2,50,000
08.3.2015	11.5.2015	17 + 31 + 31 + 28 + 31 + 30 + 11	= 179	3,000	5,37,000
				20,000	13,36,000

Average due date = Base date + $\frac{13,36,000}{20,000}$ days = 13.11.2014 + 67 days (Rounded off) = **19.1.2015**.

Working Note: **Calculation of Due Date**

Date of the bill	Period	October	November	December	January	February	March	Due date with days of grace
August 10, 2014	3 months	—	—	—	—	—	—	13.11.2014
October 23, 2014	60 days	8	30	22	—	—	—	24.12.2014*
December 4, 2014	2 months	—	—	—	—	—	—	07.2.2015
January 14, 2015	60 days	—	—	—	17	28	15	18.3.2015
March 8, 2015	2 months	—	—	—	—	—	—	11.5.2015

*After considering 3 days of grace, the actual due date falls on 25th December. It is a public holiday, therefore due date will be 24th December, 2014.

Tutorial Notes :

(1) When the period of the bill is stated in days, the calculation of due date will be in days (which includes the date of payment but excludes the date of transaction).

(2) When the period of bill is stated in months, the calculation will be made in terms of calendar month.

Illustration 6

Ramkumar having accepted the following bills drawn by his creditor Prakash Chand due on different dates approached his creditor to cancel them all and allow him to accept a bill for the payment of his entire liability on the average due date. You are requested to ascertain the total amount of the bill and its due date.

Bill No.	Date of Drawing	Date of acceptance	Amount of the bills (₹)	Tenure
(i)	16.02.2014	20.02.2014	8,000	90 days after sight
(ii)	06.03.2014	07.03.2014	6,000	2 months after sight
(iii)	24.05.2014	07.06.2014	2,000	4 months after sight
(iv)	01.06.2014	04.06.2014	9,000	1 month after sight

Solution **Calculation of Average Due Date** **Base Date : 10.05.2014**

Date	Due Date	No. of Days from base date	Amount (₹)	Products
16.02.2014	24.05.2014	14	8,000	1,12,000
06.03.2014	10.05.2014	0	6,000	0
24.05.2014	10.10.2014	153	2,000	3,06,000
01.06.2014	07.07.2014	58	9,000	5,22,000
			25,000	9,40,000

Average due date = Base Date + $\frac{9,40,000}{25,000}$ days = 10.05.2014 + 38 days (Rounded off) = **17.06.2014.**

Total amount of the bill ₹ 25,000

Working Note: **Calculation of Due Date**

Date of Acceptance of bill	Period	February	March	April	May	Due date with days of grace
20.02.2014	90 days	8	31	30	21	24.05.2014
07.03.2014	2 months					10.05.2014
07.06.2014	4 months					10.10.2014
04.06.2014	1 month					07.07.2014

Tutorial Note: In case of a bill after sight, the due date is to be calculated from the **date of acceptance**.

Calculation of days from base date.

	May	June	July	August	September	October	Days
3rd bill	21	30	31	31	30	10	153
4th bill	21	30	7				58

Illustration 7

For goods sold, Nair draws the following bills on Roy who accepts the same as per terms.

Amount of the bills (₹)	Date of Drawing	Date of Acceptance	Tenure
8,000	06.01.2014	09.01.2014	3 months after date
9,000	15.02.2014	18.02.2014	60 days after date
8,000	21.02.2014	21.02.2014	2 months after date
15,000	14.03.2014	17.03.2014	30 days after sight

On 18th March 2014, it is agreed that the above bills will be withdrawn and the acceptor will pay the whole amount in one lumpsum by a cheque, 15 days ahead of average due date and for this, a rebate of ₹ 1,000 will be allowed. Calculate the average due date, the amount and the date of the cheque.

Solution **Calculation of Average Due Date** **Base Date : 09.04.2014**

Date	Due Dates	No. of Days from base date	Amount (₹)	Products
06.01.2014	09.04.2014	0	8,000	0
15.02.2014	19.04.2014	10	9,000	90,000
21.02.2014	24.04.2014	15	8,000	1,20,000
14.03.2014	19.04.2014	10	15,000	1,50,000
			40,000	3,60,000

(a) **Average due date** = Base date + $\frac{3,60,000}{40,000}$ Days = 9th April + 9 days = **18th April, 2014**.

(b) Amount of cheque = ₹ 40,000 – ₹ 1,000 = ₹ 39,000.

(c) Due date of the cheque = 18.4.2014 – 15 days = 3.4.2014.

Average Due Date as the Basis for Calculating Interest

We have already mentioned that if the payment is made exactly on the average due date, the drawer/creditor will not suffer any loss in respect of interest. In case the drawee/debtor delays the payment of lump sum amount, the drawer/creditor will lose interest for the period of delay. In this situation the drawee/debtor should pay interest at agreed rate for the period of delay, that is, the difference between average due date and actual date of payment.

For calculating interest the following steps should be followed :

Step 1 : Calculate the average due date in the usual manner.

Step 2 : Find out the difference between the average due date (as computed above) and payment date.

Step 3 : Calculate interest by applying the following formula :

Interest = Amount × Rate of Interest p.a. × Difference Between Payment date and Due Date.

Illustration 8

Mr. Neutral purchased goods from Mr. Positive on two month's credit. The purchases were made on the following dates :

	₹
(a) 3rd March, 2014	750
(b) 13th April, 2014	500
(c) 8th May, 2014	700
(d) 5th June, 2014	1,000
(e) 20th July, 2014	600

He wishes to pay the total amount of ₹ 3,550 on the basis of average due date.

(i) Find out average due date.

(ii) If he desires to make the whole payment on 22nd September, 2014, what will be the amount of interest @ 10% p.a.?

Solution **Calculation of Average Due Date** **Base Date : 03.05.2014**

Date	Due Date	No. of Days from base date		Amount (₹)	Products
03.03.2014	03.05.2014		0	750	0
13.04.2014	13.06.2014	28 + 13	= 41	500	20,500
08.05.2014	08.07.2014	28 + 30 + 8	= 66	700	46,200
05.06.2014	05.08.2014	28 + 30 + 31 + 5	= 94	1,000	94,000
20.07.2014	20.09.2014	28 + 30 + 31 + 31 + 20	= 140	600	84,000
				3,550	2,44,700

Average due date = Base Date + $\frac{2,44,700}{3,550}$ days = 03.05.2014 + 69 days (Rounded off) = **11.07.2014.**

Desired date of payment = 22.09.2014. Difference between due date and desired date of payment
= 20 + 31 + 22 = 73 days.

Interest = ₹ 3,550 × 10 / 100 × 73 / 365 = ₹ 71.

Illustration 9

The following amounts are due to A by B :

Due Date	Amount (₹)
10.1.2014	5,000
26.1.2014 (Republic Day)	10,000
23.3.2014	30,000
21.8.2014 (Sunday)	40,000

B wants to pay off the total amount on 18.3.2014 by a single payment — interest @ 16% p.a. is to be taken into consideration. Calcuate the amount to be paid by B.

Solution **Calculation of Average Due Date** **Base Date : 10.01.2014**

Date	Due Date	No. of Days from base date		Amount (₹)	Products
10.1.2014	10.1.2014		0	5,000	0
26.1.2014	25.1.2014*		= 15	10,000	1,50,000
23.3.2014	23.3.2014	21 + 28 + 23	= 72	30,000	21,60,000
21.8.2014	20.8.2014*	21 + 28 + 31 + 30 + 31 + 30 + 31 + 20	= 222	40,000	88,80,000
				85,000	1,11,90,000

* If the due date falls on a day which is a public holiday, the due date shall be the preceding business day.

Average due date = Base Date + $\frac{1,11,90,000}{85,000}$ days = 10.01.2014 + 132 days (Rounded off) = **22.05.2014.**

When the payment is made on 18.3.2014, rebate will be allowed for the unexpired period of the average due date, i.e., 18.3.2014 to 22.5.2014. The amount of rebate =

$$₹\ 85,000 \times 16\% \times \frac{(13+30+22)}{365} = ₹\ 85,000 \times 16\% \times \frac{65}{365} = ₹\ 2,422 \text{ (approx.)}$$

Therefore, the amount to be paid = ₹ 85,000 – 2,422 = ₹ 82,578.

Illustration 10

Kausthav had accepted bills payable to Hrishav as follows :

10th April, 2014 ₹ 4,000 for 4 months
18th April, 2014 ₹ 5,000 for 3 months
25th May, 2014 ₹ 3,000 for 3 months
5th June, 2014 ₹ 6,000 for 3 months

On 1st July, it was agreed that these bills should be withdrawn and that Kausthav should accept on that day two bills, one for ₹ 10,000 due in 4 months and the other for the balance with interest, due in 6 months.

Calculate the amount of the second bill taking interest @ 10% p.a. ***(ignore days of grace)***.

Solution

On 1st July, it was agreed that the bills should be withdrawn. Among the four bills, the first due date is in respect of the second bill—the due date of which is 18th July. Therefore, 18.7.2014 will be taken as the base date.

Calculation of Average Due Date **Base Date 18.07.2014**

Date of Drawing	Period	Due Date	Amount ₹	Number of Days from Base Date	Products ₹
10.4.2014	4 months	10.08.2014	4,000	13 + 10 = 23	92,000
18.4.2014	3 months	18.07.2014	5,000	0 = 0	0
25.5.2014	6 months	25.11.2014	3,000	13 + 31 + 30 + 31 + 25 = 130	3,90,000
5.6.2014	3 months	5.09.2014	6,000	13 + 31 + 5 = 49	2,94,000
			18,000		7,76,000

Average due date = Base date + $\frac{-7,76,000}{18,000}$ = 18.7.2014 + 43 days = **30.08.2014.**

Since two new bills will be drawn, their due date will be :

First Bill — 1.7.2014 + 4 months = 1.11.2014; Second Bill — 1.7.2014 + 6 months = 1.1.2015.

Interest to be charged in respect of the above bills :

1st bill — Interest will be charged on ₹ 10,000 @ 10% p.a. for 63 days (30..8.2014 to 1.11.2014)

=₹ 10,000 × 10% × 63/365 = ₹ 172.60

2nd bill — Interest will be charged on ₹ 8,000 (₹ 18,000 – 10,000) @ 10% p.a. for 124 days (30.8.2014 to 1.1.2015) = ₹ 8,000 × 10% × 124/365 = ₹ 271.78.

Therefore, the value of the two bills :

First bill — ₹ 10,000; Second bill — ₹ (8,000 + 17.60 + 271.78) = ₹ 8,444.38 or (say) ₹ **8,444**.

Application to Partnership

Average due date technique can be used for calculating interest on partners' drawings at different dates. For calculating interest the following steps should be followed:

Step 1 Calculate the average due date in the usual manner.

Step 2 Find out the difference between the average due date (as computed above) and the date of closing the books of account.

Step 3 Calculate interest by applying the following formula:

(1) Interest $= \frac{\text{Number of months}}{12} \times \text{Rate of interest} \times \text{Amount}$ (monthly basis), or

(2) Interest $= \frac{\text{Number of days}}{365} \times \text{Rate of interest} \times \text{Amount}$ (daily basis).

Illustration 11

Gavaskar and Kapil are two partners of a firm. They have drawn the following amounts from the firm in the year ending 31st March, 2015 :

Gavaskar		Kapil	
Date	₹	Date	₹
2014, 1st June	500	2014, 1st July	500
2014, 31st August	300	2014, 1st September	600
2014, 1st October	1,000	2015, 1st January	800
2015, 31st January	400	2015, 1st February	400

Interest @ 6% is charged on all drawings. Calculate interest chargeable under Average due date system (calculation to be made in months).

Solution **Calculation of Average Due Date of Gavaskar** **Base Date : 31.01.2015**

Date	Months from base date	Amount (₹)	Products
01.06.2014	(–) 8	500	(–) 4,000
31.08.2014	(–) 5	300	(–) 1,500
01.10.2014	(–) 4	1,000	(–) 4,000
31.01.2015	0	400	0
		2,200	(-) 9,500

Average due date = Base date + $\frac{-\ 9{,}500}{2{,}200}$ months = 31st January, 2015 – 4 months. = **1st October, 2014.**

Interest to be charged for 6 months (1st Oct. to 31st March) = ₹ 2,200 x 6/12 x 6/100 = ₹ **66.**

Calculation of Average Due Date of Kapil **Base Date : 31.01.2015**

Date	No. of Days from base date	Amount (₹)	Products
01.07.2014	(–) 7	500	(–) 3,500
01.09.2014	(–) 5	600	(–) 3,000
01.01.2015	(–) 1	800	(–) 800
01.02.2015	0	400	0
		2,300	(–) 7,300

Average due date = Base date + $\frac{-7{,}300}{2{,}300}$ months = 1st Feb. – 3 months (rounded-off) = **1st Nov. 2014.**

Interest to be charged from 1st Nov. 2014 to 31st March, 2015, i.e., for 5 months.
Interest = 5/12 x 6/100 x 2,300 = ₹ 57.5.

Application to Settlement of Contra Accounts

Where there are mutual dealings between two parties, the average due date technique can be applied for the settlement of accounts. For calculating the average due date, the following steps should be followed:

Receivable

Step 1 Select the first due date as the base date.

Step 2 Calculate the number of days from the base date.

Step 3 Multiply the amounts by the number of days (calculated above)

Payables

Step 1 ***Take*** the same due date (as above) ***as the base date.***

Step 2 Calculate the number of days from the base date.

Step 3 Multiply the amounts by the number of days (calculated above).

Now, add both ***amounts*** and ***products*** of Receivable and Payables. Find out the balance ***of amounts*** and ***balance of Products*** column. ***Finally*** : Divide 'the balance of the products' by 'the balance of the amounts'. The result will give the number of days which is added to the base date and thus, the average due date is found out.

Illustration 12

A draws on B the following bills for goods sold as per terms :

Bill Value (₹)	Date of Drawing	Date of Acceptance	Tenure
10,000	1.1.2014	5.1.2014	30 days after date
7,000	20.1.2014	22.1.2014	2 months after sight
3,000	7.2.2014	10.2.2014	1 month after sight

B draws on A the following bills for goods sold as per terms :

Bill Value (₹)	Date of Drawing	Date of Acceptance	Tenure
6,000	9.1.2014	10.1.2014	60 days after sight
8,000	15.1.2014	15.1.2014	1 month after date
1,000	10.2.2014	14.2.2014	30 days after sight

Calculate the average due date on which a single payment to be made or received without loss of interest on either side.

Solution **Calculation of Due Date of Bills Receivable Drawn by A**

	1st	2nd	3rd
Date of Drawings / Acceptance*	01.01.2014	22.01.2014*	10.02.2014
Period (Days / Months)	30	2	1
	31.01.2014	22.03.2014	10.03.2014
Days of grace	3	3	3
Due Date	03.02.2014	25.03.2014	13.03.2014

Calculation of Due Date of Bills Payable Accepted by A

	1st	2nd	3rd
Date of Drawings / Acceptance*	10.01.2014	15.01.2014	14.02.2014*
Period (Days / Months)	60	1	30
	11.03.2014	15.02.2014	16.03.2014
Days of grace	3	3	3
Due Date	14.03.2014	18.02.2014	19.03.2014

Bills Receivable **Calculation of Average Due Date** **Base Date : 03.02.2014**

Due Date	No. of Days from base date		Amount (₹)	Products
03.02.2014		0	10,000	0
25.03.2014	25 + 25	= 50	7,000	3,50,000
13.03.2014	25 + 13	= 38	3,000	1,14,000
			20,000	4,64,000

Bills Payable **Calculation of Average Due Date** **Base Date : 03.02.2014**

Due Date	No. of Days from base date		Amount (₹)	Products
14.03.2014	25 + 14	= 39	6,000	2,34,000
18.02.2014	18 – 3	= 15	8,000	1,20,000
19.03.2014	25 + 19	= 44	1,000	44,000
			15,000	3,98,000

Balance of Product = ₹ 4,64,000 – 3,98,000 = ₹ 66,000.

Balance of Amount= ₹ 20,000 – 15,000 = ₹ 5,000

Average due date = Base date + $\frac{66,000}{5,000}$ days = 03.02.2014 + 13 days (rounded off)= **16.02.2014.**

Illustration 13

Anil Kapoor had the following bills receivable and bills payable against Raj Kapoor. Calculate the average due date when the payment can be made or received without any loss of interest to either party.

Note: Holidays intervening in the period: 15 August, 2014, 16th August, 2014 and 6th September, 2014.

Bills Receivable			Bills Payable		
Date	Amount (₹)	Tenure (months)	Date	Amount (₹)	Tenure (months)
01.06.2014	3,000	3	29.05.2014	2,000	2
05.06.2014	2,500	3	03.06.2014	3,000	3
09.06.2014	6,000	1	10.06.2014	6,000	2
12.06.2014	10,000	2	13.06.2014	9,000	2
20.06.2014	15,000	3	27.06.2014	13,000	1

Solution **Calculation of Due Date of Bills Receivable**

	1st	2nd	3rd	4th	5th
Date of Drawing	01.06.2014	05.06.2014	09.06.2014	12.06.2014	20.06.2014
Period	3	3	1	2	3
	01.09.2014	05.09.2014	09.07.2014	12.08.2014	20.09.2014
Days of grace	3	3	3	3	3
	04.09.2014	08.09.2014	12.07.2014	15.08.2014*	23.09.2014

Calculation of Due Date of Bills Payable

	1st	2nd	3rd	4th	5th
Date of Drawing	29.05.2014	03.06.2014	10.06.2014	13.06.2014	27.06.2014
Period	2	3	2	2	1
	29.07.2014	03.09.2014	10.08.2014	13.08.2014	27.07.2014
Days of grace	3	3	3	3	3
Due Date	01.08.2014	06.09.2014	13.08.2014	16.08.2014*	30.07.2014

***Tutorial Note**: After including days of grace, if the maturity date falls on a Public Holiday, the bill is payable on the preceding Working day. Therefore, the due date of 4th B/R will be 14.8.2014; 2nd B/P will be 5.9.2014 and that of 4th B/P will be 14.8.2014.

Bills Receivable **Calculation of Average Due Date** **Base Date : 12.07.2014**

Date	Due Date	No. of Days from base date	Amount (₹)	Products
01.06.2014	04.09.2014	54	3,000	1,62,000
05.06.2014	08.09.2014	58	2,500	1,45,000
09.06.2014	12.07.2014	0	6,000	0
12.06.2014	14.08.2014	33	10,000	3,30,000
20.06.2014	23.09.2014	73	15,000	10,95,000
			36,500	17,32,000

Bills Payable — **Calculation of Average Due Date** — **Base Date : 12.07.2014**

Date	Due Date	No. of Days from base date	Amount (₹)	Products
29.05.2014	01.08.2014	20	2,000	40,000
03.06.2014	05.09.2014	55	3,000	1,65,000
10.06.2014	13.08.2014	32	6,000	1,92,000
13.06.2014	14.08.2014	33	9,000	2,97,000
27.06.2014	30.07.2014	18	13,000	2,34,000
			33,000	9,28,000

Balance of Products = ₹ 17,32,000 – ₹ 9,28,000 = ₹ 8,04,000; Balance of Amount = ₹ 36,500 – ₹ 33,000 = ₹ 3,500.

Average due date = Base date + $\frac{8,04,000}{3,500}$ days = 12.07.2014 + 230 days **= 27.02.2015.**

Calculation of Average Due Date by Sum of the Years' Digit Method

This method is adopted when the amount of bill / instalment is equal. For calculating average due date, the following steps are followed :

Step 1 Take the first date of transaction as base date.

Step 2 Calculate number of years from the base date.

Step 3 Take the total of number of years from base date column.

Step 4 Apply the following formula for calculating average due date:

$$\text{Average Due Date} = \text{Base Date} + \frac{\text{Sum of the Years' Digit}}{\text{Number of Instalments}}$$

Illustration 14

X lends ₹ 1,00,000 to Y on 1.1.2009. The loan is repayable in 5 equal annual instalments, commencing from 1.1.2010. Calculate the Average Due Date.

Solution — **Calculation of Average Due Date** — **Base Date : 01.01.2009**

Date of Payment	No. of Years from base date	Amount (₹)
01.01.2010	1	20,000
01.01.2011	2	20,000
01.01.2012	3	20,000
01.01.2013	4	20,000
01.01.2014	5	20,000
	Sum of the Years' Digit = 15	1,00,000

$\text{Average Due Date} = \text{Base Date} + \frac{\text{Sum of the Years' Digit}}{\text{Number of Instalments}} = 1.1.2009 + \frac{15}{5}$ years = 1.1.2009 + 3 years = **1.1.2012**.

Illustration 15

P lends Q on 1.1.2012. The loan is repayable in 5 half-yearly equal instalments commencing on 1.1.2013. Calculate the Average Due Date.

Solution — **Calculation of Average Due Date** — **Base Date : 01.01.2012**

Date of Payment	No. of Years from base date	Amount (₹)
01.01.2013	1	10,000
01.07.2013	1.5	10,000
01.01.2014	2	10,000
01.07.2014	2.5	10,000
01.01.2015	3	10,000
	Sum of the Years' Digit = 10	50,000

$\text{Average Due Date} = \text{Base Date} + \frac{\text{Sum of the Years' Digit}}{\text{Number of Instalments}}$

$= 1.1.2012 + \frac{10}{5}$ years = 1.1.2012 + 2 years = **01.01.2014**.

Illustration 16

₹ 20,000 is lent by A to B on 1.1.2009. The loan is repayable in 5 equal instalments commencing from 1.1.2011. Calculate the Average Due Date and interest @ 12% p.a.

Solution **Calculation of Average Due Date** **Base Date : 01.01.2009**

Date of Payment	No. of Years from base date	Amount (₹)
01.01.2011	2	4,000
01.01.2012	3	4,000
01.01.2013	4	4,000
01.01.2014	5	4,000
01.01.2015	6	4,000
	Sum of the Years' Digit = 20	20,000

$$\text{Average Due Date} = \text{Base Date} + \frac{\text{Sum of the Years' Digit}}{\text{Number of Instalments}}$$

$$= 1.1.2009 + \frac{20}{5}\text{ years } = 1.1.2009 + 4 \text{ years } = \mathbf{01.01.2013}.$$

Interest = ₹ 20,000 × 12% × 4 = ₹ **9,600**.

Account Current

An Account Current is a statement of mutual transactions between two parties for a given period of time, and includes interest payable to or receivable from the other party at an agreed rate. It takes the form of an account with some additional columns for due date, number of days, interest or interest product, and the like. All transactions are recorded according to date. It is, in fact, a copy of the Debtor's Ledger Account in the books of the creditor.

Account Current is prepared, generally, in the following situations:

1. When frequent transactions regularly take place between two parties and interest is chargeable on outstanding balance at an agreed rate.
2. When goods are sent by the consignor to the consignee for sale but the latter is to settle the account at the end of the consignment and as per the agreement the consignee is to pay interest on outstanding balance.
3. When two or more persons are in joint venture and each co-venturer is entitled to interest on their investment and no separate set of book is maintained for the joint venture.
4. When frequent transactions take place between a banker and his customers.

Parties in an Account Current

An Account Current has two parties — one who renders the account and the other to whom the account is rendered. If X renders the account to Y, then in the books of X, the heading of the account is written as 'Y in Account Current with X'.

Preparation of Account Current

There are two methods of preparing Account Current:

(a) The Forward Method; and

(b) The Backward or Epoque Method.

The Forward Method : This method can again be divided into two:

(i) preparation of Account Current with the help of interest table; and

(ii) preparation of Account Current by means of product.

(i) Preparation of Account Current with the help of Interest Table (Forward Method)

Under this method, the number of days for interest is calculated from the due date of each transaction to the date of rendering the account. The following steps are followed for preparing an Account Current.

Step 1 Write down the heading of the account. The name of the party rendering the account will appear last and to whom it is rendered will appear first. For example, if A renders account to B,then in the books of A, the heading of the account will be as follows : ***'B in Current Account with A'.***

Step 2 Rule the account in the ledger as follows:

Dr. **B in Current Account with A** **Cr.**

Date	Particulars	Due Date	Days	Interest	Amount ₹	Date	Particulars	Due Date	Days	Interest	Amount ₹

Step 3 Record each transaction in the appropriate side after determining whether the person, to whom the account is rendered, is to be debited or credited.

Step 4 Insert the due date of each transaction.

Step 5 Calculate the number of days from the due date of each transaction to the date of rendering the account and insert it in the 'Days' column.

Step 6 Calculate the interest with the help of the interest table.

Step 7 Find out the balance of the interest column and insert this balance in the 'Amount' column of the greater interest column side.

Step 8 Lastly, bring down the balance of the 'Amount' column.

The students should note the following points :

1. ***While counting the number of days, the date of the "due date" is ignored and the date upto which the accounting is prepared, is included.***
2. ***While counting the number of days for opening balances, the opening date as well as the date upto which the account is prepared, is included.***
3. ***If nothing has been mentioned, the date of transaction should be taken as the due date.***

Illustration 17

From the following particulars, prepare the Account Current to be rendered by Mrs Singh to Mr Paul as on 31st August, 2014. The interest must be calculated @10% p.a.

2014		₹	2014		₹
June 11	Goods sent to Paul	1,020	July 7	Goods sent to Paul	700
June 15	Cash received from Paul	500	Aug. 8	Cash received from Paul	1,100
June 20	Goods sent to Paul	650			

Solution

Dr. **Mr Paul in Current Account with Mrs Singh** **Cr.**

Date 2014	Particulars	Due Date	Days	Interest	₹	Date 2014	Particulars	Due Date	Days	Interest	₹
June 11	To Sales A/c	June 11	81	22.64	1,020.00	June 15	By Cash A/c	June 15	77	10.55	500.00
June 20	To Sales A/c	June 20	72	12.82	650.00	Aug. 8	By Cash A/c	Aug. 8	23	6.93	1,100.00
July 7	To Sales A/c	July 7	55	10.55	700.00	Aug. 31	By Balance of Interest (As per Contra)			28.53	
Aug. 31	To Interest A/c (As per Contra)				28.53	Aug. 31	By Balance c/d				798.53
				46.01	2,398.53					46.01	2,398.53

(ii) Preparation of Account Current by means of Products (Forward Method)

The way of preparing the Account Current, under this method, is almost similar to the above. In this method, the interest column (of the previous method) is replaced by the products column. Generally, the following steps are followed:

Step 1 Write down the heading of the account just as in the previous method.

Step 2 Rule the account in the ledger as follows:

Dr. **B in Current Account with A** **Cr.**

Date	Particulars	Due Date	Days	Products	Amount ₹	Date	Particulars	Due Date	Days	Products	Amount ₹

Step 3 Record each transaction in the appropriate side in the usual manner.

Step 4 Insert the due date of each transaction.

Step 5 Calculate the number of days from the due date of each transaction to the date of rendering the account and insert it in the "Days" column.

Step 6 Calculate the product of each transaction by multiplying the days with amount and insert it in the 'product' column.

Step 7 Find out the balance of products of the two sides.

Step 8 Calculate the interest with the help of this formula:

$$\text{Interest} = \frac{\text{Balance of products}}{365} \times \text{Rate of Interest}$$

Step 9 Insert this interest in the 'Amount' column on the side other than that on which the balance of products appears.

Step 10 Lastly, bring down the balance of the 'Amount' column.

Illustration 18

Prepare Account Current under this method by taking the information of ***Illustration 20***.

Solution

Dr. **Mr Paul in Current Account with Mrs Singh** **Cr.**
[Interest to 31st August, 2014 @ 10% p.a.]

Date 2014	Particulars	Due Date	Days	Products	Amount ₹	Date 2014	Particulars	Due Date	Days	Products	Amount ₹
Jun. 11	To Sales A/c	Jun. 11	81	82,620	1,020.00	Jun. 15	By Cash A/c	Jun. 15	77	38,500	500.00
Jun. 20	To Sales A/c	Jun. 20	72	46,800	650.00	Aug. 8	By Cash A/c	Aug. 8	23	25,300	1,100.00
Jul. 7	To Sales A/c	Jul. 7	55	38,500	700.00	Aug. 31	By Balance of Products			1,04,120	
Aug. 31	To Interest A/c				28.53	Aug. 31	By Balance c/d				798.53
				1,67,920	2,398.53					1,67,920	2,398.53

Illustration 19

From the following particulars make up an Account Current to be rendered by S Dasgupta to A Halder at 31st December reckoning interest @ 5% p.a.

2014		₹	2014		₹
June 30	Balance owing by A Halder	520	Sept. 1	Halder accepted Dasgupta's Bill at 3 months date	300
July 17	Goods sold to A Halder	40	Oct. 22	Goods bought from A Halder	20
Aug. 1	Cash received from A Halder	500	Nov. 12	Goods sold to A Halder	14
Aug. 19	Goods sold to A Halder	720	Dec. 14	Cash received from A Halder	50
Aug. 30	Goods sold to A Halder	50			
Sept. 1	Cash received from A Halder	400			

Solution

Dr. **A. Halder in Current Account with S. Dasgupta** **Cr.**

Date 2014	Particulars	Due Date	Days	Products	₹	Date 2014	Particulars	Due Date	Days	Products	₹
Jun 30	To Balance b/d		185	96,200	520.00	Aug. 1	By Cash A/c	Aug. 1	152	76,000	500.00
July 17	To Sales A/c	July 17	167	6,680	40.00	Sept. 1	By Cash A/c	Sept. 1	121	48,400	400.00
Aug. 19	To Sales A/c	Aug. 19	134	96,480	720.00	Sept. 1	By B/R A/c	Dec. 4	27	8,100	300.00
Aug. 30	To Sales A/c	Aug. 30	123	6,150	50.00	Oct. 22	By Purchases A/c	Oct. 22	70	1,400	20.00
Nov. 12	To Sales A/c	Nov. 12	49	686	14.00	Dec. 14	By Cash A/c	Dec. 14	17	850	50.00

Dec. 31	To Interest A/c					Dec. 31	By Balance of Product			71,446	
Aug. 31	To Interest A/c $\frac{71,446}{365} \times \frac{5}{100}$				9.79	Dec. 31	By Balance c/d				83.79
				2,06,196	1,353.79					2,06,196	1,353.79

Tutorial Notes:

(1) It is assumed that the bill was honoured on the due date. The due date of the bill should be treated as the date of payment and days to be calculated from the due date to the date of account; and

(2) While counting the number of days for opening balances, the opening date as well as the date upto which the account is prepared, is included.

Red-ink Interest

In case the due date of a bill falls after the date of closing the account, generally no interest is allowed for that. However, interest from the date of closing to such due date is written in 'Red-ink' in the appropriate side of the 'Account Current'. This interest is called Red-ink Interest. This Red-ink Interest is treated as negative interest. In actual practice, however, the product of such bill [value of bill x (due date – closing date)] is written in ordinary ink on the opposite side on which the bill is entered.

Illustration 20

Mehra owed ₹ 3,000 on 1st January, 2014 to Mr Somesh. The following are the transactions that took place between them during 2014. It is agreed between the parties that interest @ 6% p.a. is to be calculated on all transactions:

		₹
January 16	Mr Somesh sold goods to Mr Mehta	2,000
January 26	Mr Somesh purchases goods from Mr Mehta	1,500
February 10	Mr Somesh paid cash	1,500
March 13	Mr Mehta accepts a bill drawn by Somesh for 1 month	2,000

They desire to settle their accounts by one single payment on 15 March, 2014. Ascertain the amount to be paid to the nearest rupee.

Ignore days of grace.

Solution

Dr. **Mr Mehra in Current Account with Mr Somesh** **Cr.**

[Interest to 15 March, 2014 @ 6% p.a.]

Date 2014	Particulars	Due Date	Days	Products	₹	Date 2014	Particulars	Due Date	Days	Products	₹
Jan. 1	To Balance b/d		75	2,25,000	3,000.00	Jan. 29	By Purchases A/c	Jan. 29	46	69,000	1,500.00
Jan. 16	To Sales A/c	Jan. 16	59	1,18,000	2,000.00	Mar. 13	By B/R A/c	Apr. 13	—	—	2,000.00
Feb. 10	To Cash A/c	Feb. 10	34	51,000	1,500.00	Mar. 15	By Balance of Product			3,81,000	
Mar. 15	To Red-in Product (2,000 x 28) (As per Contra)	Apr. 13		56,000		Mar. 15	By Balance c/d				3,062.46
Mar. 15	To Interest A/c				62.46						
				4,50,000	6,562.46					4,50,000	6,562.46

Illustration 21

Following transactions took place between X and Y during the month of April, 2014:

		₹
April 1	Amount payable by X to Y	10,000
April 7	Received acceptance of X by Y for 2 months	5,000
April 10	Bills receivable (accepted by Y) on 7.2.2014 is honoured on this due date	10,000
April 10	X sold goods to Y (invoice dated 10.5.2014)	15,000
April 12	X received cheque from Y dated 15.5.2014	7,500
April 15	Y sold goods to X (invoice dated 15.5.2014)	6,000
April 20	X returned goods sold by Y on 15.5.2014	1,000
April 20	Bill accepted by Y is dishonoured on this due date	5,000

You are required to make out an Account Current by products method to be rendered by X to Y as on 30.4.2014, taking interest into account @ 10% p.a.

Solution

Dr. **Y in Current Account with X** **Cr.**

Date 2014	Particulars	Due Date	Days	Products	₹	Date 2014	Particulars	Due Date	Days	Products	₹
Apr. 7	To B/P A/c	Jun. 10	—	—	5,000.00	Apr. 1	By Balance b/d	—	30	3,00,000	10,000.00
Apr. 10	To Sales A/c	May 10	—	—	15,000.00	Apr. 12	By Bank A/c	May 15	—	—	7,500.00
Apr. 20	To Return Outward A/c	May 15	—	—	1,000.00	Apr. 15	By Purchases A/c	May 15	—	—	6,000.00
Apr. 20	To B/R A/c (Bill dishonoured)	Apr. 20	10	50,000	5,000.00	Apr. 30	By Red Ink Product (5,000 x 41) as per Contra	Jun. 10	41	2,05,000	—
Apr. 30	To Red Ink Product (7,500 x 15) as per Contra	May 15	15	1,12,500	—	Apr. 30	By Red Ink Product (15,000 x 10) as per Contra	May 10	10	1,50,000	—
Apr. 30	To Red Ink Product (6,000 x 15) as per Contra	May 15	15	90,000	—	Apr. 30	By Red Ink Product (100 x 15) as per Contra	May 15	15	15,000	—
Apr. 30	To Balance of Products			4,17,500	—	Apr. 30	By Interest A/c $\frac{4,17,500}{365} \times \frac{10}{100}$	—	—	—	114.38
						Apr. 30	By Balance c/d				2,385.62
				6,70,500	26,000.00					6,70,500	26,000.00

No entry is required for honoured bill on 10th April, since party is not concerned.

Epoque or Backward Method : Under this method, the number of days for interest is calculated from the date of commencement of Account Current to the due date of each transaction. In other words, the number of days are calculated from the due date of each transaction ***back*** to the starting point. The following steps are followed for preparing an Account Current.

Step 1 Write down the heading of the account in the same manner.

Step 2 Rule the account in the ledger as follows :

Dr. **B in Current Account with A** **Cr.**

Date	Particulars	Due Date	Days	Products	Amount ₹	Date	Particulars	Due Date	Days	Products	Amount ₹

Step 3 Record each transaction in the appropriate side in the usual manner.

Step 4 Insert the due date of each transaction.

Step 5 Calculate the number of days from the ***date of commencement of Account Current*** to the due date of each transaction. (If 1st January is the date of commencement of Account Current, for balance brought forward the starting point would be December, 31st).

Step 6 Calculate the product of each transaction by multiplying the days with amount and insert it in the 'Products' column.

Step 7 Determine the balance of 'Amount' column. Multiply this balance by the number of days for the whole term of the account. Insert this product in the 'Products' column of that side having ***Lesser*** 'Amount' total . ***For example —*** The total of the amount column of debit side is ₹ 600 and that of the credit side ₹ 400. Number of days for the whole term of the account is 90 days. For calculating product, multiply the balance (₹ 600 – ₹ ₹ 400) ₹ 200 by 90 which will give a product of ₹ 18,000 and insert this product in the credit side (because the credit side is having lesser 'Amount' total). ***Do not insert this balance of ₹ 200 in the 'Amount' column.***

Step 8 Find out the balance of products in the two sides.

Step 9 Calculate the interest with the help of the following formula:

$$\text{Interest} = \frac{\text{Balance of products}}{365} \times \text{rate of interest}$$

Step 10 Insert this interest in the 'Amount' column on the side on which the balance of products appear.

Step 11 Bring down the balance of the 'Amount' column.

Illustration 22

From the following particulars make up an Account Current rendered by S Dasgupta to A Halder at 31st December reckoning interest @5% p.a.

2014	Particulars	₹	2014	Particulars	₹
June 30	Balance owing by A Halder	520	Sept. 1	Halder accepted Dasgupta's Bill at 3 months date	300
July 17	Goods sold to A Halder	40	Oct. 22	Goods bought from A Halder	20
Aug. 1	Cash received from A Halder	500	Nov. 12	Goods sold to A Halder	14
Aug. 19	Goods sold to A Halder	720	Dec. 14	Cash received from A Halder	50
Aug. 30	Goods sold to A Halder	50			
Sept. 1	Cash received from A Halder	400			

Solution

Dr. A Halder in Current Account with S Dasgupta Cr.

Date	Particulars	Due Date	Days	Products	₹	Date	Particulars	Due Date	Days	Products	₹
2014						2014					
June 30	To Balance b/d				520.00	Aug. 1	By Cash A/c	Aug. 1	33	16,500	500.00
July 17	To Sales A/c	July 17	18	720	40.00	Sept. 1	By Cash A/c	Sept. 1	64	25,600	400.00
Aug. 19	To Sales A/c	Aug 19	51	36,720	720.00	Sept. 1	By B/R A/c	Dec. 4	158	47,400	300.00
Aug. 30	To Sales A/c	Aug 30	62	3,100	50.00	Oct. 22	By Purchases A/c	Oct. 22	115	2,300	20.00
Nov. 12	To Sales A/c	Nov 12	136	1,904	14.00	Dec. 14	By Cash A/c	Dec. 14	168	8,400	50.00
Dec. 31	To Balance of Products			71,446		Dec. 31	By Product on Balance of amount (74 x 185)		185	13,690	
Dec. 31	To Interest				9.79		By Balance c/d				83.79
				1,13,890	1,353.79					1,13,890	1,353.79

Note: (1) Epoque, 29th June 2014; and
(2) It is assumed that the bill was honoured on the due date.

Key Points

- Average due date is a mean date on which a single amount can be paid in lieu of several payments on different dates.
- If the due date falls on a day which is a public holiday, the due date shall be the preceding business day. And now, if the preceding day is also a public holiday, it will fall due on the day preceding the previous day. For example, if the due date of a bill is 26th January (Republic Day) it falls due on 25th January and if 25th January is also a public holiday, it will fall due on 24th January (provided 24th January is not a public holiday).
- If the maturity date of a bill of exchange falls on a day which is an 'emergent holiday' declared by the Government as per the Negotiable Instruments Act, 1881, the date of maturity will be next working day.
- An Account Current is a statement of mutual transactions between two parties for a given period of time, and includes interest payable to or receivable from the other party at an agreed rate. It takes the form of an account with some additional columns for due date, number of days, interest or interest product, and the like. All transactions are recorded according to date. It is, in fact, a copy of the Debtor's Ledger Account in the books of the creditor.

THEORETICAL QUESTIONS

1. What is an average due date? State the procedures of calculating it.
2. What is an Account Current? Explain the different methods of calculating interest on Account Current.
3. What is Red-ink interest? Why is it so called?
4. State two situations where average due date technique may be used.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below :

1. If the maturity date of a bill of exchange falls on a day which is an 'emergent holiday' declared by the Government as per Negotiable Instrument Act, 1881, the date of maturity will
   A fall on preceding working day
   B fall on next working day
   C none of the above
2. If the due date falls on a day which is a public holiday, the due date shall be
   A the next working day
   B the preceding working day
   C none of the above
3. Red ink interest is
   A really not interest
   B negative interest
   C used in connection with average due date
4. Account current is prepared when frequent transactions regularly take place between two parties and interest is
   A not chargeable on outstanding balance
   B chargeable on outstanding balance @ 6% p.a.
   C chargeable on outstanding balance at an agreed rate
5. When a bill contains a direction to 'Pay three months after sight', the three months have to be counted from the
   A date of drawing the bill
   B date of accepting of the bill
   C date of discounting the bill with the bank
6. When a bill contains a direction to 'Pay three months after date', the three months have to be counted from the
   A date of drawing the bill
   B date of accepting the bill
   C date of idscounting the bill with the bank

PRACTICAL QUESTIONS

Average Due Date

1. The due dates for the payment of certain amounts are as follows :
   January 1 ₹ 400 due on February 4
   February 4 ₹ 500 due on April 7
   April 1 ₹ 800 due on May 4
   May 10 ₹ 700 due on June 13
   May 17 ₹ 1,000 due on June 20.
   Suggest a date on which the bills may be paid, without any loss of interest to either party.
2. The following purchases were made for which the due date for cash payments is as under :

on March 15	₹ 1,200	Due 18th April
on April 21	₹ 3,000	Due 24th May
on April 27	₹ 2,000	Due 30th June
on May 15	₹ 1,000	Due 18th July

   A bill is to be drawn for the total amount due on the average due date. You are required to ascertain the date.
3. Mr Radheshyam purchased goods from Hariram, the due dates for payment in cash being as follows:
   March, 15, 2014 ₹ 400 due on 18th April;
   April 27, 2014 ₹ 200 due on 30th June;
   April, 21, 2014 ₹ 300 due on 24th May;
   May 15, 2014 ₹ 250 due on 18th July.
   Hariram agreed to draw a bill for the total amount due on the average due date. Ascertain that date .

4. A owes B the following sums of money due on the dates stated :
₹ 600 due on 5th April 2014;
₹ 300 due on 20th April 2014;
₹ 1,200 due on 5th May 2014;
₹ 150 due on 26th May 2014; and
₹ 75 due on 10th June 2014.
Calculate such a date when payment may be made by A in one instalment resulting in no loss to either party.

5. Find the average due date of payment for the data given below :

Date of Acceptance	Due Date	Amount
14.1.2014	17.2.2014	2,100
30.1.2014	3.3.2014	900
6.3.2014	9.4.2014	500
9.3.2014	12.4.2014	3,000
11.4.2014	14.5.2014	2,000

6. Satyajit and Prosenjit are two partners of a firm. They have drawn the following amounts from the firm in the year ending 31st March, 2006.

Satyajit			**Prosenjit**		
Date		₹	Date		₹
2014	1st July	300	2014	1st June	500
	30th Sept.	500		1st Aug.	400
	1st Nov.	800	2015	1st Feb.	400
2015	28th Feb.	200		1st Mar.	900

Interest at 6% is charge on all drawings. Calculate interest chargeable under average due date system. (Calculation to be made in month)

7. X sold goods to Y as detailed below:

Date of Invoice	Value of goods sold	Date of Invoice	Value of goods sold
05.05.2014	₹ 3,000	26.05.2014	2,250
12.05.2014	₹ 1,500	01.06.2014	2,000
19.05.2014	₹ 3,500	03.06.2014	1,000

The payments were agreed to be made by bills payable 90 days from the respective dates of the invoice. However Y wanted to arrange for payment of all the bills to be made on a single date.
Calculate the date on which such a payment could be made without loss of interest to either party.

8. Sri Maynak has drawn the following bills of exchange on Sri Sanjay :

Bill No.	Date of Bill	Payment of bill	Amount
1	15.1.2014	3 months	35,000
2	17.2.2014	2 months	57,500
3	13.3.2014	1 month	7,500
4	19.3.2014	2 months	50,000

Find the average due date.

9. For goods sold, Nair draws the following bills on Roy who accepts the same as per terms :

Amount of the Bills (₹)	Date of Drawing	Date of Acceptance	Tenure
8,000	6.1.2015	9.1.2015	3 months after date
9,000	15.2.2015	18.2.2015	60 days
8,000	21.2.2015	21.2.2015	2 moinths
15,000	14.3.2015	17.3.2015	30 days after sight

On 18th March, 2015, it is agreed that the above bills will be withdrawn and the acceptor will pay the whole amount in one lump sum by a cheque, 15 days ahead of average due date and for this a rebate of ₹ 1,000 will be allowed.

10. A drew on B the following bills for goods sold as per terms :

Bill Value (₹)	Date of Drawing	Date of Acceptance	Tenor
10,000	1.1.2014	5.1.2014	30 days after date
7,000	20.1.2014	22.1.2014	2 months after sight
3,000	7.2.2014	10.2.2014	1 month after sight

B drew on A the following bills for goods sold as per terms :

Bill Value (₹)	Date of Drawing	Date of Acceptance	Tenor
6,000	9.1.2014	10.1.2014	60 days after sight
8,000	15.1.2014	15.1.2014	1 months after date
1,000	12.2.2014	14.2.2014	30 days after sight

Consolidate the above bills and calculate the Average Due Date on which a single payment can be made or received without loss of interest on either side.

11. Mr. Big purchased goods from Mr. Small as follows :

    ₹ 4,000 to be paid on 6th January, 2015;
    ₹ 2,000 to be paid on 3rd February, 2015;
    ₹ 3,000 to be paid on 31st March, 2015.

    He also sold goods to Mr Small as follows :

    ₹ 1,500 to be paid on 10th January, 2015;
    ₹ 2,500 to be paid on 15th February, 2015;
    ₹ 1,000 to be paid on 21st March, 2015.

    Mr. Big settled the account on 21st April, 2015.
    (a) Find out the Average Due Date.
    (b) Calculate the interest at 5% p.a. from the average due date to the date of settlement.

12. For sales made to Brijmohan from time to time, Shankar Prasad had drawn upon him trade bills payable as follows:

		₹
2014	14th May due 22nd July	6,000
	5th June due 2nd August	5,000
	15th June due 30th August	7,000
	17th June due 10th September	6,000

On 2nd July, as mutually agreed, he draws upon Brijmohan 2 bills of exchange of equal sums payable on the average due date. 15 days before the date of payment Brijmohan desired to retire one of the bills at 6% p.a. and extend the date of another by 30 days at the same rate of interest. It was agreed, subject to the condition that the discount payable on retirement would be adjusted against the interest on extended bill. The arrangement having been carried through, Shankar Prasad endorsed the second bill to Manoharlal, one of his creditors, in full discharge of his liability for ₹ 12,000. The bill was dishonoured on due date and on October 30, Brijmohan's estate finally realised 50 paise in the rupee.

Calculate the average due date and show the working of Brijmohan's Account, Bills Receivable Account and Manoharlal's Account as would appear in the books of Shankar Prasad. (Interest may be calculated on the basis of 30 days a for a month).

13. ₹ 20,000 lent by A to B on 1.1.2012. The loan is repayable in 5, two-yearly instalments commencing from 1.1.2014 — the rate of interest is 10% p.a.

    Calculate the average due date and the amount of interest, which is to be paid along with the last instalment.

Account Current

14. Make out an account current to be rendered by Murugan to Srinivasan on 30th September, 2014 in respect of the following transactions appearing in the books of Murugan :

			₹
July	1	Debit balance b/f	1,350
	5	Sold goods to Srinivasan	900
	15	Received cash from Srinivasan	1,350
Aug.	4	Sold goods to Srinivasan	1,920
	14	Received cash from Srinivasan	900
Sept.	1	Bought goods from Srinivasan	2,100
	1	Paid cash to Srinivasan	750
	12	Sold goods to Srinivasan	960
	15	Paid cash to Srinivasan	600

Interest to be taken into account @ 5% p.a. calculated to the nearest rupee according to product method.

15. The transactions that book place between Kumar and Prabhakaran during 2014 is given below :

			₹
July	1	Debit balance b/f	1,300
	5	Sold goods to Prabakaran	900
	15	Received cash from Prabakaran	1,400

Aug.	4	Prabakaran purchased goods	1,900
	15	Prabakaran remitted cash	900
Sept.	1	Bought goods from Prabakaran	2,000
	1	Paid cash to Prabakaran	700
	12	Sold goods to Prabakaran	900
	15	Prabakaran received cash	600

Prepare an account current to be rendered by Kumar to Prabakaran on 30th September, 2014. Interest is to be calculated (nearest to rupee) at 5% p.a.

16. Gopal Krishan had the following transaction with Balsubrahmaniam.

2014			₹
Jan.	1	Balance due from Balsubrahmaniam	2,000
Feb.	16	Purchased goods from him	12,000
Feb.	28	Sold goods to him	20,000
Mar.	16	Received a cheque	6,000
Apr.	20	Sold him goods (Invoiced on May 3)	20,000
June	16	Purchased goods from him (Invoiced on July 10	30,000
Sept	23	Paid him cash	6,000
Oct.	24	Accepted his bill for 3 months	10,000
Nov.	26	Received his acceptance for 2 months	16,000

You are asked to prepare an Account Current of Balsubrahmaniam completed upto December 31, 2014 as will appear in the books of Gopal Krishnan reckoning 10% interest on the balance due.

17. The following are the transactions that took place between X and Y during the period from 1st January to 30th June:

2014			₹
Jan.	1	Balance due to X	602
Jan.	17	Goods sold by X to Y	884
Feb.	16	Goods sold goods by Y to X (Invoiced April 1)	1,296
Feb.	18	Goods returned by X to Y (Out of goods purchased on Feb. 16)	112
Mar.	24	Goods sold by Y to X (Invoiced May 1)	712
Apr.	22	Bill drawn by Y on X at 3 months	300
Apr.	29	Cash paid by X to Y	500
May	17	Goods sold by X to Y (Invoiced June 1)	542
June	22	Goods sold by Y to X (Invoiced Aug. 1)	45

Draw up an Account Current upto 30th June, 2014 to be rendered by X to Y charging interest @ 5% p.a.

Guide to Answers

Multiple Choice

1. B; 2. B; 3. B; 4. C.

Practical Questions

Average Due Date

1. **Average due date—12th May.**
2. **5th June.**
3. **Average due date—30th May 2014.**
4. **Average due date—28th April, 2014.**
5. **2nd April, 2014.**
6. **In case of Satyajit—Average due date 16th Oct 2014; Interest ₹ 49.5;**
   In case of Prosenjit—Average due date 16th Nov 2014; Interest ₹ 49.5.
7. **The due date of payment—20th August, 2014.**
8. **30th June, 2014.**
9. **Average due date — April 18; Amount of the cheque — ₹ 39,000; Date of the cheque — 3rd April.**
10. **Average due date — 16th February, 2014.**
11. **Average due date — 7th February, 2015. Amount of interest — ₹ 40.**
12. **Average due date—17th August, 2014.**
13. **Average due date — 1st January, 2006. Amount of interest — ₹ 12,000.**

Account Current

14. **Interest due to Murugan—₹ 21.**
15. **Interest due to Kumar—₹ 20.**
16. **Red-ink Product—4,64,000; Balance of product 18,82,000; Interest ₹ 516 (Approx); Balance (Cr.) ₹ 5,484.**
17. **Balance of interest (Dr.) ₹ 22; Balance of account (Dr.) ₹ 498.**

21

Non-profit Organisation

Introduction

In the previous chapters, the main emphasis was on recording and reporting for trading and manufacturing organisations which are formed for the exclusive purpose of earning a profit for the owner / stakeholders. There are, however, a large number of organisations that do not operate for the profits or gains of their individual members. These organisations are known as ***Non-profit organisations***.

A non-profit organisation is operated for the benefit of the society as a whole, rather than for the benefit of a sole proprietor or a group of partners or shareholders. In every society, some organisations or associations are found which do not have profit making as their objective. Their main objective may be social, educational, religious or charitable and they take the form of clubs, societies or charitable bodies and so on.

Many government activities fall into this category, such as hospitals, schools and colleges. Their main objective is to provide service to the members or beneficiaries. The main idea is to spend the funds of the organisation in such a way that it provides maximum benefit to the members. Nonetheless, in the long run, these forms of organisation must have sufficient surplus after meeting the expenses from the income.

These organisations have no 'owner' as such and these are managed on a voluntary basis. Many social clubs are democratically managed just like a company and the members or beneficiaries get information similar to that provided to a shareholder. But the surplus of these organisations is not distributed among its members by way of dividends as it is done in case of a company. However, we may find certain charitable institutions which are autocratic. They are managed by a small group of trustees who retain the power to appoint their own successors.

Formation of a Non-Profit Organisation

A non-profit organisation is formed when a number of like-minded people decide to formalise their association. After formation, the founder member elect / select a management comittee. They also formulate the rules and regulations for managing the organisation. These matters are formalised in a document called a '***Constitution***' or '***By-laws***'.

The Constitution of the Organisation

At the time of the drafting the constitution of the organisation, the nature of the organisation, the activities of the organisation and the requirements of its members are to be taken into consideration. Generally, the following matters are included in the constitution of the organisation :

1. Purpose of the organisation (education, sports, medical aid, etc.);
2. Qualification for membership;
3. Admission / Joining fees, annual membership subscriptions;
4. Power of different committees, meeting procedures;
5. Financial records and reports;
6. Audit of financial records;
7. Members record;
8. Cheque signing authority;
9. Dissolution procedures of the organisation;
10. Procedures for addressing grievances of the members;
11. Procedures for cancellation of membership;
12. Procedures for acquisition and disposal of fixed assets.

Composition of Management Committee

The management committee of a non-profit organisation generally comprise of the following office bearers:

(a) ***President*** : President is the chief representative of the organisation. All meetings of the organisation are held under his chairmanship.

(b) ***General Secretary*** : General secretary is responsible for correspondence and issue of notice of the meetings. He is also responsible for preparing minutes of the meeting and other administrative works.

(c) ***Treasurer*** : Treasurer is responsible for maintenance of financial records and preparation for financial statements. He also manages the finance of the organisation.

In addition to the above, additional posts are created according to the needs of the organisation. For example, the organisation may have cultural secretary, game secretary, food and beverage secretary and other such office bearers.

Characteristics of a Non-profit Organisation

(1) Entity : The entity concept can well be applied to non-profit organisations because these organisations have no owners.

(2) Service : Non-profit organisations render services to members of the public. The members may range from a limited number of citizens of a community to almost the entire population of a city, state or nation.

(3) Form : Their main objective may be social, educational, religious or charitable and they take the form of clubs, societies or charitable bodies and so on. Many government activities fall into this category such as hospitals, schools, colleges, and the like.

(4) No profit motivation : Non-profit organisations do not operate with the objective of earning a profit. Their main objectives are to provide service to the members or beneficiaries. The surplus of these organisationss is not distributed among its members.

(5) Financing : Many a time, these organisations are to depend on the donations given by members or outsiders, because revenue received from the members may not cover all their operating costs.

(6) Funds : It is quite possible that a substantial portion of the resources of a non-profit organisation are donation, the organisation must account for the resources and to spend the funds of the organisation in such a fashion that provides maximum benefit to the members.

(7) Budget : It is very important for a non-profit organisation to prepare an annual budget.

Among the characteristics of non-profit organisations that resemble those of business enterprises are the following :

(1) Governance by elected members : A non-profit organisation is governed by elected members in the same way a business corporation is governed by a board of directors.

(2) Recognition of revenue and measurement of cost expirations : Allocation of costs including depreciation and recognition of revenue to the appropriate accounting period is a common characteristic of non-profit entities and busines enterprises.

(3) Use of accrual basis of accounting : A non-profit organisation employs the same accrual basis of accounting used by a business enterprise.

Accounting Records

The extent of records kept by a non-profit organisation will depend upon the size of the organisation. All big organisations are keeping detailed record of all transactions under double entry system, normally with the help of a suitable accounting package. However, small organisations keep accounting records under single entry method where mainly cash transactions are recorded regularly. Generally, the following books of accounts are maintained :

(i) Petty Cash Book
(ii) Cash Book
(iii) Purchase Journal
(iv) Sales Journal
(v) General Journal

The functions of all the books of accounts are similar to that of a trading organisation.

Non-accounting Records

A non-profit organisation needs to maintain a range of non-accounting records. These records are almost common to all non-profit organisations. Mainly the following non-accounting records are maintained :

(i) Register of Members;
(ii) Minute Book; and
(iii) Correspondence file.

Register of Members *:* It is extremely important for a non-profit organisation to maintain accurate up-to-date records relating to its members. Nowadays all records relaing to membership are maintained in the computer. A hard copy (print out) is also maintained by the organisation. The register of members should include : the name of the member, date of joining, age of the member, category of membership, permanent address, phone number, mobile number, e-mail address, etc.

A s***pecimen of Register of Members*** is given below :

<table>
<tr><td colspan="5" align="center">Bengal Rowing Club
Register of Members</td></tr>
<tr><td colspan="4">Name : Mr P. Gupta
Address : 42, Park Street
Kolkata - 700 016
Telephone No. : 033-2343638
Mobile No. : 93-4645569
E-mail: pgupta@gmail.com</td><td>Membership No. : Ord/0159
Date of Joining : 31st March, 2013
Age Group : Senior</td></tr>
<tr><td colspan="5" align="center">Financial Details</td></tr>
<tr><td>Details</td><td>Due Date</td><td>Date Received</td><td>Amount (₹)</td><td>Receipt Number</td></tr>
<tr><td>Admission Fees</td><td>31st March, 2013</td><td>31st March, 2013</td><td>50,000</td><td>A/204</td></tr>
<tr><td>Annual Subscription</td><td>1st April, 2014</td><td>16th May, 2014</td><td>2,000</td><td>S/115</td></tr>
<tr><td>Annual Subscription</td><td>1st April, 2014</td><td>20th June, 2015</td><td>2,500</td><td>S/120</td></tr>
</table>

Minute Book : All the records of the proceedings of the meetings are maintained in the Minute Book. For a non-profit organisation, regular meeting is very common. The accurate records of these meetings are maintained by the Secretary of the organisation. It is used as an evidence in case of any disputes.

Correspondence File : This file is also maintained by the Secretary of the organisation. All important documents (e.g., constitution of the organisation) copy of the correspondences (inward and outward) are kept in this file.

Financial Statements

Non-profit organisations must prepare regularly annual accounts reflecting the financial affairs of the organisation for submitting to the members and government departments for financial grants and the like. A majority of the organisations keep their accounting records under the single entry system. They mainly maintain cash book, suppliers' ledger and members' register. Where the size of the organisation is large, the accounts are kept under complete double entry system. Whatever may be the system of accounting, these organisations prepare, at the year end, the following three key statements:

1. Receipts and Payments Account;
2. Income and Expenditure Account; and
3. Balance Sheet.

Now, we explain below the nature of the above three statements.

1. Receipts and Payments Account

A Receipts and Payments Account is a summary of the Cash Book. This is the primary report prepared by the treasurers of clubs, societies etc to present the result of the year's cash position. Since it is a cash basis of reporting, the Receipts and Payments Account gives the opening cash and bank, the receipts and payments in cash or by cheque during an accounting period and the resultant balance of cash and bank at the end of the accounting period. All the receipts and payments (whether in cash or cheque) are shown on the left-hand side, and all payments (whether in cash or cheque) are shown on the right-hand side.

Features of a Receipts and Payments Account

1. It is the summary of the cash and bank transactions; like cash book, all the receipts (capital or revenue) are debited, similarly all the payments (capital or revenue) are credited.
2. It starts with opening cash and bank balances (though sometimes they are merged) and also ends with their closing balances.
3. This account is usually not a part of the double entry system. It is the duplicate of cash book in concise form.
4. It includes all cash and bank receipts and payments, whether they are related to current, past or future periods.
5. Surplus or deficit for an accounting period cannot be ascertained from this account, since it shows only the cash position and excludes all non-cash items.
6. This account is not a Trial Balance but a 'Cash Trial'.

A specimen of a Receipts and Payments Account is given below.

(Name of the Institution/Club etc.)
Receipts & Payments Account for the year ended 31st March, 2015

Receipts		₹	Payments		₹
To Opening Balance :			By Salaries		***
Cash	***		By Rent		***
Bank	***	***	By Electricity		***
To Subscriptions :			By Purchase of Investment		***
2013-14		***	By Purchase of Furniture		***
2014-15		***	By Closing Balance :		
2015-16		***	Cash	***	
To Donation		***	Bank	***	***
To Sale of Sports Equipment		***			

2. Income and Expenditure Account

The Income and Expenditure Account is equivalent to the Profit and Loss Account of a business enterprise. It is prepared by matching the revenues against the expenses for a specified period, usually a year. Since non-profit organisations do not earn profit (or incur loss) they do not prepare Profit and Loss Account but for evaluating the financial condition of the organisation, they prepare Income and Expenditure Account at the year-end. This account shows surplus or deficit of income over expenditure.

The title 'Income and Expenditure Account' is not strictly correct as the financial report actually records expenses rather than expenditure for the period. An expense is an amount of benefit that has been used up during an accounting period. Expenditure usually means an outlay of money (the benefits of the outlay may or may not be used up during the accounting period in which the outlay occured). Nevertheless, this title is in general usage and will be employed in this chapter.

The method and technique of the preparation of an Income and Expenditure Account is similar to that which is followed in the preparation of a Profit and Loss Account of a profit-seeking concern. The main sources of revenue of these organisations are subscriptions, admission fees, donations and government or other grants. The whole of the revenue income and revenue expenditure for the period is taken into consideration, irrespective of the fact whether they have been actually received or paid or not. Just like Profit and Loss Account, all accrued incomes and outstanding expenditures are shown in this account.

All incomes are shown on the right-hand side (income side) and all expenditures are shown on the left-hand side (expenditure side). No capital expenditure or receipt is taken in the Income and Expenditure Account. If the right-hand total of this account exceeds the left-hand side total, the balance is a surplus and it is called 'Excess of Income over Expenditure'.

Conversely, if the the left-hand side total exceeds the right-hand side total, the balance is a deficit and it is called 'Excess of Expenditure over Income'.

Features of an Income and Expenditure Account

1. It is a revenue account prepared at the end of the financial period for finding out the surplus or deficit of that period.
2. It is prepared by matching expenses against the revenues of the period concerned.
3. Both cash and non cash items, such as depreciation, are taken into consideration.
4. All capital expenditures and incomes are excluded.
5. Only current year's incomes and expenses are considered.

(Name of the Institution/Club etc.)
Income and Expenditure Account for the year ended ...

Expenditure		₹	Income		₹
To Salaries	***		By Subscriptions	***	
Add: Outstanding	***	***	Add: Outstanding	***	
To Rent		***	Less: Paid in Advance	***	***
To Insurance Premium	***		By Donation		***
Less: Prepaid	***	***	By Admission fees		***
To Excess of Income over Expenditure		***			
		***			***

Distinction between the Receipts and Payments Account and the Income and Expenditure Account

	Receipts and Payments Account		Income and Expenditure Account
1.	It is merely a summary of the cash transactions — which begins with the opening balances of cash and bank and ends with the closing balances of cash and bank.	1.	It is a comparable account of a profit and loss account which shows the incomes, expenses and surplus/deficit for the period.
2.	It is almost like a Real Account	2.	It is almost like a Nominal Account.
3.	It records all monies received or paid during a year, irrespective of revenue or capital nature and also relating to the past, current or following year.	3.	It records only expenses and revenues for the current year. Items of capital nature or relating to the past or future period are excluded.

4.	Here, receipts are shown on left-hand side and payments on the right-hand side.	4.	Items appearing on the Receipts and Payments Account cross over sides as they enter into Income and Expenditure Account, that is, incomes on the right-hand side and expenses on the left-hand side.
5.	The balance of this account represents closing balances of cash and bank.	5.	The balance represents either surplus or deficit for the period.
6.	This is followed by an Income and Expenditure Account.	6.	This is followed by a Balance Sheet.

Distinction between the Income and Expenditure Account and the Profit and Loss Account

	Income and Expenditure Account		Profit and Loss Account
1.	It is a revenue account prepared at the end of the accounting period for finding out the surplus or deficit of that period.	1.	It is a revenue account prepared at the end of the accounting period for measuring net profit or net loss by matching revenues and expenses according to the accounting principles.
2.	The surplus or deficit of an accounting period arises as a result of saving the income from subscriptions, small and recurring donations, profit from trading activities and from the expenses and losses incurred to render the necessary services.	2.	The net profit of an accounting period is the difference between total revenue and total expenses. Total revenue is the aggregate of gross profit, other incomes, non-trading income and abnormal gains. Likewise, total expenses combine management expenses, maintenance expenses, selling and distribution expenses, financial expenses and abnormal losses.
3.	When the organisation undertakes trading activities, a separate trading account is prepared and this is used as a subsidiary statement alongwith income and expenditure account.	3.	After preparing trading account the balance of which is transferred to the profit and loss account which is the starting point of the preparation of the profit and loss account.
4.	The surplus of an accounting period cannot be withdrawn by the members, it is added with the general fund.	4.	The net profit may be withdrawn wholly or partly by the owners.

3. Balance Sheet

The Balance Sheet of a non-profit concern is prepared on the same principles as the Balance Sheet of a profit-seeking business. It may be prepared either in the order of liquidity or in the order of permanence.

Balance Sheet of ... as at ...

Liabilities		₹	Assets	₹
Capital Fund	***		Building	***
Add: Surplus	***	***	Furniture	***
Subscriptions Received in advance		***	Sports Equipment	***
Outstanding Wages		***	Cash at Bank	***
			Cash in Hand	***
		***		***

Terminology Used in Accounts of Non-Profit Organisations

1. Capital Fund

It is an item on the Balance Sheet of a non-profit organisation representing the net investment in the organisation of its contributing members. It is nothing but the capital of non-profit organisations. It represents the surplus of assets over liabilities of the organisation. It may be made up in part by special donation or by capitalising admission fees etc. This fund is increased (or decreased) by any surplus (or deficit) on the income and expenditure account. It is also called 'General Fund' or 'Accumulated Fund'.

2. Donation
It is the amount contributed by the supporters, members and well-wishers of the organisation in the form of cash or kind. The donation may be general or special (such as donation for building, prize etc.)

3. Legacy
It is an amount or other item of value received from a deceased person under the terms of a will. When anything is personally given away by a will, it is treated as a gift in the eye of law. The gift which is made by a will, out of general fund of an estate, it is described as 'legacy'. The amount received as legacy may be big or small. A legacy may be 'demonstrative' when it is made out of a particular fund or 'specific' when a particular portion of the estate is assigned. The legacy may be for a specific purpose or just general. If it is for a specific purpose, then it should be capitalised in the name of the 'fund' for that particular purpose. Otherwise, it is directly added to capital fund.

4. Subscriptions
It is the amount paid by the members at regular intervals to keep his membership alive. Subscriptions are the normal main source of revenue of non-profit organisations. At the beginning of the accounting period all subscriptions normally become due and almost all members pay it immediately, since the organisations usually have rules which provide for members to be deleted from the membership roll if they do not pay their subscriptions within a decided period.

5. Sectional Subscriptions
It is the special subscriptions collected from the members who participate in a particular activity because of the cost involved in providing these may vary considerably.

6. Life Membership
This is a system whereby a member pays a lumpsum and then becomes a member for the whole life.

7. Honorarium
A token payment made to a person who has voluntarily undertaken a service which would normally command a fee. It is thus an expression of gratitude rather than a payment for the work done.

Sources of Income of Non-profit Organisations
1. Membership subscriptions
2. Donations
3. Life membership fees
4. 'Profits' from bar sales
5. 'Profits' from the sale of food in the club, restaurant or cafeteria
6. 'Profits' from social events, such as dinner-dance
7. Interest received on investments

Treatment of Few Items used in the Accounts of Non-profit Organisations

1. Membership Subscriptions
Annual membership subscriptions of clubs and societies are payable at the time of renewal of the membership. It should be treated as income of the period concerned after being adjusted for outstanding and advance subscriptions. In practice,outstanding subscriptions are seldom taken into consideration. It may be taken as revenue, provided there is a strong expectation that defaulting members will pay in future. (In examinations, we generally take these into consideration).

Illustration 1(a)

(i)	Subscriptions received during the year 2014	₹ 7,000
(i)	Subscriptions outstanding at the beginning of 2014	₹ 1,400
(iii)	Subscriptions outstanding at the closing of 2014	₹ 1,600

Calculate the amount of subscriptions to be credited to Income and Expenditure Account of the year 2014.

Solution

Dr. **Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Outstanding Subscriptions A/c	1,400	?	By Cash A/c	7,000
31.12.2014	To Income and Expenditure A/c	7,200	31.12.2014	By Outstanding Subscriptions A/c	1,600
		8,600			8,600

Alternatively,

	₹
Subscriptions received during the year 2014	7,000
Less: Subscriptions outstanding at the beginning of 2014	1,400
	5,600
Add: Subscriptions outstanding at the closing of 2014	1,600
Amount to be credited to Income and Expenditure Account	7,200

Illustration 1(b)

Calculate the amount of subscriptions to be credited to Income and Expenditure Account of the year 2014. ₹

		₹
(i)	Subscriptions received during 2014	12,000
(ii)	Subscriptions received in advance for 2015	1,600
(iii)	Subscriptions outstanding at the beginning of 2014	2,000
(iv)	Subscriptions outstanding at the closing of 2014	700

Solution

Dr. **Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Outstanding Subscriptions A/c	2,000	?	By Cash A/c	12,000
31.12.2014	To Subscriptions received in advance for 2015	1,600	31.12.2014	By Outstanding subscriptions	700
31.12.2014	To Income and Expenditure A/c	9,100			
		12,700			12,700

Alternatively,

	₹
Subscriptions received during the year 2014	12,000
Less: Subscriptions outstanding at the beginning of 2014	2,000
	10,000
Less: Subscriptions received in advance for 2015	1,600
	8,400
Add: Subscriptions outstanding at the closing of 2014	700
Amount to be credited to Income and Expenditure Account	9,100

Illustration 1(c)

Mr Flier, the treasurer of Fly-High Club for the accounting year April 2014 to March 2015, submits the following data for membership fees.

(i) Cash/cheque received in the year totalled ₹ 1,00,000.

(ii) As on 1.4.2014, ₹ 2,000 was in arrears for 2013-14 (but cleared by 31-3-2015) and ₹ 800 was received by the previous year's treasurer for Mr Flier.

(iii) Mr Flier received ₹ 1,500 towards next year's fees, but failed to recover ₹ 1,700 from his current year's members.

Show the final subscriptions income of the year 2014-15.

Solution

Dr. **Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Outstanding Subscriptions A/c (2013-14)	2,000	1.4.2014	By Sub. Recd. in Adv. A/c for 2014-15	800
31.3.2015	To Sub. Recd. in Adv. A/c for 2015-16	1,500	?	By Cash A/c	1,00,000
31.3.2015	To Income and Expenditure A/c		31.3.2015	By Outstanding Subscriptions A/c	1,700
	— Subscriptions income for the year	99,000			
		1,02,500			1,02,500

Illustration 1(d)

Calculate the amount of subscriptions to be credited to Income and Expenditure Account for the year 2014. ₹

		₹
(i)	Subscriptions received during 2014	15,000
(ii)	Subscriptions outstanding at the end of 2013	2,000
(iii)	Subscriptions received in advance on 31st December 2013	1,000
(iv)	Subscriptions received in advance on 31st December 2014	3,000
(v)	Subscriptions outstanding on 31st December 2014	5,000

Solution

Dr. **Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Outstanding subscriptions A/c for 2013	2,000	1.1.2014	By Subscriptions received in advance for 2014	1,000
31.12.2014	To Subscriptions received in advance for 2015	3,000	?	By Cash A/c	15,000
31.12.2014	To Income and Expenditure A/c	16,000	31.12.2014	By Outstanding subscriptions A/c	5,000
		21,000			21,000

Alternatively,

	₹
Subscriptions received during the year 2014	15,000
Less: Subscriptions outstanding at the end of 2013	2,000
	13,000
Add: Subscriptions received in advance on 31.12.2013 for 2014	1,000
	14,000
Less: Subscriptions received in advance on 31.12.2014 for 2015	3,000
	11,000
Add: Subscriptions outstanding on 31.12.2014	5,000
Amount to be credited to Income and Expenditure Account	16,000

Illustration 1(e)

Prepare a statement showing subscriptions received in 2014-15 as per Receipts and Payments Account. ₹

		₹
(i)	Subscriptions Income for 2014-15 as per Income and Expenditure Account	82,000
(ii)	Advance subscriptions received in 2013-14	4,000
(iii)	Subscriptions outstanding at the end of 2014-15 including ₹ 1,000 for 2013-14	9,500
(iv)	Advance subscriptions received for 2015-16	2,000
(v)	Subscriptions written-off during 2014-15	500
(vi)	Subscriptions receivable on 1.4.2014	5,000
(vii)	Subscriptions collected for 2014-15 by the Secretary but not deposited	1,000

Solution

Statement Showing Subscriptions Received in 2014-15 as per Receipts and Payments Account

Subscriptions Income for 2014-15 as per Income and Expenditure Account			82,000
Less :	Advance subscriptions received in 2013-14	4,000	
	Outstanding subscriptions (2014-15) — ₹ (9,500 – 1,000)	8,500	12,500
			69,500
Add:	Outstanding subscriptions collected in 2014-15 (Note 1)	3,500	
	Subscriptions received in advance for 2015-16	2,000	5,500
			75,000
Less:	Subscriptions collected by the Secretary but not deposited		1,000
			74,000

Working Note : (1) Subscriptions receivable at 1.4.2014 ₹ 5,000. Out of this, ₹ 500 has been written off during 2014-15 and at the end of 2014-15 subscriptions outstanding for 2013-14 was ₹ 1,000. Therefore, subscriptions collected in 2014-15 in respect of previous year is ₹ 3,500 (₹ 5,000 – ₹ 500 – ₹ 1,000).

Alternatively

Dr. **Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Subscription Receivable on 1.4.2014	5,000	1.4.2014	By Subscription Received in Advance A/c	4,000
31.3.2015	To Income and Expenditure A/c	82,000		By Income and Expenditure A/c	
31.3.2015	To Subscriptions Received in Advance A/c			(Subscriptions Written-off)	500
	(2015-16)	2,000		By Secretary A/c	1,000
				By Cash / Bank A/c (Balancing figure)	74,000
			31.3.2015	By Subscriptions Receivable A/c	
				2013-14	1,000
				2014-15	8,500
		89,000			89,000

Illustration 1(f)

The following information was obtained from the Secretary of the Crazy Jay Club : ₹

	₹
Subscriptions received in 2014-15 as per Receipts and Payments Account	89,000
Advance subscriptions received in 2013-14	5,000
Subscriptions outstanding at the end of 2014-15 (including ₹ 1,500 for 2013-14)	12,500

Advance subscriptions received for 2015-16	3,000
Subscriptions written-off during 2014-15	600
Subscriptions receivable on 1.4.2014	8,400

Prepare (i) a Statement or Account showing the Subscriptions Income for the year ended 31.3.2015 and (ii) show how the relevant items will appear in the Income and Expenditure Account for the year and in the Balance Sheet as at the end of the year.

Solution

Dr. (i) Subscriptions Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Subscriptions Receivable	8,400	1.4.2014	By Subscriptions Received in Advance	5,000
31.3.2015	To Income and Expenditure A/c	95,700		By Bank A/c	89,000
31.3.2015	To Subscriptions Received in Advance	3,000		By Income and Expenditure A/c (Written-off subscriptions)	600
			31.3.2015	By Subscriptions Receivable :	
				2013-14	1,500
				2014-15	11,000
		1,07,100			1,07,100

(ii) In Income and Expenditure Account ₹ 95,700 will be shown as income and ₹ 600 will be shown as expense.
In the Balance Sheet, subscriptions receivable ₹ 12,500 (₹ 11,000 for 2014-15 and ₹ 1,500 for 2013-14) will be shown on the **assets side**.
Subscription received in advance for 2015-16 ₹ 3,000 will be shown on the **liabilities side**.

Illustration 1(g)

Anderson Club has 300 annual members. In the annual general meeting held on 31st December, 2013, it was decided to raise the subscriptions from the current ₹ 200 p.a. to ₹ 300 p.a. from the year 2014. The members who have paid in advance will be allowed subscriptions at the old rates.

Subscriptions received in advance on 31.12.2013 was ₹ 2,000 and subscriptions in arrear on 31.12.2013 was ₹ 3,000.

Subscriptions in arrear on 31.12.2013 were received during 2014 with the exception of those due from 5 members.

Subscriptions in arrear for the year 2014 are in respect of 15 members.

You are required to prepare Subscriptions Account for the year 2014 and calculate the amount of subscriptions received in cash during the year 2014.

Solution

Dr. Subscriptions Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Subscriptions in Arrear A/c (15 x ₹ 200)	3,000	1.1.2014	By Subscriptions Received in Advance A/c (10 x ₹ 200)	2,000
31.12.2014	To Income and Expenditure A/c (Note 1)	89,000	?	By Cash / Bank A/c (Balancing figure)	84,500
			31.12.2014	By Subscriptions in Arrear A/c	
				2013 (5 x ₹ 200)	1,000
				2014 (15 x ₹ 300)	4,500
		92,000			92,000

Working Note : (1) Calculation of Subscriptions for the year 2014

	₹	₹
Subscriptions received at new rate ₹ 300 from 290 members (300 – 10)	87,000	
Subscriptions received at old rate ₹ 200 from 10 members who paid in advance in 2013	2,000	89,000

2. Donation

(i) Donations received from persons, firms, companies in the form of money should be added directly to the capital fund if the amount is *large and non-recurring*.

(ii) *Small and recurring* donations collected or received should be credited to Income and Expenditure Account of the period concerned.

(iii) Donations received in the form of an asset should be credited to the particular fund, for which the amount has been donated and in the absence thereof, to the Capital Fund Account.

(iv) When specific direction has been given in the rules and regulations of the organisation, it should be treated accordingly.

3. Entrance or Admission Fee

(i) Admission fee payable by a member only once, at the time of becoming a member, should be treated as capital receipts and credited to Capital Fund Account.

(ii) Where the amount is small, just to cover the expenses of admission, it should be treated as revenue receipts and credited to Income and Expenditure Account.

(iii) When a specific direction has been given in the rules and regulations of the organisation, it should be treated accordingly.

4. Life Membership Fee

(i) Amount received from life membership should be *credited to a special fund* called ***Life Membership Fund*** and an amount equal to annual subscriptions or other agreed amount is transferred every year to the Income and Expenditure Account, the balance of this fund is carried forward till it is fully exhausted. If any life member dies before the entire amount paid by him has been transferred in the above way, the balance should be transferred to the Capital Fund on the date of his death.

(ii) Alternatively, the entire amount can be credited to the Capital Fund in the year in which it is received.

There is no universal practice and a constituent treatment of such items as either revenue or capital would be acceptable.

Illustration 2(a)

A club received the following life membership fees in each of its first two years : 2013 : ₹ 15,000; 2014 : ₹ 8,000.

The club's policy is to take credit for life membership fees in equal amounts over 10 years.

Show their Life Membership Fund Account for the years 2013 and 2014. State the income from life membership fees to be shown in the Income and Expenditure Account in both the years.

Solution

Dr. **Life Membership Fund Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013	To Income and Expenditure A/c	1,500	2013	By Bank A/c	15,000
	To Balance c/d	13,500			
		15,000			15,000
2014	To Income and Expenditure A/c (Note 1)	2,300	2014	By Balance b/d	13,500
	To Balance c/d	19,200		By Bank A/c	8,000
		21,500			21,500

Working Note : (1) The amount transferred to income and expenditure account in 2nd year is made up of :

10% of 1st year = 10% of ₹ 15,000	1,500
10% of 2nd year = 10% of ₹ 8,000	800
	2,300

Illustration 2(b)

From the following information show the Life Membership Fund Account

For many years, life membership of the Club cost ₹ 1,000 but with effect from 1.1.2014, the rate has been increased to ₹ 1,200. The life membership details on 31.12.2013 were as follows :

	Number of Members
Joined more than 19 years ago	32
Joined within the last 19 years	64
	96

The balance of Life Membership Fund as on 1st January, 2014 was ₹ 37,800.

The club's policy is to take credit for life membership fees in equal amount over 20 years, beginning with the year of enrollment. During 2014, 4 new members were enrolled and one member (who had joined in 2010) died.

Solution

In respect of 32 members, those who joined more than 19 years ago, life membership fees so received have already been exhausted. Therefore, nothing will be credited to Income and Expenditure Account.

Till 31.12.2013, life membership was ₹ 1,000. Therefore, ₹ 50 (₹ 1,000 / 20) per member is credited to Income and Expenditure Account every year.

In respect of deceased members who joined in 2010, ₹ 200 (4 years — 2010 to 2013) has already been credited to Income and Expenditure Account. The balance of ₹ 800 (₹ 1,000 – 200) is to be transferred to Capital Fund Account. The Life Membership Fund Account will be as follows :

Dr. **Life Membership Fund Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Capital Fund A/c (See Note above)	800	1.1.2014	By Balance b/d	37,800
31.12.2014	To Income and Expenditure A/c (Note 1)	3,390	?	By Cash / Bank A/c (4 x ₹ 1,200)	4,800
31.12.2014	To Balance c/d	38,410			
		42,600			42,600

Working Note :

(1) Amount to be transferred to Income and Expenditure Account in respect of Life Membership Fees

	₹	₹
(i) In respect of 63 (64 – 1) members those who joined within the last 19 years @ ₹ 50 each	3,150	
(ii) In respect of 4 new members @ ₹ 60 (₹ 1,200 / 20)	240	3,390

5. Legacy

Legacy received is directly added to Capital Fund after deducting any tax payable under the law for the time being in force.

6. Restaurant or Bar Trading

In order to calculate the restaurant or bar profit, a restaurant or bar trading account is prepared in the same way as we prepare trading accounts for trading organisations. The restaurant or bar profit is then transferred to the income and expenditure account. Likewise, a trading account can also be prepared for any subsidiary activity carried on by the organisation.

7. Other Club Activities

Other club activities can be netted off on the face of the Balance Sheet. For example, surplus from charity show can be added with the excess of income over expenditure in the Balance Sheet. Alternatively, charity show receipts should appear as an income and charity show payments as an expense in the income and expenditure account.

Fund Based and Non-Fund Based Accounting

Funds are cash or its equivalents. In accounting, the term ‘fund’ is used to include securities (money invested in income-bearing assets) which have a ready market and can be converted into cash. Funds also refer to assets for specific purposes, which are not generally available for normal business activities. In fact, a fund sets aside cash or other assets to achieve specific objectives. Non-profit organisations can be distinguished by the difference in the source of its financial resources. One type includes organisations whose financial resources are obtained from subscription dues, interest or dividends on investments, and from the sale of goods or services. Normally, such revenue is inadequate to cover the expenses of the organisations. The other type obtains a significant quantum of its resources when they solicit support and capital additions from various donors. **Support** consists primarily of contributions from individuals, other non-profit organisations, etc. to be used for current operations. ***Capital additions*** are non-expendable gifts, grants, etc. restricted by the owner or granted for a particular purpose, either for an unlimited or a limited period of time.

Accounting for capital additions is known as ***fund based accounting***, while accounting for resources from sources, other than capital additions, is known as ***non-fund based accounting***.

Under fund based accounting, in order to keep a record for the funds received or raised for a particular purpose, a capital fund account is opened. At the same time, to prevent the funds being used for other purposes, a separate fund investment account is opened to record the investments made out of those funds. The Balance Sheet shows funds on the liabilities side and funds investments on the assets side. At the end of the specified period, all investments are sold away. The proceeds are utilised for meeting that particular purpose for which the fund was created, and that fund is transferred to capital fund. It should be noted that fund based accounting has nothing to do with the preparation of income and expenditure account.

Under non-fund based accounting, all financial resources, other than capital additions, are treated as income for the current period and taken to the income and expenditure account.

Special Kinds of Funds

Non-profit organisations may also set up a fund for a special purpose. For example, a cricket club may wish to acquire an electronic score board and may set up a special fund for this purpose. It should be noted that any amount received through donation or fund raising activities for a particular purpose should be transferred directly to the fund rather than to the income and expenditure account. Similarly, all expenses relating to the special purpose should be charged to the fund rather than the income and expenditure account.

(1) Unrestricted Fund : An unrestricted fund includes all the assets of a non-profit organisation that are available for use as authorised by the managing committee, and are not restricted for specific purposes.

(2) Restricted Fund : A restricted fund is generally established by a non-profit organisation to account for assets available for current operations, but expendable only as authorised by the donor of the assets.

(3) Endowment Fund : 'Endow' means to provide permanent income for. An endowment fund is generally a non- expendable fund. A pure endowment fund is one for which the principal must be maintained indefinitely in income producing investments. Only the income can be expended.

A ***term endowment fund*** can be expended only after a specified period of time or the occurrence of an event specified by the donor. A ***quasi endowment fund*** is created by the non-profit organisation itself, rather than by an outside donor, for a specific purpose (as explained earlier).

(4) Annuity Fund : An annuity fund is established when a non-profit organisation receives assets from a donor with the stipulation that the organistaion pay specified amounts periodically to designated recipients, for a specified time period.

(5) Loan Fund : A loan fund may be established by any non-profit organisation to grant loans to the members. Loan funds, generally, are revolving, i.e., as old loans are repaid, new loans are made from receipts.

(6) Agency Fund : An agency fund is used to account for money held by a non-profit organisation as a custodian. The money is disbursed only as instructed by their owner. For example, for lending books, a club may ask for a deposit from members. The deposit is refunded to the member when he does not want to avail of this facility. An agency fund is shown as a ***liability*** than as a fund balance.

Types of Problems

1. Preparation of Income and Expenditure Account and Balance Sheet when Trial Balance and other information are given.
2. Preparation of Income and Expenditure Account and Balance Sheet when Receipts and Payments Account and other information are given.
3. Preparation of Income and Expenditure Account and Balance Sheet from incomplete records.
4. Preparation of Receipts and Payments Account, Income and Expenditure Account and Balance Sheet when ledger balances and other information are given.
5. Preparation of Receipts and Payments Account when Income and Expenditure Account, Balance Sheet and other information are given.
6. Preparation of opening and closing Balance Sheet when Receipts and Payments Account and Income and Expenditure Account are given.

1. Preparation of Income and Expenditure Account and Balance Sheet when Trial Balance and other Information are Given

The method of preparation of an Income and Expenditure Account is similar to that which is used in the preparation of a Profit and Loss Account. The following points are worth noting about the Income and Expenditure Account:

(i) All the incomes are shown on the right hand side of the account and all the expenses are shown on the left hand side of the account.

(ii) It should be carefully noted that the incomes and expenses shown are those which relate to the period for which such an account is prepared. The whole of income and expenditure for the year are taken into account, irrespective of the fact whether they have been actually received and paid respectively or not. If an income is accrued or if an expenditure is outstanding, it is to be adjusted properly in the account.

(iii) All capital income and expenditure are shown in the Balance Sheet.

(iv) If the total of the right hand side is greater than the total of the left-hand side, the balance is a surplus and is called 'Excess of Income over Expenditure'. If, on the other hand, the total of the left-hand side is greater than the total of the right-hand side, the balance is a deficit and is called 'Excess of Expenditure over Income'.

(v) The surplus is not distributed as profit among the members but it is added to the Accumulated/Capital Fund in the Balance Sheet. Similarly, the deficit is deducted from the Accumulated Fund.

Illustration 3

From the following Trial Balance of Calcutta Club prepare an Income and Expenditure Account for the year ended on 31st March, 2015 and a Balance Sheet as on that date (all figures in Rupees):

Particulars	Dr.	Cr.	Particulars	Dr.	Cr.
General Fund		30,000	Subscriptions received in advance		1,500
Cash in hand	2,000		Steward's and servant's wages	5,800	
Cash at Bank	3,000		Extension of Club house	10,000	
Sundry Debtors	2,400		Printing and stationery	1,000	
Sundry Creditors		1,500	Law charges	500	
Loan @ 15% (01.07.2014)		20,000	Annual subscriptions		30,000
Furniture and Fixture	10,000		Card and Billiard room receipts		4,000
Club house	40,000		Washing of liveries and sundries	1,600	
Stock of Cigar (01.04.2014)	500		Wines, Cards and Cigars sold		5,000
Rent	6,000		Repairs to Club house and furniture	400	
Rates, Taxes and Insurance	600		Conversion expenses	1,000	
Secretary's Honorarium	1,200		Wine Cards and Cigars purchased	4,000	
Entrance Fees	1,000		Interest on Loan	1,000	
			TOTAL	92,000	92,000

Additional Information : (i) Subscriptions for 2014-15 outstanding ₹ 2,000; (ii) Write-off depreciation @ 10% p.a. on furniture and 2% on Club house including the extention; and (iii) Stock of Cigars ₹ 400; Wine ₹ 600 on 31.03.2015.

Solution

Calcutta Club

Income and Expenditure Account for the year ended 31st March, 2015

Expenditure		₹	Income		₹
To Stock of Cigar		500	By Subscriptions	30,000	
To Wine, cards & cigars purchased		4,000	Add: Outstanding	2,000	32,000
To Rent		6,000	By Card & Billiard Room receipts		4,000
To Rates, Taxes & Insurance		600	By Wine, Cards & Cigars sold		5,000
To Secretary's Honorarium		1,200	By Closing Stock :		
To Entrance Fees		1,000	Cigars	400	
To Steward's and Servant's wages		5,800	Wine	600	1,000
To Printing and Stationery		1,000			
To Law charges		500			
To Washing of liveries & sundries		1,600			
To Repairs to Club house and furniture		400			
To Conversion expenses		1,000			
To Interest on Loan	1,000				
Add: Outstanding	1,250	2,250			
To Depreciation on :					
Furniture @ 10% p.a.		1,000			
Club house @ 2%		1,000			
To Excess of Income over Expenditure — Surplus		14,150			
		42,000			42,000

Balance Sheet of Calcutta Club as at 31st March, 2015

Liabilities		₹	Assets		₹
General Fund	30,000		Club house	40,000	
Add: Surplus	14,150	44,150	Add: Extension	10,000	
Sundry Creditors		1,500		50,000	
15% Loan		20,000	Less: Depreciation	1,000	49,000

Interest on Loan (outstanding)	1,250	Furniture & Fixture	10,000	
Subscriptions received in advance	1,500	Less: Depreciation	1,000	9,000
		Stock in hand :		
		Cigars	400	
		Wine	600	1,000
		Sundry Debtors		2,400
		Subscriptions due		2,000
		Cash at Bank		3,000
		Cash in hand		2,000
	68,400			68,400

2. Preparation of Income and Expenditure Account and Balance Sheet when Receipts and Payments Account and other Information are Given

The following steps are to be followed for preparing the Income and Expenditure Account and Balance Sheet from a given Receipts and Payments Account :

Step 1

Prepare Balance Sheet at the beginning of the period after taking into account (i) the opening balances of cash and bank as per Receipts and Payments Account, and (ii) Assets and Liabilities (supplied through additional information) at the beginning. The difference between the Assets and Liabilities represents Accumulated Fund. This Accumulated Fund is also called General Fund or Capital Fund.

Step 2

Identify, from the Payments side of the Receipts and Payments Account, the Capital Payments and Revenue Payments. Now,

(i) Post revenue payments in which no adjustments to be made directly, to the expenditure side (left hand side/debit side) of the Income and Expenditure Account.
(ii) Prepare statements or open ledger accounts in respect of revenue payments in which adjustment to be made. Post the adjusted amount to the expenditure side of the Income and Expenditure Account.
(iii) Post capital payments to appropriate assets or liabilities accounts for being incorporated in the Balance Sheet.

Step 3

Identify, from the Receipts side of the Receipts and Payments Account, the Capital Receipts and Revenue Receipts. Now,

(i) Post revenue receipts in which no adjustment is to be made, directly to the income side (right hand side/credit side) of the Income and Expenditure Account.
(ii) Prepare statement or open ledger accounts in respect of revenue receipts in which adjustment is to be made. Post the adjusted amount is to the income side of the Income and Expenditure Account.
(iii) Post capital receipts to appropriate assets and liabilities for being incorporated in the Balance Sheet.

Step 4

Analyse the additional information given and make necessary entries in the Income and Expenditure Account for depreciation on fixed assets, loss or profit on sale of assets etc.

(i) Depreciation ⟶ Post to the expenditure side of the Income and Expenditure Account.
(ii) Loss on sale of Assets ⟶ Post to the expenditure side of the Income and Expenditure Account.
(iii) Profit on sale of Assets ⟶ Post to the income side of the Income and Expenditure Account.

Step 5

Calculate surplus or deficit in the Income and Expenditure Account. (i) If the income side is greater than expenditure side, there is a 'surplus' and put it in the expenditure side as 'To Excess of Income over Expenditure'; (ii) If the expenditure side is greater than the Income side, there is a 'deficit' and put it on the

Income side as 'By Excess of Expenditure over Income'; (iii) Transfer the surplus or deficit of the Income and Expenditure Account to the Accumulated Fund Account; and (iv) Prepare Balance Sheet at the end of the period after taking into account opening balance, addition and/or, sale during the year and other adjustments like depreciation etc. in respect of the assets.

Illustration 4

Calcutta Golf Club prepared the following Receipts and Payments Account for the year ended 31.12.2014 :

Receipts	₹	Payments	₹
To Balance b/d	3,800	By Sports Equipments (purchased on 1.9.2014)	10,000
To Subscriptions :		By Tournament Expenses	4,000
2013	2,000	By Electricity	500
2014	18,500	By Printing	300
2015	900	By Salaries and Wages	3,400
To Entrance Fees (capital receipts)	800	By Expenses for Exhibition	2,100
To Interest on Investment	1,500	By Balance c/d	7,200
	27,500		27,500

Additional information : (i) Fixed assets of the club on 1.1.2014 include the following : Sports Equipment — ₹ 15,500; Club Ground—₹ 62,000; Furniture—₹ 2,000; (ii) Subscriptions for 2014 collected in 2013—₹ 500; (iii) Unpaid subscriptions for 2014—₹ 300; (iv) Depreciation to be provided @ 20% p.a. on sports equipment and @ 5% p.a. on furniture.

Prepare an Income and Expenditure Account for the year ended on 31.12.2014.

Solution

Calcutta Golf Club

Income and Expenditure Account for the year ended 31st December, 2014

Expenditure	₹	Income		₹
To Tournament Expenses	4,000	By Subscriptions	18,500	
To Electricity	500	Add: Received in 2013	500	
To Printing	300		19,000	
To Salaries and Wages	3,400	Add: Subscriptions in arrear	300	19,300
To Expenses for Exhibition	2,100	By Interest on Investment		1,500
To Depreciation on :				
Sports Equipments (Note 1)	3,767			
Furniture	100			
To Excess of Income over Expenditure	6,633			
	20,800			20,800

Working Note : (1) Depreciation on sports equipments — 20% on ₹ 15,500 for 1 year + 20% on ₹ 10,000 for 4 months = ₹ 3,100 + ₹ 667 = ₹ 3,767.

Illustration 6

A summary of receipts and payments of Medical Aid Society for the year ended 31.12.2014 is given below:

Receipts	₹	Payments	₹
To Balance (1.1.2014)	7,000	By Payment for medicines	30,000
To Subscriptions	50,000	By Honorarium to doctors	10,000
To Donations	14,500	By Salaries	27,500
To Interest on investments @ 7% p.a.	7,000	By Sundry expenses	500
To Charity show proceeds	10,000	By Equipment purchased	15,000
		By Charity show expenses	1,000
		By Balance (31.12.2014)	4,500
	88,500		88,500

Additional information (in Rupees):	1.1.2014	31.12.2014		1.1.2014	31.12.2014
Subscriptions due	500	1,000	Amount due to Medicine suppliers	8,000	12,000
Subscriptions received in advance	1,000	500	Value of equipments	21,000	30,000
Stock of medicines	10,000	15,000	Value of Buildings	40,000	38,000

You are required to prepare Income and Expenditure Account for the year ended 31st December, 2014 and the Balance Sheet as on that date.

Solution

Medical Aid Society
Income and Expenditure Account for the year ended 31st December, 2014

Expenditure	₹	Income	₹
To Medicines consumed (Note 4)	29,000	By Subscriptions (Note 2)	51,000
To Honorarium to Doctors	10,000	By Interest on investment	7,000
To Salaries	27,500	By Charity show proceeds	10,000
To Sundry Expenses	500	By Excess of Expenditure over Income	8,000
To Charity show expenses	1,000		
To Depreciation :			
On Equipment	6,000		
On Buildings	2,000		
	76,000		76,000

Balance Sheet of Medical Aid Society as at 31st December, 2014

Liabilities		₹	Assets		₹
Capital Fund :	1,69,500		Building	40,000	
Add: Donations	14,500		Less: Depreciation	2,000	38,000
	1,84,000		Equipments	21,000	
Less: Excess of Expenditure over Income	8,000	1,76,000	Add: Purchased	15,000	
Subscriptions received in advance for 2015		500		36,000	
Creditors for Medicines		12,000	Less: Depreciation (Note 7)	6,000	30,000
			Stock of medicines		15,000
			Investments		1,00,000
			Subscriptions outstanding for 2014		1,000
			Cash in hand		4,500
		1,88,500			1,88,500

Working Notes : **(1) Balance Sheet of Medical Aid Society as at 1st January 2014**

Liabilities	₹	Assets	₹
Capital Fund (balancing figure)	1,69,500	Building	40,000
Creditors for Medicines	8,000	Equipment	21,000
Subscriptions received in advance	1,000	Stock of medicines	10,000
		Subscriptions outstanding	500
		Investment (Note 5)	1,00,000
		Cash in hand	7,000
	1,78,500		1,78,500

Dr. **(2) Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Outstanding subscriptions for 2013	500	1.1.2014	By Subscriptions received in advance for 2014	1,000
31.12.2014	To Income and Expenditure A/c (balancing fig.)	51,000	?	By Cash	50,000
31.12.2014	To Subscriptions received in advance in 2014	500	31.12.2014	By Outstanding subscriptions for 2007	1,000
		52,000			52,000

Dr. **(3) Creditors for Medicines Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Cash A/c (payments)	30,000	1.1.2014	By Balance b/d	8,000
31.12.2014	To Balance c/d	12,000	31.12.2014	By Purchase of medicines (balancing figure)	34,000
		42,000			42,000

(4) Medicines Consumed = Opening stock ₹ 10,000 + Purchases ₹ 34,000 – Closing stock ₹ 15,000 = ₹ 29,000

(5) Interest on investment received ₹ 7,000 in 2014 indicates that there was investments at the beginning of 2014. The rate of interest is 7%. So, the value of investment = 100/7 x ₹ 7,000 = ₹ 1,00,000

(6) Donation has been transferred to capital fund.

Dr. **(7) Equipment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d	21,000	31.12.2014	By Income and Expenditure A/c	6,000
?	To Cash (purchase)	15,000	31.12.2014	By Balance c/d	30,000
		36,000			36,000

Illustration 6

The following summary of the Cash Book has been prepared by the Treasurer of a Club:

Receipts	₹	Payments	₹
Cash in hand and at bank on April 1, 2014	4,740	Wages — Outdoor staff	13,380
Members' subscriptions	29,720	Restaurant purchases	50,400
Entrance fees	3,200	Rent — 18 months to June 30, 2015	7,500
Restaurant receipts	56,800	Rates	2,200
Games competition receipts	13,640	Secretary's salary	3,120
Due to secretary for petty expenses	80	Lighting, cleaning and sanitary services	7,700
		Competition prizes	4,000
		Printing, postage and sundries	6,000
		Placed in fixed deposits with bank	8,000
		Balance in hand and at bank on March 31, 2015	5,880
	1,08,180		1,08,180

On April 2014, the Club's assets were: Furniture and Equipment ₹ 48,000; Restaurant Stocks ₹ 2,600; Stock of Prizes ₹ 800. ₹ 5,200 was owing for supplies to the Restaurant.

On March 31, 2015 the Restaurant Stocks were ₹ 3,000 and prizes in hand were ₹ 500 while the Club owed ₹ 5,600 for Restaurant Supplies.

It was also found that Members' Subscriptions unpaid at March 31, 2015, amounted to ₹ 1,000 and that the figure of ₹ 29,720 shown in the Cash Book included ₹ 700 in respect of the previous year and ₹ 400 paid in advance for the following year.

Prepare an account showing the profit or loss made on the Restaurant and a General Income ad Expenditure Account for the year ended 31st March, 2015 together with a Balance Sheet at that date, after writing 10 per cent off on the furniture and equipment.

Solution

Dr. **Restaurant Trading for the year ended 31st March, 2015** **Cr.**

Particulars	₹	Particulars	₹
To Opening stock	2,600	By Restaurant receipts	56,800
To Purchases (Note 2)	50,800	By Closing Stock	3,000
To Profit (transferred to Income and Expenditure A/c)	6,400		
	59,800		59,800

Income and Expenditure Account for the year ended 31st March, 2015

Expenditure	₹	Income	₹
To Wages—Outdoor staff	13,380	By Members' subscriptions (Note 3)	29,620
To Rent	5,000	By Games competition receipts	13,640
To Rates	2,200	By Restaurant profit	6,400
To Secretary's salary	3,120		
To Lighting, cleaning and sanitary services	7,700		
To Competition Prizes (Note 4)	4,300		
To Printing , postage and sundries	6,000		
To Depreciation on Furniture & Equipment—10%	4,800		
To Excess of Income over Expenditure	3,160		
	49,660		49,660

Balance Sheet as at 31st March, 2015

Liabilities		₹	Assets		₹
Capital Fund :			Furniture & Equipment	48,000	
Opening Balance	50,390		Less: 10% Depreciation	4,800	43,200
Add: Entrance Fees	3,200		Restaurant Stock		3,000
Add: Excess of Income over Expenditure	3,160	56,750	Prizes in hand		500
Subscriptions received in advance		400	Fixed deposit with bank		8,000
Creditor for restaurant supply		5,600	Cash in hand and at bank		5,880
Due to Secretary		80	Prepaid Rent (April to June 2015)		1,250
			Subscriptions outstanding		1,000
		62,830			62,830

Working Notes : **(1) Balance Sheet as at 1st April, 2014**

Liabilities	₹	Assets	₹
Capital Fund (balancing figure)	50,390	Furniture & Equipment	48,000
Outstanding rent (₹ 7,500 / 18) x 3	1,250	Stock of prizes	800
Creditor for restaurant supply	5,200	Restaurant Stock	2,600
		Cash in hand and at bank	4,740
		Subscriptions outstanding	700
	56,840		56,840

Dr. **(2) Creditors for Restaurant Supply Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Cash (payments)	50,400	1.4.2014	By Balance b/f	5,200
31.3.2015	To Balance c/d	5,600	31.3.2015	By Purchases (balancing figure)	50,800
		56,000			56,000

Dr. **(3) Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/f	700	?	By Cash	29,720
31.3.2015	To Income and Expenditure A/c	29,620	31.3.2015	By Subscriptions outstanding	1,000
31.3.2015	To Subscriptions received in advance	400			
		30,720			30,720

Dr. **(4) Prizes Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/f	800	31.3.2015	By Income and Expenditure A/c	4,300
?	To Cash (purchases)	4,000	31.3.2015	By Balance c/d	500
		4,800			4,800

Illustration 7

New Delhi Recreation Club consists of a Tennis section and a Badminton section. The Balance Sheet of the Club as on 1.1.2014 is as under :

Liabilities	₹	Assets	₹
Accumulated Fund	4,17,500	Club House	2,50,000
		Courts : Tennis (cost ₹ 1,00,000)	80,000
		Badminton (cost ₹ 50,000)	35,000
		Furniture	25,000
		Bank Deposit	10,000
		Cash and Bank	17,000
		Petty Cash	500
	4,17,500		4,17,500

The following is the Receipts and Payments Account for the year ended 31.12.2014 :

Receipts	₹	Payments	₹
To Balance b/d	17,000	By New Tennis Court	1,00,000
To Ten-year Tennis Memberships	60.000	By Annual Dinner — Expenses	10,500
To Subscriptions :		By Expenses on Tournament :	
General	25,000	Tennis	15,000
Sectional :		Badminton	4,000
Tennis	32,000	By Bank Deposits	3,000
Badminton	21,000	By General Expenses on :	
To Tournament Entry Fees :		Tennis	12,000
Tennis	20,000	Badminton	10,000
Badminton	5,000	By Rates of Club House	12,000
To Annual Dinner — Sale of Tickets	12,000	By Miscellaneous Expenses	14,000
		By Petty Cash	700
		By Balance c/d	10,800
	1,92,000		1,92,000

Additional information :

(1) In order to help pay for the new tennis court, ten-year tennis memberships were offered for sale at the beginning of 2014 at ₹ 2,000 each.

(2) It is the club's policy to write-off the cost of the tennis and badminton courts over a ten-year period.
(3) The petty cash balance on 31.12.2014 was ₹ 200. The petty cash float is used exclusively for postage.
(4) ₹ 10,000 received as donations during the year for the new coaching scholarship fund. This will be utilised for the provision of training facilities for promising young sportspersons. It is expected to make the first award during 2012. Though the amount has been invested in short-term securities, no entry has been made in the books.
(5) The balance of the Bank Deposit Account on 31.12.2014 was ₹ 14,200.
(6) Furniture is to be depreciated at 10%.

Prepare an Income and Expenditure Account for the year ended 31.12.2014 showing the net surplus or deficit arising separately from the tennis section and badminton section. Also prepare the Balance Sheet of the Club as on 31.12.2014.

Solution

New Delhi Recreation Club
Income and Expenditure Account for the year ended 31st December, 2014

Expenditure	Tennis ₹	Badminton ₹	Income	Tennis ₹	Badminton ₹
To Expenses on Tournament	15,000	4,000	By Ten-year Tennis Membership		
To Depreciation on Court :			(1/10th of ₹ 60,000)	6,000	—
Tennis [10% on ₹ (1,00,000 + 1,00,000)]	20,000	—	By Sectional Subscriptions	32,000	21,000
Badminton (10% on ₹ 50,000)	—	5,000	By Tournament Entry Fees	20,000	5,000
To General Expenses	12,000	10,000			
To Net Surplus c/d	11,000	7,000			
	58,000	26,000		58,000	26,000
To Depreciation on Furniture (10% on ₹ 25,000)		2,500	By Net Surplus b/d — ₹ (11,000 + 7,000)		18,000
To Postage — ₹ (500 + 700 – 200)		1,000	By General Subscriptions		25,000
To Rates of Club House		12,000	By Profit on Annual Dinner :		
To Miscennaleous Expenses		14,000	Sale of tickets	12,000	
To Excess of Income over Expenditure		16,200	Less: Expenses	10,500	1,500
			By Interest on Bank Deposit — ₹ (14,200 – 10,000 – 3,000)		1,200
		45,700			45,700

Balance Sheet of New Delhi Recreation Club as on 31st December, 2014

Liabilities	₹	Assets		₹
Accumulated Fund	4,17,500	Club House		2,50,000
Add: Excess of Income over Expenditure	16,200	Courts :		
	4,33,700	Tennis (₹ 80,000 + 1,00,000)	1,80,000	
Ten-year Tennis Membership (₹ 60,000 – 6,000)	54,000	Less: Depreciation	20,000	1,60,000
Coaching Scholarship Fund	10,000	Badminton	35,000	
		Less: Depreciation	5,000	30,000
		Furniture	25,000	
		Less: Depreciation	2,500	22,500
		Coaching Scholarship Fund Investments		10,000
		Bank Deposit :		
		Opening Balance	10,000	
		Add: Further Deposit	3,000	
		Accrued Interest	1,200	14,200
		Cash and Bank		10,800
		Petty Cash		200
	4,97,700			4,97,700

Illustration 8

From the following information, you are required to prepare an Income and Expenditure Account for the year ended 31.3.2015 and a Balance Sheet as on that date :

(i)

Dover Lane Music Society
Receipts and Payments Account for the year ended 31st March, 2015

Receipts	₹	Payments	₹
To Balance b/d	7,200	By Rent	30,000
To Members' Joining Fees	35,000	By Electricity	12,400
To Annual Subscriptions	35,500	By Salaries	21,300
To Training Fees	76,600	By Training Expenses	40,200
To Interest on Investments	600	By Purchase of Investments	15,600
		By Short-term Deposits	10,000

	₹		₹
		By Balance c/d	25,400
	1,54,900		1,54,900

(ii) On joining the society, members pay a non-returnable fee of ₹ 1,000 (before 1.4.2012, the fee had been ₹ 500). It had been found from experience that, on average, members remain in the society for five years. On this basis, one-fifth of each joining fee is credited to Income and Expenditure Account each year.

New members' statistics are :

During year ended 31st March	Number of new members (No.)	Joining fees in Suspense at 31.3.2014 (₹)
2011	20	2,000
2012	24	4,800
2013	32	19,200
2014	27	21,600
2015	35	Nil
		47,600

(iii) Annual subscriptions are due on 1st April each year. It is the society's policy to credit these to Income and Expenditure Account on an actual receipts basis, not on an accrual basis. However, if subscriptions are received in advance, the amounts are credited to Income and Expenditure Account for the year for which they are paid. Subscriptions received in advance included in the actual receipts for the year are as under :

2014-15 — ₹ 3,000; 2015-16 — ₹ 4,000.

(iv) The society has a permanent training room. Non-members can use the facilities on payment of a fee. In order to guarantee a particular facility, advance booking is allowed. Advance booking fees received before 31.3.2015 in respect of 2015-16 total ₹ 4,700. The corresponding amount paid up to 31.3.2014 in advance of 2014-15 was ₹ 3,250. Members can use the facilities free of charge.

(v) The club received interest on investments bought a number of years ago at a cost of ₹ 50,000 (current valuation ₹ 52,000). At the end of March, 2015, the club acquired further investments which cost ₹ 15,600 (current valuation ₹ 16,000) and at the same time, placed ₹ 10,000 in a short-term deposit account.

Solution

Dover Lane Music Society
Income and Expenditure Account for the year ended 31st March, 2015

Expenditure	₹	Income		₹
To Rent	30,000	By Members' Joining Fees (Note 2)		23,200
To Electricity	12,400	By Annual Subscriptions (Note 4)		34,500
To Salaries	21,300	By Training Fees (Note 5)	75,150	
To Excess of Income over Expenditure	29,550	Less: Training Expenses	40,200	34,950
		By Interest on Investments		600
	93,250			93,250

Balance Sheet of Dover Lane Music Society as on 31st March, 2015

Liabilities		₹	Assets	₹
Capital Fund :			Investments at cost (Current valuation ₹ 68,000)	65,600
Opening balance (Note 1)	3,350		Short-term Deposit	10,000
Add: Excess of Income over Expenditure	29,550	32,900	Cash and Bank	25,400
Joining Fees in Suspense (Note 3)		59,400		
Subscriptions in Advance		4,000		
Joining Fees in Advance		4,700		
		1,01,000		1,01,000

Working Notes : **(1) Balance Sheet as on 1st April, 2014**

Liabilities	₹	Assets	₹
Capital Fund (Balancing figure)	3,350	Investments	50,000
Joining Fees in Suspense	47,600	Cash and Bank	7,200
Subscriptions in Advance	3,000		
Training Fees in Advance	3,250		
	57,200		57,200

(2) Members' Joining Fees Credited to Income and Expenditure Account

Year ended	Amount Received (Number of New Members x Joining Fees)	Total ₹
31.3.2011	20 x ₹ 500	10,000
31.3.2012	24 x ₹ 500	12,000
31.3.2013	32 x ₹ 1,000	32,000
31.3.2014	27 x ₹ 1,000	27,000
31.3.2015	35 x ₹ 1,000	35,000
		1,16,000

1/5th of ₹ 1,16,000 is to be credited to Income and Expenditure Account, i.e., ₹ 1,16,000 / 5 = ₹ 23,200.

	₹
(3) Joining Fees in Suspense at 31.3.2015	₹
Joining fees in suspense at 31.3.2014	47,600
Add: Joining fees received during the year ended 31.3.2015	35,000
	82,600
Less: Joining fees credited to Income and Expenditure Account	23,200
	59,400
(4) Annual Subscriptions Credited to Income and Expenditure Account	₹
Annual subscriptions received	35,500
Add: Subscriptions received in advance before 1.4.2014	3,000
	38,500
Less: Subscriptions received in advance for 2015-16	4,000
	34,500
(5) Training Fees Credited to Income and Expenditure Account	₹
Training fees received	76,600
Add: Training fees received in advance before 1.4.2014	3,250
	79,850
Less: Training fees received in advance for 2015-16	4,700
	75,150

Illustration 9

The Receipts and Payments Account for the year ended 31.12.2014 of The Gardeners' Club is as follows :

Receipts		₹	Payments	₹
To Balance b/d		87,280	By Creditors of Seeds and Fertilisers	1,64,000
To Subscriptions :	Individuals	33,700	By Cost of Visit to Research Centre	24,700
	Groups	10,000	By Purchase of Garden Equipments	73,800
To Sale of Tickets to Visit Research Centre		23,200	By Repairs to Garden Equipments	10,200
To Debtors of Seeds and Fertilisers		1,30,000	By Annual Garden Show :	
To Annual Garden Show :			Hire of marquee	36,400
	Sale of tickets	82,900	Prizes	65,000
	Competition Fees	41,000	By Cost of Printing Pamphlets	3,500
To Annual Garden Party		20,100	By Annual Garden Party Expenses	15,000
To Sales of Pamphlets		4,000	By Balance c/d	39,580
		4,32,180		4,32,180

The assets and liabilities as on 1.1.2014 and 31.12.2014 are as follows (all figures in rupees) :

Date	Garden Equipments	Stock of Pamphlets	Seeds and Fertilisers		
			Debtors	Creditors	Stock
1.1.2014	24,200	2,500	22,200	80,400	26,100
31.12.2014	89,400	2,000	42,400	54,700	39,000

Additional information :

(1) Annual subscriptions are ₹ 100 for an individual member and ₹ 250 for a group. On 31.12.2014, 4 group members had paid in advance and 15 individual members were in arrear. There were no subscriptions in advance on 31.12.2013, but 10 individual members were in arrears.

(2) Cash received from annual garden party was banked after deducting payments of ₹ 1,800 general expenses and ₹ 290 postage.

(3) The employee who had handled sales of seeds and fertilisers, had disappeared taking with him monies he had received from the debtors of seeds and fertilisers. It was not known how much he had stolen, but seeds and fertilisers were sold at a profit of $33^1/_3$ on cost price.

(4) ₹ 1,500 is yet to be received for pamphlets sold.

You are required to prepare Income and Expenditure Account for the year ended 31.12.2014 and the Balance Sheet as on that date.

Solution

The Gardeners' Club
Income and Expenditure Account for the year ended 31st December, 2014

Expenditure	₹	Income		₹
To Loss on Visit to Research Centre (Note 4)	1,500	By Subscriptions (Note 1) :		
To Cash Stolen (Note 7)	17,000		Individuals	34,200
To Repairs to Garden Equipments	10,200		Groups	9,000
To General Expenses	1,800	By Profit on Pamphlets (Note 2)		1,500
To Postage	290	By Profit on Annual Garden Party (Note 3)		7,190

To Depreciation on Garden Equipments (₹ 24,200 + 73,800 – 89,400)	8,600	By Profit on Annual Garden Show (Note 5)	22,500
To Excess of Income over Expenditure	76,800	By Profit on Seeds and Fertilisers (Note 8)	41,800
	1,16,190		1,16,190

Balance Sheet of Gardeners' Club as on 31st December, 2014

Liabilities	₹	Assets	₹
Accumulated Fund	82,880	Garden Equipments	89,400
Add: Excess of Income over Expenditure	76,800	Stock : Pamphlets	2,000
	1,59,680	Seeds and Fertilisers	39,000
Creditors for Seeds and Fertilisers	54,700	Debtors : Pamphlets	1,500
Subscriptions in Advance (Groups)	1,000	Seeds and Fertilisers	42,400
		Subscriptions in Arrear (Individuals)	1,500
		Cash and Bank	39,580
	2,15,380		2,15,380

Working Notes :

Dr. (1) Subscriptions Account Cr.

Date	Particulars	Individuals ₹	Groups ₹	Date	Particulars	Individuals ₹	Groups ₹
2014 Jan. 1	To Subscriptions in Arrear (10 x ₹ 100)	1,000		2014 ?	By Bank	33,700	10,000
Dec. 31	To Income and Expenditure A/c (Balancing figure)	34,200	9,000	Dec. 31	By Subscriptions in Arrear (15 x ₹ 100)	1,500	—
Dec. 31	To Subscriptions in Advance	—	1,000				
		35,200	10,000			35,200	10,000

Dr. (2) Pamphlets Trading Account Cr.

Particulars	₹	Particulars		₹
To Opening Stock	2,500	By Sales :		
To Cost of Printing Pamphlets	3,500	Cash	4,000	
To Profit on Pamphlets	1,500	Credit	1,500	5,500
		By Closing Stock		2,000
	7,500			7,500

(3) Calculation of Profit / Loss on Annual Garden Party

			₹
Cash Deposited		20,100	
Add: Paid for — General expenses	1,800		
Postage	290	2,090	22,190
Less: Expenses			15,000
Profit on Annual Garden Party			7,190

(4) Calculation of Profit / Loss on Visit to Research Centre

	₹
Sale of tickets	23,200
Less: Cost	24,700
Loss on visit to Research Centre	1,500

(5) Calculation of Profit / Loss on Annual Garden Show

		₹
Receipts — Sale of tickets	82,900	
Competition fees	41,000	1,23,900
Less: Payments — Hire of marquee	36,400	
Prizes	65,000	1,01,400
Profit on Annual Garden Show		22,500

Dr. (6) Creditors for Seeds and Fertilisers Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
?	To Cash	1,64,000	Jan. 1	By Balance b/d	80,400
Dec. 31	To Balance c/d	54,700	Dec. 31	By Purchases (Balancing figure)	1,38,300
		2,18,700			2,18,700

Dr. (7) Debtors for Seeds and Fertilisers Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Jan. 1	To Balance b/d	22,200	?	By Bank	1,30,000
Dec. 31	To Sales (Note 8)	1,67,200	Dec. 31	By Cash Stolen (Balancing figure)	17,000
				By Balance c/d	42,400
		1,89,400			1,89,400

Dr. (8) Seeds and Fertilisers Trading Account Cr.

Particulars	₹	Particulars	₹
To Opening Stock	26,100	By Sales	1,67,200
To Purchases (Note 6)	1,38,300	By Closing Stock	39,000
To Profit on Seeds and Fertilisers	41,800		
	2,06,200		2,06,200

Cost of seeds and fertilisers sold = Opening stock + Purchases — Closing Stock = ₹ (26,100 + 1,38,300 – 39,000) = ₹ 1,25,400. Seeds and fertilisers are sold at a profit of $33^1/_3$ on cost. Therefore, profit = $33^1/_3$ on ₹ 1,25,400 = ₹ 41,800; and sales = ₹ (1,25,400 + 41,800) = ₹ 1,67,200.

Dr. (9) Balance Sheet as at 1st January, 2014 Cr.

Liabilities	₹	Assets	₹
Accumulated Fund (Balancing figure)	82,880	Garden Equipments	24,200
Creditors of Seeds and Fertilisers	80,400	Stock : Pamphlets	2,500
		Seeds and Fertilisers	26,100
		Debtors of Seeds and Fertilisers	22,200
		Cash and Bank	87,280
		Subscriptions in Arrear	1,000
	1,63,280		1,63,280

Illustration 10

The following is the Receipts and Payments Account of The Calcutta Football Club for the year ended 31.12.2014 :

Receipts	₹	Payments	₹
1.1.2014		31.12.2014	
Cash in hand	2,000	Remuneration to Club coach	5,000
Balance as per Bank Pass Book :		Groundmen's pay	2,500
Saving Account	19,300	Purchase of equipments	15,500
Current Account	6,000	Bar room expenses	2,000
31.12.2014		Ground rent	2,500
Bank interest	500	Club night expenses	3,800
Entrance fees	1,800	Printing and stationery	3,000
Donations and subscriptions	25,000	Repairs to equipment	5,000
Bar room receipts	4,000	Honorarium to Secretary for the year 2013	4,000
Contribution to Club night	1,000	Balance at Bank as per Pass Book :	
Sale of equipment	800	Savings Account	20,400
Net proceeds of Club night	7,800	Current Account	2,000
		Cash in hand	2,500
	68,200		68,200

You are given the following additional information (all figures in rupees) :

Particulars	1.1.2014	31.12.2014
(a) Subscriptions due from members	1,500	1,000
(b) Sums due for printing and stationery	1,000	800
(c) Unpresented cheques on Current Account being payments for repairs	3,000	2,500
(d) Interest on Savings Bank Account, not entered in Pass Book	—	200
(e) Estimated value of equipments	8,000	17,500
(f) For the year ended 31.12.2014, the honorarium to Secretary are to be increased by a total of ₹ 2,000 and the Groundman is to receive a bonus of ₹ 2,000.		

You are required to prepare :

(a) An Income and Expenditure Account for the year ended 31.12.2014; and (b) A Balance Sheet as on that date.

Solution

Calcutta Football Club

Income and Expenditure Account for the year ended 31st December, 2014

Expenditure	₹	Income		₹
To Remuneration to Club Coach	5,000	By Donations and Subscriptions (Note 4)		24,500
To Groundmen's pay	2,500	By Profit from bar room :		
To Groundmen's bonus	2,000	Bar room receipts	4,000	
To Ground rent	2,500	Less: Bar room expenses	2,000	2,000
To Printing and Stationery (Note 1)	2,800	By Profit from Club night :		
To Repairs to Equipments (Note 2)	4,500	Contribution to club night	1,000	
To Honorarium to Secretary : ₹ (4,000 + 2,000)	6,000	Net proceeds of Club night	7,800	
To Depreciation on Equipments (Note 3)	5,200		8,800	
To Excess of Income over Expenditure	1,700	Less : Club night expenses	3,800	5,000
		By Bank interest	500	
		Add: Accrued interest	200	700
	32,200			32,200

Balance Sheet of Calcutta Football Club as on 31st December, 2014

Liabilities		₹	Assets		₹
Capital Fund :			Equipments (Note 3)		17,500
Opening balance (Note 5)	28,800		Subscriptions Due		1,000
Add: Surplus	1,700		Bank : Saving Account	20,400	
Add: Entrance fees	1,800	32,300	Add: Accrued interest	200	20,600
Outstanding Expenses :			Cash		2,500
Groundman's bonus		2,000			
Printing and Stationery		800			
Honorarium to Secretary		6,000			
Bank Overdraft (Note 6)		500			
		41,600			41,600

Working Notes :

Dr. (1) Printing and Stationery Account Cr.

To Bank	3,000	By Outstanding Printing	1,000
To Outstanding Printing	800	By Income and Expenditure (Balancing figure)	2,800
	3,800		3,800

(2) Repairs to Equipment = ₹ 5,000 – ₹ 3,000 + ₹ 2,500 = ₹ 4,500

Dr. (3) Equipments Account Cr.

To Balance b/d	8,000	By Bank - sale	800
To Bank - purchase	15,500	By Depreciation (Balancing figure)	5,200
		By Balance c/d	17,500
	23,500		23,500

Dr. (4) Donations and Subscriptions Account Cr.

To Subscriptions due	1,500	By Receipts and Payments	25,000
To Income and Expenditure (Balancing figure)	24,500	By Subscriptions due	1,000
	26,000		26,000

(5) Balance Sheet of Calcutta Football Club as on 1st January, 2014

Liabilities	₹	Assets		₹
Outstanding Expenses :		Equipments		8,000
Printing and Stationery	1,000	Subscriptions Due		1,500
Honorarium to Secretary	4,000	Bank : Saving Account	19,300	
Capital Fund (Balancing figure)	28,800	Current Account (Note 6)	3,000	22,300
		Cash in hand		2,000
	33,800			33,800

(6) Bank Balance of Current Account as per Cash Book (figures in rupees)

Particulars	1.1.2014	31.12.2014
Balance as per Pass Book	6,000	2,000
Less : Cheque issued but not presented	3,000	2,500
Balance as per Cash Book *	3,000	(O/D) (500)

* **Tutorial Note :** When Balance Sheet is prepared, balance as per Cash Book is taken into consideration in place of balance as per Pass Book.

Illustration 11

The following is the Receipts and Payments Account of Sydney Club for the year ended 31st March, 2015 :

Receipts	₹	Payments	₹
Opening Balance :		Salaries	1,20,000
Cash	10,000	Creditors	15,20,000
Bank	3,850	Printing and Stationery	70,000
Subscriptions Received	2,02,750	Postage	40,000
Entrance Donation	1,00,000	Telephones and Telex	52,000
Interest Received	58,000	Repairs and Maintenance	48,000
Sale of Assets	8,000	Glass and Table Linen	12,000
Miscellaneous Income	9,000	Crockery and Cutlery	14,000
Receipts at :		Garden Upkeep	8,000
Coffee Room	10,70,000	Membership Fees	4,000
Wines and Spirits	5,10,000	Insurance	5,000

Swimming Pool	80,000	Electricity	28,000
Tennis Court	1,02,000	Closing Balance :	
		Cash	8,000
		Bank	2,24,600
	21,53,600		21,53,600

The Assets and Liabilities as on 01.04.2014 were as follows :

Particulars	₹	Particulars	₹
Fixed Assets (net)	5,00,000	Sundry Creditors	1,12,000
Stock	3,80,000	Subscriptions Received in Advance	15,000
Investment in 12% Government Securities	5,00,000	Entrance Donation Received pending Membership	1,00,000
Outstanding Subscriptions	12,000	Gratuity Fund	1,50,000
Prepaid Insurance	1,000		

The following adjustments are to be made while drawing up the Accounts :

(i) Subscriptions received in advance as on 31st March, 2015 was ₹ 18,000.

(ii) Outstanding subscriptions as on 31st March, 2015 was ₹ 7,000.

(iii) Outstanding expenses are salaries ₹ 8,000 and electricity ₹ 15,000.

(iv) Fifty per cent of the Entrance Donation was to be capitalised. There was no pending membership as on 31st March, 2015.

(v) The cost of assets sold net as on 01.04.2014 was ₹ 10,000.

(vi) Depreciation is to be provided at the rate of 10% on assets.

(vii) A sum of ₹ 20,000 received in October 2014 as Entrance Donation from an applicant was to be refunded as he has not fulfilled the requisite membership qualifications. The refund was made on 03.06.2015.

(viii) Purchases made during the year amounted to ₹ 15,00,000.

(ix) The value of closing stock was ₹ 2,10,000.

(x) The club as a matter of policy charges-off to Income and Expenditure Account all purchases made on account of crockery, cutlery, glass and linen in the year of purchase.

You are required to prepare an Income and Expenditure Account for the year ended 31st March, 2015 and the Balance Sheet as on 31st March, 2015 alongwith necessary workings. ***[C.A. (Foundation) — Adapted]***

Solution

Sydney Club

Income and Expenditure Account for the year ended 31st March, 2015

Expenditure	₹	Income	₹
To Salaries (₹ 1,20,000 + 8,000)	1,28,000	By Subscriptions (Note 3)	1,94,750
To Printing and Stationery	70,000	By Entrance Donation (Note 6)	90,000
To Postage	40,000	By Interest (12% on ₹ 5,00,000)	60,000
To Telephone and Telex	52,000	By Miscellaneous Income	9,000
To Repairs and Maintenance	48,000	By Profit from Operations (Note 5)	92,000
To Glass and Table Linen	12,000	By Excess of Expenditure over Income	30,250
To Crockery and Cutlery	14,000		
To Garden Upkeep	8,000		
To Membership Fees	4,000		
To Insurance (₹ 1,000 + ₹ 5,000)	6,000		
To Electricity Charges (₹ 28,000 + ₹ 15,000)	43,000		
To Loss on sale of assets (Note 2)	2,000		
To Depreciation on Fixed Assets (Note 2)	49,000		
	4,76,000		4,76,000

Balance Sheet of Sydney Club as on 31st March, 2015

Liabilities		₹	Assets	₹
Capital Fund :			Fixed Assets	4,41,000
Opening balance (Note 1)	10,29,850		Stock	2,10,000
Add: Entrance donation capitalised	90,000		Investment in 12% Government Securities	5,00,000
	11,19,850		Accrued Interest (₹ 60,000 – ₹ 58,000)	2,000
Less: Excess of expenditure over income	30,250	10,89,600	Outstanding Subscriptions :	7,000
Gratuity Fund		1,50,000	Bank	2,24,600
Sundry Creditors (Note 4)		92,000	Cash	8,000
Subscriptions received in advance		18,000		
Entrance donation refundable (Note 6)		20,000		
Outstanding expenses :				
Salaries	8,000			
Electricity	15,000	23,000		
		13,92,600		13,92,600

Working Notes : **(1) Balance Sheet as on 1st April, 2014**

Liabilities	₹	Assets	₹
Sundry Creditors	1,12,000	Fixed Assets (Note 2)	5,00,000
Subscriptions received in advance	15,000	Stock	3,80,000
Entrance donation received in advance	1,00,000	Investment in 12% Government Securities	5,00,000
Gratuity Fund	1,50,000	Outstanding Subscriptions	12,000
Capital Fund (Balancing figure)	10,29,850	Prepaid Insurance	1,000
		Cash	10,000
		Bank	3,850
	14,06,850		14,06,850

Dr. **(2) Fixed Assets Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	5,00,000	By Bank A/c (sold)	8,000
		By Loss on Sale of Assets (₹ 10,000 – ₹ 8,000)	2,000
		By Depreciation A/c (10% on ₹ 5,00,000 – ₹ 10,000)	49,000
		By Balance c/d	4,41,000
	5,00,000		5,00,000

Dr. **(3) Subscriptions Account** **Cr.**

Particulars	₹	Particulars	₹
To Outstanding Subscriptions A/c (1.4.2014)	12,000	By Subscriptions Received in Advance A/c (1.4.2014)	15,000
To Income and Expenditure A/c (Balancing figure)	1,94,750	By Bank A/c (Subscriptions received)	2,02,750
To Subscriptions Received in Advance A/c (31.3.2015)	18,000	By Outstanding Subscriptions A/c (31.3.2015)	7,000
	2,24,750		2,24,750

Dr. **(4) Creditors Account** **Cr.**

Particulars	₹	Particulars	₹
To Bank A/c	15,20,000	By Balance b/d	1,12,000
To Balance c/d	92,000	By Credit Purchases A/c	15,00,000
	16,12,000		16,12,000

Dr. **(5) Profit and Loss Account on Operations** **Cr.**

Particulars	₹	Particulars	₹
To Opening Stock	3,80,000	By Receipts from Operations :	
To Purchases A/c	15,00,000	Coffee Room	10,70,000
To Profit from Operations	92,000	Wines and Spirits	5,10,000
		Swimming Pool	80,000
		Tennis Court	1,02,000
		By Closing Stock	2,10,000
	19,72,000		19,72,000

Dr. **(6) Entrance Donation Account** **Cr.**

Particulars	₹	Particulars	₹
To Entrance Donation Refundable	20,000	By Balance b/d	1,00,000
To Income and Expenditure A/c [50% capitalised — i.e., 50% of ₹ 1,80,000 (₹ 2,00,000 – ₹ 20,000)]	90,000	By Bank A/c	1,00,000
To Capital Fund	90,000		
	2,00,000		2,00,000

Illustration 12

The accountant of City Club gave the following information about the receipts and payments of the club for the year ended 31st March, 2015 :

Receipts	₹	Payments	₹
Subscriptions	62,130	Premises	30,000
Fair Receipts	7,200	Rent	2,400
Variety Show Receipts (net)	12,810	Rates and Taxes	3,780
Interest	690	Printing and Stationery	1,410
Bar Collections	22,350	Sundry Expenses	5,350
		Wages	2,520
		Fair Expenses	7,170
		Honorarium to Secretary	11,000
		Bar Purchases (payments)	17,310
		Repairs	960
		New Car (less proceeds of old car ₹ 9,000)	37,800

The following additional information could be obtained (all in rupees):

Particulars	1.4.2014	31.3.2015	Particulars	1.4.2014	31.3.2015
Cash in hand	450	—	Accumulated Depreciation on Premises	56,400	?
Bank balance as per Cash Book	24,420	10,350	Car at cost	36,570	46,800
Cheque issued for Sundry Expenses not presented to the bank (entry has been duly made in the Cash Book)	270	90	Accumulated Depreciation on car	30,870	?
			Bar Stock	2,130	2,610
			Creditors for Bar Purchases	1,770	1,290
Subscriptions Due	3,600	2,940			
Premises — at cost	87,000	1,17,000			

Annual honorarium to Secretary is ₹ 12,000. Depreciation on premises is to be provided at 5% p.a. on written-down value. Depreciation on new car is to be provided at 20%.

You are required to prepare the Receipts and Payments Account and Income and Expenditures Account for the year ended 31.3.2015.

Solution

City Club

Receipts and Payments Account for the year ended 31st March, 2015

Receipts	₹	Payments	₹
To Balance b/d :		By Premises	30,000
Cash in hand	450	By Rent	2,400
Bank balance	24,420	By Rates and Taxes	3,780
To Subscriptions	62,130	By Printing and Stationery	1,410
To Fair Receipts	7,200	By Sundry Expenses	5,350
To Variety Show Receipts (net)	12,810	By Wages	2,520
To Interest	690	By Fair Expenses	7,170
To Bar Collections	22,350	By Honorarium to Secretary	11,000
To Sale proceeds of old car	9,000	By Bar Purchases (payments)	17,310
		By Repairs	960
		By New Car — ₹ (37,800 + 9,000)	46,800
		By Balance c/d :	
		Cash in hand	—
		Bank balance	10,350
	1,39,050		1,39,050

Income and Expenditure Account of City Club for the year ended 31st March, 2015

Expenditure	₹	Income	₹
To Rent	2,400	By Subscriptions (Note 1)	61,470
To Rates and Taxes	3,780	By Fair Receipts	7,200
To Printing and Stationery	1,410	By Variety Show Receipts (Net)	12,810
To Wages	2,520	By Interest	690
To Fair Expenses	7,170	By Profit on Bar (Note 3)	6,000
To Honorarium to Secretary — ₹ (11,000 + 1,000)	12,000	By Profit on sale of Car (Note 4)	3,300
To Sundry Expenses	5,350		
To Repairs	960		
To Depreciation :			
On Premises @ 5% on ₹ (1,17,000 – 56,400)	3,030		
On Car @ 20% on ₹ 46,800	9,360		
To Excess of Income over Expenditure	43,490		
	91,470		91,470

Working Notes :

Dr. (1) Subscriptions Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	3,600	By Bank A/c	62,130
To Income and Expenditure A/c (Balancing figure)	61,470	By Balance c/d	2,940
	65,070		65,070

Dr. (2) Creditors for Bar Purchases Account Cr.

Particulars	₹	Particulars	₹
To Bank A/c	17,310	By Balance b/d	1,770
To Balance c/d	1,290	By Bar Purchases (Balancing figure)	16,830
	18,600		18,600

Dr. **(3) Bar Profit and Loss Account** **Cr.**

Particulars	₹	Particulars	₹
To Opening Stock	2,130	By Bank A/c (Bar collection)	22,350
To Purchases (Note 2)	16,830	By Closing Stock	2,610
To Profit on Bar	6,000		
	24,960		24,960

Dr. **(4) Car Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	36,570	By Bank (Sale proceeds of old car)	9,000
To Bank A/c (new car)	46,800	By Accumulated Depreciation	30,870
To Profit on Sale of Car (Balancing figure)	3,300	By Balance c/d	46,800
	86,670		86,670

Illustration 13

The following information is supplied to you by the Treasurer of The Delhi Boys Club. From these details, prepare the Income and Expenditure Account for the year ended 31.12.2014, and the Balance Sheet as on that date :

(a) The club was founded five years before when a loan of ₹ 2,00,000 was obtained, free of interest, from a local authority. A club house was erected at the cost of ₹ 1,75,000 and paid for out of the Loan Account. ₹ 80,000 has now been repaid on account of the loan.

(b) Subscriptions received during 2014 totalling ₹ 56,950, made up of the following —

for 2013 ₹ 2,750; for 2014 ₹ 53,000; for 2016 ₹ 1,200.

In 2013, some subscriptions for 2015 were received in advance, amounting to ₹ 2,350. When the annual accounts for 2013 were prepared, it was estimated that 2013 subscriptions arrears amounting to ₹ 4,400 would be collected in 2014.

On 31.12.2014, it was considered that 2014 subscriptions arrears of ₹ 3,800 would be received in 2015, but the subscriptions still in arrears for 2013 should be written-off.

(c) As an alternative to paying annual subscriptions, members can at any time opt to pay a lump sum which gives them membership for life without further payment. Amounts so received are held in suspense in a Life Membership Fund Account and then credited to Income and Expenditure Account in equal instalments over 10 years; the first such transfer takes place in the year in which the lump sum is received. On 31.12.2013, the credit balance on the Life Membership Fund Account was ₹ 47,200, of which ₹ 8,500 is to be taken as income for the year ended 31.12.2014. During 2014, amount received in respect of life membership amounted to ₹ 27,000.

(d) The net profit on bar during the year was ₹ 10,500 after charging 1/2 of salaries. Purchases and sales of bar during the year amounted to ₹ 15,000 and ₹ 30,000 respectively. The stock of bar on 31.12.2014 was ₹ 8,000.

(e) During the year ended, among others, the club paid for the following —

Loan repayment ₹ 20,000; Salaries ₹ 15,000; Electricity ₹ 5,500; Cleaning ₹ 2,600;

Sundry expenses ₹ 8,200.

(f) The other assets and liabilities as on 1.1.2014 and 31.12.2014 were as follows (all figures in rupees) —

Date	Cash and Bank	Equipments	Vehicles	Furniture
1.1.2014	25,150	15,000	80,000	40,000
31.12.2014	?	12,000	65,000	36,000

Solution

The Delhi Boys' Club

Income and Expenditure Account for the year ended 31st December, 2014

Expenditure	₹	Income	₹
To Salaries (1/2 of ₹ 15,000)	7,500	By Subscriptions (Note 1)	56,800
To Electricity	5,500	By Life Membership Fund (Note 2)	11,200
To Cleaning	2,600	By Net Profit on Bar	10,500
To Sundry Expenses	8,200		
To Bad Debts (Note 1)	1,650		
To Depreciation on :			
Equipments (₹ 15,000 – 12,000)	3,000		
Vehicles (₹ 80,000 – 65,000)	15,000		
Furniture (₹ 40,000 – 36,000)	4,000		
To Excess of Income over Expenditure	31,050		
	78,500		78,500

Balance Sheet of Delhi Boys' Club as on 31st December, 2014

Liabilities	₹	Assets	₹
Capital Fund	1,55,000	Building	1,75,000
Add: Excess of Income over Expenditure	31,050	Equipments	12,000
	1,86,050	Vehicles	65,000
Life Membership Fund (Note 2)	63,000	Furniture	36,000
Loan from Local Authority (₹ 2,00,000 – 80,000)	1,20,000	Bar Stock	8,000
Subscriptions in Advance (Note 1)	3,550	Cash and Bank (Note 5)	72,800
		Subscriptions in Arrear	3,800
	3,72,600		3,72,600

Working Notes :

Dr. **(1) Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Jan. 1	To Subscriptions in Arrear	4,400	Jan. 1	By Subscriptions Received in Advance A/c	2,350
Dec. 31	To Income and Expenditure A/c (Balancing figure)	56,800	?	By Cash and Bank A/c	56,950
"	To Subscriptions Received in Advance A/c [See Note below (ii)]	3,550	Dec. 31	By Bad Debts (See Note below (i)]	1,650
			"	By Subscriptions in Arrear	3,800
		64,750			64,750

(i) Subscriptions in arrear for 2013 was ₹ 4,400, out of which only ₹ 2,750 was collected in 2014. The balance of ₹ 1,650 (₹ 4,400 – 2,750) is to be written-off as bad debts.

(ii) ₹ 2,350 was received in 2013 for 2015 and ₹ 1,200 was received in 2014 for 2016. Therefore, total amount to be carried forward to next year = ₹ (2,350 + 1,200) = ₹ 3,550.

Dr. **(2) Life Membership Fund Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Dec. 31	To Income and Expenditure A/c (₹ 8,500 + 10% of ₹ 27,000)	11,200	Jan. 1	By Balance b/d	47,200
"	To Balance c/d	63,000	?	By Cash and Bank A/c	27,000
		74,200			74,200

Dr. **(3) Bar Trading and Profit and Loss Account** **Cr.**

Particulars	₹	Particulars	₹
To Opening Stock (Balancing figure)	5,000	By Sales	30,000
To Purchases	15,000	By Closing Stock	8,000
To Gross Profit c/d	18,000		
	38,000		38,000
To Salaries (1/2 of ₹ 15,000)	7,500	By Gross Profit b/d (Balancing figure)	18,000
To Net Profit on Bar	10,500		
	18,000		18,000

Dr. **(4) Balance Sheet as at 1st January, 2014** **Cr.**

Liabilities	₹	Assets	₹
Capital Fund (Balancing figure)	1,55,000	Building	1,75,000
Life Membership Fund	47,200	Equipments	15,000
Loan from Local Authority (See Note below)	1,40,000	Vehicles	80,000
Subscriptions in Advance	2,350	Furniture	40,000
		Bar Stock (Note 3)	5,000
		Cash and Bank	25,150
		Subscriptions in Arrear	4,400
	3,44,550		3,44,550

Total loan upto 31.12.2014 was ₹ 80,000. During 2014, ₹ 20,000 was paid. Therefore, upto 31.12.2013 only ₹ 60,000 (₹ 80,000 – 20,000) was paid. Loan outstanding on 1.1.2014 was ₹ (2,00,000 – 60,000) = ₹ 1,40,000.

Dr. **(4) Receipts and Payments Account for the year ended 31st December, 2014** **Cr.**

Particulars	₹	Particulars	₹
To Opening Cash and Bank	25,150	By Bar Purchases	15,000
To Subscriptions	56,950	By Loan Repayment	20,000
To Life Membership Fund	27,000	By Salaries	15,000
To Bar Sales	30,000	By Electricity	5,500

		By Cleaning	2,600
		By Sundry Expenses	8,200
		By Closing Cash and Bank	72,800
	1,39,100		1,39,100

Illustration 14

The following is the Receipts and Payments Account of Barisha Recreation Club for the year ended 31.12.2014 :

Receipts	₹	Payments	₹
To Cash in Hand	500	By Rent of Club House	1,300
To Cash at Bank	6,000	By Painting of Club House	700
To Members' Subscriptions :		By Wages of Ground Maintenance	1,500
Ordinary for 2013	100	By General Expenses	1,300
Ordinary for 2014	1,800	By Electricity Charges	1,800
Ordinary for 2015	200	By Investment	10,000
To Life Membership Subscriptions	2,000	By Secretary's Honorarium	600
To Sale of Tickets for Annual Exhibition	10,000	By Annual Meeting Expenses	400
To Sale of Refreshments	12,000	By Sports Equipments	1,800
To Interest on Investments	1,300	By Purchase of Refreshments	5,500
To Sale of Furniture (original cost on 1.1.2013 was ₹ 500)	100	By Printing and Stationery	500
		By Insurance	300
		By Cash in Hand	2,000
		By Cash at Bank	6,300
	34,000		34,000

The following information are also available :

(a) On 31.12.2013, outstanding subscriptions for 2013 was ₹ 150.

(b) On 31.12.2013, advance subscriptions for 2014 received was ₹ 50.

(c) On 31.12.2014, outstanding subscriptions for 2014 was ₹ 300.

(d) A life membership scheme was introduced in 2013. Under the scheme, life membership subscription is ₹ 500 and it was to be apportioned to income 1/10th every year over a period of 10 years. Life membership subscriptions totalling ₹ 2,500 were collected during 2013.

(e) On 1.1.2014, Investment was ₹ 20,000 and interest accrued on investment on 31.12.2014 was ₹ 1,200.

(f) On 1.1.2013, Furniture costing ₹ 8,000 were purchased and it was decided to write off depreciation on furniture and sports equipments @ 10% p.a. on cost.

(g) In 2013, a plot of land was purchased for ₹ 20,000 to construct club house.

(h) Other assets and liabilities of the club were : (all figures in rupees)

	Stock of refreshment	Insurance prepaid	Rent accrued	Creditors for refreshment
31.12.2013	1,900	70	200	400
31.12.2014	2,100	50	100	500

You are required to prepare an Income and Expenditure Account for the year ended 31.12.2014 and also a Balance Sheet as on that date.

Solution

Barisha Recreation Club

Income and Expenditure Account for the year ended 31st December, 2014

Expenditure	₹	Income		₹
To Rent of Club House (Note 1)	1,200	By Subscriptions : ordinary (Note 6)		2,150
To Painting of Club House	700	life (Note 7)		450
To Wages of Ground Maintenance	1,500	By Sale of Tickets for Annual Exhibition		10,000
To General Expenses	1,300	By Sale of Refreshment		12,000
To Electricity Charges	1,800	By Interest on Investment	1,300	
To Secretary's Honorarium	600	Add : Accrued Interest	1,200	2,500
To Annual Meeting Expenses	400			
To Printing and Stationery	500			
To Insurance Premium (Note 2)	320			
To Loss on Sale of Furniture (Note 3)	350			
To Refreshments Consumed (Note 5)	5,400			
To Depreciation on :				
Furniture	750			
Sports Equipments	180			
To Excess of Income over Expenditure	12,100			
	27,100			27,100

Balance Sheet of Barisha Recreation Club as at 31st December, 2014

Liabilities		₹	Assets		₹
Capital fund :			Land		20,000
Opening balance (Note 8)	52,920		Furniture : ₹ (8,000 – 800)	7,200	
Add: Surplus	12,100	65,020	Less: W.D.V. of furniture sold :₹ (500 – 50)	450	
Rent accrued of Club House		100		6,750	
Creditors for Refreshment		500	Less: Depreciation @ 10% p.a. on ₹ (8,000 – 500)	750	6,000
Advance Subscriptions for 2015		200	Sports Equipments	1,800	
Life Subscriptions (Note 7)		3,800	Less: Depreciation @ 10% p.a.	180	1,620
			Investments	20,000	
			Add: Purchase	10,000	30,000
			Accrued Interest on Investment		1,200
			Stock of Refreshment		2,100
			Prepaid Insurance		50
			Outstanding subscriptions :		
			2013 (₹ 150 – 100)	50	
			2014	300	350
			Bank		6,300
			Cash		2,000
		69,620			69,620

Working Notes :

Dr. (1) Rent of Club House Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Bank	1,300		By Rent Accrued	200
	To Rent Accrued	100		By Income and Expenditure (Balancing figure)	1,200
		1,400			1,400

Dr. (2) Insurance Premium Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Insurance Prepaid	70		By Income and Expenditure (Balancing figure)	320
	To Bank	300		By Insurance Prepaid	50
		370			370

(3) Calculation of Loss on Sale of Furniture

Particulars	₹
Written down value of the furniture sold on 1.1.2013 : ₹ (500 – 50)	450
Less: Selling price	100
Loss on Sale of Furniture	350

Dr. (4) Creditors for Refreshment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Bank	5,500		By Balance b/d	400
	To Balance c/d	500		By Purchases (Balancing figure)	5,600
		6,000			6,000

Dr. (5) Stock of Refreshment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	1,900		By Income and Expenditure (Balancing figure)	5,400
	To Purchases	5,600		By Balance c/d	2,100
		7,500			7,500

Dr. (6) Subscriptions Account (for 2014) Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Income and Expenditure (Balancing figure)	2,150		By Advance subscriptions	50
				By Receipts and payments	1,800
				By Outstanding subscriptions	300
		2,150			2,150

Outstanding subscriptions of : ₹ (150 – 100) = ₹ 50 for 1995 is still due. And, advance subscriptions for 2015 is ₹ 200.

Dr. **(7) Life Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2013	To Income and Expenditure A/c	250	?	By Bank A/c	2,500
"	To Balance c/d	2,250			
		2,500			2,500
31.12.2014	To Income and Expenditure A/c : ₹ (250 + 200)	450	1.1.2014	By Balance c/d	2,250
"	To Balance c/d	3,800	?	By Bank A/c	2,000
		4,250			4,250

(8) Balance Sheet of Barisha Recreation Club as at 1st January, 2014

Liabilities		₹	Assets		₹
Rent Accrued		200	Land		20,000
Creditors for Refreshment		400	Furniture	8,000	
Advance Subscriptions for 2014		50	Less: Depreciation	800	7,200
Life Subscriptions : ₹ (2,500 – 250)		2,250	Investment		20,000
Capital Fund (Balancing figure)		52,920	Stock of Refreshment		1,900
			Prepaid Insurance		70
			Outstanding Subscriptions for 2013		150
			Bank		6,000
			Cash		500
		55,820			55,820

Illustration 15

The United Club closes its accounts on calendar year basis. It runs a pantry and general services. On 1st January, 2014 on the persuasion of some members, it laid a tennis court on the understanding that half of the cost of laying the court would be met by the said members individually and that the maintenance of the court would be subsidised fully by them.

The following figures are furnished to you by the accountant of the Club for the year ended 31st December, 2014:

	₹		₹
General Fund	1,25,000	Salaries and wages	30,000
Admission fees from members	10,000	Tennis court laying expenses	4,000
Membership subscriptions	57,000	Marker's wages	1,800
Audit fees	250	Salaries of stewards, bearers and cooks	24,080
Subscriptions outstanding on 1.1.2014	3,000	Sundry creditors for pantry purchases	2,630
Pantry stock on 1.1.2014	300	Subscriptions to books and periodicals	17,060
Bank balance	1,275	Sports equipments	19,800
Cash in hand	95	Furniture & Fittings (pantry)	24,770
Pantry sales	70,000	Fixed deposits with bank	70,000
Tennis court maintenance collections	5,000	Library	8,000
Rent outstanding on 1.1.2014	1,500	Rent	21,000
Pantry purchases	40,000	Printing & Stationery	5,700

1. 2014 subscriptions in arrears are ₹ 1,400 and 2013 subscriptions received during the year are ₹ 480.
2. The monthly rent is ₹ 1,500.
3. Fixed deposits in Banks were made: ₹ 15,000 on 1st April 2014; ₹ 30,000 on 1st September, 2015 and the balance on 1st October, 2014. Interest on these deposits for the current year has not been received and is at 8% p.a.
4. Depreciation at the rate of 15% on Library, 10% on Furniture and Fittings and 30% on Sports Equipments is to be provided.
5. In connection with the inauguration of the tennis court, the club on its own brought out a souvenir. Printing expenses on this came to ₹ 1,000 and these remain unpaid on 31st December. Amounts due from the advertisers are ₹ 1,500. These figures have not been taken into account by the accountant.
6. Salaries and wages of ₹ 30,000 include salary of ₹ 9,000 to the managers of the club. Manager's salary is to be distributed between Pantry, General and Tennis court in the ratio of 3:2:1 and the rest among the departments in the ratio 5:4:1.
7. Bills of supplies of provisions to the Pantry in December 2014 amounting to ₹ 1,750 have not been paid and taken into account.
8. Pantry stock on hand on 31st December, 2014 is valued at cost of ₹ 250.
9. Subscriptions to periodicals to the extent of ₹ 3,950 have been paid in advance.

You are required to prepare the Income and Expenditure Account in columnar form for the year ended 31st December, 2014 and the Balance Sheet on that date.

Solution

Working Notes :

(1) Material Consumed	₹
Opening stock	300
Add: Cash purchases	40,000
Add: Credit purchases	1,750
	42,050
Less: Closing stock	250
	41,800

(2) Printing & Stationery	₹
As per book	5,700
Add: Outstanding	1,000
	6,700

(3) Subscriptions of Periodicals	₹
As per book	17,060
Less: Prepaid	3,950
	13,110

(4) Subscriptions	₹
As per book	57,000
Add: Outstanding for 2014	1,400
	58,400
Less: Received in advance for 2015	480
	57,920
Less: Received for 2013 in 2014	3,000
	54,920
Less: Subscriptions for Tennis court (assuming that it includes the contribution of member towards capital cost of tennis court)	2,000
	52,920

(5) Salaries & Wages	General	Pantry	Tennis
Marker's wages	—	—	1,800
Steward, bearers etc	—	24,080	—
Other salaries (₹ 30,000 — ₹ 9,000) 4 : 5 : 1	8,400	10,500	2,100
	8,400	34,580	3,900

United Club
Income & Expenditure Account for the year ended 31.12.2014

Expenditure	General	Pantry	Tennis	Total	Income	General	Pantry	Tennis	Total
To Materials consumed	—	41,800	—	41,800	By Subscriptions (Note 4)	52,920	—	5,000	57,920
To Salaries & Wages :					By Sales	—	70,000	—	70,000
General (Note 5)	8,400	34,580	3,900	46,880	By Advertisement	1,500	—	—	1,500
Manager	3,000	4,500	1,500	9,000	By Interest on deposit	3,800	—	—	3,800
To Printing & Stationery	6,700	—	—	6,700	By Deficit recoverable				
To Rent	18,000	—	—	18,000	from tennis player	—	—	400	400
To Subs. of Periodicals	13,110	—	—	13,110	By Excess of				
To Audit fee	250	—	—	250	Expenditure over				
To Depreciation :					Income	—	13,357	—	11,737*
On Library 15%	1,200	—	—	1,200					
On Fittings 10%	—	2,477	—	2,477					
On Sports equip. 5%	5,940	—	—	5,940					
To Excess of Income over									
Expenditure	1,620	—	—	—					
	58,220	83,357	5,400	1,45,357		58,220	83,357	5,400	1,45,357

* ₹ 13,357 – ₹ 1,620 = ₹ 11,737.

Balance Sheet of United Club as at 31.12.2014

Liabilities	₹	₹	Assets	₹	₹
General Fund :			Furniture & Fittings	24,770	
Opening balance	1,25,000		Less: Depreciation	2,477	22,293
Add: Admission fee	10,000		Sports equipment	19,800	
	1,35,000		Less: Depreciation	5,940	13,860
Less: Excess of expenditure over income	11,737	1,23,263	Library	8,000	
			Less: Depreciation	1,200	6,800
Sundry Creditors :			Tennis court, cost less contr. of members		2,000
For Purchases		4,380	Sundry Debtors — Advertisers		1,500
For Expenses		1,000	Tennis player		400
Subscriptions received in advance		480	Subscriptions outstanding for 2014		1,400
			Rent paid in advance		1,500
			Periodical subscriptions paid in advance		3,950

			Pantry stock Fixed Deposit Interest accrued on deposits Cash at bank Cash in hand		250 70,000 3,800 1,275 95
		1,29,123			1,29,123

Special Problems

Illustration 16

The accounting records of the Happy Tickers Sports and Social Club are in a mess. You manage to find the following information to help you prepare the accounts for the year to 31 December, 2014.

Summarised Balance Sheet as at 31.12.2013

Liabilities		₹	Assets	₹
Insurance (three months)	150		Half-share in motorised roller	600
Subscriptions — 2014	120		New sports equipment unsold	1,000
Life subscriptions	1,400	1,670	Used sports equipment at valuation	700
Accumulated fund		2,900	Rent (two months)	200
			Subscriptions — 2013	60
			Cafe stocks	800
			Cash and bank	1,210
		4,570		4,570

Receipts	₹	Payments	₹
Subscriptions — 2013	40	Rent (for 12 months)	1,200
Subscriptions — 2014	1,100	Insurance (for 18 months)	900
Subscriptions — 2015	80	To Suppliers of sports equipment	1,000
Subscriptions — Life	200	To Cafe suppliers	1,900
From sales of new sports equipment	900	Wages of Cafe Manager	2,000
From sales of used sports equipment	14	Total cost of repairing motorised roller	450
Cafe takings	4,660		
	6,994		7,450

Notes :

(1) Ownership and all expenses of the motorised roller are agreed to be shared equally with the Carefree Conveyancers Sports and Social Club which occupies a nearby site. The roller cost a total of ₹ 2,000 on January 1, 2010 and had an estimated life of 10 years.

(2) Life subscriptions are brought into income equally over 10 years, in a scheme begun in 2009. Since the scheme began the cost of ₹ 200 per person has been constant. Prior to 31 December 2013, 10 life subscriptions had been received.

(3) Four more annual subscriptions of ₹ 20 each had been promised relating to 2014, but not yet received. Annual subscriptions promised but unpaid are carried forward for a maximum of 12 months.

(4) New sports equipment is sold to members at cost plus 50%. Used equipment is sold off to members at book valuation. Half the sports equipment bought in the year (all from a cash and carry supplier) has been used within the club, and half made available for sale, new to members. The 'used equipment at valuation' figures in the 31 December 2014 Balance Sheet is to remain at ₹ 700.

(5) Closing cafe stocks are ₹ 850 and ₹ 80 is owed to suppliers at 31 December 2014.

Required : (a) Calculate profit on cafe operations and profit on sale of sports equipment; (b) Prepare statement of subscriptions income for 2014; and (c) Prepare Income and Expenditure Account for the year to 31 December, 2014 and Balance Sheet as at 31st December, 2014.

Solution

(a) Profit on Cafe Operation

Particulars	₹	₹
Cafe Takings		4,660
Opening Stock	800	
Purchases (1,900 + 80)	1,980	
	2,780	
Less: Closing stock	850	1,930
		2,730
Less : Wages of Cafe Manager		2,000
Profit		730

Profit on Sale of Sports Equipments

Particulars	₹
Sale of New Sports Equipment	900
Less: Cost of Goods sold (100 / 150 x Sales)	600
Profit	300

It should be noted that there is no profit on the sale of used sports equipment as it is sold at book valuation.

(b) Statement of Subscriptions Income for 2014

Particulars	₹
Ordinary Subscriptions — ₹ (120 + 1,100 + 20 x 4)	1,300
Life Subscriptions allocated (11 x 200 x 1/10)	220
	1,520

(c) Happy Tickers Sports and Social Club
Income and Expenditure Account for the year ended 31st December, 2014

Expenditure	₹	Income	₹
To Rent	1,200	By Subscriptions (as above)	1,520
To Insurance (900 x 12/18)	600	By Profit from Cafe Operation	730
To Subscriptions of 2013 written-off (Note 1)	20	By Profit on Sale of Sports Equipment	300
To Share of Roller Repair Expenses (450 x 1/2)	225	By Excess of Expenditure over Income	81
To Depreciation of Roller (2,000 x 10% x 1/2)	100		
To Depreciation of Used Sports Equipment (Note 2)	486		
	2,631		2,631

Balance Sheet of Happy Tickers Sports and Social Club as at 31st December, 2014

Liabilities	₹	₹	Assets	₹	₹
Accumulated Fund	2,900		Motorised Roller (Half share)	600	
Less : Deficit	81	2,819	Less: Depreciation (1/2)	100	500
Cafe Suppliers		80	New Sports Equipment Unsold (Note 4)		900
Subscriptions 2015		80	Used Sports Equipment at Valuation		700
Life Subscriptions (Note 6)		1,380	Rent paid in Advance		200
			Prepaid Insurance (Note 3)		150
			Amount due from C.C.S.C.		225
			Subscriptions for 2014 (₹ 20 x 4)		80
			Cafe Stock		850
			Cash and Bank (Note 5)		754
		4,359			4,359

Working Notes :

(1) Outstanding subscriptions is carried forward only for 12 months. Subscriptions of 2013 carried forward to 2014 is ₹ 60. In 2014, only ₹ 40 was recovered. Therefore, the balance ₹ 20 to be written off in 2014.

(2) Depreciation on Sports Equipment / **(3) Prepaid Insurance**

Particulars	₹	Particulars	₹
Opening balance	700	Total amount paid in 2014	900
Add : 1/2 of newly bought used in the Club	500	Less: Outstanding for 2013	150
	1,200		750
Less: Sold at book value	14	Less : Charged to Income and Expenditure	600
	1,186		150
Less: Value of sports equipments on 31.12.2014	700		
	486		

(4) Opening balance of unsold new sports equipment = ₹ 1,000 *plus* Purchases (1/2 of ₹ 1,000 = ₹ 500) *minus* cost of new sports equipment sold (₹ 600) = ₹ 900.

(5) Opening balance of cash and bank = ₹ 1,210 + Total receipts – ₹ 6,994 less total payments – ₹ 7,450 = ₹ 754.

(6) Opening balance of life subscriptions is ₹ 1,400. Life subscriptions received during the year is ₹ 200. The amount transferred to Income and Expenditure Account is ₹ 220. Therefore, balance at the end of the year = ₹ (1,400 + 200 – 220) = ₹ 1,380.

Illustration 17

The treasurer of the Calcutta Dancing and Rambling Club has prepared the following Receipts and Payments Account for the year ended 31st December 2014.

Receipts	₹	Payments	₹
Opening balance	1,760	Purchase of amplifier (1st July, 2014)	700
Subscriptions [Note (i)] :		Country dancing :	
Country dancing	2,410	Musicians' fees	900
Rambling	1,690	Coaching fees	820
Annual dinner ticket sales	340	Hall rent	330
Sales of hut	670	Rates for the year to 31st December, 2014	800
Country dancing festival :		Decorating	110
Admissions	940	Cleaning	160
Sales — Clothes	2,100	Annual rambling expedition	1,320
Refreshments	8,300	Annual dinner — hotel and catering	410

		Country dancing festival :	
		Prizes	170
		Adjudicator's fee	90
		Purchases — Clothes	1,800
		Refreshments	7,000
		Closing balance	3,600
	18,210		18,210

Additional information :

(a) (i) Subscriptions

	Country Dancing	Rambling
Received in 2013 for 2014	130	60
Received in 2014 for 2013	10	140
Received in 2014 for 2014	2,300	1,520
Received in 2014 for 2015	100	30
	2,410	1,690

(ii) It is not the policy of the Society to take into account subscriptions in area until they are paid.

(b) The hut which was sold during 2014 had been valued at ₹ 800 on 31st December 2013 and was used for the Society's activities until sold on 30th June 2014.

(c) Immediately after the sale of the hut, the Society rented a new hall at ₹ 330 per annum.

(d) The above receipts and payments account is a summary of the Soceity's bank account for the year ended 31st December, 2014; the opening and closing balances shown above were the balances shown in the bank statement on 31st December, 2013 and 2014 respectively.

(e) All cash is banked immediately and all payments are made by cheque.

(f) A cheque for ₹ 200 drawn by the Society on 28th December, 2014, for stationery was not paid by the bank until 4th January, 2015.

(g) The Society's assets and liabilities at 31st December, 2013 and 2014 in addition to those mentioned earlier, were as follows:

	2013	2014
Stock of goods for resale, at costs :		
Clothes	1,300	1,100
Refreshments	310	600
Sundry creditors — Annual dinner (catering)	—	70
Purchases — Clothes	600	400
Purchases — Refreshments	300	500

The Society has now instructed its treasurer to prepare an income and expenditure account for the year ended 31st December, 2014, and a Balance Sheet at that date. It is proposed to provide for depreciation on the amplifier at the rate of 20% per annum on cost, pro-rata to time.

Required : The Society's income and expenditure account for the year ended 31st December, 2014 and Balance Sheet as at that date. Comparative figures are not required.

Solution

Working Notes :

(1) Subscriptions (Country Dancing)	₹	**(2) Subscriptions (Rambling)**	₹
Received in 2014	2,410	Received in 2014	1,690
Less: Subscriptions for 2015 received in 2014	100	Less: Subscriptions for 2015 (received in 2014)	30
	2,310		1,660
Add: Subscriptions for 2014 received in 2013	130	Add: Subscriptions for 2014 (received in 2013)	60
	2,440		1,720

(3) Balance Sheet as at 1st January, 2014

Liabilities	₹	Assets	₹
General Fund (Balancing figure)	3,080	Stock of Goods	
Sundry Creditors :		Cloth	1,300
Cloth	600	Refreshment	310
Refreshment	300	Hut	800
Subscriptions Received in Advance :		Cash	1,760
Dancing	130		
Rambling	60		
	4,170		4,170

Calcutta Dancing and Rambling Club
Income and Expenditure Account for the year ended 31st December, 2014

Expenditure	₹	₹	Income	₹	₹
To Stock of Goods :			By Subscriptions :		
Cloth	1,300		Country Dancing (Note 1)	2,440	
Refreshment	310	1,610	Rambling (Note 2)	1,720	4,160
To Country Dancing :			By Annual Dinner		340
Musician's fees	900		By Country Dancing Festival :		
Coaching fees	820	1,720	Admission	940	
To Hall Expenses :			Cloth	2,100	
Rent (less: prepaid)	165		Refreshment	8,300	11,340
Rates	800		By Closing Stock :		
Decorating	110		Cloth	1,100	
Cleaning	160	1,235	Refreshment	600	1,700
To Annual Rambling Expendition		1,320			
To Annual Dinner Expenses	410				
Add: Outstanding	70				
To Country Dancing Festival :					
Prizes	170				
Adjudicator's fess	90				
Purchase (₹ 1,600 + 7,200)	8,800	9,060			
To Loss on Sale of Hut (₹ 800 – 670)		130			
To Depreciation on Amplifier		70			
To Stationery		200			
To Excess of Income over Expenditure		1,715			
		17,540			17,540

Balance Sheet of Calcutta Dancing and Rambling Club as at 31st December, 2014

Liabilities	₹	₹	Assets	₹	₹
General Fund (Note 3)	3,080		Amplifier	700	
Add: Excess of Income over Expenditure	1,715	4,795	Less: Depreciation	70	630
Sundry Creditors :			Stock		
For dinner	70		Clothes	1,100	
Cloth purchase	400		Refreshments	600	1,700
Refreshment	500	970	Prepaid Hall Rent		165
Prepaid Subscriptions :			Bank (₹ 3,600 – 200)		3,400
Country		100			
Rambling		30			
		5,895			5,895

3. Preparation of Income & Expenditure Account and Balance Sheet from Incomplete Records

Examination questions often require candidates to prepare an Income and Expenditure Account and Balance Sheet from incomplete records. Generally, a summary of bank and cash transactions is provided along with information relating to opening and closing assets and liabilities. To solve these types of problems, the following steps are followed :

Step 1 Prepare a cash book with cash and bank columns.

Step 2 Open such ledger accounts as are deemed necessary.

Step 3 Draft a proforma Income and Expenditure Account and Balance Sheet.

Step 4 Post the balances from the opening Balance Sheet into an appropriate ledger accounts, or in the appropriate place in the Income and Expenditure Account / Closing Balance Sheet.

Step 5 Post the cash book entries to the appropriate ledger accounts or draft Income and Expenditure / Balance Sheet.

Step 6 Enter the closing adjustments (outstanding accruals, depreciation) either in the appropriate ledger account or the draft final accounts, making sure that the double entry is carried out.

Step 7 Post the balancing figure of the Ledger Accounts to the Income and Expenditure Account / Balance Sheet.

Step 8 Find out the surplus or deficit of the Income and Expenditure Account and transfer it to Balance Sheet.

Illustration 18

The Comrades club makes up its account to 31st December in each year. On 31st December, 2014 the treasurer left the club premises and has not been seen since. An examination of the records showed that the books had not been written up for a considerable time, and it was decided to reconstruct the figures from 1st January 2014.

A summary of the Bank Account for the year showed the following:

Receipts	₹	Payments	₹
Balance (1.1.2014)	416	Rent & Rates	460
Bank deposits	42,610	Insurance	40
		Light & heat	156
		Bar purchases	35,067
		Telephone	59
		Cash withdrawn	5,848
		Balance as on 31.12.2014	1,396
	43,026		43,026

The following information is also obtained:

1. The barman places takings in the bank 'night safe' on his way home for crediting to the club account. The duplicate paying-in-slips total ₹ 40,612 for the year. The treasurer had no access to bar takings or stock.
2. The receipt counterfoils for members' subscriptions total ₹ 3,050 for the year.
3. A summary of expenditure for petty cash and wages was as follows:
   Glasses, crockery and maintenance—₹ 1,310; Wages—₹ 2,658; National Insurance—₹ 210; Sundry expenses—₹ 257.
4. Outstanding amounts and prepayments at 31st December, were :

	2013	2014
Rates prepaid	26	28
Rent outstanding	40	82
Electricity outstanding	24	18

5. The Bar stock on 1st January, 2014 was ₹ 3,607 and on 31st December, 2014 was ₹ 2,916. The cash in hand with the treasurer at the beginning of the year was ₹ 35.

You are required to prepare :

(i) A summary of the cash position for the year ended 31st December, 2014 indicating the amount, if any, to be claimed under the club's fidelity insurance policy;

(ii) An Income and Expenditure Account for the year 2014.

Solution

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

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/f	35	2014	By Bank (deposits) (₹ 42,610 — ₹ 40,612)	1,998
?	To Subscriptions	3,050	?	By Glasses, crockery and maintenance	1,310
	To Bank (withdrawals)	5,848		By Wages	2,658
				By Insurance	210
				By Sundry expenses	257
				By Insurance claim (balancing figure)	2,500
		8,933			8,933

The Comrades Club

Income and Expenditure Account for the year ended 31st December, 2014

Expenditure	₹	Income	₹
To Rent & Rates (Note 1)	500	By Subscriptions	3,050
To Insurance (Note 3)	250	By Bar takings	40,612
To Electricity (Note 2)	150		
To Bar stock consumed (Note 4)	35,758		
To Telephone charges	59		
To Glasses, crockery and maintenance	1,310		
To Wages	2,658		
To Sundry expenses	257		
To Excess of Income over Expenditure	2,720		
	43,662		43,662

Working Notes :

Dr. **(1) Rent & Rates Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/f (rates)	26	1.1.2014	By Balance b/f (rent)	40
?	To Bank A/c	460	31.12.2014	By Income & Expenditure A/c (balancing fig.)	500
31.12.2014	To Balance c/d (rent)	82	31.12.2014	By Balance c/d (rates)	28
		568			568

Dr. **(2) Light and heat (Electricity) Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Bank A/c	156	1.1.2014	By Balance b/f	24
31.12.2014	To Balance c/d	18	31.12.2014	By Income & Expenditure A/c (balancing fig.)	150
		174			174

Dr. **(3) Insurance Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Cash (National insurance)	210	31.12.2014	By Income & Expenditure A/c	250
?	To Bank A/c	40			
		250			250

Dr. **(4) Bar Stock Consumed Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/f	3,607	31.12.2014	By Income & Expenditure A/c	35,758
?	To Bank A/c (purchases)	35,067	31.12.2014	By Balance b/d	2,916
		38,674			38,674

Illustration 19

Universal Brotherhood Club does not maintain complete double entry books of account. From the following details, prepare a Receipts and Payment Account, and an Income and Expenditure Account for the year ended 31.12.2014, and a Balance Sheet as on that date (all figures in rupees) :

Date	Outstanding Subscriptions	Advance Subsriptions	Outstanding Salaries	Advance Salaries	Cash and Bank	5% Investments	Furniture	Sports Goods
1.1.2014	14,000	2,800	1,400	—	14,000	14,000	2,800	5,600
31.12.2014	19,600	5,600	700	700	?	7,000	1,400	11,200

Subscriptions for the year amount to ₹ 70,000. Salaries paid ₹ 15,400. Face value of investments was ₹ 16,800. 50% of investments was sold at 80% of face value. Interest on investments left unsold was received. ₹ 1,400 furniture was sold for ₹ 700 at the beginning of the year. Sports goods were purchased at the end of the year. Charge 20% depreciation on sports goods and 10% on furniture. Sports expenses amount ₹ 14,000. Miscellaneous expenses are ₹ 4,200 and rent amount to ₹ 8,400.

Solution **Universal Brotherhood Club**

Dr. **Receipts and Payments Account for the year ended 31st December, 2014** **Cr.**

Receipts	₹	Payments	₹
To Balance b/d	14,000	By Salaries	15,400
To Subscriptions (Note 1)	67,200	By Sports Expenses	14,000
To Sale of Investments ₹ (16,800 x 50% x 80%)	6,720	By Purchase of Sports Goods ₹ (11,200 – 5,600)	5,600
To Interest on Investments ₹ (16,800 x 50% x 5%)	420	By Miscallenous Expenses	4,200
To Sale of Furniture	700	By Rent	8,400
		By Balance c/d	41,440
	89,040		89,040

Income and Expenditure Account for the year ended 31st December, 2014

Expenditure	₹	Income	₹
To Salaries (Note 2)	14,000	By Subscriptions	70,000
To Sports Expenses	14,000	By Interest on Investments	420
To Miscallenous Expenses	4,200		
To Rent	8,400		
To Loss on Sale of Investment —₹ (7,000 – 6,720)	280		
To Loss on Sale of Furniture — ₹ (1,400 – 700)	700		
To Depreciation on —			
Furniture (10% on ₹ 1,400)	140		
Sports Goods (20% on ₹ 5,600)	1,120		
To Excess of Income over Expenditure	27,580		
	70,420		70,420

Balance Sheet of Universal Brotherhood Club as on 31st December, 2014

Liabilities		₹	Assets		₹
Capital Fund :			Furniture	1,400	
Opening balance (Note 3)	46,200		Less: Depreciation	140	1,260
Add: Surplus	27,580	73,780	Sports Goods	11,200	
Advance Subscriptions		5,600	Less: Depreciation	1,120	10,080
Outstanding Salaries		700	Investments (Face value ₹ 8,400)		7,000
			Cash and Bank		41,440
			Outstanding Subscription		19,600
			Advance Salaries		700
		80,080			80,080

Working Notes :

Dr. (1) Subscriptions Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Oustanding Subscriptions (Opening)	14,000	1.1.2014	By Advance Subscriptions (Opening)	2,800
31.12.2014	To Income and Expenditure A/c	70,000	31.12.2014	By Receipts and Payments A/c (Bal. fig.)	67,200
31.12.2014	To Advance Subscriptions (Closing)	5,600	31.12.2014	By Outstanding Subscriptions (Closing)	19,600
		89,600			89,600

Dr. (2) Salaries Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Bank	15,400	1.1.2014	By Outstanding Salaries (Opening)	1,400
31.12.2014	To Outstanding Salaries (Closing)	700	31.12.2014	By Income and Expenditure A/c (Bal. fig.)	14,000
			31.12.2014	By Advance Salaries (Closing)	700
		16,100			16,100

(3) Balance Sheet of Universal Brotherhood Club as on 1st January, 2014

Liabilities	₹	Assets	₹
Advance Subscriptions	2,800	Furniture	2,800
Outstanding Salaries	1,400	Sports Goods	5,600
Capital Fund (Balancing figure)	46,200	5% Investments (Face value ₹ 16,800)	14,000
		Cash and Bank	14,000
		Outstanding Subscriptions	14,000
	50,400		50,400

Illustration 20

The Noida Sports Club provides the following information :

(1) The Club conducts all its transactions in cash — any surplus being paid into a Building Society Account. Interest credited to this account for the year to 31.3.2015 was ₹ 3,500.

(2) The Club has 100 members who pay an annual subscription of ₹ 50 each. However, on 31.3.2014, ten members had already paid their subscriptions for 2014-15.
On 31.3.2015, two members who had not been seen in the Club since august 2014 had not paid subscriptions for 2014-15 and it has been decided that the amount due be written-off and that their names be removed from the list of members.

(3) The Club has only two sources of income : subscriptions from members and bar sales. A profit margin of 30% of selling price is normally applied to determine bar selling prices but during the year ₹ 3,970 of goods were sold at cost.

(4) A summary of the payments for the year is as follows (all figures in rupees) :

Purchase of Equipments	1,000	Rental of Premises	10,000
Lighting	2,620	Club Match Expenses	6,750
Repairs to Equipments	1,760	Trophies (treated as an expense)	4,240
Bar Creditors	74,550	Refreshments for Visiting Teams	2,350

(5) The Club has the following other assets and liabilities (all figures in rupees) :

Date	Equipments	Building Society Account	Bar Stock	Bar Creditors
1.4.2014	40,000	46,000	8,400	6,300
31.3.2015	?	?	9,200	4,700

(6) Equipments are depreciated at 10% of the value of equipments held on 31st March each year.

You are required to prepare : (a) A Bar Trading Account for the year ended 31.3.2015; (b) A Receipts and Payments Account for the year ended 31.3.2015; (c) An Income and Expenditure Account for the year ended 31.3.2015; and (d) A Balance Sheet as at 31.3.2015.

Solution

The Noida Sports Club

Bar Trading Account for the year ended 31st March, 2015

Dr. Particulars	₹	Particulars	₹ Cr.
To Opening Stock	8,400	By Sales (Note 2)	1,01,370
To Purchases (Note 1)	72,950	By Closing Stock	9,200
To Profit on Bar	29,220		
	1,10,570		1,10,570

Receipts and Payments Account for the year ended 31st March, 2015

Receipts	₹	Payments	₹
To Subscriptions (Note 3)	4,400	By Purchase of Equipments	1,000
To Bar Sales	1,01,370	By Lighting	2,620
		By Repairs to Equipments	1,760
		By Bar Creditors	74,550
		By Rental of Premises	10,000
		By Club Match Expenses	6,750
		By Trophies	4,240
		By Refreshment for Visiting Teams	2,350
		By Deposit to Building Society Account (Balancing figure)	2,500
	1,05,770		1,05,770

Income and Expenditure Account for the year ended 31st March, 2015

Expenses	₹	Income	₹
To Lighting	2,620	By Subscriptions (98 x ₹ 50)	4,900
To Repairs to Equipments	1,760	By Profit on Bar	29,220
To Rental of Premises	10,000	By Interest on Building Society Account	3,500
To Club Match Expenses	6,750		
To Trophies	4,240		
To Refreshment for Visiting Teams	2,350		
To Depreciation on Equipments [10% on ₹ (40,000 + 1,000)]	4,100		
To Excess of Income over Expenditure	5,800		
	37,620		37,620

Balance Sheet of Noida Sports Club as on 31st March, 2015

Liabilities		₹	Assets		₹
Capital Fund :			Equipments	40,000	
Opening balance (Note 4)	87,600		Add: Purchases	1,000	
Add: Excess of Income over Expenditure	5,800	93,400		41,000	
Bar Creditors		4,700	Less: Depreciation	4,100	36,900
			Bar Stock		9,200
			Building Society Account :		
			Opening balance	46,000	
			Add: Further deposit	2,500	
			Interest credited	3,500	52,000
		98,100			98,100

Working Notes :

(1) Bar Creditors Account

Dr. Particulars	₹	Particulars	₹ Cr.
To Cash	74,550	By Balance b/d	6,300
To Balance c/d	4,700	By Bar Purchases (Balancing figure)	72,950
	79,250		79,250

(2) Calculation of Bar Sales

Cost of goods sold = Opening stock + Purchases – Closing stock

= ₹ (8,400 + 72,950 – 9,200) = ₹ 72,150

Out of ₹ 72,150, goods costing ₹ 3,970 were sold at cost.

Therefore, sales are :

	₹
at cost	3,970
at 30% margin — ₹ (72,150 – 3,970) / 70%	97,400
	1,01,370

(3) Calculation of Subscriptions Received in Cash

Subscriptions from 98 (100 – 2) members @ ₹ 50 each	4,900
Less: Received in advance in the previous year (10 × ₹ 50)	500
	4,400

(4) Balance Sheet as on 1st April, 2014

Liabilities	₹	Assets	₹
Capital Fund (Balancing figure)	87,600	Equipments	40,000
Bar Creditors	6,300	Bar Stock	8,400
Subscriptions in Advance (10 x ₹ 50)	500	Building Society Account	46,000
	94,400		94,400

4. Preparation of Receipts and Payments Account, Income and Expenditure Account and Balance Sheet when Ledger Balances and other Information are Given

A Receipts and Payments Account is a summary of the Cash Book. Therefore, as in the Cash Book, receipts are shown on the debit side, that is, left-hand side and payments on the credit side, that is, right-hand side. The following points are worth noting about the preparation of a Receipts and Payments Account:

(i) Any opening balance of Cash and Bank are shown first on the receipts side separately.

(ii) It includes all receipts and payments whether they are of revenue or capital nature.

(iii) It does not exclude receipts and payments relating to preceding years or the subsequent years. For example, if a member pays his subscriptions in advance for the coming year, it is shown on the receipts (debit) side.

(iv) It excludes outstanding expenses of the period.

(v) Closing balance represents cash-in-hand and at Bank at the end of the period.

However, Income and Expenditure Account and Balance Sheet are prepared in the usual manner.

Illustration 21

From the following information, prepare a Receipts and Payments Accounts for the year ended 31st December, 2014.

Receipts:

Donation for Building ₹ 60,000; Sale of old news papers ₹ 500; Fees for coaching ₹ 2,000; Sundries ₹ 200; Subscriptions realised for 2013 ₹ 4,000; Subscriptions for 2014 ₹ 25,000; Subscriptions for 2015 ₹ 600.

Payments:

Salaries ₹ 6,000; Repairs ₹ 1,000; Newspaper ₹ 1,000; Printing and Stationery ₹ 500; Rates and Taxes ₹ 1,000; Electricity ₹ 400; Sundries ₹ 200; Construction of Building ₹ 50,000.

Cash-in-Hand:

1st January ₹ 1,000; 31st December 2014 ₹ 33,200.

Other Information:

(i) Subscriptions to be realised for 2014 ₹ 1,200; (ii) Outstanding Expenses: Repairs ₹ 100; Printing ₹ 400.

Solution **Receipts & Payments Account for the year ended 31st December, 2014**

Receipts	₹	Payments	₹
To Balance b/f	1,000	By Salaries	6,000
To Donation for building	60,000	By Repairs	1,000
To Sale of old newspaper	500	By Newspaper	1,000
To Fees for coaching	2,000	By Printing & Stationery	500
To Sundries	200	By Rates & Taxes	1,000
To Subscriptions :		By Electricity	400
2013	4,000	By Sundries	200
2014	25,000	By Construction of building	50,000
2015	600	By Balance c/d	33,200
	93,300		93,300

Illustration 22

The following balances are obtained from the books of Kanpur Cricket Club as on 31.3.2014 and 31.3.2015 (all figures in rupees):

Particulars	31.3.2014	31.3.2015	Particulars	31.3.2014	31.3.2015
Buildings	80,000	85,500	Outstanding Expenses	3,000	1,200
Furniture	40,000	30,600	Sports Equipments	24,000	21,600
Advance Subscriptions	1,500	1,000	Investments	—	12,000
Arrears of Subscriptions	3,000	5,000	Books	15,000	16,200
Prepaid Expenses	800	1,000	Cash	16,000	17,100

Consider the following information relevant to the year 2014-15 :

(i) Depreciation provided for the year : Building—₹ 4,500; Furniture—₹ 3,400; Sports equipments—₹ 5,400; Books—₹ 1,800.

(ii) Some old furniture standing in the books for ₹ 6,000 as on 1.4.2014 was sold for ₹ 4,000 on the same date.

(iii) The Club had 300 members on 31.3.2015 as per the Register of Members. No fresh members were admitted during the year but 10 members left the Club on 1.10.2014.

(iv) Subscriptions payable—₹ 15 per month.

(v) Donation received ₹ 5,000 has been capitalised.

(vi) Considerable expenses were paid during the year.

You are required to prepare Receipts and Payments Accounts and Income and Expenditure Account for the year ended 31.3.2015 and the Balance Sheet as on that date.

Solution

Kanpur Cricket Club

Receipts and Payments Account for the year ended 31st March, 2015

Receipts	₹	Payments	₹
To Balance b/d — Cash	16,000	By Investment (Note 2)	12,000
To Subscriptions (Note 1)	52,400	By Buildings (Note 3)	10,000
To Sale of Furniture	4,000	By Sports Equipments (Note 4)	3,000
To Donation	5,000	By Books (Note 5)	3,000
		By Expenses (Balancing figure)	32,300
		By Balance c/d — Cash	17,100
	77,400		77,400

Income and Expenditure Account for the year ended 31st March, 2015

Expenditure	₹	Income	₹
To Expenses (Note 6)	30,300	By Subscriptions (Note 1)	54,900
To Depreciation on :			
Building	4,500		
Furniture	3,400		
Sports Equipments	5,400		
Books	1,800		
To Loss on Sale of Furniture : ₹ (6,000 – 4,000)	2,000		
To Excess of Income over Expenditure	7,500		
	54,900		54,900

Balance Sheet of Kanpur Cricket Club as at 31st March, 2015

Liabilities		₹	Assets	₹
Capital fund :			Buildings	85,500
Opening balance (Note 7)	1,74,300		Furniture	30,600
Add: Surplus	7,500		Sports Equipments	21,600
Donation	5,000	1,86,800	Books	16,200
Advance Subscriptions		1,000	Investments	12,000
Outstanding Expenses		1,200	Arrears of Subscriptions	5,000
			Prepaid Expenses	1,000
			Cash	17,100
		1,89,000		1,89,000

Working Notes : (1) Calculation of Subscriptions due and received : There are 300 members as on 31.3.2015 and 10 members left the club on 1.10.2014. Therefore, the number of members at the beginning of the year were 300 + 10 = 310.

Total subscriptions for the year 2014-15 are as under :	₹	
300 members @ 15 per month for the whole year = 300 x ₹ 15 x 12	= 54,000	
10 members @ 15 per month for 6 months = 10 x ₹ 15 x 6	= 900	₹ 54,900

Subscriptions received can be ascertained by preparing the Subscriptions Account as under :

Dr. **Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Arrears of subscriptions (opening balance)	3,000		By Advance Subscriptions (opening balance)	1,500
	To Income and Expenditure A/c (as above)	54,900		By Receipts and Payments A/c (balancing figure)	52,400
	To Advance Subscriptions (closing balance)	1,000		By Arrears of Subscriptions (closing balance)	5,000
		58,900			58,900

Dr. (2) Investment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Bank A/c	12,000		By Balance c/d	12,000

Dr. (3) Buildings Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	80,000		By Depreciation A/c	4,500
	To Bank A/c	10,000		By Balance c/d	85,500
		90,000			90,000

Dr. (4) Sports Equipments Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	24,000		By Depreciation A/c	5,400
	To Bank A/c	3,000		By Balance c/d	21,600
		27,000			27,000

Dr. (5) Books Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	15,000		By Depreciation A/c	1,800
	To Bank A/c	3,000		By Balance c/d	16,200
		18,000			18,000

Dr. (6) Expenses Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Prepaid Expenses (opening)	800		By Outstanding Expenses (opening)	3,000
	To Bank A/c (Balance of Receipts & Payments A/c)	32,300		By Income and Expenditure A/c (Balancing figure)	30,300
	To Outstanding Expenses (closing)	1,200		By Prepaid Expenses (closing)	1,000
		34,300			34,300

(7) Balance Sheet of Kanpur Cricket Club as at 1st April, 2014

Liabilities	₹	Assets	₹
Subscriptions Received in Advance	1,500	Buildings	80,000
Outstanding Expenses	3,000	Furniture	40,000
Capital Fund (Balancing figure)	1,74,300	Sports Equipments	24,000
		Books	15,000
		Arrears of Subscriptions	3,000
		Cash	16,000
		Prepaid Expenses	800
	1,78,800		1,78,800

5. Preparation of Receipts and Payments Account when Income and Expenditure Account, Balance Sheet and other Information are Given

The following steps are to be followed for preparing a Receipts and Payments Account:

Step 1 Draw up a proforma of Receipts and Payments Account. Opening Balance of Cash and Bank are to be written first on the receipts side separately. If no information regarding opening balance of Cash and Bank has been given, leave space for that.

Step 2 Analyse the figure given in the expenditure side of the Income and Expenditure Account. Now,

(i) Post those items of expenditure in which no adjustment to be made, directly to the payments side of the Receipts and Payments Account.

(ii) Prepare statement or open ledger accounts in respect of items of expenditure in which adjustment to be made. Post the adjusted amount to the payments side of the Receipts and Payments Account.

Step3 Analyse the given information and Balance Sheet and post capital expenditure (involving outflow of Cash and/or Bank) to the payments side of the Receipts and Payments Account.

Step4 Analyse the figures given in the income side of the Income and Expenditure Account. Now,

(i) Post those items of income in which no adjustment to be made, directly to the receipts side of the Receipts and Payments Account.

(ii) Prepare statement or open ledger accounts in respect of items of income in which adjustment to be made. Post the adjusted amount to the receipts side of the Receipts and Payments Account.

Step 5 Analyse the given information and Balance Sheet and post capital receipts, if any, to the receipts side of the Receipts and Payments Account.

Step 6 Now, balance the Receipts and Payments Account. The closing balance will represent balance of cash and bank at the end of the period.

In this respect the following points are important:
(i) If both the opening and closing balances of Cash and Bank are given, both payments side and receipts side of the Receipts and Payments Account will be equal.
(ii) If only the opening balances of Cash and Bank have been given, the balance will represent closing balances of Cash and Bank.
(iii) If only the closing balances of Cash and Bank have been given, the balancing figure will represent opening Cash and Bank.

Illustration 23

Prepare a Receipts and Payments Account of Woodburn Club for the year ended 31.12.2014.

Income & Expenditure Account for the year ended 31.12.2014

Expenditure	₹	Income	₹
To Salaries	700	By Donations	420
To General expenses	200	By Subscriptions	800
To Depreciation of assets	120		
To Surplus for the year	200		
	1,220		1,220

Adjustments were also to be made for the following items: Subscriptions for 2013 outstanding on 1.1.2014, ₹ 80 but ₹ 72 only of this amount were realised in 2014. Subscriptions received in advance on 31.12.2013 were ₹ 20 and 31.12.2014 were ₹ 16. Subscriptions for 2014 outstanding at 31.12.2014 were ₹ 28. Sundry Assets on 1.1.2014 were ₹ 1,040. Sundry Assets (after depreciation) were ₹ 1,080 on 31.12.2014. Cash in hand on 31.12.2014 was ₹ 264.

Solution

Woodburn Club
Receipts & Payments Account for the year ended 31st December, 2014

Receipts	₹	Payments	₹
To Balance b/f (balancing figure)	64	By Salaries	700
To Donations	420	By General expenses	200
To Subscriptions (Note 1)	840	By Purchase of assets (Note 2)	160
		By Balance c/d	264
	1,324		1,324

Working Notes :

(1) Subscriptions	₹	**(2) Purchase of Assets**	₹
As per Income & Expenditure A/c	800	Closing balance of Sundry assets	1,080
Add: Subscriptions for 2013 realised in 2014	72	Add: Depreciation	120
Add: Subscriptions for 2015 received in advance in 2014	16		1,200
	888	Less: Opening balance	1,040
Less: Subscriptions for 2014 received in advance in 2013	20		160
	868		
Less: Subscriptions for 2014 outstanding	28		
	840		

Illustration 24

From the following Income and Expenditure Account and the Balance Sheet of a club, prepare its Receipts and Payments Account and Subscriptions Account for the year ended 31.3.2015.

Income and Expenditure Account for the year ended 31st March, 2015

Expenditure	₹	Income	₹
To Upkeep of ground	10,000	By Subscriptions	17,320
To Printing	1,000	By Sale of newspapers (old)	260
To Salaries	11,000	By Lectures	1,500
To Depreciation on furniture	1,000	By Entrance fees	1,300
To Rent	600	By Miscellaneous income	400
		By Deficit	2,820
	23,600		23,600

Balance Sheet as at 31st March, 2015

Liabilities		₹	Assets	₹
Subscriptions in advance (2015-16)		100	Furniture	9,000
Prize fund :			Ground and building	47,000
Opening balance	25,000		Prizes fund investment	20,000
Add: Interest	1,000		Cash in hand	2,300
	26,000		Subscriptions (2014-15)	700
Less: Prizes	2,000	24,000		
General fund :				
Opening balance	56,420			
Less: Deficit	2,820			
	53,600			
Add: Entrance fees	1,300	54,900		
		79,000		79,000

The following adjustments have been made in the above accounts:

1. Upkeep of ground ₹ 600 and Printing ₹ 240 relating to 2013-14 were paid in 2014-15.
2. One-half of entrance fee has been capitalised by transfer to General fund.
3. Subscriptions outstanding in 2013-14 was ₹ 800 and for 2014-15 was ₹ 700.
4. Subscriptions received in advance in 2013-14 was ₹ 200 and in 2014 for 2015-16 was ₹ 100.

Solution **Receipts & Payments Account for the year ended 31st March, 2015**

Receipts	₹	Payments	₹
To Balance b/f (balancing figure)	4,660	By Upkeep of ground (Note 3)	10,600
To Subscriptions (Note 1)	17,320	By Printing (Note 4)	1,240
To Sale of old newspaper	260	By Salaries	11,000
To Lecture fees	1,500	By Rent	600
To Entrance fees (Note 2)	2,600	By Prizes	2,000
To Miscellaneous income	400	By Balance c/d	2,300
To Interest on prize fund investment	1,000		
	27,740		27,740

Working Notes :

Dr. **(1) Subscriptions Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Subscriptions outstanding for 2013-14	800	1.4.2014	By Subscriptions received in advance for 2013-14	200
	To Subscriptions received in advance for 2015-16	100		By Cash (balancing figure)	17,320
31.3.2015	To Income & Expenditure A/c	17,320	31.3.2015	By Subscriptions outstanding for 2014-15	700
		18,220			18,220

(2) Entrance fees	₹
As per Income & Expenditure A/c	1,300
Add: Capitalised	1,300
	2,600

(3) Upkeep of Ground	₹
As per Income & Expenditure A/c	10,000
Add: Outstanding expenses for 2013-14	600
	10,600

(4) Printing	₹
As per Income & Expenditure A/c	1,000
Add: Outstanding expenses for 2013-14 paid in 2014-15	240
	1,240

Illustration 25

The Income and Expenditure Account of Ganga Boat Club for the year ended on 31.12.2014 stood as follows :

Expenditure	₹	Income	₹
To Salaries	19,500	By Subscriptions	38,000
To General Expenses	10,000	By Entrance Fees	10,500
To Audit Fees	2,500	By Donation	12,000
To Printing and Stationery	6,000	By Sale of Old Periodicals	500
To Interest and Bank Charges	3,000		
To Rent	3,000		
To Periodicals	4,000		
To Travelling Expenses	2,500		
To Depreciation on Furniture	1,500		
To Surplus	9,000		
	61,000		61,000

The following is the Balance Sheet of the Club as at 31.12.2013 :

Liabilities		₹	Assets	₹
Liabilities for :	Salaries	1,500	Furniture	7,500
	Rent	500	Sports Equipment	10,000
Advance Subscriptions (2014)		1,000	Subscriptions Receivable	4,000
General Fund		37,000	Cash and Bank	18,500
		40,000		40,000

Other details on 31.12.2014 : Salaries outstanding — ₹ 2,500; Subscriptions outstanding — ₹ 3,000; Subscriptions received in advance — ₹ 1,000. Prepare Receipts and Payments Account for 2014 and Balance Sheet as at 31.12.2014.

Solution

Ganga Boat Club
Receipts and Payments Account for the year ended 31st December, 2014

Receipts		₹	Payments	₹
To Balance b/d		18,500	By Salaries (Note 2)	18,500
To Subscriptions (Note 3) :			By General Expenses	10,000
2013 (Opening Balance Sheet)	4,000		By Audit Fees	2,500
2014 (Balancing figure)	34,000		By Printing and Stationery	6,000
2015 (Note 1)	1,000	39,000	By Interest and Bank Charges	3,000
To Entrance Fees		10,500	By Rent : ₹ (3,000 + 500)	3,500
To Donations		12,000	By Periodicals	4,000
To Sale of Old Periodicals		500	By Travelling Expenses	2,500
			By Balance c/d (Balancing figure)	30,500
		80,500		80,500

Balance Sheet of Ganga Boat Club as at 31st December, 2014

Liabilities		₹	Assets		₹
Capital Fund :			Furniture	7,500	
Opening balance	37,000		Less : Depreciation	1,500	6,000
Add : Surplus	9,000	46,000	Sports Equipments		10,000
Advance Subscriptions (Note 1)		1,000	Subscriptions Receivable (Note 1)		3,000
Salaries Outstanding		2,500	Cash and Bank		30,500
		49,500			49,500

Working Notes : (1) All the figures are given in the question.

Dr. (2) Salaries Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Receipts and Payments (Balancing figure)	18,500		By Outstanding Salaries	1,500
	To Outstanding Salaries	2,500		By Income and Expenditure	19,500
		21,000			21,000

Dr. (3) Subscriptions Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Subscriptions Receivable	4,000		By Advance Subscriptions	1,000
	To Income and Expenditure	38,000		By Receipts and Payments (Balancing figure)	39,000
	To Advance Subscriptions	1,000		By Subscriptions Receivable	3,000
		43,000			43,000

6. Preparation of Opening and Closing Balance Sheets when Receipts and Payments Account and Income & Expenditure Account are Given

Illustration 26

Adult Education Society submits to you the following Receipts and Payments Account and Income and Expenditure Account for the year ended 31.3.2015 :

Receipts and Payments Account (2014-15)

Receipts			₹	Payments	₹
To Balance b/d			450	By Printing Charges	75
To Interest :	2013-14	100		By Advertisement	141
	2014-15	150	250	By Salary to Staff (including payment for 2013-14)	1,300
To Tution Fees :	2014-15	1,000		By Rent	520
	2015-16	100	1,100	By Miscellaneous Expenses	110
To Entrance Fees :	2014-15		420	By Furniture Purchase	670
To Membership Fees :	2013-14	300		By Balance c/d	1,374
	2014-15	1,150			
	2015-16	390	1,840		
To Miscellaneous Income			130		
			4,190		4,190

Income and Expenditure Account (2014-15)

Expenditure	₹	Income	₹
To Printing Charges	80	By Tuition Fees	1,100
To Advertisement	150	By Membership Fees	1,150
To Rent	600	By Miscellaneous Income	130
To Salary to Staff	1,200	By Interest	160
To Miscellaneous Expenses	110		
To Excess of Income over Expenditure	400		
	2,540		2,540

You are asked to prepare the Balance Sheets of the Society as on 31.3.2014 and 31.3.2015.

Additional information :

The Society had the following assets on 31.3.2014 :

Investments ₹ 4,000; Furniture ₹ 2,000; Library Books ₹ 1,500.

Solution **Balance Sheet of Adult Education Society as at 31st March, 2014**

Liabilities	₹	Assets	₹
Capital fund (Balancing figure)	8,250	Furniture	2,000
Outstanding Salaries : ₹ (1,300 – 1,200)	100	Investments	4,000
		Library Books	1,500
		Membership Fees Receivable (2013-14)	300
		Interest Receivable	100
		Bank	450
	8,350		8,350

Balance Sheet of Adult Education Society as at 31st March, 2015

Liabilities		₹	Assets	₹
Capital fund :			Furniture — ₹ (2,000 + 670)	2,670
Opening Balance	8,250		Investments	4,000
Add : Surplus	400		Library Books	1,500
Entrance fees	420	9,070	Tuition Fees Receivable : ₹ (1,100 – 1,000)	100
Tuition Fees received in Advance		100	Interest Receivable : ₹ (160 – 150)	10
Membership Fees Received in Advance		390	Bank	1,374
Outstanding Expenses :				
Printing charges : ₹ (80 – 75)		5		
Advertisement : ₹ (150 – 141)		9		
Rent : ₹ (600 – 520)		80		
		9,654		9,654

Illustration 27

The following are the items of receipts and payments of the All India Sports Club summarized from the books of account maintained by the secretary:

Receipts	₹	Payments	₹
Opening balance (1.1.2014)	4,200	Manager's salary	1,000
Entrance fees (2013)	1,000	Printing & stationery	2,600
Entrance fees (2014)	10,000	Advertising	1,200
Subscriptions (2013)	600	Fire Insurance	1,800
Subscriptions (2014)	15,000	Investments purchased	20,000
Interest received on investments	3,000	Closing balance (31.12.2014)	7,600
Subscriptions (2015)	400		
	34,200		34,200

It was ascertained from enquiry that the following represented a fair picture of the income and expenditure of the club for the year 2014 for audit purposes :

Expenditure		₹	Income	₹
Manager's salary		1,500	Entrance fees	10,500
Printing & stationery	2,000		Subscriptions	15,600
Add: Outstanding	400	2,400	Interest on investments	4,000
Advertising		1,600		
Audit fees		500		
Fire insurance		1,000		
Depreciation		4,940		
Excess of income over expenditure		18,160		
		30,100		30,100

You are required to prepare the Balance Sheets of the club as on 1.1.2014 and 31.12.2014, it being given that the book values of the fixed assets as on 1.1.2014 were Building ₹ 44,000, Cricket Equipment ₹ 25,000 and Furniture ₹ 4,000. The rates of depreciation on Building 5%, Cricket Equipment 10%, Furniture 6%.

Solution **Balance Sheet of All India Sports Club as at 1st January, 2014**

Liabilities	₹	Assets	₹
Capital fund (balancing figure)	78,000	Building	44,000
Outstanding expenses:		Furniture	4,000
Advertisement (₹ 1,800 – ₹ 1,600)	200	Cricket equipment	25,000
Printing and stationery (₹ 2,600 – ₹ 2,000)	600	Entrance fees outstanding (2013)	1,000
		Subscriptions outstanding (2014)	600
		Cash in hand	4,200
	78,800		78,800

Balance Sheet of All India Sports Club as at 31st December, 2014

Liabilities	₹	₹	Assets	₹	₹
Capital fund			Building	44,000	
Opening balance	78,000		Less: Depreciation @ 5%	2,200	41,800
Add: Excess of income over expenditure	18,160	96,160	Furniture	4,000	
Subscriptions received in advance		400	Less: Depreciation @ 6%	240	3,760
Outstanding expenses :			Cricket equipment	25,000	
Printing & stationery	400		Less: Depreciation @ 10%	2,500	22,500
Manager's salary (Note 5)	500		Investments		20,000
Audit fees (Note 6)	500	1,400	Subscriptions outstanding (Note 1)		600
			Entrance fees outstanding (Note 2)		500
			Accrued interest (Note 3)		1,000
			Prepaid Fire insurance (Note 4)		200
			Cash in hand		7,600
		97,960			97,960

Working Notes :

(1) Subscriptions Outstanding	₹	**(2) Entrance fees outstanding**	₹
As per Income & Expenditure A/c	15,600	As per Income & Expenditure A/c	10,500
Less: As per Receipts and Payments A/c	15,000	Less: As per Receipts and Payments A/c	10,000
	600		500
(3) Accrued Interest	₹	**(4) Prepaid Fire Insurance**	₹
As per Income & Expenditure A/c	4,000	As per Income & Expenditure A/c	1,200
Less: As per Receipts and Payments A/c	3,000	Less: As per Receipts and Payments A/c	1,000
	1,000		200
(5) Outstanding Manager's Salary	₹	**(6) Outstanding Audit Fees**	₹
As per Income & Expenditure A/c	1,500	As per Income & Expenditure A/c	500
Less: As per Receipts and Payments A/c	1,000	Less: As per Receipts and Payments A/c	Nil
	500		500

Illustration 28

The Secretary of The Systematic Club has prepared the following draft Balance Sheet of the Club as on 30.9.2015 :

Liabilities		₹	Assets		₹
Capital Account :			Fixtures and Fittings :		
Balance as on 30.9.2015	14,300		As on 30.9.2015	10,600	
Less : Loss for the year	2,100	12,200	Less: Depreciation for the year	1,000	9,600
Subscriptions in Advance		600	Stock		3,200
Creditors		2,400	Debtors		1,400
			Balance at Bank		950
			Cash in Hand		50
		15,200			15,200

You ascertain the following :

(1) The amount of loss was only a balancing figure as the books had been kept on a single entry basis.

(2) The balance at bank was that shown by the bank statement at the close of the business on 30.9.2015.

(3) The following amounts had been paid into bank on 30.9.2015 but had not been credited by the bank :

(i) Two cheques of ₹ 50 each had been cashed for a member—one had since been duly honoured but the other had been returned marked 'refer to drawer' and, on being approached, the member repaid ₹ 50 in cash.

(ii) A member's subscriptions of ₹ 80 for the year 2015-16.

(4) The following cheques had been drawn in September but has not been presented until October :
(i) ₹ 480 for bar supplies which had been delivered but had not been included in stock;
(ii) ₹ 350 for additional typewriter received on October 2;
(iii) ₹ 100 as bonus of the professional included under the creditors;
(iv) ₹ 140 for fuel which had been included in the stock figure but not in the creditors and this cheque was dated October 1, 2015.

You are required to prepare :

(a) a bank reconciliation statement as on 30.9.2015; and (b) a revised Balance Sheet as on the date to give effect to the consequential adjustments, assuming that otherwise the items in the draft Balance Sheet were correct.

Solution **(a) Bank Reconciliation Statement of The Systematic Club as on 30th September, 2015**

Bank balance as per Bank Statement			950
Add :	Cheque dishonoured but not entered in the Cash Book	50	
	Cheque deposited but not credited	80	130
			1,080
Less:	Cheques issued but not presented for payment :		
	Bar supplies	480	
	Advance for office equipment	350	
	Bonus of the professional	100	
	Fuel (Note 1)	—	930
Bank Balance as per Cash Book			150

(b) Balance Sheet of The Systematic Club as at 30th September, 2015

Liabilities		₹	Assets		₹
Capital Fund :			Furniture and Fittings	10,600	
Opening balance	14,300		Less: Depreciation	1,000	9,600
Less: Excess of Expenditure over Income (Balancing figure)	2,140	12,160	Stock : ₹ (3,200 + 480)		3,680
			Debtors		1,400
Subscriptions in Advance ₹ (600 + 80)		680	Advance for Office Equipment (Note 2)		350
Creditors (Note 3)		2,440	Bank		150
			Cash : ₹ (50 + 50)		100
		15,280			15,280

Working Notes :

(1) No adjustment is required for ₹ 140 for fuel since the cheque was dated October 1.

(2) Since the typewriter was not received before 30.9.2015, it should be shown as an advance for office equipment in the Balance Sheet on 30.9.2015.

(3) Ascertainment of correct balance of creditors.

Dr. **Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Bonus of Professional (cancelled)	100		By Balance c/d	2,400
	To Balance c/d	2,440		By Fuel (previously not recorded)	140
		2,540			2,540

Key Points

- A non-profit organisation is operated for the benefit of the society as a whole, rather than for the benefit of a sole proprietor or a group of partners or shareholders.
- A non-profit organisation is formed when a number of like-minded people decide to formalise their association.
- A Receipts and Payments Account is a summary of the Cash Book. This is the primary report prepared by the treasurers of clubs, societies etc to present the result of the year's cash position.
- The Income and Expenditure Account is equivalent to the Profit and Loss Account of a business enterprise. It is prepared by matching the revenues against the expenses for a specified period, usually a year.
- Amount received from life membership should be *credited to a special fund* called ***Life Membership Fund*** and an amount equal to annual subscriptions or other agreed amount is transferred every year to the Income and Expenditure Account, the balance of this fund is carried forward till it is fully exhausted.

THEORETICAL QUESTIONS

1. What are the main features of Receipts and Payments Account ?
2. What are the main features of Income and Expenditure Account ?
3. Distinguish between Receipts and Payments Account and Income and Expenditure Account.
4. How do you treat the following at the time of preparation of final accounts of a non-profit organisation ?
   (i) Donations (ii) Legacy (iii) Life Membership Fees (iv) Admission Fees (v) Sectional Subscriptions.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below.

1. The Income and Expenditure Account begins with :
   A debit balance
   B credit balance
   C no balance
2. The Receipts and Payments Account records receipts and payments of :
   A revenue nature only
   B capital nature only
   C revenue as well as capital nature.
3. A profit on the sale of furniture of a club will be taken to :
   A cash account
   B receipts and payments account
   C income and expenditure account
4. Entrance fees are generally :
   A capitalised
   B taken as income
   C treated as a liability
5. Legacy for specific purpose is:
   A added to the specific fund
   B shown in the income and expenditure account
   C shown as a separate liability

PRACTICAL QUESTIONS

Preparation of Income and Expenditure Account

1. The following is the Receipts and Payments Account of Silver Streek Cricket Club for the year ended 31.12.2014. You are to prepare the Income and Expenditure Account for 2014 and Balance Sheet as at 31.12.2014 of the Club:

Receipts	₹	Payments	₹
Opening Balance — Cash	290	New building constructed	75,000
Bank	3,710	Souvenir	2,000
Subscriptions	12,000	Salaries	6,000
Donations	13,000	Postage	500
Activities collection	6,900	Telephone	500
Sale of old newspapers	300	Electricity	600
Souvenir advertisement	5,800	Maintenance expenses	12,000
Endowment income	3,000	Newspapers	500
Sale proceeds of old building at book value	60,000	Closing balance — Cash	300
Income from investments @ 10%	4,000	Bank	11,600
	1,09,000		1,09,000

Subscriptions : For 2013 (due as at 31.12.2013, ₹ 1,500) received ₹ 1,000; For 2015 advance ₹ 1,200; Due for 2014 ₹ 800; Expenses outstanding : Salaries ₹ 1,200; Electricity ₹ 100; Telephones ₹ 100; Postage ₹ 100; Provide depreciation on Building @ 5%.

2. The following is the Receipts and Payments Account of the Calcutta Club for the year ending 31.12.2014:

Receipts	₹	Payments	₹
Opening Balance :		Salaries	6,000
Cash	1,025	Sports expenses	6,900
Stamps	50	Electricity	1,000
Bank F.D.	10,000	Telephone	1,200

S/B Account	4,200	Postage expenses	200
Current Account	2,100	General body expenses	700
Subscriptions		Printing & Stationery	850
2013	1,010	Building purchase account	12,000
2014	18,900	Repairs	400
2015	900	Closing Balance :	
Donations	7,000	Cash	1,740
Bank interest received	1,340	Stamps	25
Receipts from sports	2,600	Bank F.D.	11,000
Telephone recoveries	900	S/B A/c	4,310
		Current A/c	3,700
	50,025		50,025

A building costing one lakh of rupees was purchased during the last year and ₹ 88,000 was paid for it.

Subscriptions outstanding for 2014 — ₹ 1,100; Interest accrued on bank deposits but not received ₹ 200; and Salaries outstanding ₹ 200. From the above, prepare Income and Expenditure Account for the year 2014 and also the Balance Sheet as on 31.12.2014 of the Calcutta Club.

3. Given below is the Receipts and Payments Account of a club for the year ending 31st December, 2014:

Receipts	₹	Payments	₹
To Balance	1,500	By Salaries	600
To Subscriptions:		By Expenses	100
2013	50	By Drama Expenses	500
2014	2,000	By Newspapers	120
2015	80	By Municipal Taxes	60
To Donations	550	By Charity	400
To Sale of Drama tickets	1,050	By Investments	2,000
To Sale of waste paper	50	By Electric Charges	200
To Entrance fees	300	By Payment on new furniture	1,000
		By Balance	600
	5,580		5,580

Prepare the club's Income and Expenditure Account for the year ended 31st December, 2014 and its Balance Sheet as at that date after taking the following information into account:

(i) There are 400 members each paying ₹ 5 as annual subscriptions, ₹ 60 subscriptions still outstanding for 2013;

(ii) Municipal Taxes amounting to ₹ 60 per annum have paid upto 31st March 2015;

(iii) 6 per cent has accrued on investment for five months; and

(iv) Building stands in the books at ₹ 5,000 on 1.1.2014.

4. The following is the Receipts and Payments Account of the Sanatan Sangha for the year ended 31st December 2014.

Receipts	₹	Payments	₹
To Balance b/d	800	By Salaries	300
To Subscriptions :		By Stationery	300
2013	50	By Rates	300
2014	1,000	By Telephone charges	100
2015	200	By Investments on 4% Govt. securities (pur. on 30.6.2014)	1,000
To Admission fees	400	By Sundry expenses	150
To Dividends on investments	200	By Balance c/d	500
	2,650		2,650

The following additional information are given below:

1. There are 600 members paying annual subscriptions of ₹ 2 per head, ₹ 90 being in arrear for 2013 at the beginning of 2014.
2. Stock of stationery at 31st December 2013 was ₹ 200, at 31st December 2014 ₹ 100
3. The rates were paid for fifteen months upto 31st March, 2015.
4. Sundry Expenses outstanding at 31st December 2013 was ₹ 50.
5. The telephone charges for 3 months is outstanding, amount acrrued being ₹ 40.
6. At 31st December 2013 the building stood in the books at ₹ 10,000 and it is required to write off depreciation at 5% p.a.
7. At 31st December 2013 Investments were ₹ 4,000.

You are required to prepare an Income and Expenditure Account for the year ended 31st December 2014 and a Balance Sheet as at that date

5. Prantik Boys' Club prepared the following Receipts and Payments Account for the year ended 31st December, 2014:

Receipts	₹	Payments	₹
To Balance b/d	7,600	By Sports Equipment purchased on 1.10.2014	30,000
To Subscriptions :		By Postage and stationery	700
2013	2,000	By Salaries and wages	5,000
2014	37,000	By Upkeep of ground	1,000
2015	3,000	By Electric charges	2,300
To Admission fees	4,000	By Tournament expenses	8,000
To Locker rents	1,000	By Balance c/d	8,800
To Interest on Govt. Securities	1,200		
	55,800		55,800

The fixed assets of the club on 1st January, 2014 include the following: sports equipments ₹ 40,000, furniture ₹ 6,000, 10% Government securities ₹ 16,000 and club ground ₹ 25,000.

Prepare Income and Expenditure Account of Prantik Boys' Club for the year ended 31st December, 2014 and a Balance Sheet as at that date after taking into account the following information :

(a) Subscriptions for 2014 collected in 2013 for ₹ 1,500; (b) Subscriptions for 2014 are outstanding for ₹ 1,000; (c) Depreciation to be provided at 15% p.a. on sports equipment and at 7.5% p.a. on furniture.

6. The following is the Receipts and Payments Account of an Amusement Club :

Receipts	₹	Payments	₹
Balance b/d :		Salary of secretary	3,600
Cash	60	Honorarium	450
Bank	3,000	Wages	2,400
Subscriptions (including subscriptions for 2013 ₹ 150)	9,000	Charities	2,000
Sale of old furniture on January 1, 2014	750	Printing & stationery	300
Sale of newspapers	50	Postage	100
Legacies	3,000	Rates and taxes	1,200
Interest on Investments (cost of investments ₹ 20,000)	1,200	Upkeep of the land	500
Endowment fund receipts	10,000	Sports materials	2,500
Proceeds of concerts	800	Balance c/d	14,850
Advertisement in the year book	40		
	27,900		27,900

Current assets and liabilities as on December 31, 2013 and 2014 were as follows :		31.12.2013	31.12.2014
Subscriptions in arrears	₹	200	750
Subscriptions in advance	₹	300	600
Furniture	₹	2,000	1,080

Depreciation was 10% p.a. on the furniture left after selling a part of it. Legacies to be capitalised.

Prepare Income & Expenditure Account and the Balance Sheet as on that date.

7. Citizen's Club was registered in a city and the accountant prepared the following Receipts and Payments Account for the year ended October 31, 2014 and showed a deficit of ₹ 14,520.

Receipts	₹	Payments	₹
Subscriptions	62,130	Premises	30,000
Fair receipts	7,200	Honorarium to Secretary	12,000
Variety show receipts (net)	12,810	Rent	2,400
Interest	690	Rates & taxes	3,780
Bar collection	22,350	Printing & stationery	1,410
Cash spent more	1,000	Sundry expenses	5,350
Deficit	14,520	Wages	2,520
		Fair expenses	7,170
		Bar purchases payments	17,310
		Repair	960
		New car (less proceeds of old car — ₹ 9,000)	37,800
	1,20,700		1,20,700

The following additional information could be obtained :	1.11.2013	31.10.2014
Cash in hand	450	—
Bank balances as per pass book	24,690	10,440
Cheques issued not presented for sundry expenses	270	90
Subscriptions due	3,600	2,940
Premises at cost	87,000	1,17,000
Accumulated depreciation on premises	56,400	—
Car at cost	36,570	46,800
Accumulated depreciation on car	30,870	—
Bar stock	2,130	2,610
Creditors for bar purchases	1,770	1,290

Cash over spent represent honorarium to Secretary not withdrawn due to cash deficit. His annual honorarium is ₹ 12,000. Depreciation on premises and car is to be provided at 5% and 20% on written down value.

You are required to prepare the correct Receipts and Payments Account, Income and Expenditure Account and Balance Sheet on October 31, 2014.

8. The following is the Receipts and Payments Accounts of Apollo Club in respect of the year 31st March, 2015:

Date	Receipts	₹	Date	Payments	₹
1.4.2014	To Balance c/d :		31.3.2015	By Salaries	3,000
	Cash in hand	2,000		By Rates & Taxes	300
31.3.2015	To Subscriptions :			By Stationery	1,000
	2013-14	3,000		By Telephone charges	1,500
	2014-15	4,000		By 8% securities at par	5,000
	2015-16	1,000		By Sundry expenses	200
	To Profit on sports	3,000		By Balance c/d — Cash in hand	3,000
	To Interest on 8% securities	1,000			
		14,000			14,000

The following additional facts are ascertained:

(a) There are 500 members, each paying an annual subscriptions of ₹10, ₹ 3,500 being in arrears for 2013-14 at the beginning of 2014-15. During 2013-14, subscriptions were paid in advance by 30 members for 2014-15.

(b) Stock of Stationery at 31st March 2014 was ₹ 400 and at 31st March 2015 ₹ 500.

(c) At 31st March, 2014, the rates and taxes were prepaid to the following 31st January, the yearly charge being ₹ 300.

(d) A quarter's charge for telephone is outstanding, the amount accrued being ₹ 300. The charge for each quarter is same for both 2013-14 and 2014-15.

(e) Sundry Expenses accruing at 31st March 2014 were ₹ 50 and at 31st March 2015 ₹ 60.

(f) At 31st March 2014, Building stood in the books at ₹ 30,000 and it is required to write off depreciation @ 10% p.a.

(g) Value of 8% securities at 31st March 2014 was ₹ 15,000 which was purchased at that date at par, additional securities worth ₹ 5,000 are purchased on 31st March 2015.

You are required to prepare :

(i) Income & Expenditure Account for the year ended 31st March 2015; and (ii) Balance Sheet as at that date.

9. The following information was obtained from the books of Delhi Club as on 31.3.2015 at the end of the first year of the club. You are required to prepare Receipts and Payments Account, Income and Expenditure Account for the year ended 31.3.2015, and a Balance Sheet as at 31.3.2015 on mercantile basis :

(i) Donations received for building and library room ₹ 2,00,000.

(ii) Other revenue income and actual receipts (figures in rupees) :

	Entrance Fees	Subscriptions	Locker Rents	Sundry Income	Refreshments Account
Revenue Income	17,000	20,000	600	1,600	—
Actual Receipts	17,000	19,000	600	1,060	16,000

(iii) Other revenue expenditure and actual payments (figures in rupees) :

	Land (Cost ₹ 10,000)	Furniture (Cost ₹ 1,46,000)	Salaries	Maintenance of Playgrounds	Rent	Refreshments Account
Revenue Expenses	—	—	5,000	2,000	8,000	—
Actual Payments	10,000	1,30,000	4,800	1,000	8,000	8,000

Donations to the extent of ₹ 25,000 were utilised for the purchase of library books, balance was still unutilised. In order to keep it safe, 9% Govt. Bonds of ₹ 1,60,000 were purchased on 31.3.2015. Remaining amount was put in the bank on 31.3.2015 under the term deposit. Depreciation at 10% p.a. was to be provided for the whole year on furniture and library books. ***[C.A. (Foundation) — Adapted]***

10. The Sports Writers Club give the following Receipts and Payments Account for the year ended March 31, 2015.

Receipts	₹	Payments	₹
To Balance b/d	4,820	By Salaries	12,000
To Subscriptions	28,600	By Rent & electricity	7,220
To Miscellaneous	700	By Library books	1,000
To Interest on fixed deposit	2,000	By Magazines and newspaper	2,172
		By Sundry expenses	10,278
		By Sports equipments	1,000
		By Balance c/d	2,450
	36,120		36,120

Figure of other assets and liabilities are furnished as follows:	As at March, 31 2014	2015
Salaries outstanding	710	170
Outstanding rent & electricity	864	973
Outstanding for magazines & newspapers	226	340
Fixed deposit (10%) with Bank	20,000	20,000
Interest accrued thereon	500	500
Subscriptions receivable	1,263	1,575
Prepaid expenses	417	620
Furniture	9,600	?
Sports equipments	7,200	?
Library books	5,000	?

The closing values of furniture and sports equipments are to be determined after charging depreciation at 10% and 20% p.a. respectively inclusive of the additions, if any, during the year. The clubs library books are revalued at the end of every year and the value at the end of March 31, 2015 were ₹ 5,250.

From the above information, you are required to prepare :

(a) The club's opening Balance Sheet as at March 31, 2014;

(b) The club's Income and Expenditure Account for the year ended on that date; and

(c) The club's closing Balance Sheet as at March 31, 2015.

11. From the following ledger balances of SBI Recreation Club prepare Income and Expenditure Account for the year ended on 31st March 2015 and Balance Sheet as on that date. The profit or loss on Bar and Restaurant should be shown separately.

Capital Fund Balance (1.4.2014)	17,720	Bar Collections	21,250
Stock on Bar (1.4.2014)	1,560	Restaurant collections	14,360
Stock on Restaurant (1.4.2014)	510	Tennis receipts	7,620
Purchases for Restaurant	11,735	Furniture purchased	500
Purchases for Bar	14,365	Subscriptions	25,730
Rent & Rates	6,700	Electric charges	1,720
China, Cutlery, Linen (1.4.2014)	2,400	Establishment :	
Furniture (1.4.2014)	15,000	Bar	4,960
Tennis Accessories (1.4.2014)	5,500	Restaurant	3,540
Interest	480	General	4,260
Outstanding subscriptions on 31.3.2015	3,650	Purchases of China cutlery	1,200
Creditors on 31.3.2015	5,000	Investment	4,000
Cash and Bank (31.3.2015)	10,560		

Additional Information:

(i) Stock in Bar on 31.3.2015 ₹ 4,000; Stock in Restaurant on 31.3.2015 ₹ 1,230; and

(ii) Provide depreciation on opening balances: Furniture @ 20% (1/2 to be charged to Bar and Restaurant on collection basis); Tennis Accessories @ 20%; China Cutlery, Linen @ 30% (to be charged on collection basis).

12. From the following Receipts and Payments Account of Kapil Cricket Club and the additional information prepare the Income and Expenditure Account for the year ended 31st March, 2015 and the Balance Sheet as on that date. Receipts and Payments Account for the year ended 31st March, 2015.

Date	Receipts	₹	Date	Payments	₹
1.4.2014	Cash in hand	4,400	31.3.2015	Wages	36,000
"	Current Account balance as per Pass Book	9,400	"	Ground rent	12,000
31.3.2015	Membership fees	48,000	"	Cost of refreshments	90,000
"	Income from refreshments	1,20,000	"	Fun fair expenses	10,000
"	Fun fair receipt	3,000	"	Equipment purchased	40,000
"	Interest received from bank	500	"	Administration expenses	4,500
"	Interest @ 7.5% p.a. on securities	15,000	"	Repairs and maintenance	16,000
"	Sale proceds of Plant & Equipment	28,200	"	Caretaker's salary	15,000
"	Net proceeds of fund-raising match	35,350	"	Cash in hand	5,350
			"	Current Account balance as per Pass Book	35,000
		2,63,850			2,63,850

Other information :

Particulars	1.4.2014	31.3.2015
Value of Plant and Equipment	45,000	50,000
Membership fees due	5,000	2,000
Interest not entered in the Pass Book	—	150
Cheques issued for repair works but not presented	1,500	3,500
Administrative expenses outstanding	1,000	500

Depreciation is to be provided on the closing balance of plant and equipment at 10%. Bonus payable to workers ₹ 3,000 is to be provided. Caretaker's salary in the Receipts and Payments Account pertains to the accounting year 2013-14. The salary for 2014-15 ₹ 18,000 has not yet been paid.

13. From the following Receipts and Payments Account of Janak Puri Football Club and additional information, prepare an Income and Expenditure Account for the year ending 31.3.2015 and a Balance sheet as on that date.

Receipts	₹	Payments	₹
Cash in hand on 1.4.2014	10,200	Purchase of Balls	65,000
Cash at Bank as per Bank Pass Book	30,000	Tournament Fees	10,000
Subscriptions	2,45,000	Affiliation Fees for 5 years	2,000
Interest on Investment	1,800	Rent of Playground	6,000
Sale of Tickets for variety programme	20,000	Expenses on variety programme	15,000
Sale of furniture on 30.9.2014	9,000	Refreshment expenses	4,000
Donation for Club building	50,000	Travelling expenses	20,000
Legacy	11,000	Furniture bought on 1.10.2014	5,000
		Repairs to Building	5,000
		Advance paid to Contractor for pavilion building	50,000
		Salary	15,000
		Telephone bill	1,500
		Miscellaneous Exp. (including Honorarium of ₹ 3,000)	8,000
		12% Investments (F.V. ₹ 1,70,000 bought on 31.12.2014)	1,50,000
		Cash in Hand on 31.3.2015	8,500
		Balance in the Bank as per Pass Book on 31.3.2015	12,000
	3,77,000		3,77,000

Additional information :

(i) Subscriptions received include ₹ 9,000 outstanding subscriptions of the year 2013-14. Subscriptions for the year 2014-15 amounting to ₹ 16,000 is still outstanding. Some members have paid subscriptions for the year 2015-16 amounting to ₹ 8,000 which is included in the subscriptions received.

(ii) Face value of 12% investments on 31.3.2014 was ₹ 15,000 (cost price ₹ 12,000).

(iii) Book value of furniture sold on 1.4.2014 was ₹ 12,000, depreciation being 20% p.a. Provide depreciation on new furniture at the same rate.

(iv) Telephone bill for one quarter of ₹ 300 is outstanding. The charge for each quarter is same for 2013-14 and 2014-15.

(v) Unrepresented cheques for repairs to Building ₹ 4,000 for 2013-14 and ₹ 12,000 for 2014-15.

(vi) Stock of balls with the Club on 31.3.2015 amounted to ₹ 6,000.

14. The assets and liabilities of the Barley Sports Club at 31st December, 2013 were as follows :

	₹		₹
Pavilion at cost less depreciation	13,098	Bar creditors	427
Bank and cash	1,067	Loans to sports club	1,080
Bar stock	291	Accruals :	
Bar Debtors	231	Water	13
Rates prepaid	68	Electricity	130
Contributions owing to sports club by users of sports club facilities	778	Miscellaneous	75
Contribution paid in advance to sports club by users of sports club facilities	398	Loan interest	33

The treasurer has analysed the cash book for the year, and produced the following receipts and payments account for the year ended 31st December, 2014 :

Receipts	₹	Payments	₹
Opening balance	1,067	Bar purchases	2,937
Bar sales	4,030	Repayment of loan capital	170
Telephone	34	Rent of ground	79
Contribution from users of club facilities	1,780	Rates	320
Socials	177	Water	38
Miscellaneous	56	Electricity	506
		Insurance	221
		Repairs to equipment	326
		Expenses of socials	67
		Maintenance of ground	133
		Wages of groundmen	140
		Telephone	103
		Bar sundries	144
		Loan interest	97
		Miscellaneous	163
		Closing balance	1,700
	7,144		7,144

The treasurer also provides the following information as at 31st December, 2014 :

	₹		₹
Bar stock	394	Creditors for bar sundries	65
Bar Debtors	50	Contribution by users of sports club facilities —	
Bar Creditors	901	owing to sports club	425
Rent prepaid	16	paid in advance to sports club	657
Water charges owing	23	Rates prepaid	76
Electricity owing	35	Depreciation on the pavilion for the year	498

You are required : (a) Ascertain the balance on the accumulated fund as at 1st January, 2014; (b) Prepare a statement showing the gross and net profit earned by the bar; and (c) Prepare an Income and Expenditure Account for the year ended 31st December, 2014 and a Balance Sheet as at that date.

15. From the following information relating to the Bengal Club you are required to prepare:
    1. An Income and Expenditure Account (showing separately profit or loss on the bar) for the year ended on 31st December, 2014;
    2. A Balance Sheet as on that date;

    (a) A summary of the Cash Book for the year 2014 is as follows:

Particulars	₹	Particulars	₹
Opening bank balance	850	Salaries & wages	1,500
Annual subscriptions	4,000	Bar wages	1,000
Bar receipts	15,950	Office expenses	450
Hire of rooms	500	Lighting and heating	360
Sale of investments (original cost ₹ 250)	350	Rates and insurance	250
Income from investments	350	Bar supplies	13,350
		Miscellaneous expenses	250
		Investments	1,500
		Furniture (30.6.2014)	1,000
		Closing bank balance	2,340
	22,000		22,000

(b) The balance at bank on 1st January, 2014 represents ₹ 350 on current account and ₹ 500 on deposit account. All the receipts shown in the above summary were paid into the current account except for ₹ 50 deposit account interest (included in income from investments) and all payments were made from the current account. During 2014 ₹ 400 was transferred from the current account to the deposit account.

(c) The following items were outstanding on 31st December:

Particulars	2013	2014	Particulars	2013	2014
Subscriptrions in arrear	100	150	Debtors for bar sales	25	75
Salaries & wages accrued	50	90	Repairs account outstanding	20	60
Creditors for bar supplies	1,225	1,400	Stock of coal	100	70
Stock of stationery	75	85	Bar wages accrued	50	25
Subscriptions in advance	25	40	Rates and insurance prepaid	150	75
Telephone account outstanding	100	50	Stock of bar supplies	1,500	2,000
Electricity account outstanding	30	40			

(d) At 31st December 2014 the club owned the following assets which are shown at the amounts they cost on purchase. At 31st December 2013, they had been in the ownership of the club for the number of years indicated;

	₹	
Freehold premises	10,000	12 years
Furniture	3,000	12 years
Furniture	800	5 years
Investments	10,000	4 years

(e) The club is providing for the depreciation on freehold premises at 2.5 % p.a. and on furniture at 10% p.a., both rates calculated on original cost.

16. The following receipts and payments account for the year ended 31st March 2015 for the Reserve Bank Sports Club has been prepared by the treasurer, Md. Jafar Ali.

Receipts	₹	Payments	₹
To Balance b/f on 1st April 2014 :		By Painting of club house	600
Cash in hand	200	By Maintenance of grounds	1,400
Bank current account	5,500	By Bar steward's salary	6,000
To Members' subscriptions :		By Insurance	240
Ordinary	1,600	By General expenses	1,200
Life	800	By Building society investment account	1,500
To Annual dinner ticket sales	500	By Secretary's honorarium	200

To Bar takings	22,000	By Annual dinner — expenses	600
		By New furniture and fittings	1,870
		By Bar purchases	13,000
		By Rent of club house	500
		By Balance c/d on 31st March, 2015 :	
		Bank current account	3,200
		Cash in hand	290
	30,600		30,600

The following additional information has been given:

1. Ordinary membership subscriptions received in advance at 31st March 2014 was ₹ 200. The subscriptions received during the year ended 31st March 2015 included ₹ 150 in advance for the following year.
2. A life membership scheme was introduced on 1st April 2013. Under the scheme, life membership subscriptions are ₹ 100 and are apportioned to revenue over a ten year period. Life membership subscriptions totalling ₹ 1,100 were received during the first year of the scheme.
3. The Club's building society investment account balance at 31st March, 2014 was ₹ 2,676; during the year ended 31st March, 2015 interest of ₹ 278 was credited to the account.
4. All the furniture and fittings in the Club's account at 31st March, 2014 were bought in January, 2014 at a cost of ₹ 8,000. It is the Club's policy to provide depreciation annually on fixed assets at 10% of the cost of such assets held at the relevant year end.
5. Other assets and liabilities of the club were :

	As at 31st March 2014	2015
Bar stock	1,860	2,110
Insurance prepaid	70	40
Rent accrued	130	140
Bar purchase creditors	370	460

You are required to prepare: (a) the Bar Trading and Profit and Loss Account for the year ended 31st March 2015; and (b) Income and Expenditure Account for the same period and Balance Sheet as at 31st March 2015.

Preparation of Receipts and Payments Account

17. From the following Income and Expenditure Account of Victoria Club for the year ended 31st December 2014 and Balance Sheet as on 31st December 2013 and other information available as on 31st December 2014, prepare Receipts and Payments Account for the year ended 31st December, 2014 and a Balance Sheet as at that date:

Income and Expenditure Account for the year ended 31st December, 2014

Expenditure	₹	Income	₹
To Salaries	50,000	By Subscriptions	94,000
To Rent	11,000	By Entrance fees	6,000
To Travelling expenses	500	By Donations	10,000
To Printing & stationery	1,000	By Interest	5,000
To General charges	1,500		
To Periodicals	500		
To Excess of Income over Expenditure	50,500		
	1,15,000		1,15,000

Balance Sheet as at 31st December, 2013

Liabilities	₹	Assets	₹
General fund	1,72,500	Furniture	40,000
Liabilities :		Sports equipments	20,000
For Rent	1,000	Investments	1,00,000
For Salaries	6,500	Subscriptions receivable	5,000
		Interest receivable	1,000
		Bank balance	14,000
	1,80,000		1,80,000

Other details as on 31.12.2014 are : Subscriptions Receivable — ₹ 8,000; Salaries outstanding — ₹ 4,000; Rent outstanding ₹ 2,000.

18. The Income and Expenditure Account of Repose Club for the year ended 31.12.2014 is as follows:

Expenditure	₹	Income	₹
To Salaries	1,750	By Subscriptions	2,000
To General expenses	500	By Donations	1,050
To Depreciation	300		
To Excess of Income over expenditure	500		
	3,050		3,050

Adjustments were made in respect of the following:

1. Subscriptions for 2013 unpaid at 1st January 2014, ₹ 200; ₹ 180 of which was received in 2014.
2. Subscriptions paid in advance at 1.1.2014, ₹ 50.
3. Subscriptions paid in advance at 31.12.2014, ₹ 40.
4. Subscriptions for 2014 unpaid at 31.12.2014, ₹ 70.
5. Sundry Assets at beginning of the period ₹ 2,600; Sundry Assets after depreciation ₹ 2,700 at the end of the period.
6. Cash balance at 1st January 2014, ₹ 160.

Prepare Receipts and Payments Account for the year ended 31.12.2014.

19. The following Income and Expenditure Account of Joyous Club is given for the year ended on 31st December, 2014:

Expenditure	₹	Income	₹
To Opening Stock of provisions	10,000	By Subscriptions	26,000
To Purchases of provisions	30,000	By Donations	30,000
To Salaries	10,000	By Entrance fees	8,000
To General expenses	3,000	By Sale of provisions	28,000
To Printing & stationery	5,000	By Closing stock of provisions	5,000
To Depreciation on equipment	1,000		
To Excess of income over expenditure	38,000		
	97,000		97,000

The following further information is given :

Balance Sheet of the Club as on 31st December, 2013

Liabilities	₹	Assets	₹
Creditors for provisions	8,000	Equipment at written down value	10,000
General fund	37,000	Stock of provisions	10,000
		Cash in hand & at bank	20,000
		Subscriptions receivable	5,000
	45,000		45,000

Balance Sheet of the Club as on 31st December, 2014

Liabilities	₹	Assets	₹
Creditors for provisions	10,000	Equipment at written down value	15,000
General fund	75,000	Stock of provisions	5,000
		Cash in hand & at bank	45,000
		Subscriptions receivable	20,000
	85,000		85,000

Prepare a Receipts and Payments Account of the club, for the year ended on 31st December, 2014.

Preparation of Income and Expenditure Account from Incomplete Records

20. The Chief Accountant of Best Club Limited suddenly expired on December, 31, 2014 and the following informations were available on that date:

(a) The Books of Account were maintained improperly and the last Balance Sheet as at December 31, 2013 showed the following:

Assets:	₹	₹
Furniture and Fixtures	76,570	
Less : Depreciation to-date	36,570	40,000
Bar Stocks	26,560	
Members' Subscriptions due	720	
Bank balance	96,820	
Cash in hand	1,900	1,26,000
Total		1,66,000
Liabilities:		
General fund		1,52,540
Creditors for bar purchases		13,100
Members' subscriptions in advance		360
Total		1,66,000

(b) Members of the club paid an annual subscriptions of ₹ 60. Duplicate receipts issued showed that as at December 31, 2014, 540 members had paid the current year's subscriptions, 10 members paid arrears of previous year and 5 members paid advance for 2015. Two members resigned without paying their arrears of previous year and as at the end of the year, there were 550 members as per records.

(c) The Cash Book was not written up to date and the records showed that the following bills were paid : Food for bar— ₹ 33,280; Sundry expenses— ₹ 5,440; Repairs and Renewals— ₹ 2,400; Salaries— ₹ 36,690; and Stationery— ₹ 2,290.

(d) The Club's source of income was from bar sales and the bartender generally hands over daily cash collections to the accountant along with cash collection list.
On enquiry, it was found that certain cash collection lists were misplaced or lost. The bartender stated that the average gross profit on bar sales were fifty per cent of sales. Bar stocks as on December 31, 2014 were ₹ 30,260 and cash in hand ₹ 125.

(e) Bank statements were summarized and showed the following:

Balance on 1.1.2014	96,820	Bar purchases	2,39,040
Cash deposited	3,92,310	Salaries	1,19,450
		Rent	62,420
		Power	12,570
		Telephone	910
		Repairs & Renewals	18,510
		Washing machine	5,940
		Balance on 31.12.2014	30,290
	4,89,130		4,89,130

(f) The accountant's records were searched and following unpaid bills were located :
Bar purchases — ₹ 62,540; Power — ₹ 1,830; Stationery — ₹ 2,170; and Telephone — ₹ 460.

You are required to prepare :

(1) Income and Expenditure Account for the year ended December 31, 2014. (2) Balance Sheet as at that date after providing depreciation at 20 per cent on written down value of Fixed Assets.

21. Suresh runs a Circulating Library and his accounts are in a mess. One Bank Account has been used for both the business as well as his personal transactions. After looking into his records you gather the following information:-
    1. Payments for magazines in the year ended 31st March 2015 ₹ 9,700.
    2. Payment of delivery peon's wages for the year ended 31st March 2015 ₹ 2,200.
    3. Payment of other expenses for the year ended 31st March 2015 ₹ 3,080.
    4. Subscriptions collected ₹ 21,695.
    5. He has taken ₹ 500 per month in cash from the subscriptions collections to pay to his wife for their household and personal expenses, depositing the balance of the collections into Bank.
    6. During the year he bought a second-hand car (not used for the business) from a friend for ₹ 4,000. However, as the friend owned him ₹ 250 for subscriptions, the matter was settled by a cheque for the difference.
    7. An assurance policy on his life matured during the year and realised ₹ 7,000.
    8. Suresh issued a cheque for ₹ 1,200 to a friend as loan. The friend is repaying by instalments in cash, and owes ₹ 500 on 31.3.2015.
    9. Magazine subscriptions for the year amounting to ₹ 400 had to be written off by Suresh as irrecoverable.
    10. Other personal payments by cheques total ₹ 2,350.
    11. Cash collected includes ₹ 600 in respect of magazine subscriptions written-off as irrecoverable in a previous year.
    12. Suresh runs the business from his flat for which a rent of ₹ 90 per month is included in the payments for other expenses ₹ 3,080. The living accommodation may be regarded as two-thirds of the whole.
    13. The following balances may be accepted as correct:

	31st March 2014	31st March 2015
Cash in hand	115	70
Bank balance	4,720	5,880
Subscriptions receivable (Debtors) considered good	1,830	2,105
Creditors for purchase of magazines	900	840
Stock of magazines, at cost	2,450	830

You are required to prepare:

1. A Cash and Bank Account for the year;
2. Suresh (Proprietor's) Account for the year;
3. An Income and Expenditure Account of the Circulating Library for the year ended 31st March 2015; and,
4. A Balance Sheet of the Business as at 31st March 2015. (Show your workings.)

Preparation of Opening and Closing Balance Sheet

22. The following particulars related to Fast Sports Club :

Receipts and Payments Account for the year ended 31.12.2014

Receipts	₹	Payments	₹
To Balance	5,000	By Salary (including advance)	7,500
To Admission fees:		By Printing & stationery	2,500
2013	2,500	By Advertising	1,000
2014	13,500	By Insurance charges (partly for next year)	1,200
To Subscriptions:		By Electricity charges	500
2013	1,000	By Purchase of fixed assets	20,000
2014	23,000	By Balance	17,900
2015	2,000		
To Rent	3,600		
	50,600		50,600

On 1st January, 2014 the club had the following assets :

Land and Buildings — ₹ 60,000; Sports equipments — ₹ 30,000; Furniture — ₹ 4,500.

Prepare opening and closing Balance Sheets.

Guide to Answers

Multiple Choice

1. C 2. C 3. C 4. A 5. A.

Practical Questions

1. **Surplus ₹ 3,250. Balance Sheet total ₹ 1,24,450. Subscriptions ₹ 10,600. Opening capital fund ₹ 1,05,500.**
2. **Surplus ₹ 7,590. Balance Sheet total ₹ 1,22,075. Donations have been capitalised. Opening capital fund ₹ 1,06,385.**
3. **Surplus ₹ 1,735. Balance Sheet total ₹ 8,725. Donations have not been capitalised. Opening capital fund ₹ 6,610.**
4. **Deficit ₹ 260. Balance Sheet total ₹ 15,420. Opening capital fund ₹ 15,040. Admission fees have been capitalised.**
5. **Excess of income over expenditure ₹ 17,525. Total of Balance Sheet ₹ 1,19,625. Opening Capital Fund ₹ 95,100. Subscriptions income ₹ 39,500. Admission fees have been capitalised. Depreciation on sports equipments ₹ 7,125.**
6. **Excess of expenditure over income ₹ 2,180; Total of Balance Sheet ₹ 36,380. Opening Capital Fund ₹ 24,960. Subscriptions income ₹ 8,950.**
7. **Cash at bank ₹ 10,350 (₹ 10,440 – ₹ 90).**
   Excess of increase over expenditure ₹ 43,490. Total of Balance Sheet ₹ 1,10,910. Opening Capital Fund ₹ 65,130.
8. **Excess of income over expenditure ₹ 590; Total of Balance Sheet ₹ 52,150. Opening Capital Fund ₹ 50,200.**
9. **Bank Overdraft ₹ 1,08,140.**
   Excess of income over expenditure ₹ 15,100. Total of Balance Sheet ₹ 3,40,440.
10. **Deficit ₹ 2,888. Balance Sheet total ₹ 45,595. Subscriptions ₹ 28,912. Opening capital fund ₹ 47,000.**
11. **Bar profit ₹ 3,033. Restaurant loss ₹ 1,083. Surplus ₹ 20,500. Balance Sheet total ₹ 43,220. Depreciation — 3 : 2 (App.)**
12. **Surplus ₹ 16,200. Balance Sheet total ₹ 2,84,000. Repairs and maintenance ₹ 18,000.**
13. **Excess of income over expenditure ₹ 1,15,800. Total of Balance Sheet ₹ 2,53,700. Opening Capital Fund ₹ 68,500. Subscription Income ₹ 2,44,000.**
14. **Deficit ₹ 707. Bar net profit ₹ 332. Balance Sheet total ₹ 15,261. Opening accumulated fund ₹ 13,377.**
15. **Surplus ₹ 3,660. Bar profit ₹ 2,000. Balance Sheet total ₹ 24,065. Capital fund ₹ 18,700. Subscriptions ₹ 4,035. Depreciation on furniture (₹ 80 + 50) = ₹ 130.**
16. **Deficit ₹ 267. Bar profit ₹ 3,160. Balance Sheet total ₹ 16,577. Subscriptions : ordinary ₹ 1,650. Life ₹ 190.**
17. **Closing balance of Receipts and Payment Account ₹ 61,000. Subscriptions collected ₹ 91,000. B/S total ₹ 2,29,000.**
18. **Closing balance of Receipts and Payment Account ₹ 660. Subscriptions collected ₹ 2,100.**
19. **Subscriptions collected ₹ 11,000. Donations ₹ 30,000. Entrance fees ₹ 8,000. Sales ₹ 28,000.**
20. **Bar purchases ₹ 2,88,480. Bar materials consumed ₹ 2,84,780. Bar sales ₹ 6,36,120. Subscriptions collected ₹ 33,300. Subscriptions credited ₹ 33,000. Surplus ₹ 76,612. Balance Sheet total ₹ 2,96,452.**
21. **Capital fund ₹ 8,215. Subscriptions ₹ 22,020. Surplus ₹ 6,400. Balance Sheet total ₹ 8,885.**
22. **Opening capital fund ₹ 1,03,000. Total of opening Balance Sheet ₹ 1,03,000. Total of closing Balance Sheet ₹ 1,26,900.**

22

Incomplete Records

Introduction

Many small businesses have neither the time nor the experience necessary to maintain a full set of accounting records using the double entry system; and cannot afford the expense of outside staff to keep such records. However, every business is interested to know its profit from time to time. Any set of procedures for ascertaining profits that does not provide for the ***analysis of each transaction*** in terms of the double entry system of bookkeeping is generally referred to as 'Single Entry System'. Strictly speaking, single entry constitutes ***incomplete records*** rather than single entry accounting. Under this system, certain transactions are recorded just like the double entry system; for example : cash collected from debtors — it is recorded in the Debtors Account as well as in the Cash Account. Again, certain transactions are recorded partially, e.g., cash sales, cash purchases, etc. Similarly, certain transactions are not recorded at all, e.g., Bad Debt, Depreciation, etc. Since all the transactions are not recorded strictly on the double entry principle, it is not possible to prepare a Trial Balance and check the arithmetical accuracy of the books of account. Consequently, the system engenders a spirit of laxity and invites frauds and misappropriation.

In India, there are many small-scale business which do not keep complete records for all their financial transactions because the proprietors of these businesses are untrained in accounting and regard it better to keep an additional productive employee rather than a bookkeeper. They assume that without an elaborate accounting system, they can exercise control over assets, expenses, revenues and liabilities. They record few transactions completely just like the double entry system but a majority of the transactions are recorded only partially.

Features of Incomplete Records (Single Entry System)

1. This system is a mixture of: (i) double entry; (ii) single entry; and (iii) no entry.
2. This system is suitable for small businesses where the proprietor or partners can directly control the affairs of the business.
3. In this system, generally Personal Accounts are kept but Real and Nominal Accounts are ignored. This is because, a single entry takes account only of the personal transactions and leaves the impersonal transactions of the business unit entirely unrecorded.
4. In the absence of record of the two-fold aspect of every transaction, it is not possible to prepare a trial balance and check the arithmetical accuracy of the books of account. Similarly, no Balance Sheet can be prepared in the absence of balances in ledger.

5. This system is highly changeable and flexible and it is not governed by any definite rules of operation.
6. Under this system the profit or loss can be found out but its composition will not be available.

Limitations of Incomplete Records (Single Entry System)

Single entry system ignores the concept of duality and, therefore, transactions are not recorded in their two-fold aspects. As a result, the final accounts of the business concern cannot be prepared in the usual way. The other limitations are as under :

1. Since no trial balance can be prepared, arithmetical accuracy of the books of account cannot be checked.
2. This system engenders a spirit of laxity and invites frauds and misappropriations.
3. Since no Nominal Accounts are maintained, the Trading and Profit and Loss Account cannot be prepared and, consequently, the different ratios such as gross profit ratio, net profit ratio and operating ratio, etc., cannot be computed.
4. Owing to incompleteness of record, proper appraisal of the financial position of the business is not possible.
5. No limited company can keep account under this system, because of legal restrictions.

Difference between Double Entry System and Single Entry System

Double Entry System		Single Entry System	
1.	Under this system, both aspects of each transaction are recorded.	1.	Under this system, both aspects of each transaction are not recorded.
2.	In this system, Personal, Real and Nominal Accounts are kept fully.	2.	In this system, only Personal Accounts are kept and Real and Nominal Accounts are ignored. (However, in some cases Cash Account is maintained.)
3.	In this system, Cash Book, General Ledger, Debtors' Ledger and Creditors' Ledger are maintained.	3.	In this system, only Debtors' Ledger and Creditors' Ledger are kept. Cash Book is also kept but personal transactions get mixed up with business transactions.
4.	Under this system, arithmetical accuracy can be checked by preparing Trial Balance at any moment of time.	4.	Under this system, arithmetical accuracy cannot be checked because no Trial Balance can be prepared.
5.	In this system, Trading, Profit and Loss Accounts and Balance Sheet can be prepared.	5.	In this system, Trading, Profit and Loss Accounts and Balance Sheet cannot be prepared.
6.	For interpretation of financial statement, we can compute different ratios, if the accounts are maintained under this method.	6.	Vital ratios cannot be computed (such as gross profit ratio, net profit ratio, etc), if the accounts are maintained under this system.
7.	This system is scientific and follows certain rules.	7.	This system is unscientific and does not follow any concrete rules.

Ascertainment of Profit or Loss

There are mainly two approaches for income determination :

(a) The Transaction Approach, and (b) The Balance Sheet Approach.

(a) The Transaction Approach

When books of account are maintained under complete double entry principles of bookkeeping, this approach is followed for determining the profit or loss of a particular period. In this approach, every transaction is analysed and the following steps are followed:

1. We record only transactions to business — events which can be translated into monetary terms.
2. Every transaction involves two accounts — one of these accounts is debited and the other is credited in the books of primary entry.

3. From books of primary entry, we prepare Ledger Accounts and, thereafter, accounts are balanced.
4. A Trial Balance is prepared from the Ledger; balances to ensure the arithmetical accuracy of the records.
5. After preparing the Trial Balance, adjusting entries are passed to record the internal transactions such as provision for bad debts, depreciation, etc.
6. A second Trial Balance (called Adjusted Trial Balance) is prepared to incorporate the adjusting entries.
7. From the Trial Balance, nominal accounts are transferred to Trading and Profit and Loss Account.
8. The Trading Account shows the gross profit and the Profit and Loss Account shows the net profit or loss.

The above procedures have been discussed here just for comparison of the two approaches.

(b) The Balance Sheet Approach

When books of account are maintained under single entry system, it is not possible to determine profit or loss by the transaction approach because we cannot get full information regarding all transactions.

The problems that arise in the single entry system for the determination of profit can be solved within the context of the fundamental Balance Sheet equation, as under:

Capital = Assets – Liabilities

Under this method, two Balance Sheets (better to say, Statement of Affairs) are prepared. One, at the beginning of the period for finding out ***the Opening Capital*** and the other at the end of the period for finding out ***the Closing Capital.*** A comparison is made between the opening and closing capital. If the closing capital is more than the opening capital, it shows an increase in capital, which means a ***profit.*** Conversely, if the closing capital is less than the opening capital, it shows a decrease in capital, which means a loss for the period. In other words:

Closing Balance Sheet: Assets = Liabilities + Capital
Opening Balance Sheet: Assets = Liabilities + Capital
Change in period : Δ Assets = Δ Liabilities + Δ Capital

The change (Δ) in assets may be due to change in liabilities or capital or both. The increase in assets due to increase in capital represents profit.

Let us take a simple example in which Mr X keeps no adequate records. The firm was set up on 1st January, 2014 with a capital in cash ₹ 50,000. At the end of the year, the following assets and liabilities were revealed:

Assets : Building at cost — ₹ 30,000; Stock — ₹ 10,000; Trade debtors — ₹ 20,000; Cash — ₹ 15,000

Liabilities : Trade creditors — ₹ 5,000. From this, it appears that the changes for the year are :

	Assets =	Liabilities +	Capital
Closing position (₹)	75,000	5,000	70,000
Opening position (₹)	50,000	—	50,000
Net changes (₹)	25,000	5,000	20,000

Assets have increased by ₹ 25,000. Out of this increase, ₹ 5,000 owing to increase in liabilities and ₹ 20,000 owing to increase in capital and it is nothing but profit earned during the year 2014.

We can also calculate the above profit as follows :

Statement of Profit and Loss

	₹
Closing Capital (Assets — Liabilities)	70,000
Less: Opening Capital	50,000
Profit for the year	20,000

The above are only the initial figures for income. Any fresh capital introduced during the period by the owner or any withdrawal by him will definitely affect the size of the profit calculated. The ascertainment of profit by the above process needs to be adjusted for the introduction or withdrawal of capital. This is because, ignoring capital introduced during the period would be an overstatement of income. Similarly, ignoring withdrawals would show an understatement of income. Therefore, if there is any introduction of fresh capital or withdrawal by the proprietor, then the profit or loss should be calculated as follows :

Statement of Profit and Loss

	₹
Closing Capital (Assets — Liabilities)	***
Add: Drawings (Since if they had not been withdrawn from the business, the increase in capital would have been greater)	***
	***
Less: Opening Capital	***
	***
Less: New Capital paid in (Since without the increase in capital would have been smaller)	***
Profit for the year	***

However, the above profit figure is not really a very satisfactory one, because no adjustments have so far been made for depreciation on assets or provision for doubtful debts etc. The above profit is termed as 'Trading Profit' or 'Profit before adjustments'. Therefore, net profit can be ascertained only when we deduct the depreciation, provision, etc from the above trading profit.

Steps For Ascertaining Profit

Step 1 – Calculate Opening Capital : It can be calculated by preparing a Statement of Affairs at the beginning of the year. The Statement of Affairs is just similar to a Balance Sheet. All the assets are shown on the right-hand side and all the liabilities are shown on the left-hand side of the Statement of Affairs. If the total of the right-hand side is greater than the total of the left-hand side, it represents 'Opening Capital'. The assets and liabilities are ascertained as follows:

1. Amount of cash is ascertained by physical count;
2. Bank balance is ascertained from the Pass Book;
3. The closing stock is ascertained by physical stock taking;
4. The balances of debtors and creditors can be ascertained from the list, the trader maintains;
5. Regarding other assets, the trader prepares a list and values them; and
6. Other relevant information is supplied by the trader from his memory.

Step 2

Ascertain the Drawings During the Period : Ascertainment of drawings for the period is a most difficult task. Drawings increase the personal capital but decrease the business capital. Since the entries are recorded from the point of the proprietor, personal affairs of the proprietor get mixed up with the business affairs. To take an account of drawings, all withdrawals from the business must be traced. For calculating drawings, the following are to be considered: (i) How much is drawn from the business at regular intervals for household or private purposes ? and (ii) How much has been utilized for household or private purposes from the sale proceeds or other receipts before depositing it into the bank ?

Step 3 – Ascertain the Capital Introduced During the Period : A trader may introduce new capital (in the form of cash or assets) during the period. The trader is to make a list of the amount of capital introduced during the period.

Step 4 – Calculate Closing Capital : It can be calculated by preparing the closing Statement of Affairs in the same manner we prepare the opening Statement of Affairs in Step 1. However, in the closing Statement of Affairs, we will consider assets and liabilities at the end of the period (***before adjustments***).

Step 5 – Prepare Statement of Profit : The statement of profit is to be prepared as follows:

Statement of Profit and Loss for the year ended ...

		₹
Closing Capital (before adjustment)		***
Add: Drawings for the period		***
		***
Less: Opening Capital	***	
New Capital introduced	***	***
Profit before adjustments		***
Less : Adjustments :		
(i) Depreciation	***	
(ii) Provision for Bad debts, etc	***	***
Net profit for the period		***
Less: Appropriations :		
(i) Salary of the partners*	***	
(ii) Interest on capital*	***	***
Divisible profit *		***

*Applicable to partnership firms.

Final Statement of Affairs

After ascertaining profit by following the above procedures, a final Statement of Affairs is prepared at the end of the period after incorporating adjustment for depreciation, provision for bad debts, etc. The final Statement of Affairs will appear as follows :

Statement of Affairs as at ...

Liabilities	₹	₹	Assets	₹	₹
Opening Capital	***		Plant & Machinery	***	
Add: New Capital introduced	***		*Less:* Depreciation	***	***
Add: Profit for the year	***		Furniture	***	
	***		*Less:* Depreciation	***	***
Less: Drawings	***	***	Debtors	***	
Creditors		***	*Less:* Provision for bad debts	***	***
			Stock		***
			Cash at bank		***
			Cash in hand		***
		***			***

Difference Between Statement of Affairs and Balance Sheet

A Statement of Affairs is a statement of the assets, liabilities and capital prepared from incomplete records whereas a Balance Sheet is a statement of the assets, liabilities and capital extracted from ledger balances maintained under the double entry system.

Under the double entry system, the basic purpose of the Balance Sheet is to show the financial position of the business on the last day of the accounting period. Under single entry, the same purpose is served by the Statement of Affairs. Also, it is used as the basis for calculating the trading profit or loss for the period.

Illustration 1

Mr Sunanda Sanyal, who keeps his books on single entry system, tells you that his capital on 31.12.2014 is ₹ 18,700 and on 1st January, 2014 was ₹ 19,200. He further informs you that he gave loan of ₹ 3,500 to his brother on private account and withdrew ₹ 300 p.m. for personal purposes. He also used a flat for his personal purposes, the rent of which @ ₹ 100 per month and electric charges ₹ 10 per month were paid from the business account. He sold his 7% Government Bond of ₹ 2,000 at 3% premium and brought that money into business. Besides this, there is no other information.

You are required to prepare his Statement of Profit for the year ended 31.12.2014.

Solution

Sunanda Sanyal

Statement of Profit and Loss for the year ended 31st December, 2014

	₹	₹
Closing Capital (31.12.2014)		18,700
Add: Drawings :		
Loan given to brother	3,500	
Withdrawals for personal purposes (₹ 300 x 12)	3,600	
Rent of the flat (₹ 100 x 12)	1,200	
Electric charges (₹ 10 x 12)	120	8,420
		27,120
Less: Capital introduced during the period — 7% of Govt. Bond of ₹ 2,000 at 3% premium, i.e., (₹ 2,000 x 103) / 100		2,060
		25,060
Less: Opening Capital (1.1.2014)		19,200
Profit for the period		5,860

Illustration 2

On January 1, 2014 a trader started a business with a capital of ₹ 1,00,000 with which he opened a bank account. On the same day, he bought furniture and fittings for shop costing ₹ 4,800 and goods for trade costing ₹ 25,000.

On December 31, his stock-in-hand was valued at ₹ 29,000 and furniture and fittings stood at ₹ 6,300. On that date, his book debts amounted to ₹ 78,000 of which ₹ 1,200 was considered to be bad. Creditors amounted to ₹ 15,000. His balance as per Cash Book was ₹ 5,500 a cheque for ₹ 400 sent for deposit on December 30, was not realized till after December 31, and cheque for ₹ 700 issued on December 29, was not presented to Bank till after December 31. Bank charges for the year amounted to ₹ 50 but this was not known to the trader on December 31. His drawings during the year amounted to ₹ 9,300. He had also taken for personal use goods from the shop valued at ₹ 1,500.

Prepare a Statement showing the trader's profit or loss during 2014.

Solution **Ascertainment of Closing Capital (before adjustments)**

Liabilities	₹	Assets	₹
Creditors	15,000	Stock	29,000
Closing capital (balancing figure)	1,03,800	Furniture & Fittings	6,300
		Book debts	78,000
		Cash-at-bank (Note 1)	5,500
	1,18,800		1,18,800

Statement of Profit and Loss for the year ended 31st December, 2014

	₹	₹
Closing Capital (as above)		1,03,800
Add: Drawings during the year :		
Cash	9,300	
Goods	1,500	10,800
		1,14,600
Less: Opening Capital (as given)		1,00,000
Profit before adjustment		14,600
Less: Adjustments :		
Bad debts	1,200	
Bank charges (See Note)	50	1,250
Profit for the period		13,350

Note Since the amended Cash Book balance is to be taken as the closing balance of cash at Bank, there will be no adjustment for: (a) Cheque deposited into bank but not realised, and (b) cheque issued but not presented.

Therefore, in this problem, when we prepare the closing Statement of Affairs, Cash-at-Bank will be ₹ 5,450 (₹ 5,500 – ₹ 50).

Illustration 3

The Statement of Affairs of Sri S. Roy as on 1st April, 2014 is given below:

Liabilities	₹	Assets	₹
Sundry Creditors	16,500	Cash	7,450
Accrued expenses	3,500	Sundry Debtors	25,350
Capital	50,000	Stock	30,300
		Furniture	6,900
	70,000		70,000

During the year ended 31st March, 2015 his drawings amounted to ₹ 15,000. He also withdrew goods worth ₹ 600 for his personal use. On 1st July, 2014, S. Roy transferred some of his household furniture to the business at a value of ₹ 2,100. His assets and liabilities as on 31st March, 2015 were:

Liabilities	₹	Assets	₹
Sundry Creditors	18,600	Cash	6,580
Accrued expenses	4,300	Sundry Debtors	36,900
		Stock	40,320
		Furniture	9,000
		Prepaid Rent	400

Furniture is to be depreciated @ 10% p.a. and a provision is to be created on debtors @ 5%, Interest 5% to be allowed on capital as at the beginning of the year. Ascertain the profit or loss for the year ended 31st March, 2015 and prepare the Statement of Affairs as on that date.

Solution **Ascertainment of Closing Capital (before adjustments)**

Liabilities	₹	Assets	₹
Sundry Creditors	18,600	Cash	6,580
Accrued expenses	4,300	Sundry Debtors	36,900
Closing Capital (balancing figure)	70,300	Stock	40,320
		Furniture	9,000
		Prepaid Rent	400
	93,200		93,200

Statement of Profit and Loss of Sri S. Roy for the year ended 31st March, 2015

		₹
Closing Capital (as above)		70,300
Add: Drawings during the year		
Cash	15,000	
Goods	600	15,600
		85,900

Less : Capital introduced during the year	2,100	
Opening Capital (as given)	50,000	52,100
Profit before adjustments		33,800
Less : Adjustments :		
(i) Depreciation on Furniture (₹ 690 + 158)	848	
(ii) Provision for doubtful debts	1,845	2,693
Net profit for the period		31,107
Less: Interest on Capital (5% of ₹ 50,000)		2,500
Net profit		28,607

Statement of Affairs of Sri S. Roy as at 31st March, 2015

Liabilities	₹	₹	Assets	₹	₹
Opening Capital	50,000		Furniture (₹ 6,900 + ₹ 2,100)	9,000	
Add: New Capital introduced	2,100		Less: Depreciation	848	8,152
Add: Interest on Capital	2,500		Stock		40,320
Add: Profit for the year (Net)	28,607		Sundry Debtors	36,900	
	83,207		Less: Provision for Doubtful debts	1,845	35,055
Less: Drawings	15,600	67,607	Prepaid rent		400
Accrued expenses		4,300	Cash		6,580
Sundry Creditors		18,600			
		90,507			90,507

Illustration 4

R had ₹ 3,00,000 in bank on 1st January 2014 when he started his business. He closed his accounts on 31st March, 2015. His single entry books (in which he did not maintain any account for the bank) showed his position as follows:

	31.3.2014	31.3.2015
Cash in hand	2,000	3,000
Stock in trade	19,000	29,000
Debtors	1,000	2,000
Creditors	5,000	3,000

On 1st February, 2014, he began drawing ₹ 700 per month for his personal expenses from the Cash Box of the business.

His account in the bank had the following entries :

	Deposits	Withdrawals
1.1.2014	3,00,000	—
1.1.2014 to 31.3.2014	—	2,23,000
1.4.2014 to 31.3.2015	2,30,000	2,70,000

The above withdrawals included payments by cheques of ₹ 2,00,000 and ₹ 60,000 respectively during the period from 1st January, 2014 to 31st March, 2014 and from 1st April, 2014 to 31st March, 2015 for the purchase of machinery for the business. The deposits after 1st January, 2014 consisted wholly of sale price received from customers by cheques. Draw up R's Statement of Affairs as at 31st March, 2014 and 31st March, 2015 respectively and work out his profit or loss for the year ended 31st March, 2015.

Solution **Ascertainment of Opening Capital (31st March, 2014)**

Liabilities	₹	Assets		₹
Sundry Creditors	5,000	Cash in hand		2,000
Capital (Balancing figure)	2,94,000	Cash at bank	3,00,000	
		Less: Withdrawals	2,23,000	77,000
		Stock in trade		19,000
		Debtors		1,000
		Machinery		2,00,000
	2,99,000			2,99,000

Ascertainment of Closing Capital (31st March, 2015)

Liabilities	₹	Assets	₹
Sundry Creditors	3,000	Cash in hand	3,000
Capital (balancing figure)	3,28,000	Cash at bank (Note 2)	37,000
		Stock in trade	29,000
		Sundry Debtors	2,000
		Machinery	2,60,000
	3,31,000		3,31,000

Statement of Profit and Loss of R for the year ended 31st March, 2015

		₹
Closing Capital (as above)		3,28,000
Add: Drawings during the year (₹ 700 x 12)		8,400
		3,36,400
Less: Opening Capital (as above)		2,94,000
Net profit for the year		42,400

Notes : 1. The above profit of ₹ 42,400 is earned by R subject to depreciation on machinery;
2. Opening balance + Deposit – Withdrawals = ₹ 77,000 + 2,30,000 – 2,70,000 = ₹ 37,000.

Illustration 5

On 1.1.2014, the assets and liabilities of Sougata Roy, a retailer, were as follows :

Building ₹ 5,00,000; Motor van ₹ 1,00,000; Furniture ₹ 80,000; Stock ₹ 60,000; Debtors ₹ 40,000; Provision for Doubtful Debts ₹ 4,000; Cash ₹ 2,500; Creditors ₹ 42,000; Loan ₹ 1,00,000; Bank Overdraft ₹ 15,000.

The following information was available at 31.12.2013 :

(1) Stock ₹ 60,000; Debtors ₹ 50,000; Cash ₹ 4,500; Creditors ₹ 37,000; Loan ₹ 80,000; Bank Overdraft ₹ 10,000.

(2) No fixed assets had been bought or sold during the year.

(3) Fixed assets are to be depreciated as follows :
(i) Motor van by 20% p.a.; and (ii) Furniture by 25% p.a.

(4) A provision for doubtful debts is to be maintained at 10% of year-end debtors.

(5) Sougata withdrew ₹ 6,000 p.m. for his own use.

(6) On 1.3.2014, Sougata brought further ₹ 30,000 as capital into the business.

You are required to prepare a Statement of Profit and Loss for the year ended 31.12.2014 and a Statement of Affairs as on that date.

Solution

Opening Statement of Affairs as on 1.1.2014

Liabilities	₹	Assets		₹
Opening Capital (Balancing figure)	6,21,500	Building		5,00,000
Loan	1,00,000	Motor van		1,00,000
Creditors	42,000	Furniture		80,000
Bank Overdraft	15,000	Stock		60,000
		Debtors	40,000	
		Less : Provision for doubtful debts	4,000	36,000
		Cash		2,500
	7,78,500			7,78,500

Closing Statement of Affairs as on 31.12.2014

Liabilities	₹	Assets	₹
Closing Capital (Balancing figure)	6,67,500	Building	5,00,000
Loan	80,000	Motor van	1,00,000
Creditors	37,000	Furniture	80,000
Bank Overdraft	10,000	Stock	60,000
		Debtors	50,000
		Cash	4,500
	7,94,500		7,94,500

Statement of Profit and Loss of Sougata Roy for the year ended 31st December, 2014

Particulars	₹	₹
Closing Capital (as above)	6,67,500	
Add : Drawings (₹ 6,000 x 12)	72,000	7,39,500
Less : Opening Capital (as above)	6,21,500	
Capital introduced during the year	30,000	6,51,500
Profit before Adjustments		88,000
Less: Adjustments —		
(1) Depreciation on motor vehicles	20,000	
(2) Depreciation on furniture	20,000	
(3) Provision for doubtful debts	5,000	45,000
Net Profit for the year		43,000

Final Statement of Affairs of Sougata Roy as at 31st December, 2014

Liabilities		₹	Assets		₹
Capital :			Building		5,00,000
Opening balance	6,21,500		Motor van	1,00,000	
Add : Capital introduced	30,000		Less : Depreciation	20,000	80,000
Net profit	43,000		Furniture	80,000	
	6,94,500		Less : Depreciation	20,000	60,000
Less : Drawings	72,000	6,22,500	Stock		60,000
Loan		80,000	Debtors	50,000	
Creditors		37,000	Less : Provision for doubtful debts	5,000	45,000
Bank Overdraft		10,000	Cash		4,500
		7,49,500			7,49,500

Illustration 6

The following balances are obtained from the books of Mr Chetri as on 31st March, 2015 and 31st March, 2014 :

Particulars	31.3.2015	31.3.2014	Particulars	31.3.2015	31.3.2014
Sundry Creditors	1,50,000	2,20,000	Sundry Debtors	1,70,000	1,60,000
Furniture and Fixtures	1,26,000	92,000	Stock	75,000	50,000
Oiffice Equipments	95,400	96,000	Bills Payable	10,000	18,000
Outstanding Salary	6,000	2,000	Outstanding Audit Fees	1,500	1,000
Motor Car	75,200	94,000	Outstanding Printing	560	800
Advance Salary	4,500	2,500	Outstanding Rent	2,500	1,200
Prepaid Insurance	500	300	Outstanding Repairs	1,200	—
Cash and Bank	76,000	90,000			

The following information is relevant for the year 2014-15 :

(i) Cash drawings as per books during 2014-15 amounted to ₹ 30,000.

(ii) He sold one building at New Delhi for ₹ 2,00,000 out of which he invested ₹ 50,000 in his business.

(iii) One sales invoice amounting to ₹ 10,000 dated 2.9.2014 was omitted in the books.

(iv) Outstanding audit fees on 31.3.2015 includes ₹ 300 for 2013-14.

(v) Cash collected from debtors ₹ 12,000 was deposited in his private Bank Account.

You are required to show by means of a statement as to how would you arrive at the Net Profit for the year ended 31.3.2015 if the accounts were maintained on cash basis.

Solution

Chetri

Statement of Profit and Loss for the year ended 31st March, 2015 (under cash basis)

Particulars			₹
Closing Capital (Note 1)			4,48,840
Add: Drawings (₹ 30,000 + 12,000)			42,000
			4,90,840
Less:	Capital introduced	50,000	
	Opening Capital (Note 1)	3,41,800	3,91,800
	Net Profit on Accrual Basis		99,040
Add:	Outstanding Expenses as on 31.3.2015 : Salary — ₹ 6,000; Audit fees — ₹ 1,200 (₹ 1,500 – 300); Printing — ₹ 560; Rent — ₹ 2,500; Repairs — ₹ 1,200		11,460
			1,10,500
Add:	Expenses paid in advance on 31.3.2014 : Advance salary — ₹ 2,500; Prepaid insurance — ₹ 300		2,800
			1,13,300
Less:	Outstanding expenses as on 31.3.2014 : Salary — ₹ 2,000; Audit fees — ₹ 700 (₹ 1,000 – 300); Printing — ₹ 800; Rent — ₹ 1,200		4,700
			1,08,600
Less:	Expenses paid in advance on 31.3.2015 : Advance Salary — ₹ 4,500; Prepaid Insurance — ₹ 500		5,000
	Net Profit on Cash Basis		1,03,600

Working Note : **(1) Ascertainment of Opening and Closing Capital (figures in rupees)**

Liabilities	31.3.2014	31.3.2015	Assets	31.3.2014	31.3.2015
Capital (Balancing figure)	3,41,800	4,48,840	Furniture and Fixtures	92,000	1,26,000
Sundry Creditors	2,20,000	1,50,000	Office Equipments	96,000	95,400

Bills Payable	18,000	10,000	Motor Car	94,000	75,200
Outstanding Salary	2,000	6,000	Stock	50,000	75,000
Outstanding Audit Fees	1,000	1,500	Sundry Debtors	1,60,000	*1,68,000
Outstanding Printing	800	560	Cash and Bank	90,000	76,000
Outstanding Rent	1,200	2,500	Advance Salary	2,500	4,500
Outstanding Repairs	—	1,200	Prepaid Insurance	300	500
	5,84,800	6,20,600		5,84,800	6,20,600

* Final balance of debtors : Balance as given ₹ 1,70,000 + Sales omitted ₹ 10,000 – Collections from debtors ₹ 12,000 = ₹ 1,68,000.

Tutorial Note : Opening capital and Closing capital can be ascertained on cash basis, ignoring outstanding expenses and prepaid expenses as well as advance salary. In that case, opening capital will be ₹ 3,44,000 and closing capital will be ₹ 4,55,600. However, profit will be the same, i.e., ₹ 1,03,600; ₹ (4,55,600 + 42,000 – 3,44,000 – 50,000).

Illustration 7

Mr Kothari does not keep complete records of his business but gives you the following information:

His assets on 31.3.2015 consisted of Machineries ₹ 1,50,000; Furniture ₹ 60,000; Motor Car ₹ 40,000; Stock-in-trade ₹ 50,000; Debtors ₹ 80,000; Cash in hand ₹ 12,000 and Cash at Bank ₹ 30,000; Creditors on that date amounted to ₹ 1,20,000.

On further information received, you come to know that:

On 1.10.2014 he purchased a new machinery costing ₹ 50,000.

Sales are made for cash as well as on credit. There is no cash purchases. He always sells his goods at cost plus 25%. Cash sales for the year 2014-15 were accounted for ₹ 80,000.

During the year 2014-15 collection from debtors amounted to ₹ 5,00,000 and a sum of ₹ 4,25,000 was paid to creditors. He obtained a Bank loan for ₹ 50,000 on 1.2.2014. The entire amount was repaid in February, 2015 with interest ₹ 2,500.

In November, 2014 his life insurance policy for ₹ 50,000 became matured and the same was invested in the business. His drawings were ₹ 2,500 p.m. all through the year.

On 1.4.2014 he had ₹ 1,500 as cash in hand and balance at bank for ₹ 40,000. Debtors and Creditors on that date amounted to ₹ 60,000 ad ₹ 90,000 respectively.

Provide depreciation on Machineries @ 15% p.a., on Furniture @ 10% p.a. and on Motor Car @ 20% p.a.

Mr Kothari requests you to prepare a statement of Profit & Loss for the year ended 31.3.2015.

Solution

Working Notes

(1) Ascertainment of Opening Capital

Liabilities	₹	Assets	₹
Creditors	90,000	Machineries (Note 6)	1,00,000
Bank Loan	50,000	Furniture	60,000
Outstanding Interest (Note 7)	417	Motor Car	40,000
Capital (balancing figure)	2,36,083	Stock in trade (Note 5)	75,000
		Debtors	60,000
		Cash in hand	1,500
		Cash at bank	40,000
	3,76,500		3,76,500

(2) Ascertainment of Closing Capital (before adjustments)

Liabilities	₹	Assets	₹
Creditors	1,20,000	Machineries	1,50,000
Capital (balancing figure)	3,02,000	Furniture	60,000
		Motor Car	40,000
		Stock in trade	50,000
		Debtors	80,000
		Cash in hand	12,000
		Cash at bank	30,000
	4,22,000		4,22,000

Dr. **(3) Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Bank A/c	4,25,000	1.4.2014	By Balance b/d	90,000
31.3.2015	To Balance c/d	1,20,000	?	By Credit purchases (balancing figure)	4,55,000
		5,45,000			5,45,000

Dr. **(4) Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d	60,000	?	By Bank A/c	5,00,000
?	To Credit sales (balancing figure)	5,20,000	31.3.2015	By Balance c/d	80,000
		5,80,000			5,80,000

(5) Ascertainment of Opening Stock : Total Sales = Credit sales + Cash sales = ₹ 5,20,000 + ₹ 80,000 = ₹ 6,00,000.
Gross profit is 25% on cost or 20% on sales. Therefore, cost of goods sold is 80% of Sales = 80% of ₹ 6,00,000 = ₹ 4,80,000.
We know, Opening stock + Purchases = Cost of goods sold + Closing stock
Or Opening Stock + ₹ 4,55,000 = ₹ 4,80,000 + ₹ 50,000; Or Opening Stock = ₹ 75,000.

Dr. **(6) Machineries Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d (balancing figure) To Bank A/c	1,00,000 50,000	31.3.2015	By Balance c/d	1,50,000
		1,50,000			1,50,000

(7) Statement showing allocation of interest
Total interest from 1.2.2014 to 1.2.2015 = ₹ 2,500; Therefore, interest from 1.2.2014 to 31.3.2014 = ₹ 417;
And, interest from 1.4.2014 to 1.2.2015 = ₹ 2,083.
(8) Depreciation on Machinery
On ₹ 1,00,000 @ 15% for 1 year = ₹ 15,000 + On ₹ 50,000 @ 15% for 1/2 year = ₹ 3,750; Therefore, total = ₹ 18,750.

Statement of Profit and Loss of Kothari for the year ended 31st March, 2015

		₹
Closing Capital		3,02,000
Add: Drawings for the period (₹ 2,500 x 12)		30,000
		3,32,000
Less: Opening Capital	2,36,083	
New Capital introduced	50,000	2,86,013
Profit before adjustments		45,917
Less : Adjustments :		
(i) Depreciation on Machinery @ 15% p.a.	18,750	
(ii) Depreciation on Furniture @ 10% p.a.	6,000	
(iii) Depreciation on Motor Car @ 20% p.a.	8,000	32,750
Net Profit		13,167

Single Entry System as Applied to Partnerships

When the single entry system is adopted by a partnership firm, the calculation of profit or loss is made along the lines indicated before. The Statement of Affairs would yield the amount of the combined capital of the partners; and the Statement of Profit and Loss would show the profit made during the year, which should be divided among the partners in agreed proportions.

Therefore, in case of a partnership firm, the Statement of Profit and Loss will be as under :

Statement of Profit and Loss for the year ended ...

		₹
Combined closing Capital		***
Add: Combined drawings for the period		***
		***
Less: Combined opening Capital	***	
Combined new Capital introduced	***	***
Profit before adjustments		***
Less : Adjustments :		
(i) Depreciation	***	
(ii) Provision for Doubtful debts etc	***	***
Net profit for the period		***
Less: Appropriations :		
(i) Salary of the partners	***	
(ii) Interest on Capital	***	***
Add: Interest on Drawings		***
Divisible profit		***

Illustration 8

Akash and Bikash are partners in a firm sharing profits and losses in the proportion of 3 and 2. They keep their books on the Single Entry System. On 31st December, 2013, the following Statement of Affairs was extracted from their books:-

Liabilities	₹	Assets	₹
Capital Accounts		Plant & Machinery	30,000
Akash	25,000	Stock	20,000
Bikash	20,000	Sundry Debtors	35,000
Loan — Bikash	25,000	Cash at bank	15,000
Sundry Creditors	30,000		
	1,00,000		1,00,000

On 31st December, 2014, their assets and liabilities were: Sundry Debtors ₹ 40,000; Sundry Creditors ₹ 25,000; Plant and Machinery ₹ 50,000; Stock ₹ 30,000; Bills Receivable ₹ 5,000; Cash at Bank ₹ 25,000; Loan —Bikash ₹ 25,000.

You are required to prepare a Profit and Loss Statement for the year ended 31st December, 2014 and a Statement of Affairs as at that date after taking into consideration the following:

(a) Plant and machinery is to be depreciated by 10% p.a.
(b) Stock is to be reduced to ₹ 25,000.
(c) A provision for bad debts to be raised at 5% on Sundry Debtors.
(d) Interest on loan is to be allowed at 6% p.a.
(e) During the period Akash and Bikash drew ₹ 5,000 and ₹ 3,000 respectively.

Solution **Ascertainment of Combined Closing Capital (Before adjustments)**

Liabilities	₹	Assets	₹
Sundry Creditors	25,000	Sundry Debtors	40,000
Loan — Bikash	25,000	Plant & Machinery	50,000
Capital (balancing figure)	1,00,000	Stock	30,000
		Bills Receivable	5,000
		Cash at bank	25,000
	1,50,000		1,50,000

Statement of Profit and Loss of Akash and Bikash for the year ended 31st December, 2014

		₹
Combined closing Capital (as above)		1,00,000
Add: Combined Drawings during the year (₹ 5,000 + ₹ 3,000)		8,000
		1,08,000
Less : Combined Opening Capital (₹ 25,000 + ₹ 20,000)		45,000
Profit before adjustments		63,000
Less : Adjustments :		
(i) Stock written-off	5,000	
(ii) Depreciation on Plant & Machinery (₹ 3,000 + ₹ 1,000)	4,000	
(iii) Provision for Doubtful debts (5% on ₹ 40,000)	2,000	
(iv) Interest on loan (6% of ₹ 25,000)	1,500	12,500
Divisible profit :		50,500
Akash — 3/5th of ₹ 50,500	30,300	
Bikash 2/5th of ₹ 50,500	20,200	50,500

Statement of Affairs of Akash & Bikash as at 31st December, 2014

Liabilities	₹	₹	Assets	₹	₹
Capital — Akash			Plant & Machinery	50,000	
Opening balance	25,000		Less: Depreciation	4,000	46,000
Add: Profit	30,300		Stock		25,000
	55,300		Sundry Debtors	40,000	
Less: Drawings	5,000	50,300	Less: Provision for Doubtful debts	2,000	38,000
Capital — Bikash			Bills Receivable		5,000
Opening balance	20,000		Cash at bank		25,000
Add: Profit	20,200				
	40,200				
Less: Drawings	3,000	37,200			
Loan — Bikash	25,000				
Add: Outstanding interest	1,500	26,500			
Sundry Creditors		25,000			
		1,39,000			1,39,000

Illustration 9

A and B are carrying on business in partnership sharing profits and losses equally. They were unable to maintain full and complete records. From the following available information, compute the profits of the firm and prepare a Balance Sheet:

	1.1.2014 (₹)	31.12.2014 (₹)
Land and Building (cost)	50,000	50,000
Machinery (cost)	60,000	75,000
Furniture (cost)	20,000	25,000
Stock	12,000	30,000
Debtors	17,000	22,000
Bank	4,900	5,000
Cash	1,100	5,000
Prepaid Insurance Premium	5,000	—
Bills Receivable	—	8,000
Creditors	60,000	50,000
Bills Payable	10,000	—

At the beginning of the year, the capital of the partners were equal. During the year, A brought in ₹ 15,000 and B has withdrawn ₹ 5,000. An insurance policy matured during the year for ₹ 10,000. A sum of ₹ 4,000 has become bad out of debtors. Provision has to be made for depreciation @ 10% on Land and Building, Machinery and Furniture.

Solution

Ascertainment of Combined Opening Capital

Liabilities	₹	Assets	₹
Creditors	60,000	Land and Building	50,000
Bills Payable	10,000	Machinery	60,000
Capital (balancing figure)		Furniture	20,000
A — 1/2 of ₹ 1,00,000	50,000	Stock	12,000
B — 1/2 of ₹ 1,00,000	50,000	Debtors	17,000
		Bank	4,900
		Cash	1,100
		Prepaid Insurance Premium	5,000
	1,70,000		1,70,000

Ascertainment of Combined Closing Capital (before adjustments)

Liabilities	₹	Assets	₹
Creditors	50,000	Land and Building	50,000
Capital (balancing figure)	1,70,000	Machinery	75,000
		Furniture	25,000
		Stock	30,000
		Debtors	22,000
		Bank	5,000
		Cash	5,000
		Bills Receivable	8,000
	2,20,000		2,20,000

Statement of Profit and Loss of A and B for the year ended 31st December, 2014

		₹
Combined closing Capital (as above)		1,70,000
Add: Drawings by B		5,000
		1,75,000
Less : Capital introduced by A	15,000	
Opening combined Capital	1,00,000	1,15,000
Profit before adjustments		60,000
Less: Profit on insurance policy (₹ 10,000 — ₹ 5,000)		5,000
Trading profit before adjustments		55,000
Less : Adjustments :		
(i) Depreciation on (Land & Building ₹ 5,000; Machinery ₹ 7,500; Furniture ₹ 2,500)	15,000	
(ii) Bad debts	4,000	19,000
Divisible profit :		36,000
A — 1/2 of ₹ 36,000	18,000	
B — 1/2 of ₹ 36,000	18,000	36,000

Balance Sheet as at 31st December, 2014

Liabilities		₹	Assets		₹
Capital — A			Land and Building	50,000	
Opening Balance	50,000		Less: Depreciation	5,000	45,000
Add: Introduced	15,000		Machinery	75,000	
Profit	18,000		Less: Depreciation	7,500	67,500
Profit on insurance	2,500	85,500	Furniture	25,000	
			Less: Depreciation	2,500	22,500
Capital — B			Stock in trade		30,000
Opening Balance	50,000		Sundry Debtors	22,000	
Add: Profit	18,000		Less: Bad debts	4,000	18,000
Profit on insurance	2,500		Bills Receivable		8,000
	70,500		Cash at bank		5,000
Less: Drawings	5,000	65,500	Cash in hand		5,000
Sundry Creditors		50,000			
		2,01,000			2,01,000

Preparation of Final Accounts from Incomplete Records

The procedure to be adopted for preparation of final accounts from incomplete (single entry) records depends upon the nature of the records and data available. It is not possible to give a formula which can be applied in every situation. However, as a general rule, the following steps are followed :

Step 1 Prepare opening Balance Sheet, if last year's Balance Sheet is not available. In examination problem on incomplete records, it may not be possible to prepare the opening Balance Sheet due to the missing out of opening balances of certain assets and liabilities. For example, opening debtors or opening creditors or opening cash in hand may be missing. In such a situation, students are advised to prepare the Balance Sheet as far as possible with the available information and leave it for the time being. (I have discussed the procedures of calculating missing figures in the next few pages.)

Step 2 If no Cash Account or Bank Account is maintained properly, a careful scrutiny of the Bank Statement or Pass Book shall be made and enquiry should be done in respect of the amount of cash takings which has been used by the trader for meeting personal expenses, business expenses or for cash purchases, etc. After collecting information through enquiry and scrutiny, a Cash Book (with cash and bank columns etc.) should be prepared as follows :

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

Particulars	Cash	Bank	Particulars	Cash	Bank
To Balance b/d			By Sundry Creditors (Payments)		
To Sundry Debtors (Collection)			By Assets (Purchased)		
To Sales (Cash)			By Drawings		
To Income from Interest			By Wages		
To Sale of Assets			By Balance c/d		

In examination problems, the opening or closing balance of cash or bank may be missing. The balance of the Cash Book will represent the respective figure at the beginning or at the end. Cash Book must be prepared even when both the opening and closing balances of cash and bank are given. The shortage on the debit side of cash column represents cash sales or capital introduced or sundry income. Similarly, shortage on the credit side of the cash column represents cash purchases, drawing or sundry expenses. Where the Cash Book is maintained, care should be taken in respect of private income and private expenditure which have been entered in the Cash Book. All the private income such as interest on private investment, etc should be credited to Capital Account. Similarly, all the private payments should be debited to Capital Account.

Step 3 Prepare Total Debtors Account, Total Creditors Account, Bills Receivable Account and Bills Payable Account, Total Sales Account and Total Purchases Account. The preparation of these accounts will help for finding out different missing information regarding; (i) opening/closing debtors balances; (ii) opening/closing creditors balances; (iii) credit purchases; and (iv) credit sales, etc.

Step 4 Now complete the opening Balance Sheet (left incomplete at Step 1) with the available information. The balance of the Balance Sheet represents ***Opening Capital***.

Step 5 Draft a pro-forma Profit and Loss Account and Balance Sheet (this is without figures).

Step 6 Enter the balances from the opening Balance Sheet into the appropriate ledger accounts or the appropriate place in the final accounts

Step 7 Post the cash and bank accounts entries either to the appropriate ledger accounts or to the draft final accounts.

Step 8 Enter the closing adjustments (depereciation, outstanding, prepaid, bad debts, stock etc.) either in the appropriate ledger account or the draft final accounts, making sure that the double entry is followed.

Step 9 Transfer the balancing figures of the ledger account to the final accounts.

Step 10 Complete the final accounts.

Initially these steps may look complicated and difficult to remember. Actually they should not cause too many problems, if you practice a little.

Calculation of Missing Figures

In examination problems on incomplete records, there must be certain missing figures. For finding out those, the relevant account is prepared. Missing figures come out by way of ***balancing figures***.

Illustration 10

S, a trader, does not keep a complete set of books. On May 1, 2014 his debtors were ₹ 24,500 and creditors ₹ 7,500.

A summary of his Cash Book for the year to 30th April, 2015 showed the following totals:

	Cash (₹)	Bank (₹)
Credits — Payments to Creditors for purchases	1,350	11,250
Deibis — Receipts from Debtors for sales	—	21,250
Sale of machinery	13,000	—
Rent of warehouse sublet	390	—
Cash sales	5,000	3,750
Cash Capital introduced on November 1, 2014	—	2,500

At April 30, 2015 the debtors and creditors respectively amounted to ₹ 44,000 and ₹ 9,750; Cash discount allowed to debtors were ₹ 230 and those received from creditors were ₹ 810.

Ascertain Total Sales and Total Purchases for the year.

Solution

Dr. Total Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.5.2014	To Balance b/f	24,500	30.4.2015	By Bank	21,250
30.4.2015	To Credit Sales (balancing figure)	40,980	30.4.2015	By Discount allowed	230
			30.4.2015	By Balance c/d	44,000
		65,480			65,480

Dr. Total Creditors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.4.2015	To Cash	1,350	1.5.2014	By Balance b/f	7,500
30.4.2015	To Bank	11,250	30.4.2015	By Credit purchases (balancing figure)	15,660
30.4.2015	To Discount received	810			
30.4.2015	To Balance c/d	9,750			
		23,160			23,160

Calculation of Total Sales and Total Purchases : Total Sales = Cash ₹ 8,750 + Credit ₹ 40,980 = ₹ 49,730;
Total Purchases = Cash ₹ Nil + Credit ₹ 15,660 = ₹ 15,660.

Illustration 11

Sri Bose kept his books under Single Entry System. From the following particulars obtained from his books, you are required to calculate : Total Sales and Total Purchases during the year 2014-15.

	₹
Balance as on 1.4.2014 :	
Debtors	56,250
Creditors	43,525
Bills Receivable	30,200
Bills Payable	15,275
Transactions during the year :	
Cash Sales	10,280
Cash Purchases	18,530
Cash paid to Creditors (including ₹ 2,000 for purchase of office furniture)	26,500
Cash received from Debtors	31,960
Discount earned from suppliers	2,325
Bad Debts written off	3,200
Return Inward	2,650
Discount allowed to customers	3,150
Return Outward	2, 000
Payment made against Bills Payable	16,000
Cash received against Bills Receivable	28,300
Balance as on 31.3.2015 :	
Debtors	52,450
Creditors	39,000
Bills Receivable	27,200
Bills Payable	27,900

Solution

Dr. Bills Payable Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 ?	To Cash A/c	16,000	1.4.2014	By Balance b/d	15,275
31.3.2015	To Balance c/d	27,900		By Total Creditors A/c (Balancing figure)	28,625
		43,900			43,900

Dr. Total Creditors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015 ?	To Cash A/c (₹ 26,500 – 2,000)	24,500	1.4.2014	By Balance b/d	43,525
	To Discount Received A/c	2,325		By Credit Purchases (Balancing figure)	52,925
	To Purchase Returns A/c	2,000			
	To Bills Payable A/c	28,625			
31.3.2015	To Balance c/d	39,000			
		96,450			96,450

Dr. Bills Receivable Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d	30,200	?	By Cash A/c	28,300
	To Debtors A/c (Balancing figure)	25,300	31.3.2015	By Balance c/d	27,200
		55,500			55,500

Dr. Total Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d	56,250	?	By Cash A/c	31,960
	To Credit Sales (Balancing figure)	62,460		By Bad Debts A/c	3,200
				By Return Inward A/c	2,650
				By Discount Allowed A/c	3,150
				By Bills Receivable A/c	25,300
			31.3.2015	By Balance c/d	52,450
		1,18,710			1,18,710

(a) Total Sales = Cash Sales + Credit Sales = ₹ 10,280 + ₹ 62,460 = ₹ **72,740**.
(b) Total Purchases = Cash Purchases + Credit Purchases = ₹ 18,530 + ₹ 52,925 = ₹ **71,455**.

Illustration 12

From the following facts supplied by A, who keeps his books on single entry, you are required to calculate Total Purchases and Bills Payable Account:

	₹		₹
Opening balance of Bills payable	5,000	Bills payable discharged during the year	8,900
Opening balance of Creditors	6,000	Cash paid to Creditors during the year	30,200
Closing balance of Bills payable	9,000	Returns outwards	1,200
Closing balance of Creditors	4,000	Cash purchases	25,800

Solution

Dr. Bills Payable Account Cr.

Particulars	₹	Particulars	₹
To Cash	8,900	By Balance b/f	5,000
To Balance c/d	9,000	By Total creditors (balancing figure)	12,900
	17,900		17,900

Dr. Total Creditors Account Cr.

Particulars	₹	Particulars	₹
To Cash	30,200	By Balance b/f	6,000
To Returns outwards	1,200	By Credit purchases (balancing figure)	42,300
To Bills payable (Acceptance given)	12,900		
To Balance c/d	4,000		
	48,300		48,300

Total purchases = Cash ₹ 25,800 + Credit ₹ 42,300 = ₹ 68,100.

Illustration 13

From the following facts supplied by Mr X, who keeps his books on the single entry system, you are required to calculate "Total Sales" :

Opening balance of bills receivable ₹ 2,500; Opening balance of sundry debtors ₹ 3,900; Closing balance of bills receivable ₹ 3,500; Closing balance of Sundry debtors ₹ 2,540; Bills receivable encashed during the year ₹ 10,000; Cash received from Debtors during the year (Including ₹ 300 being the sales proceeds of an old typewriter sold on credit received during the year) ₹ 29,000; Returns Inwards ₹ 560; Bad debts written-off ₹ 700; Bills receivable dishonoured ₹ 500; Cash Sales ₹ 7,000.

Solution

Dr. Bills Receivable Account Cr.

Particulars	₹	Particulars	₹
To Balance b/f	2,500	By Cash	10,000
To Total Debtors A/c	11,500	By Total Debtors A/c (Bills receivable dishonoured)	500
(Bills receivable recd. during the year — balancing figure)		By Balance c/d	3,500
	14,000		14,000

Dr. Total Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/f	3,900	By Cash (₹ 29,000 — ₹ 300)	28,700
To Bills Receivable (dishonoured)	500	By Returns Inwards	560
To Credit sales (balancing figure)	39,600	By Bad debts	700
		By Bills Receivable	11,500
		By Balance c/d	2,540
	44,000		44,000

Total sales = Cash ₹ 7,000 + Credit ₹ 39,600 = ₹ 46,600.

Illustration 14

From the following information, calculate Drawings in cash by the proprietor :

Opening cash in hand	10,000	Cash purchases	15,000
Opening cash at bank	5,000	Purchase of furniture (for office use) in cash	600
Cash sales	20,000	Expenses — Cash	1,000
Cash collected from Debtors	50,000	Expenses — Cheque	1,500
Drawings by cheque	5,000	Cash deposited	60,000
Cheque issued to creditors	30,000	Closing cash in hand	12,500
Closing cash at bank	8,500		

Solution

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

Particulars	Cash	Bank	Particulars	Cash	Bank
To Balance b/f	10,000	5,000	By Drawings		5,000
To Sales	20,000		By Creditors		30,000
To Sundry Debtors	50,000		By Purchases	15,000	
To Cash "C"		60,000	By Office furniture	600	
To Bank "C"	20,000		By Sundry expenses	1,000	1,500
			By Bank "C"	60,000	
			By Cash (balancing) "C"		20,000
			By Drawings (balancing figure)	10,900	
			By Balance c/d	12,500	8,500
	1,00,000	65,000		1,00,000	65,000

Therefore, the drawings for the period is ₹ 10,900 in cash.

Illustration 15

X does not maintain proper books of account. From the following information, prepare Trading and Profit and Loss Account for the year ended December 31, 2014 and a Balance Sheet as on that date :

Assets and Liabilities	On 31.12.2013 ₹	On 31.12.2014 ₹
Debtors	9,000	12,500
Stock	4,900	6,600
Furniture	500	750
Creditors	3,000	2,250

Analysis of other transactions are :	₹
Cash collected from Debtors	30,400
Cash paid to Creditors	22,000
Salaries	6,000
Rent	750
Office Expenses	900
Drawings	1,500
Fresh Capital introduced	1,000
Cash Sales	750
Cash Purchases	2,500
Discount Received	350
Discount Allowed	150
Return Inward	500
Return Outward	400
Bad Debts	100

He had ₹ 2,500 cash at the beginning of the year.

Solution

X

Dr. **Trading and Profit and Loss Account for the year ended 31st December, 2014** **Cr.**

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		4,900	By Sales : Cash	750	
To Purchases : Cash	2,500		Credit (Note 2)	34,650	
Credit	22,000			35,400	
	24,500		Less: Returns Inward	500	34,900
Less: Returns Outward	400	24,100	By Closing Stock		6,600
To Gross Profit c/d		12,500			
		41,500			41,500
To Salaries		6,000	By Gross Profit b/d		12,500
To Rent		750	By Discount Received		350
To Office Expenses		900			
To Discount Allowed		150			
To Bad Debts		100			
To Net Profit (transferred to Capital)		4,950			
		12,850			12,850

Balance Sheet of X as at 31st December, 2014

Liabilities	₹	Assets	₹
Capital : Opening balance (Note 3)	13,900	Furniture	750
Add: Capital introduced	1,000	Stock	6,600
Net Profit	4,950	Debtors	12,500
	19,850	Cash (Note 4)	750
Less: Drawing	1,500		
	18,350		
Creditors	2,250		
	20,600		20,600

Working Notes :

Dr. (1) Creditors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 ?	To Cash A/c	22,000	1.1.2014	By Balance b/d	3,000
	To Discount Received A/c	350		By Credit Purchases (Balancing figure)	22,000
	To Returns Outward A/c	400			
31.12.2014	To Balance c/d	2,250			
		25,000			25,000

Dr. (2) Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d	9,000	2014 ?	By Cash A/c	30,450
	To Credit Sales (Balancing figure)	34,650		By Discount Allowed A/c	150
				By Returns Inward A/c	500
				By Bad Debts A/c	100
				By Balance c/d	12,500
		43,650			43,650

(3) Balance Sheet of X as at 31st January, 2014

Liabilities	₹	Assets	₹
Capital (Balancing figure)	13,900	Furniture	500
Creditors	3,000	Stock	4,900
		Debtors	9,000
		Cash	2,500
	16,900		16,900

Dr. (4) Cash Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d	2,500		By Creditors A/c	22,000
	To Debtors A/c	30,400		By Sales A/c	6,000
	To Capital (Introduced)	1,000		By Rent A/c	750
	To Sales	750		By Office Expenses A/c	900
				By Drawings A/c	1,500
				By Purchases A/c	2,500
				By Furniture (Purchased)	250
			31.3.2014	By Balance c/d	750
		34,650			34,650

Illustration 16

Mr Sen did not keep the books of accounts of his business in double entry system. But he maintained the following record of cash transactions :

Receipts	₹	Payments	₹
Opening (1.1.2014) :		Purchase	30,000
Cash in Hand	30,000	Payment to Creditors	45,000
Cash at Bank	40,000	Wages	20,000
Sales	80,000	Salary	22,000
Collection from Debtors	75,000	Rent	6,000
Sale of Furntirue	5,000	Outstanding rent of last year	2,000
		Selling Expenses	3,000

		Closing (31.12.2014) :	
		Cash in Hand	12,000
		Cash at Bank	90,000
	2,30,000		2,30,000

The following information is also received :

Particulars	On 31.12.2013 ₹	On 31.12.2014 ₹
Debtors	60,000	75,000
Creditors	20,000	15,000
Stock-in-trade	13,000	18,000
Machinery	80,000	80,000
Furntirue	30,000	17,000

Furniture was sold on 1 January, 2014 and on the same date Mr Sen took furniture worth ₹ 5,000 for his personal use. Depreciation on machinery and furniture was charged @ 10% per annum. Debt of ₹ 1,000 became bad.

Prepare Trading and Profit and Loss Account for the year ended 31 December, 2014 and Balance Sheet as on that date.

Solution

Mr Sen

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		13,000	By Sales : Cash	80,000	
To Purchases : Cash	30,000		Credit (Note 2)	91,000	1,71,000
Credit (Note 1)	40,000	70,000	By Closing Stock		18,000
To Wages		20,000			
To Gross Profit c/d		86,000			
		1,89,000			1,89,000
To Salary		22,000	By Gross Profit b/d		86,000
To Rent		6,000			
To Selling Expenses		3,000			
To Bad Debts		1,000			
To Loss on Sale of Furniture (Note 4)		3,000			
To Depreciation :					
Furniture (Note 5)	1,700				
Machinery	8,000	9,700			
To Net Profit c/d		41,300			
		86,000			86,000

Balance Sheet of Mr Sen as at 31st December, 2014

Liabilities	₹	Assets		₹
Capital : Opening Balance (Note 3)	2,31,000	Machinery	80,000	
Add: Net Profit	41,300	Less: Depreciation	8,000	72,000
	2,72,300	Furniture	17,000	
Less: Drawings (Furniture taken over)	5,000	Less: Depreciation	1,700	15,300
	2,67,300	Debtors		75,000
Creditors	15,000	Stock		18,000
		Bank		90,000
		Cash		12,000
	2,82,300			2,82,300

Working Notes :

Dr. (1) Creditors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 ?	To Cash A/c	45,000	1.1.2013	By Balance b/d	20,000
31.12.2013	To Balance c/d	15,000		By Purchases A/c (Balancing figure)	40,000
		60,000			60,000

Dr. (2) Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2013	To Balance b/d	60,000	2013 ?	By Cash A/c	75,000
	To Sales A/c (Balancing figure)	91,000		By Bad Debts A/c	1,000
			31.12.2013	By Balance c/d	75,000
		1,51,000			1,51,000

(3) Balance Sheet of Mr Sen as at 1st January, 2014

Liabilities	₹	Assets	₹
Capital (Balancing figure)	2,31,000	Machinery	80,000
Creditors	20,000	Furniture	30,000
Outstanding Rent (Last year's)	2,000	Debtors	60,000
		Stock	13,000
		Bank	40,000
		Cash	30,000
	2,53,000		2,53,000

(4) Loss on Sale of Furniture

Cost of furniture sold ₹ 30,000 – ₹ (17,000 + 5,000) = ₹ 8,000.

Loss on sale = ₹ (8,000 – 5,000) = ₹ 3,000.

(5) Depreciation on Furniture = 10% of ₹ 17,000 = ₹ 1,700.

Illustration 17

Mr X carries on a small business, but he does not maintain a complete set of books of accounts. He banks all receipts and makes all payments only by means of cheques. He maintains properly a Cash Book, a Sales Ledger and a Purchase Ledger. He also makes a proper record of the assets and liabilities as at the close of every accounting year. From such records you are able to gather the following facts :

	₹
Receipts for the year ended March 31, 2014 :	
From Sundry Debtors (Sales Ledger Account)	17,625
Cash Sales	4,125
Paid in by Mr X, the proprietor	2,500
Payments made in the year ended March 31, 2014 :	
New Furniture Purchased	625
Drawings	1,500
Wages	6,725
Salaries	1,125
Interest paid	75
Telephone	125
Rent	1,200
Light and Power	475
Sundry Expenses	2,125
Sundry Creditors (Purchase Ledger Accounts)	7,625

Assets and Liabilities:

Particulars	As on 31.3.2013 ₹	As on 31.3.2014 ₹
Purchase Ledger Balance (Creditors)	2,525	2,400
Sales Ledger Balance (Debtors)	3,750	6,125
Bank	625	—
Stock	6,250	3,125
Furniture	7,500	7,315

From the above data prepare the Trading and Profit and Loss Account for the year ended 31st March, 2014 and the Balance Sheet as on that date.

Solution

X

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2014 Cr.

Particulars	₹	Particulars			₹
To Opening Stock	6,250	By Sales :	Cash	4,125	
To Purchases (Note 1)	7,500		Credit	20,000	24,125
To Wages	6,725	By Closing Stock			3,125
To Light and Power (Note 6)	475				
To Gross Profit c/d	6,300				
	27,250				27,250
To Salaries	1,125	By Gross Profit b/d			6,300
To Sundry Expenses	2,125				
To Telephone	125				

To Interest	75		
To Rent	1,200		
To Depreciation on Furniture (Note 5)	810		
To Net Profit (Transferred to Capital)	840		
	6,775		6,775

Balance Sheet of X as at 31st March, 2014

Liabilities	₹	Assets	₹
Opening Capital (Note 4)	15,600	Furniture	7,315
Less: Capital introduced	2,500	Stock	3,125
Net Profit	840	Sales Ledger Balance (Debtors)	6,125
	18,940	Bank (Note 3)	3,275
Less: Drawings	1,500		
	17,440		
Purchases Ledger Balance (Creditors)	2,400		
	19,840		19,840

Working Notes :

Dr. (1) Purchases Ledger Control (Creditors) Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 ?	To Bank A/c	7,625	1.4.2013	By Balance b/d	2,525
31.3.2014	To Balance c/d	2,400	?	By Purchases A/c (Balancing figure)	7,500
		10,025			10,025

Dr. (2) Sales Ledger Control (Debtors) Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2013	To Balance b/d	3,750	2013 ?	By Bank A/c	17,625
	To Sales A/c (Balancing figure)	20,000	31.3.2014	By Balance c/d	6,125
		23,750			23,750

Dr. (3) Bank Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2013	To Opening balance	625	1.4.2013	By Furniture A/c	625
	To Debtors A/c	17,625		By Drawings A/c	1,500
	To Sales A/c	4,125		By Wages A/c	6,725
	To Capital A/c	2,500		By Salaries A/c	1,125
				By Interest A/c	75
				By Telephone A/c	125
				By Rent A/c	1,200
				By Light and Power A/c	475
				By Sundry Expenses A/c	2,125
				By Sundry Creditors A/c	7,625
				By Balance c/d	3,275
		24,875			24,875

Balance Sheet of X as at 1st April, 2014

Liabilities	₹	Assets	₹
Capital (Balancing figure)	15,600	Furniture	7,500
Purchase Ledger Control (Creditors)	2,525	Stock	6,250
		Sales Ledger Control (Debtors)	3,750
		Bank	625
	18,125		18,125

(5) Depreciation on Furniture

	₹
Opening balance	7,500
Add: Purchases	625
	8,125
Less: Closing balance	7,315
	810

(6) It is assumed that light and power is direct in nautre.

Illustration 18

Lucky does not maintain a proper books of account. However, he maintains a record of his bank transactions and is also to give the following information from which you are requested to prepare his final accounts for the year 2014 :

Particulars	1.1.2014 (₹)	31.12.2014 (₹)
Debtors	1,02,500	?
Creditors	?	46,000
Stock	50,000	62,500
Bank Balance	?	50,000
Fixed Assets	7,500	9,000

Details of his bank transactions were as follows :

Particulars	₹
Received from Debtors	3,40,000
Additional Capital Brought in	5,000
Sale of Fixed Assets (Book value ₹ 2,500)	1,750
Paid to Creditors	2,80,000
Expenses Paid	49,250
Personal Drawings	25,000
Purchase of Fixed Assets	5,000

No cash transactions took place during the year. Goods are sold at cost plus 25%. Cost of goods sold was ₹ 2,60,000.

Solution

Lucky

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	50,000	By Sales A/c (Note 6)	3,25,000
To Purchases (Note 7)	2,72,500	By Closing Stock	62,500
To Gross Profit c/d	65,000		
	3,87,500		3,87,500
To Expenses	49,250	By Gross Profit b/d	65,000
To Depreciation on Fixed Assets	1,000		
To Loss on Sale of Fixed Assets	750		
To Net Profit c/d	14,000		
	65,000		65,000

Balance Sheet of Lucky as at 31st December, 2014

Liabilities	₹	Assets	₹
Capital Account :		Fixed Assets	9,000
Opening Balance (Note 7)	1,69,000	Stock	62,500
Add: Capital Introduced	5,000	Debtors (Note 3)	87,500
Add: Net Profit	14,000	Bank	50,000
	1,88,000		
Less: Drawings	25,000		
	1,63,000		
Creditors	46,000		
	2,09,000		2,09,000

Working Notes :

Dr. (1) Bank Account Cr.

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

Dr. (2) Fixed Assets Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	7,500	By Bank A/c	1,750
To Bank A/c	5,000	By Loss on Sale of Fixed Assets A/c	750
		By Depreciation A/c (Balancing figure)	1,000
		By Balance c/d	9,000
	12,500		12,500

Dr. (3) Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	1,02,500	By Bank A/c	3,40,000
To Sales A/c (Note 6)	3,25,000	By Balance c/d (Balancing figure)	87,500
	4,27,500		4,27,500

Dr. (4) Creditors Account Cr.

Particulars	₹	Particulars	₹
To Bank A/c	2,80,000	By Balance b/d (Balancing figure)	53,500
To Balance c/d	46,000	By Purchases A/c (Note 7)	2,72,500
	3,26,000		3,26,000

(5) Balance Sheet as at 1st January, 2014

Liabilities	₹	Assets	₹
Capital (Balancing figure)	1,69,000	Fixed Assets	7,500
Creditors (Note 4)	53,500	Debtors	1,02,500
		Stock	50,000
		Bank (Note 1)	62,500
	2,22,500		2,22,500

(6) Calculation of Sales

	₹
Cost of goods sold	2,60,000
Profit 25%	65,000
Sales	3,25,000

(7) Opening Stock + Purchases – Closing Stock = Cost of Goods sold
or, Purchases = Cost of Goods Sold – Opening Stock + Closing Stock
or, Purchases = ₹ 2,60,000 – ₹ 50,000 + ₹ 62,500 = ₹ **2,72,500**.

Illustration 19

P maintains accounts under single entry system and furnishes the following information for the year ending 31.12.2001 (all figures in rupees) :

Date	Bank	Stock	Debtors	Furniture (after depreciation)	Building	Creditors
1.1.2001	28,000	30,000	45,000	15,000	1,50,000	32,000
31.12.2001	?	40,000	33,000	18,000	?	36,000

Cost of goods sold during the year was ₹ 3,60,000, which constituted 75% of the sales for the year. The rate of gross profit is 25% on sales.

All purchases and sales are on credit and amounts received from customers and payments to suppliers are by cheques. P realised ₹ 10,000 in cash on the sale of scrap from which he paid ₹ 6,000 as freight on purchases and the balance was retained for his personal use.

Details of his other transactions with the bank are as under :

Receipts

Capital invested ₹ 1,50,000; Sale of furniture (book value ₹ 1,000) ₹ 800.

Payments

10% Govt. Bonds (face value ₹ 1,40,000 purchased on 1.7.2001) ₹ 1,50,000; Salaries ₹ 60,000; Taxes (11 months ending 30.11.2001) ₹ 11,000; Printing and stationery ₹ 7,800; Miscellaneous expenses ₹ 12,000; Drawings ₹ 26,000.

Bad Debts written-off during the year were ₹ 7,000. Furniture has been depreciated by 10% and Building is to be depreciated by 2%.

The shop assistant is entitled to a commission of 10% of net profit after charging his commission.

Prepare Trading and Profit and Loss Account for the year ending 31.12.2001 and Balance Sheet as on that date.

[I.C.W.A. (Foundation) — Dec., 2002]

Solution

P

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2001 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	30,000	By Sales (₹ 3,60,000 / 75%)	4,80,000
To Purchases (Balancing figure)	3,64,000	By Closing Stock	40,000
To Freight on Purchases	6,000		
To Gross Profit c/d (25% of ₹ 4,80,000)	1,20,000		
	5,20,000		5,20,000

To Salaries		60,000	By Gross Profit b/d	1,20,000
To Taxes	11,000		By Sale of Scrap	10,000
Add: Outstanding	1,000	12,000	By Interest on Investments	
To Printing and Stationery		7,800	(@ 10% p.a. on ₹ 1,40,000 for 6 months)	7,000
To Miscellaneous Expenses		12,000		
To Bad Debts		7,000		
To Loss on Sale of Furniture (₹ 1,000 – 800)		200		
To Depreciation on :				
Furniture (Note 3)	2,000			
Building	3,000	5,000		
To Commission to Shop Assistant (Note 6)		3,000		
To Net Profit — transferred to Capital		30,000		
		1,37,000		1,37,000

Balance Sheet of P as at 31st December, 2001

Liabilities	₹	Assets		₹
Capital : Opening balance (Note 5)	2,36,000	Building	1,50,000	
Add: Introduced	1,50,000	Less: Depreciation	3,000	1,47,000
Net Profit	30,000	Furniture	15,000	
	4,16,000	Less: Sold	1,000	
Less: Drawings (₹ 26,000 + 4,000)	30,000		14,000	
	3,86,000	Add: Purchased	6,000	
Outstanding Shop Assistant's Commission	3,000		20,000	
Creditors	36,000	Less: Depreciation	2,000	18,000
Outstanding Taxes	1,000	Investments (10% of Govt. Bonds — face value ₹ 1,40,000)		1,50,000
		Stock		40,000
		Debtors		33,000
		Bank (Note 4)		31,000
		Outstanding Interest on Investment		7,000
	4,26,000			4,26,000

Working Notes :

Dr. **(1) Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2001			2001		
?	To Bank A/c (Balancing figure)	3,60,000	Jan. 1	By Balance b/d	32,000
Dec. 31	To Balance c/d	36,000	?	By Purchases A/c	3,64,000
		3,96,000			3,96,000

Dr. **(2) Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2001			2001		
Jan. 1	To Balance b/d	45,000	?	By Bank A/c (Balancing figure)	4,85,000
?	To Sales A/c	4,80,000	?	By Bad Debts A/c	7,000
			Dec. 31	By Balance c/d	33,000
		5,25,000			5,25,000

Dr. **(3) Furniture Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2001			2001		
Jan. 1	To Balance b/d	15,000	?	By Bank A/c	800
?	To Bank A/c (Purchases)	6,000	?	By Profit and Loss A/c (Loss)	200
			?	By Depreciation A/c (₹ 18,000 / 9)	2,000
			Dec. 31	By Balance c/d	18,000
		21,000			21,000

Dr. **(4) Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2001			2001		
Jan. 1	To Balance b/d	28,000	?	By Investments A/c (10% of Govt. Bonds)	1,50,000
?	To Capital A/c	1,50,000	?	By Salaries A/c	60,000
?	To Furniture A/c	800	?	By Taxes A/c	11,000
?	To Debtors A/c (Note 2)	4,85,000	?	By Printing and Stationery A/c	7,800
			?	By Miscellaneous Expenses A/c	12,000

			?	By Creditors A/c (Note 1)	3,60,000
			?	By Furniture A/c (Note 3)	6,000
			?	By Drawings A/c	26,000
			Dec. 31	By Balance c/d	31,000
		6,63,800			6,63,800

(5) Balance Sheet as at 1st January, 2001

Liabilities	₹	Assets	₹
Capital (Balancing figure)	2,36,000	Building	1,50,000
Creditors	32,000	Furniture	15,000
		Stock	30,000
		Debtors	45,000
		Bank	28,000
	2,68,000		2,68,000

(6) Net Profit before shop assistant's commission = ₹ 33,000. Therefore, commission = ₹ 33,000 × 10/110 = ₹ 3,000.

Illustration 20

On 1.1.2014, Mr S. Sen commenced business. He did not maintain proper books of account. At the end of the year, the following information is obtained after going through the records :

(i) All cash received from cash sales was banked after keeping ₹ 1,000 p.m. for petty expenses and after withholding monthly drawings of ₹ 500.

(ii) Counter foils of pay-in-slip revealed the following deposits :
capital contributed ₹ 1,00,000; balance of cash sales ₹ 78,000; collections from debtors ₹ 1,00,000.

(iii) Counter foils of cheques revealed the following payments :
payment to creditors ₹ 1,50,000; salary ₹ 35,000; purchase of furniture ₹ 10,000.

(iv) Sales were effected at a uniform rate of gross profit at 25% on sales.

(v) Discount allowed ₹ 2,000, discount received ₹ 3,000 and bad debts ₹ 1,000.

(vi) Petty cash expenses were : postage ₹ 200; stationery ₹ 1,000; conveyance ₹ 2,000 and rent ₹ 2,200.

(vii) On 31.12.2014 amount due from debtors ₹ 10,000 and amount owing to creditors were ₹ 20,000.

Prepare Trading and Profit and Loss Account for the year ended 31.12.2014 and a Balance Sheet as on that date.

Solution

S. Sen

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars		₹
To Purchases	1,73,000	By Sales — Cash	96,000	
To Gross Profit c/d (25% of ₹ 2,09,000)	52,250	Credit	1,13,000	2,09,000
		By Closing Stock (Balancing figure)		16,250
	2,25,250			2,25,250
To Salaries	35,000	By Gross Profit b/d		52,250
To Petty Expenses (₹ 200 + 1,000 + 2,000 + 2,200)	5,400	By Discount Received		3,000
To Discount Allowed	2,000			
To Bad Debts	1,000			
To Net Profit (transferred to capital)	11,850			
	55,250			55,250

Balance Sheet of S Sen as on 31st December, 2014

Liabilities		₹	Assets	₹
Capital : Drawings	1,00,000		Furniture	10,000
Net Profit	11,850		Stock	16,250
	1,11,850		Debtors	10,000
Less: Drawings	6,000	1,05,850	Bank	83,000
Creditors		20,000	Petty Cash (Note 2)	6,600
		1,25,850		1,25,850

Working Notes :

Dr. (1) Cash Book Cr.

Particulars	Cash	Bank	Particulars	Cash	Bank
To Capital	—	1,00,000	By Bank (c)	78,000	—
To Sales (Note 5)	96,000	—	By Petty Cash	12,000	—
To Debtors	—	1,00,000	By Drawings	6,000	—

To Cash (c)	—	78,000	By Creditors By Salaries By Furniture By Balance c/d	— — — —	1,50,000 35,000 10,000 83,000
	96,000	2,78,000		96,000	2,78,000

Dr. **(2) Petty Cash Book** **Cr.**

Particulars	₹	Particulars	₹
To Cash A/c	12,000	By Postage By Stationery By Conveyance By Rent By Balance c/d	200 1,000 2,000 2,200 6,600
	12,000		12,000

Dr. **(3) Total Debtors Account** **Cr.**

Particulars	₹	Particulars	₹
To Credit Sales (Balancing figure)	1,13,000	By Bank By Discount Allowed By Bad Debts By Balance c/d	1,00,000 2,000 1,000 10,000
	1,13,000		1,13,000

Dr. **(4) Total Creditors Account** **Cr.**

Particulars	₹	Particulars	₹
To Bank To Discount received To Balance c/d	1,50,000 3,000 20,000	By Credit Purchases (Balancing figure)	1,73,000
	1,73,000		1,73,000

(5) Amount of cash sales = ₹ 78,000 + 6,000 (Drawings @ ₹ 500 p.m.) + ₹ 12,000 (Petty expenses @ ₹ 1,000 p.m.) = ₹ 96,000.
(6) For lack of information, depreciation on furniture has not been provided.

Illustration 21

A fire in the office of Pioneer Trading Limited occured in the evening of 31.3.2015, as a result of which the Cash Book and the Nominal Ledger kept in the cupboard were completely destroyed. The cash box containing cash representing the day's taking for 31.3.2015 was also destroyed. The insurance company concerned requests you to ascertain the amount of cash lost in the fire accident.

The Balance Sheet of the Company as at 31.12.2014 was as follows :

Liabilities	₹	Assets		₹
Share Capital	60,000	Office Furniture (at cost)	14,616	
Reserve and Balance of Profit and Loss Account	85,028	Less: Depreciation	7,204	7,412
Creditors	14,140	Stock (at cost)		75,742
Dividend Unpaid	6,000	Debtors		71,212
		Bank		10,802
	1,65,168			1,65,168

From the records and documents saved from the accident, the following information was obtained :

Balance on 31.3.2015 —

Debtors : ₹ 1,19,612; Creditors : ₹ 31,610;

Bank balance after adjusting outstanding ₹ 14,822.

Transactions from 1.1.2015 to 31.3.2015 were as follows —

Cash and Credit sales less returns ₹ 8,21,154; Miscellaneous expenses ₹ 2,03,124; Wages and salaries ₹ 90,634; Office furniture purchased ₹ 1,300; Dividend paid ₹ 6,000; Goods purchased on credit ₹ 4,69,212; Depreciation on furniture ₹ 360.

All receipts have been banked except those for 31.3.2015. Stock on 31.3.2015 (value at cost) was ₹ 53,816.

Required :

(i) A statement showing the computation of the amount of cash lost in the fire accident; and

(ii) Trading, and Profit and Loss Account for 3 months ending on 31.3.2015 and a Balance Sheet as at that date.

Solution (i) Statement Showing the Computation of the Amount of Cash Lost in Fire

Particulars	₹
Opening balance of Debtors	71,212
Add : Cash and Credit sales less returns	8,21,154
	8,92,366
Less : Balance of Debtors on 31.3.2015	1,19,612
Cash Available for Deposit into the Bank	7,72,754
Less : Cash Deposited into the Bank (Note 2)	7,56,820
Cash Lost by Fire	15,934

Pioneer Trading Limited

Dr. (ii) Trading and Profit and Loss Account for the year ended 31st March, 2015 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	75,742	By Sales (Credit + Cash)	8,21,154
To Purchases	4,69,212	By Closing Stock	53,816
To Wages & Salaries (Note 3)	90,634		
To Gross Profit c/d	2,39,382		
	8,74,970		8,74,970
To Miscellaneous Expenses	2,03,124	By Gross Profit b/d	2,39,382
To Depreciation on Furniture	360		
To Loss of Cash (Note 4)	15,934		
To Net Profit	19,964		
	2,39,382		2,39,382

Balance Sheet of Pioneer Trading Limited as at 31st March, 2015

Liabilities	₹	Assets		₹
Share Capital	60,000	Office Furniture (at cost) : ₹ (14,616 + 1,300)	15,916	
Reserve and Profit and Loss Account : ₹ (85,028 + 19,964)	1,04,992	Less: Depreciation : ₹ (7,204 + 360)	7,564	8,352
Creditors	31,610	Stock (at cost)		53,816
		Debtors		1,19,612
		Bank		14,822
	1,96,602			1,96,602

Working Notes :

Dr. (1) Creditors Account Cr

Date	Particulars	₹	Date	Particulars	₹
?	To Bank A/c (Balancing figure)	4,51,742	1.1.2015	By Balance b/d	14,140
31.3.2015	To Balance c/d	31,610	?	By Credit Purchases	4,69,212
		4,83,352			4,83,352

Dr. (2) Bank Account Cr

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/d	10,802	?	By Creditors (Note 1)	4,51,742
?	To Cash (Balancing figure)	7,56,820	?	By Miscellaneous Expenses	2,03,124
			?	By Wages and Salaries	90,634
			?	By Office Furniture	1,300
			?	By Dividend	6,000
			31.3.2015	By Balance c/d	14,822
		7,67,622			7,67,622

(3) It is assumed that wages and salaries of ₹ 90,634 is a direct expense. If it is taken as an indirect expense, the gross profit will be ₹ 3,30,016.

(4) For lack of information in respect of insurance claim for loss of cash by fire, it has been charged to Profit and Loss Account. If any amount is received from the insurance company in the subsequent period, Cash Account will be debited and Profit and Loss Adjustment Account will be credited as a prior period adjustment.

Illustration 22

The following balances are available from the books of Sanjoy as on 31.12.2013 and 31.12.2014 (all figures in rupees) :

Date	Building	Equipments	Furniture	Debtors	Creditors	Stock	Bank Loan	Cash
31.12.2013	60,000	1,20,000	10,000	?	32,000	?	20,000	32,000
31.12.2014	60,000	1,34,000	10,000	48,000	?	34,000	16,000	22,000

The transactions of Sanjoy during the year ended 31.12.2014 were the following :

Collection from Debtors ₹ 1,86,000; Payment to Creditors ₹ 1,22,000; Cash Purchases ₹ 32,000; Expenses ₹ 20,000; Sale of one Equipment (book value ₹ 10,000) ₹ 6,000; Drawings ₹ 20,000.

Cash sales amounted to 10% of total sales. Credit sales amounted to ₹ 1,80,000. Credit purchases were 80% of total purchases. Sanjoy sells goods at cost plus $33^1/_3$%. His suppliers allowed him discount ₹ 2,000.

Equipments and furniture are to be depreciated by 10% p.a. and building by 2% p.a.

Prepare the Trading and Profit and Loss Account for the year ended 31.12.2014, and a Balance Sheet as on that date.

Solution

Sanjoy

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Opening Stock (Balancing figure)	24,000	By Sales (Note 1)	2,00,000
To Purchases (Note 2)	1,60,000	By Closing Stock	34,000
To Gross Profit c/d (Note 3)	50,000		
	2,34,000		2,34,000
To Expenses	20,000	By Gross Profit b/d	50,000
To Loss on Sale of Equipments (Note 4)	4,000	By Discount Received	2,000
To Depreciation on (Note 5) :			
(Furniture : 1,000; Equipments : 12,200; Building : 1,200)	14,400		
To Net Profit	13,600		
	52,000		52,000

Balance Sheet of Sanjoy as on 31st December, 2014

Liabilities		₹	Assets		₹
Capital :			Building	60,000	
Opening Balance (Note 8)	2,48,000		Less : Depreciation	1,200	58,800
Add : Net Profit	13,600		Equipments	1,20,000	
	2,61,600		Less: Sold	10,000	
Less : Drawings	20,000	2,41,600		1,10,000	
Bank Loan		16,000	Add: Additions	24,000	
Creditors (Note 7)		36,000		1,34,000	
			Less : Depreciation	12,200	1,21,800
			Furniture	10,000	
			Less : Depreciation	1,000	9,000
			Debtors		48,000
			Stock		34,000
			Cash		22,000
		2,93,600			2,93,600

Working Notes :

(1) Since cash sales were 10% of total sales, credit sales were 90% of total sales which were ₹ 1,80,000. Therefore, cash sales were ₹ 1,80,000 / 9 = ₹ 20,000. Total sales were ₹ 2,00,000.

(2) Since credit purchases were 80% of total purchases, cash purchases were 20% of total purchases which were ₹ 32,000. Therefore, credit purchases were ₹ 32,000 x 4 = ₹ 1,28,000. Total purchases were ₹ 1,60,000.

(3) Gross profit was $33^1/_3$% on cost or 25% on sales. Therefore, gross profit was 25% on ₹ 2,00,000 = ₹ 50,000.

(4) Loss on sale of equipments = ₹ (10,000 – 6,000) = ₹ 4,000.

(5) Depreciation on : Furniture — 10% on ₹ 10,000 = ₹ 1,000; Equipments — 10% on ₹ 1,10,000 (1,20,000 – 10,000) for full year and 10% on ₹ 24,000 (addition) for half year = ₹ (11,000 + 1,200) = ₹ 12,200; Building — 2% on ₹ 60,000 = ₹ 1,200.

Dr. (6) Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d (Balancing figure)	54,000	31.12.2014	By Cash	1,86,000
31.12.2014	To Credit Sales	1,80,000	31.12.2014	By Balance c/d	48,000
		2,34,000			2,34,000

Dr. (7) Creditors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Cash	1,22,000	1.1.2014	By Balance b/d	32,000
31.12.2014	To Discount Received	2,000	31.12.2014	By Credit Purchases (Note 2)	1,28,000
31.12.2014	To Balance c/d (Balancing figure)	36,000			
		1,60,000			1,60,000

(8) Balance Sheet of Sanjoy as on 1st January, 2014

Liabilities	₹	Assets	₹
Capital (Balancing figure)	2,48,000	Building	60,000
Bank Loan	20,000	Equipments	1,20,000
Creditors	32,000	Furniture	10,000
		Debtors (Note 6)	54,000
		Stock (Note 9)	24,000
		Cash	32,000
	3,00,000		3,00,000

(9) Opening stock = Sales + Closing Stock – Purchases – Gross Profit = ₹ (2,00,000 + 34,000 – 1,60,000 – 50,000) = ₹ 24,000.

Tutorial Note. It should be noted that depreciation on equipments is to be charged @ 10% p.a. Therefore, on addition, depreciation has been charged for 1/2 year.

Illustration 23

Following are the particulars of Arpita and Co. :

(i) Assets and liabilities (all figures in rupees) :

Date	Furniture	Stock	Debtors	Creditors	Prepaid Expenses	Outstanding Expenses	Cash and Bank
1.1.2014	36,000	48,000	96,600	66,000	3,600	12,000	7,200
31.12.2014	38,100	42,000	?	90,000	4,200	10,800	3,750

(ii) Cash transactions during the year 2014 :

Particulars	₹	Particulars	₹
Receipts from Debtors (after allowing 2.5% discount)	3,51,000	Freight Inwards	18,000
Bills Receivable discounted at an average rate of 2%	36,750	Drawings	42,000
4% Investment purchased at ₹ 96 (on 1.7.2014)	57,600	Furniture purchased	6,000
Paid to Creditors (discount at 2%)	2,35,200	Miscellaneous receipts	3,000
Expenses	87,000		

(iii) During the year Bills Receivable received was ₹ 60,000; ₹ 12,000 of which were endorsed in favour of creditors. Of the latter, a bill for ₹ 2,400 was dishonoured.

(iv) Goods costing ₹ 5,400 were used as advertising materials.

(v) Goods are invariably sold to show a profit of 50% on cost.

(vi) Difference in Cash Book, if any, is to be treated as drawings or introduction of capital by the proprietor.

(vii) Provision @ 2.5% on debtors for doubtful debts is to be provided for.

Prepare Trading and Profit and Loss Account for the year ended 31.12.2014 and Balance Sheet as on that date.

Solution

Arpita and Co.

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	48,000	By Sales (Note 7)	4,38,300
To Purchases (Note 4)	2,73,600	By Advertisement	5,400
To Freight Inwards	18,000	By Closing Stock	42,000
To Gross Profit c/d (1/3 of Sales)	1,46,100		
	4,85,700		4,85,700
To Expenses (Note 5)	85,200	By Gross Profit b/d	1,46,100
To Discount Allowed (Note 3)	9,000	By Miscellaneous Receipts	3,000
To Discount on Bills (Note 6)	750	By Interest on Investment (Note 8)	1,200
To Advertisement	5,400	By Discount Received	4,800
To Depreciation on Furniture	3,900		
To Provision for Bad Debts (2.5% of ₹ 1,17,300)	2,933		
To Net Profit (transferred to Capital)	47,917		
	1,55,100		1,55,100

Balance Sheet of Arpita and Co. as on 31st December, 2014

Liabilities		₹	Assets		₹
Capital : Opening balance (Note 2)	1,13,400		Furniture	36,000	
Introduced (Note 1)	51,600		Add: Purchased	6,000	
Net Profit	47,917			42,000	
	2,12,917		Less: Depreciation (Balancing figure)	3,900	38,100
Less: Drawings	42,000	1,70,917	Investments (Face value ₹ 60,000)	57,600	
Creditors (Note 4)		90,000	Add : Accrued Interest	1,200	58,800

Outstanding Expenses	10,800	Stock		42,000
		Debtors (Note 3)	1,17,300	
		Less: Provision for Bad Debts	2,933	1,14,367
		Bills Receivable (Note 6)		10,500
		Cash and Bank (Note 1)		3,750
		Prepaid Expenses		4,200
	2,71,717			2,71,717

Working Notes :

Dr. **(1) Cash and Bank Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	7,200	By Investments	57,600
To Debtors	3,51,000	By Creditors	2,35,200
To Bills Receivable	36,750	By Expenses	87,000
To Miscellaneous Receipts	3,000	By Freight Inwards	18,000
To Capital (Balancing figure)	51,600	By Drawings	42,000
		By Furniture	6,000
		By Balance c/d	3,750
	4,49,550		4,49,550

(2) Ascertainment of Opening Capital

Liabilities	₹	Assets	₹
Capital (Balancing figure)	1,13,400	Furniture	36,000
Creditors	66,000	Stock	48,000
Outstanding Expenses	12,000	Debtors	96,600
		Cash and Bank	7,200
		Prepaid Expenses	3,600
	1,91,400		1,91,400

Dr. **(3) Debtors Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	96,600	By Bills Receivable	60,000
To Creditors	2,400	By Bank	3,51,000
To Credit Sales (Note 7)	4,38,300	By Discount Allowed	9,000
		By Balance c/d	1,17,300
	5,37,300		5,37,300

Dr. **(4) Creditors Account** **Cr.**

Particulars	₹	Particulars	₹
To Bank	2,35,200	By Balance b/d	66,000
To Discount Received	4,800	By Debtors	2,400
To Bills Receivable	12,000	By Credit Purchases (Balancing figure)	2,73,600
To Balance c/d	90,000		
	3,42,000		3,42,000

Dr. **(5) Expenses Account** **Cr.**

Particulars	₹	Particulars	₹
To Prepaid Expenses	3,600	By Outstanding Expenses	12,000
To Bank	87,000	By Profit and Loss	85,200
To Outstanding Expenses	10,800	By Prepaid Expenses	4,200
	1,01,400		1,01,400

Dr. **(6) Bills Receivable Account** **Cr.**

Particulars	₹	Particulars	₹
To Debtors	60,000	By Bank	36,750
		By Discount on Bills	750
		By Creditors	12,000
		By Balance c/d	10,500
	60,000		60,000

(7) Ascertainment of Sales

Particulars	₹
Opening Stock	48,000
Purchases (Note 4)	2,73,600
Freight	18,000
	3,39,600

Less:	Advertisement	5,400	
	Closing Stock	42,000	47,400
Cost of Goods sold			2,92,200
Add: Profit 50%			1,46,100
		Sales	4,38,300

(8) Face value of investment purchased on 1.7.2014 = ₹ 57,600 / 96 x 100 = ₹ 60,000. Interest is payable @ 4% on face value of ₹ 60,000 for 6 months. Therefore, interest accrued = ₹ 60,000 x 4% x 1/2 = ₹ 1,200.

Illustration 24

M.H. Kabir owns a small business and keeps all the accounting records himself on a computer using basic accounting package. He does not understand financial statements and therefore never uses this part of the software. He does, however, regularly print out the analysis of the receipts and payments in and out of his bank account. Unfortunately, his computer's hard disk was crashed and his accountant now wants to prepare his accounts. The accountant has the Balance Sheet of the previous year and this is given below :

Balance Sheet as at 31st March, 2014

Liabilities	₹	Assets		₹
Capital	8,20,000	**Fixed Assets :**		
Long-term Loan (10%)	1,00,000	Machinery		2,50,000
Current Liabilities :		Vehicles		5,00,000
Trade Creditors	1,60,000	**Current Assets :**		
Outstanding Vehicles Expenses	10,000	Stock		1,20,000
		Sundry Debtors	1,90,000	
		Less: Provision for Bad Debts	10,000	1,80,000
		Prepaid Advertising		30,000
		Bank		10,000
	10,90,000			10,90,000

The accountant has asked Kabir for some additional information and Kabir has prepared the following schedule (all figures in rupees) :

1. The following payments appeared on the bank statement for the year ended on 31st March, 2015 :

(i)	Wages	1,50,000	
(ii)	Payment to Suppliers	13,50,000	Kabir takes a cash discount of 10% on invoice amount on all payments to suppliers.
(iii)	Vehicle Expenses	90,000	
(iv)	New Vehicle	1,20,000	
(v)	General Expenses	80,000	
(vi)	Advertising	30,000	This includes a prepayment of ₹ 10,000.
(vii)	Loan Interest	5,000	₹ 5,000 was paid on 1st April, 2015.
(viii)	Drawings	2,00,000	Kabir also took goods from the business worth ₹ 20,000.
	TOTAL	20,25,000	

2. The following receipts appeared on the bank statement in the year ended 31st March, 2015 :

Receipts from sale	₹ 21,50,000
Sale of old vehicle	20,000
	21,70,000

3. The following amounts relate to cheques dated before 31st March, 2015, but not presented by that date :

	₹
General expenses	60,000
Vehicle expenses	30,000

4. At 31st March, 2015 :
Sundry Debtors were ₹ 2,10,000 (after excluding bad debts for ₹ 20,000);
Sundry Creditors ₹ 1,80,000; and Stock ₹ 1,00,000.

The accountant has the following information on his file :

(i) The net book value of the old vehicle which was sold was ₹ 30,000.

(ii) Depreciation is charged on the net book value at the year ended :
Vehicles 25% and Machinery 20%.

(iii) A general provision is made for doubtful debts of 5% of debtors, after bad debts have been written off.

You are required to prepare :

(i) Profit and Loss Account for the year ended on 31st March, 2015;

(ii) Balance Sheet as at 31st March, 2015.

Solution **M.H. Kabir**

Dr. **Profit and Loss Account for the year ended 31st March, 2015** **Cr.**

Particulars		₹	Particulars	₹
To Opening Stock		1,20,000	By Sales (Note 5)	21,90,000
To Purchases (Note 2)		15,20,000	By Drawings (Goods taken over)	20,000
To Wages		1,50,000	By Closing Stock	1,00,000
To Gross Profit c/d		5,20,000		
		23,10,000		23,10,000
To Vehicle Expenses (Note 3)		80,000	By Gross Profit b/d	5,20,000
To General Expenses		80,000	By Discount Received	1,50,000
To Loss on Sale of Vehicles		10,000		
To Advertising Expenses (Note 4)		50,000		
To Interest on Bank Loan	5,000			
Add: Outstanding Interest	5,000	10,000		
To Bad Debts		20,000		
To Depreciation on :				
Vehicles @ 25% on ₹ 5,90,000		1,47,500		
Machinery @ 20% on ₹ 2,50,000		50,000		
To Provision for Bad Debts				
New	10,500			
Less: Old	10,000	500		
To Net Profit (Transferred to Capital A/c)		2,22,000		
		6,70,000		6,70,000

Balance Sheet of M.H. Kabir as at 31st December, 2015

Liabilities	₹	₹	Assets	₹	₹
Capital	8,20,000		**Fixed Assets :**		
Add: Net Profit	2,22,000		Machinery	2,50,000	
	10,42,000		Less: Depreciation @ 20%	50,000	2,00,000
Less: Drawings	2,20,000	8,22,000	Vehicles	5,90,000	
Long-term Loan		1,00,000	Less: Depreciation @ 25%	1,47,500	4,42,500
Current Liabilities :			**Current Assets :**		
Trade Creditors		1,80,000	Stock		1,00,000
Outstanding Interest on Long-term Loan		5,000	Sundry Debtors	2,10,000	
			Less: Provision for Bad Debts	10,500	1,99,500
			Prepaid Advertising		10,000
			Bank (Note 1)		1,55,000
		11,07,000			11,07,000

Working Notes :

Dr. **(1) Bank Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	10,000	By Wages	1,50,000
To Vehicles A/c (Sale)	20,000	By Trade Creditors A/c	13,50,000
To Sundry Debtors	21,50,000	By Vehicle Expenses A/c	90,000
		By Vehicles (New)	1,20,000
		By General Expenses	80,000
		By Advertising	30,000
		By Bank Interest	5,000
		By Drawings	2,00,000
		By Balance c/d	1,55,000
	21,80,000		21,80,000

Dr. **(2) Trade Creditors Account** **Cr.**

Particulars	₹	Particulars	₹
To Bank A/c	13,50,000	By Balance b/d	1,60,000
To Discount Received A/c	1,50,000	By Purchases (Balancing figure)	15,20,000
To Balance c/d	1,80,000		
	16,80,000		16,80,000

Dr. **(3) Vehicles Expenses Account** **Cr.**

Particulars	₹	Particulars	₹
To Bank A/c	90,000	By Outstanding Vehicles Expenses A/c	10,000
		By Profit and Loss A/c	80,000
	90,000		90,000

Dr. (4) Advertising Account Cr.

Particulars	₹	Particulars	₹
To Prepaid Advertising A/c	30,000	By Profit and Loss A/c	50,000
To Bank A/c	30,000	By Prepaid Advertising A/c	10,000
	60,000		60,000

Dr. (5) Sundry Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	1,90,000	By Bad Debts A/c	20,000
To Sales A/c (Balancing figure)	21,90,000	By Bank A/c	21,50,000
		By Balance c/d	2,10,000
	23,80,000		23,80,000

Dr. (6) Vehicles Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	5,00,000	By Bank A/c	20,000
To Bank A/c (Purchases)	1,20,000	By Loss on Sale of Vehicles A/c	10,000
		By Balance c/d	5,90,000
	6,20,000		6,20,000

(7) Unpresented cheques for expenses will not be taken into consideration for calculating balance at Bank. In the Balance Sheet bank balances as per cash book / ledger is shown.
Unpresented cheques will be taken into consideration at the time of preparing Bank Reconciliation Statement.

Illustration 25

The following is the Balance Sheet of the retail business of Mr Padamsi as at 31st December, 2014.

Particulars	₹	Particulars	₹
Mr Padamsi's Capital	1,25,000	Furniture & Fittings	25,000
Creditors for goods	30,000	Stocks	75,000
Outstanding expenses (Rent)	1,000	Sundry Debtors	20,000
		Cash at bank	35,000
		Cash in hand	1,000
	1,56,000		1,56,000

You are furnished with the following information :

1. Mr Padamsi always sells his goods at a profit of 25% on sales.
2. Goods are sold for cash and credit. Credit customers pay by cheques only.
3. Payments for purchases are always made by cheques.
4. It is the practice of Mr Padamsi to send to the bank every weekend the takings of the week after paying every week salaries of ₹ 250 to the clerk, sundry expenses of ₹ 50 and personal expenses of ₹ 100.

An analysis of the Bank Pass Book for the period ending 31st March, 2015 disclosed the following:

Payment to Creditors ₹ 75,000; Payment of rent ₹ 4,000; Amount remitted into the bank ₹ 1,35,000 including cheques for ₹ 10,000 received from customers to whom the goods were sold on credit.

The following are the balances on 31st March, 2015 :

Stocks ₹ 32,500; Creditors for goods ₹ 32,500; Sundry Debtors ₹ 30,000.

On the evening of 31st March, 2015 the cashier absconded with the cash available in the cash box.

You are required to prepare a statement showing the amount of cash defalcated by the cashier and also a Profit and Loss Account for the period ended 31st March, 2015 and a Balance Sheet as on that date.

Solution

Padamsi

Dr. Trading and Profit and Loss Account for the period ended 31st March, 2015 Cr.

Particulars	₹	Particulars	₹
To Opening stock	75,000	By Cash sales	1,40,000
To Purchases	77,500	By Credit sales	20,000
To Gross profit c/d	40,000	By Closing stock	32,500
	1,92,500		1,92,500
To Salaries (₹ 250 x 13)	3,250	By Gross profit b/d	40,000
To Sundry expenses (₹ 50 x 13)	650		
To Rent (₹ 4,000 — ₹ 1,000)	3,000		
To Defalcation loss	10,800		
To Net profit	22,300		
	40,000		40,000

Balance Sheet of Padamsi as at 31st March, 2015

Liabilities		₹	Assets		₹
Capital:			Furniture & fittings		25,000
Opening balance	1,25,000		Stock		32,500
Add: profit	22,300		Sundry Debtors		30,000
	1,47,300		Cash at bank		91,000
Less: Drawings (₹ 100 x 13)	1,300	1,46,000			
Creditors		32,500			
		1,78,500			1,78,500

Working Notes : [Taking 13 weeks; (52/12) x 3]

Cash Book

Dr.		Cr.	
To Balance b/f	1,000	By Bank	1,25,000
To Sales	1,40,000	By Salary	3,250
		By Sundry expenses	650
		By Drawings	1,300
		By Defalcation (bal.fig)	10,800
	1,41,000		1,41,000

Bank Account

Dr.		Cr.	
To Balance b/f	35,000	By Creditors	75,000
To Cash	1,25,000	By Rent	4,000
To Debtors	10,000	By Balance c/d	91,000
	1,70,000		1,70,000

Sundry Debtors Account

Dr.		Cr.	
To Balance b/f	20,000	By Bank	10,000
To Sales	20,000	By Balance c/d	30,000
	40,000		40,000

Sundry Creditors Account

Dr.		Cr.	
To Bank	75,000	By Balance b/f	30,000
To Balance c/d	32,500	By Purchases	77,500
	1,07,500		1,07,500

Cost of Sales = Opening Stock + Purchases — Closing Stock = ₹ 75,000 + ₹ 77,500 – ₹ 32,500 = ₹ 1,20,000. Total Sales = ₹ 1,20,000/75 x 100 = ₹ 1,60,000. Credit Sales ₹ 20,000. So Cash Sales = ₹ 1,40,000. **No depreciation has been charged on furniture for lack of information.**

Illustration 26

Dear Mr Hanif,

I am most relieved that you have agreed to assist me by sorting out the financial affairs of my second-hand business, which, as you know, commenced on 1 January, 2014. Such records as I have kept are, unfortunately, to be found on now rather scruffy scraps of paper stored in a large cardboard box. Doubtless, you will want to examine these records for yourself, but I thought it might assist you if I were to summarize my business dealings up to 31 December, 2014 as I recall them.

In December, 2013, I was lucky enough to win ₹ 5,000 on the football pools, and this, together with ₹ 1,000 loaned to me by a friend — I agreed, incidentally, to pay him 10% per year interest — formed the initial capital of ₹ 6,000. I put ₹ 5,500 into the bank immediately, in a separate business account, I needed a lorry to enable me to collect and deliver the second-hand goods, a dealer was asking ₹ 1,300 for a second-hand lorry, but, I beat him down to ₹ 840. I've only paid by cheque ₹ 200 of this so far, but as I will finish paying the full ₹ 840 in three years, it will be mine before it falls to pieces in another five years from now. I rent some business premises, and, as they are fairly dilapidated, I only pay ₹ 350 a year. I've paid by cheque this year's rent and also ₹ 50 in respect of next year.

My first bit of business was to buy a job lot of 2,000 pairs of jeans for ₹ 6,000. I've paid a cheque for ₹ 4,000 so far, and my supplier is pressing me for the balance. To date, I've sold 1,500 pairs, and received ₹ 5,800, but I reckon I'm still owed ₹ 500, most of which I should be able to collect. I promptly banked the ₹ 5,800 as it was all in cheques.

I bought 800 T-shirts for ₹ 1,200 out of my bank account. I've sold 700 of these for cash — ₹ 1,500 in all — but as the remainder have got damaged, I'd be lucky if I get ₹ 50 for them.

I managed to get some pocket-calculators cheaply — 50 of them only cost me ₹ 400, but I'm rather pleased I haven't paid for them yet, as I think there is something wrong with them. My supplier has indicated that he will in fact accept ₹ 200 for them, and I intend to take up his offer, as I reckon I can repair them for Re 1 each and then sell them at ₹ 8 a time — a good profit.

I haven't paid my cash into the bank at all, as the cash I got for the T-shirts and my initial float enabled me to pay for my petrol ₹ 400 and odd expenses ₹ 250. Also, it enabled me to draw ₹ 20 per week for myself. As I've done so well, I also took my wife on holiday it made a bit of a hole in the bank account but it was worth all ₹ 600 of it.

Perhaps, from what I've told you, you can work out what profit I've made, only keep it as small as possible as I don't want to pay too much tax.

Yours sincerely,
P. Ali

Required: a) From the data provided by Mr P. Ali prepare a business Trading and Profit and Loss Account for the period ended 31 December, 2014, and a Balance Sheet as at that date. Show clearly all your workings and assumptions as notes to the accounts.

Solution **P. Ali**

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars		₹	Particulars		₹
To Purchases			By Sales		
Jeans	6,000		Jeans	6,300	
T Shirts	1,200		T Shirts	1,500	7,800
Calculators	200	7,400	By Closing stock		
To Gross Profit c/d		2,150	Jeans	1,500	
			T Shirts	50	
			Calculators	200	1,750
		9,550			9,550
To Provision for doubtful debts		50	By Gross Profit b/d		2,150
To Interest on loan		100			
To Depreciation on lorry		140			
To Rent		350			
To Petrol		400			
To Sundry expenses		250			
To Net profit		860			
		2,150			2,150

Balance Sheet of P. Ali as on 31st December, 2014

Liabilities		₹	Assets		₹
Capital:			Lorry at cost	840	
Opening	5,000		Less: Depreciation	140	700
Add: Profit	860		Debtors	500	
	5,860		Less: Provision for bad debts	50	450
Less: Drawings	1,640	4,220	Closing stock		1,750
Loan		1,000	Cash at bank		4,900
Interest on loan		100	Cash in hand		310
Creditors for lorry		640	Prepaid rent		50
Creditors for goods		2,200			
		8,160			8,160

Assumptions : (1) 52 weeks in a year; (2) Provision for doubtful debts 10%.
Working Notes:

Dr. (1) Cash Book Cr.

Particulars	₹	Particulars	₹
To Capital	5,000	By Bank	5,500
To Loan	1,000	By Petrol	400
To Sales	1,500	By Sundry expenses	250
		By Drawings	1,040
		By Balance c/d	310
	7,500		7,500

Dr. (2) Bank Account Cr.

Particulars	₹	Particulars	₹
To Cash	5,500	By Lorry	200
To Debtors	5,800	By Rent	350
		By Adv. rent	50
		By Creditors	4,000
		By Purchases	1,200
		By Drawings	600
		By Balance c/d	4,900
	11,300		11,300

(3) Depreciation on lorry = 840/6 = ₹ 140 (2014 + 5 years)

Illustration 27

On April 1, 2014 Mr Silgardo bought for ₹ 50,000 a business whose assets and liabilities are shown below. The business carried on its operations in a rented shop from which it sold cosmetics and confectionery. The business did not keep double entry accounts, but you are provided with the following information:

(i) Balance Sheet of the company as on 31st March, 2014:

Liabilities	₹	Assets	₹
Capital	50,000	**Fixed Assets :**	
Profit & Loss A/c	10,500	Furniture & fixtures (at cost)	30,000
Creditors :		**Current Assets :**	
Cosmetics	2,500	Stock of Cosmetics (at cost)	5,000
Confectionary	2,000	Stock of Confectionary (at cost)	3,000
Outstanding rent	500	Sundry Debtors : Confectionary	500

		Prepaid : Rent & Insurance	2,500
		Balance with bank	23,500
		Cash in hand	1,000
	65,500		65,500

(ii) *Analysis of the Bank statements for the year ended March 31, 2015 :*

	₹
Paid in : Cash	2,45,000
Withdrawn for :	
Purchase of cosmetics	1,00,000
Purchase of confectionary	1,10,000
Repairs	4,000
Rent	6,000
Rates & Insurance	10,000
Electricity	4,000
Mr Silgardo	15,000

(iii) *The following were paid in cash* :

	₹
Salaries	15,000
Confectionary purchases	1,500
Trade expenses	1,250
Cosmetic purchases	5,000

(iv) Mr Silgardo had taken from the shop Cosmetics for his own consumption and paid into the till the cost price of ₹ 4,550.

(v) The following are the gross profit percentages with reference to sales: Cosmetics — 9%; Confectionery — 30%

(vi) On 31st March, 2015 there were :		Stock at cost	Debtors/Prepayments and Cash	Liabilities
Cosmetics	(₹)	4,850	Nil	2,000
Confectionary	(₹)	3,500	1,000	3,000
Rent	(₹)			500
Rates & Insurance	(₹)		2,750	
Cash in hand	(₹)		250	
Accountancy / Audit fees	(₹)			2,000

(vii) Mr Silgardo has instructed you to regard any shortage in cash as being due to amounts withdrawn by him.

You are required to prepare:

(a) The Trading and Profit and Loss Account for the year ended March 31st, 2015 showing separately the gross profit from (i) Cosmetics; and (ii) Confectionery.

(b) The Balance Sheet as at March 31, 2015;

(c) Total Debtors and Total Creditors Accounts; and

(d) An Account in columnar form for cash and bank transactions.

Solution

Silgardo

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2015 Cr.

Particulars	Cos-metics	Confec-tionary	Total ₹	Particulars	Cos-metics	Confec-tionary	Total ₹
To Opening stock	5,000	3,000	8,000	By Sales	1,10,000	1,60,000	2,70,000
To Purchases	1,04,500	1,12,500	2,17,000	By Drawings	4,550	—	4,550
To Gross profit c/d	9,900	48,000	57,900	By Closing stock	4,850	3,500	8,350
	1,19,400	1,63,500	2,82,900		1,19,400	1,63,500	2,82,900
To Salaries			15,000	By Gross profit b/d :			
To Rates & Insurance		10,000		Cosmetics		9,900	
Add: Paid in 2013-02		2,500		Confectionary		48,000	57,900
		12,500					
Less: Paid for 2015-04		2,750	9,750				
To Rent		6,000					
Add: Outstanding for 2014-03		500					
		6,500					
Less: Outstanding for 2013-02		500	6,000				
To Repairs			4,000				
To Electricity			4,000				
To Trade expenses			1,250				
To Accountancy/Audit fees			2,000				
To Net Profit			15,900				
			57,900				57,900

Balance Sheet of Silgardo as at 31st March, 2015

Liabilities		₹	Assets		₹
Capital:			Furniture & fittings (at cost)		30,000
Opening balance	60,500		Stock-in-trade :		
Add: Net profit	15,900		Cosmetics		4,850
	76,400		Confectionary		3,500
Less: Drawings	22,050	54,350	Sundry Debtors : Confectionary		1,000

Creditors			Cash at bank		19,500
Cosmetics		2,000	Cash in hand		250
Confectionary		3,000	Prepaid expenses		2,750
Outstanding Accountancy/Audit fees		2,000			
Rent outstanding		500			
		61,850			61,850

Dr. **Total Debtors Account** **Cr.**

Particulars	Cosmetics	Confectionary	Particulars	Cosmetics	Confectionary
To Balance b/d	—	500	By Cash A/c (balancing figure)	1,10,000	1,59,500
To Sales	1,10,000	1,60,000	By Balance c/d	—	1,000
	1,10,000	1,60,500		1,10,000	1,60,500

Dr. **Total Creditors Account** **Cr.**

Particulars	Cosmetics	Confectionary	Particulars	Cosmetics	Confectionary
To Bank A/c	1,00,000	1,10,000	By Balance b/d	2,500	2,000
To Cash A/c	5,000	1,500	By Purchases (balancing figure)	1,04,500	1,12,500
To Balance c/d	2,000	3,000			
	1,07,000	1,14,500		1,07,000	1,14,500

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

Particulars	Cash	Bank	Particulars	Cash	Bank
To Balance b/d	1,000	23,500	By Total Creditors:		
To Total Debtors:			Cosmetics		1,00,000
Cosmetics	1,10,000		Confectionary		1,10,000
Confectionary	1,59,500		By Bank (contra)	2,45,000	
To Sales (cash)	4,550		By Repairs		4,000
To Cash (contra)		2,45,000	By Rent		6,000
			By Rates & Insurance		10,000
			By Electricity		4,000
			By Drawings		15,000
			By Salary	15,000	
			By Total Creditors A/c :		
			Cosmetics	5,000	
			Confectionary	1,500	
			By Trade expenses	1,250	
			By Drawings	7,050	
			By Balance c/d	250	19,500
	2,75,050	2,68,500		2,75,050	2,68,500

Working Notes : **Ascertainment of the Sales Proceeds**

Particulars	Cosmetics	Confectionary
Opening Stock	5,000	3,000
Add: Purchases	1,04,500	1,12,500
	1,09,500	1,15,500
Less: Stock used for personal purpose (at cost)	4,550	—
	1,04,950	1,15,500
Less: Closing stock	4,850	3,500
Cost of goods sold	1,00,100	1,12,000

Therefore, sale proceeds for cosmetics is $\frac{1,00,100 \times 100}{91} = ₹\ 1,10,000.$

And, sale proceeds for confectionary is $\frac{1,12,000 \times 100}{70} = ₹\ 1,60,000.$

Drawings = Goods ₹ 4,550 + Cash ₹ 2,500 + Bank ₹ 15,000 = ₹ 22,050.

Key Points

- Any set of procedures for ascertaining profits that does not provide for the ***analysis of each transaction*** in terms of the double entry system of bookkeeping is generally referred to as 'Single Entry System'.
- There are mainly two approaches for income determination : (a) the Transaction Approach, and (b) the Balance Sheet Approach.
- A Statement of Affairs is a statement of the assets, liabilities and capital prepared from incomplete records.
- A Balance Sheet is a statement of the assets, liabilities and capital extracted from ledger balances maintained under the double entry system.

THEORETICAL QUESTIONS

1. What are the essentials of the Single Entry System of Book-keeping?
   In what respects is the Double Entry System superior to it?
2. What is a Statement of Affairs? How does it differ from a Balance Sheet?
3. How are profits calculated under the Single Entry System ?
4. How would you convert a set of books of accounts from the Single Entry to the Double Entry System ?
5. What are the advantages of Single Entry Book-keeping?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below.

1. From incomplete records, it is possible to prepare
   A Trial Balance
   B Balance Sheet
   C Statement of Affairs
   D none of the above
2. Under single entry system, opening capital is calculated by preparing
   A Closing Balance Sheet
   B Final Statement of Affairs
   C Opening Statement of Affairs
   D Opening Balance Sheet
3. Under single entry system details of
   A expenses will not be available
   B income will not be available
   C both expenses and income will not be available
   D both income and expenses will be available
4. Final Statement of Affairs is prepared for ascertaining
   A net profit of the business
   B capital of the owner
   C financial position of the business at the end of the accounting period
   D financial position of the business at the beginning of the accounting period
5. The shortage on the debit side of the Cash Book represents
   A credit Sales
   B cash Purchases
   C cash Sales
   D credit Purchases
6. The fundamental Balance Sheet equation is :
   A Capital – Liabilities = Assets
   B Assets = Capital
   C Capital = Assets – Liabilities
   D none of the above

PRACTICAL QUESTIONS

Preparation of Statement of Profit and Statement of Affairs

1. Sri R. Mitra commenced business on 1st January 2014, with ₹ 20,000 as Capital. He kept his books on Single Entry System. On 31st December, 2014, his books disclosed the following : Sundry Creditors ₹ 7,500; Plant ₹ 15,000; Stock-in-trade ₹ 12,000; Debtors ₹ 13,500; and Cash at Bank ₹ 3,000. He drew from his business at the rate of ₹ 225 at the end of each month. On 1st July, 2014, he introduced a further capital amounting to ₹ 6,000.
You are required to prepare a statement of Profit and Loss for the year ended 31.12.2014 and a Statement of Affairs as on that date after taking into consideration the following: (i) 7.5% of sundry debtors proved to be bad; (ii) plant suffered depreciation @ 10%; and (iii) a provision for doubtful debts was required to be made at 2.5% of debtors.
2. Mr A does not maintain complete double entry books of account. From the following details, determine the profit for the year and statement of affairs at the end of the year:
₹ 1,000 (Cost) furniture was sold for ₹ 5,000 on 1.1.2014; 10% depreciation is to be charged on furniture. Mr A has drawn ₹ 1,000 per month, ₹ 2,000 was invested by Mr A in 2014. (all figures in ₹)

	1.1.2014	31.12.2014
Stock	40,000	60,000
Debtors	30,000	40,000
Cash	2,000	1,000
Bank	10,000	(O.D.) 5,000
Creditors	15,000	25,000
Outstanding Expenses	5,000	8,000
Furniture (Cost)	3,000	2,000

Bank balance on 1.1.2014 is as per Cash Book, but the bank overdraft on 31.12.2014 is as per bank statement ₹ 2,000, Cheques drawn in December, 2014 have not been encashed within the year.
3. X is a small cloth merchant, who has not kept full double entry records. His position as on 1st January 2014 stood as follows:- Cash in hand ₹ 760; Balance at Bank ₹ 6,950; Stock ₹ 12,600; Sundry Debtors ₹ 4,500; Furniture ₹ 2,000 and Sundry Creditors ₹ 4,310.
His position at the end of 2014 was as : Cash in hand ₹ 470; Balance at Bank, as per Bank Pass Book ₹ 5,930; Stock ₹ 16,700; Sundry Debtors ₹ 6,320; Furniture ₹ 2,000; Mobike ₹ 4,000; and Sundry Creditors ₹ 5,300.
During the year, he had withdrawn ₹ 400 per month for his personal expenses and purchased a new mobike for his business use for ₹ 4,000. A cheque of ₹ 1,000 issued on 29.12.2014 was presented for payment on 12.1.2015.
Prepare a Statement, showing his trading result for the year ended 31st December, 2014 and a Balance Sheet as on 31st December, 2014 after (a) providing 10% depreciation on furniture and 20% depreciation on mobike; (b) writing-off ₹ 320 as actual bad debts; and (c) making a 5% provision for likely bad debts.
4. K and D are partners in a firm sharing profits and losses as K 60% and D 40%. Their Statement of Affairs as at 31st March 2014, is given below:

Liabilities	₹	₹	Assets	₹	₹
Sundry Creditors		40,000	Plant		40,000
Capital Accounts			Furniture		15,000
K	50,000		Stock		25,000
D	30,000	80,000	Debtors		30,000
			Cash		10,000
		1,20,000			1,20,000

The partners keep their books by Single Entry System. On 31st March 2015, the position of the business was :
Plant ₹ 50,000; Furniture ₹ 20,000; Stock ₹ 40,000; Debtors ₹ 45,000; Cash ₹ 11,000 and Sundry Creditors ₹ 30,000.
On 30th September, 2014 K and D withdrew from the business ₹ 6,000 and ₹ 4,000 respectively.
You are required to ascertain the profit made by the partners during the year and draw up a Statement of Affairs as at 31st March, 2015 by taking into consideration the following further information:
Plant and Furniture are to be depreciated at 10% and 20% p.a. respectively. A Bad Debts Reserve of 2.5% to be raised against Sundry Debtors, Interest on Capital is to be allowed at 5% per annum and Interest on drawings at 12% p. a.
5. Ram, Shyam and Jadu were in partnership and towards the end of 2014, most of their books and records were destroyed in a fire. The Balance Sheet of the firm as on 31.12.2013 was as follows:

Liabilities	₹	₹	Assets	₹	₹
Sundry Creditors		15,040	Cash at Bank		6,000
Capital A/cs:			Debtors		8,800
Ram	10,000		Stock		12,500
Shyam	5,000		Plant & Machinery		4,950
Jadu	5,000	20,000	Fixture & Furniture		2,800

Current A/c:			Current A/c:		
Ram	300		Jadu		500
Shyam	210	510			
		35,550			35,550

Partners' Drawings during the year were : Ram ₹ 3,000; Shyam ₹ 2,500; and Jadu ₹ 1,500. On 31.12.2014 Cash at Bank was 8,000; Debtors ₹ 9,500; Stock ₹ 12,000; Creditors ₹ 10,000; Plant and Machinery to be depreciated at 10% and fixture and furniture at 7.5%. The partners share profits in the proportion of 2 : 1 : 1.

You are required to prepare a Statement showing net profit for the year 2014 and the division of the same between the partners, together with the Balance Sheet as at 31.12.2014.

6. A, B and C are in partnership and keep their books by single entry system. They are entitled to 5% interest on the amounts standing to their credits at the beginning of each year, and B and C are entitled to salary of ₹ 250 and ₹ 175 per month respectively, in addition. The remaining profits are to be shared as A — 1/2, B — 1/3rd, C — 1/6th.

   On 1st January, 2014 their Capital Accounts were: A — ₹ 27,600, B — ₹ 10,800 and C — ₹ 1,200 and their Plant was valued at ₹ 8,200.

   In the half-year ended 30.6.2014, each partner had drawn interest on capital to which he was entitled: B and C had received their salaries. They had also drawn at the end of each month : A — ₹ 500, B — ₹ 300 and C — ₹ 250. They had bought Plant costing ₹ 2,200 and now valued the whole at ₹ 9,500. Creditors were for ₹ 10,700, Cash — ₹ 4,600, Debtors — ₹ 30,400 and Stock — ₹ 18,900.

   Prepare Statement of Profit and Loss for half-year ended 30th June, 2014 and Balance Sheet as on that date.

7. A and B started business on January 1, 2013 with ₹ 50,000 as capital contributed equally but the profit-sharing ratio was 3 : 2. Their drawings were ₹ 300 and ₹ 200 per month respectively. They had kept no accounts except the following information :

	31.12.2013	31.12.2014
	₹	₹
Machinery at cost	20,000	25,000
Stock in trade	30,000	30,000
Debtors	50,000	60,000
Cash	2,000	500
Creditors	30,000	20,000
Outstanding expenses	4,000	3,000
Bank balance (as per pass book)	6,000	8,000

   Provision is to be made for depreciation at 10% on the cost of the machinery as at the end of the each year. Debtors on 31.12.2013, include ₹ 5,000 for goods sent out on consignment at 25% above cost, and the goods were not sold until 2014. A cheque for ₹ 1,000 had been deposited on 31.12.2013 but was credited on 2.1.2014.

   A cheque for ₹ 2,000 issued on 26.12.2014 was presented on 3.1.2015. A cheque for ₹ 1,000 was directly deposited by a customer on 27.12.2014 and a cheque for ₹ 500 deposited in December 2014 was dishonoured. No adjustment for these was made. Determine the profits for 2013 and 2014 and draw up a Balance Sheet as on 31.12.2014.

8. Naresh, Ramesh and Dinesh are partners in a firm sharing profits and losses in the ratio 5 : 3 : 2 respectively. They kept their books on the Single Entry System. On 31st March, 2014, the following Statement of Affairs are extracted from their books:

Liabilities	₹	Assets	₹
Creditors	20,000	Plant	45,000
Ramesh — Loan A/c	10,000	Land & Building	30,000
Capital		Stock	20,000
Naresh	50,000	Debtors	15,000
Ramesh	40,000	Cash	8,000
		Capital — Dinesh	2,000
	1,20,000		1,20,000

   On 31.3.2015 the Assets and Liabilities were as follows :
   Plant ₹ 50,000; Land and Building ₹ 30,000; Stock ₹ 30,000; Debtors ₹ 25,000; Creditors ₹ 25,000; Cash ₹ 15,000.
   You are required to prepare a Profit and Loss Statement for the year ended 31.3.2015 and a Statement of Affairs as at that date after taking into consideration the following additional information:
   (i) Plant is to be depreciated by 10% p.a.;
   (ii) A Reserve for Bad Debts is to be raised at 2.5%;
   (iii) Interest on Partners' Capital is to be allowed at 5% p.a.; and
   (iv) During 2014-15, Naresh and Ramesh withdrew from business ₹ 7,500 and ₹ 5,000 respectively.

9. A and B are in partnership, sharing profits and losses, two-thirds and one-third respectively. The books are kept on the single entry system and their Statement of Affairs dated 31st December, 2013 showed their position to be as follows:

Statement of Affairs of A and B as at 31st December, 2013

Liabilities	₹	Assets	₹
Capital :		Freehold Building	6,000
A	10,000	Plant and Machinery	2,000
B	4,000	Office Furniture	500
Creditors	5,000	Stock	4,000
Loan	1,000	Debtors	6,000
Bills Payable	500	Bills Receivable	1,500
		Cash	500
	20,500		20,500

On 31st December, 2014 the books disclosed the following facts: Debtors ₹ 8,000, Creditors on open accounts ₹ 8,500, Creditors for loan ₹ 1,600 and Cash ₹ 800. The Stock was valued at ₹ 4,200 and the bills receivable amounted ₹ 1,400.

An examination of the Cash Book showed that during the year, A had drawn on account of profits ₹ 1,500 and B ₹ 600. A had, in addition, withdrawn ₹ 2,000 from his Capital Account on 30th June, 2014.

The partners agree to reduce the existing valuation of the Plant and Machinery by 5 per cent and the office furniture by 10 per cent by way of depreciation, and to charge 5 per cent by way of interest on capital.

You are required to prepare:

(1) A Statement of Profit, dividing the balance between A and B; and

(2) A Statement of Affairs showing the position as at 31st December, 2014.

Preparation of Final Accounts from Incomplete Records

10 Anandram is a wholesaler in textile goods. On January 1, 2015, he had stocks of main varieties A and B valued at ₹ 14,000 and ₹ 24,000 respectively. During the six months ended June 30, 2015, his purchases were ₹ 72,000 and ₹ 1,44,000 respectively. He had taken for personal and family use one bale of variety A costing ₹ 6,000. On 30th June, his stocks were : A, ₹ 8,000 and B ₹ 18,000.

Goods were sold by Anandram at the retail prices fixed by the manufacturer, which yield 25% gross profit on sales. Determine the total sales figure of Anandram for the six months.

11. From the following particulars for the years 2013 and 2014 determine the value of closing stock at the end of 2014 :

	2013 (₹)	2014 (₹)
Opening Stock	20,000	30,000
Purchases	1,20,000	1,90,000
Sales	2,00,000	2,40,000

Uniform rate of gross profit may be assumed.

12. You are required to calculate for each product of the company as a whole:

(a) Value of Stock at 31st December, 2014, at cost;

(b) The amount of Gross Profit, as they would appear in the company's Trading Account.

The company sells three products A, B and C on which it earns gross profit percentages, calculated on normal selling prices, of 20, 25 and $33^1/_3$ respectively.

The value of its stock at 1st January, 2014 valued at cost, were A ₹ 24,000; B ₹ 36,000; C ₹ 12,000.

During the year ended 31st December 2014 the actual purchases and sales were :

Purchases : A ₹ 1,46,000; B ₹ 1,24,000; C ₹ 48,000; **Sales** : A ₹ 1,72,500; B ₹ 1,59,400; C ₹ 74,600.

However, certain items were sold during the year at a discount on the normal selling prices and these discounts were reflected in the values of sales shown above. The items sold at a discount were :

Normal Sales Price : A ₹ 10,000; B ₹ 3,000; C ₹ 1,000;

Actual Sales Price : A ₹ 7,500; B ₹ 2,400; C ₹ 600.

These discounts were not provided for in the cost values at 1st January, 2014 given above.

13. S.K.S. does not maintain proper books of account. However, he provides you with the following details:

(a) **Sales and Purchases policy :** Total sales during the year 2014 — ₹ 6,00,000. Volume of sales during 2nd half of 2014 was 1/3 that of 1st half. Volume of credit sales was twice that of cash sales throughout the year. All purchases were on credit and were made evenly throughout the year.

(b) **Credit policy :** Closing debtors represent last two months' sales, whereas closing creditors represent last 3 months' purchases.

(c) **Price Policy :** Goods are sold at 10% profit on credit sales. Cash selling price was always at a profit of 5% of Sales.

(d) **Inventory Policy :** The firs two months' requirement was held as opening stock whereas the last month's requirement was held as closing stock. From the above details, ascertain the following: (i) Opening Stock; (ii) Closing Stock; (iii) Total Purchases; and (iv) Closing Debtors and Creditors.

14. You are preparing an income statement and balance sheet for Longman, a sole trader who does not keep adequate accounting records.

    The following information is available to you to compute the figures for inclusion in the accounts for sales revenue and purchases for the year ending 31 March, 2015 (all figures in Rupees) :

(a) Sales revenue			**(b) Purchases**		
Cash received from credit customers		2,18,500	Payment to suppliers		1,14,400
Cash sales receipts paid into bank		1,14,700	Trade Creditors :	31 March, 2014	22,900
Expenses paid out of cash sales before banking		9,600		31 March, 2015	24,800
Trade Debtors :	31 March, 2014	41,600	Cost of items taken from inventory by Longman for personal use		400
	31 March, 2015	44,200			
Refunds to customers		800	Amount due from credit customer deducted by Longman in settling supplier's account		700
Discounts allowed		2,600			
Bad debts written off		1,500			
Amount due from credit customer deducted by Longman in paying supplier's account		700			

    You are required to compute the sales revenue figure and the purchases figure.

15. Mr Mukherjee commenced business on 1st January, 2014, with a capital of ₹ 45,000. He immediately purchased Furniture of ₹ 24,000. During the year he received from his uncle a gift of ₹ 3,000 and he borrowed from his father a sum of ₹ 5,000. He had withdrawn ₹ 600 per month for his household expenses. He had no Bank Account and all dealings were in cash. He did not maintain any books but the following information is given:

Sales (including cash sales ₹ 30,000)	1,00,000	Salaries	6,200
Purchases (including cash purchases ₹ 10,000)	75,000	Bad debts written off	1,500
Carriage Inwards	700	Trade expenses	1,200
Wages	300	Advertisements	2,200
Discount allowed to Debtors	800		

    He used goods worth ₹ 1,300 for personal purposes and paid ₹ 500 to his son for examination and college fees.

    On 31st December, 2014, his Debtors were worth ₹ 21,000 and Creditors ₹ 15,000. Stock in trade was valued at ₹ 10,000. Furniture to be depreciated by 10% p.a.

    Prepare Trading and Profit and Loss Account for the year ended on 31st December, 2014 and Balance Sheet as at 31st December, 2014.

16. Motilal is a small trader, and is financially incapable of engaging the services of an accountant. He keeps no books but only an account with a bank in which all takings are lodged after meeting business expenses and his personal drawings and through which all payments for business purchases are passed.

    You are required to ascertain his trading result for the year ended 31.3.2015 and the financial position of his business as on that date from the following information supplied by him :

    (a) The bank statement shows deposits during the year of ₹ 12,020 and withdrawals of ₹ 11,850.
    (b) ₹ 1,000 had been placed in fixed deposit account on 31.12.2013 at 10% p.a. and withdrawn with interest on 30.6.2014.
    (c) The assets and liabilities on 31.3.2015 were : Stock ₹ 1,100; Book Debts ₹ 1,150; Bank balance ₹ 320, Furniture ₹ 2,000; and Trade Creditors ₹ 400.
    (d) In the absence of reliable information, estimates are supplied on the following matters :
        (i) The stock and book debts have each increased by ₹ 100 during the year.
        (ii) The trade creditors were ₹ 200 on 1.4.2014.
        (iii) During the year, personal expenses amounted to ₹ 800 and business expenses ₹ 700. Ignore fractions.

17. X does not maintain regular books of account. The following information is available for the year ended 31.12.2014:

    (i) Cash sales ₹ 38,400;
    (ii) Cash collections from debtors ₹ 60,000;
    (iii) A summary of the bank transactions for the year ended 31.12.2014 :
        Deposits : cash ₹ 95,820.
        Withdrawals : expenses ₹ 19,020; interest ₹ 180; salaries ₹ 20,400; drawings ₹ 4,800; creditors ₹ 36,000.
    (iv) Balances as on 1.1.2014 were as follows : Bank overdraft : ₹ 9,600; Stock : ₹ 21,600; Debtors : ₹ 52,800; Furniture ₹ 2,400; Buildings ₹ 36,000; Creditors ₹ 19,200; Cash ₹ 200.
    (v) X purchased an old motor cycle for ₹ 2,400 on 1.10.2014.
    (vi) The other balances on 31.12.2014 were : Creditors ₹ 13,200; Stock ₹ 24,480 and Debtors ₹ 72,000.

    Prepare a Profit and Loss Account for the year ended 31.12.2014 and a Balance Sheet as on that date after charging depreciation @ 10% p.a. on fixed assets.

18. Shri V.L. Srivastav does not maintain regular books but keeps only memoranda of his transactions. He furnishes the following information from the memoranda for the year ended 30.9.2014:
    (a) Total collection from Debtors (in cash) ₹ 30,000;
    (b) Cash Sales ₹ 19,200;
    (c) The abstract of Bank Account for the year ended 30.9.2014: (all figures in ₹)

To Deposits (cash)	47,910	By Balance (overdraft) (1.10.2013)	4,800
		By Interest & bank charges	90
		By Drawings	2,400
		By Salaries	10,200
		By General expenses	9,510
		By Creditors	18,000
		By Balance on 30.9.2014	2,910
	47,910		47,910

    (d) Other balances as on 1.10.2013 were: Stock ₹ 10,800; Debtors ₹ 26,400; Furniture ₹ 1,200; Buildings ₹ 18,000; Creditors ₹ 9,600; Cash in hand ₹ 100;
    (e) He purchased an old scooter at ₹ 1,200 on 30.6.2014.
    (f) Besides cash balance other balances on 30.9.2014 were: Stock ₹ 12,240; Debtors ₹ 36,000; Creditors ₹ 6,600.

    Prepare a Profit and Loss Account for the year ended 30.9.2014 and a Balance Sheet on that date after charging depreciation @ 10% p.a. on Buildings, Furniture and Scooter.

19. Rama Reddi is a retail merchant who keeps only a memorandum of his transactions. By going through his notes and records, you are able to ascertain the following:
    (a) Summary of Bank Account (1.4.2014 to 31.3.2015)

	₹		₹
To Balance b/d	2,500	By Payment to Creditors	2,20,000
To Cash deposited	2,30,000	By Rent paid	12,000
To Balance c/d	13,100	By Electric charges	3,600
		By Drawings	10,000
	2,45,600		2,45,600

    (b) Other cash transactions : Cash purchases — ₹ 20,000; Office expenses paid — ₹ 20,500; Cash balance on 1.4.2014 — ₹ 500; and Cash balance on 31.3.2015 — ₹ 1,000.
    (c) Other information :
    (i) Stock in trade : As on 1.4.2014 — ₹ 50,000; As on 31.3.2015 — ₹ 75,000.
    (ii) A deposit of ₹ 3,000 for rent lies with the landlord.
    (iii) Furniture with a written-down value of ₹ 30,000 on 1.4.2014 is subject to depreciation at 10% p.a.
    (iv) Electricity bills to be paid on 1.4.2014 and 31.3.2015 were for ₹ 400 and ₹ 600 respectively.
    (v) Amounts due to creditors on 1.4.2014 and 31.3.2015 were ₹ 10,600 and ₹ 21,000 respectively.
    (vi) An amount of ₹ 2,000 being irrecoverable from a customer is to be written-off as bad.
    (vii) Debtors on 1.4.2014 and 31.3.2015 were ₹ 20,000 and ₹ 17,400 (excluding bad debts of ₹ 2,000) respectively.

    From the above information, prepare Rama Reddi's:
    1. Trading and Profit and Loss Account for the year ended 31st March 2015; and
    2. Balance Sheet as at 31st March, 2015.

20. Bhuvanabhoopati who commenced business as a retail trader on 1.1.2014 has not kept proper records of his transactions for the year ended 31.12.2014. He, however, has kept a cash diary from which he has extracted the following:

Cash Account

Receipts	₹	Payments	₹
Amount withdrawn from Bank on various dates	3,520	Postage expenses	720
		Conveyance expenses	2,400
		Licence fees	60
		Miscellaneous expenses	220
		Balance c/d	120
	3,520		3,520

    An analysis of his Bank Statements reveals the following :
    Deposits: Capital introduced ₹ 50,000; Cash sales ₹ 2,40,000; Collection from debtors ₹ 20,000;
    Withdrawals : Cash withdrawals for petty expenses ₹ 3,520; Rent paid ₹ 2,200; Electricity bills paid ₹ 660; Payments to suppliers ₹ 1,80,000; Insurance ₹ 12,000; Salaries ₹ 3,600; Furniture & Fixtures purchased ₹ 24,000; Advance income-tax paid ₹ 12,000; Typewriter purchased ₹ 2,000; Personal drawings ₹ 36,000.

You also ascertain the following additional information:
(a) All fixed assets were purchased in each January. Furniture is to be depreciated at 10% and Typewriter at 15%.
(b) Rent and electricity payable to the landlord are in arrears for December, 2014.
(c) At the end of the year, debtors were ₹ 5,000, creditors ₹ 2,700 and stock ₹ 39,000.

You are required to prepare:

(i) A summary of the Bank Account and ascertain the closing balance; (ii) Trading and Profit and Loss Account for the year ended 31.12.2014; and (iii) Balance Sheet as at that date.

21. The following is a summary of the Bank Account of Mr Khanna, a trader, for the year 2014.

Bank Summary

Particulars	₹	Particulars	₹
Balance on January 1, 2014	5,140	Payment to trade creditors	1,87,860
Cash receipts on account of credit sales	2,43,720	General expenses	16,970
Balance on December 31, 2014	1,180	Rent & rates	7,710
		Drawings	37,500
	2,50,040		2,50,040

All business takings had been paid into the bank except ₹ 21,180, out of which he paid wages amounting to ₹ 12,800. He retained ₹ 8,380 for private purposes. The following information is obtained from the books:

Particulars	31.12.2013	31.12.2014	Particulars	31.12.2013	31.12.2014
Stock in trade	24,300	31,500	Rates paid in advance	420	450
Creditors for goods	19,450	17,090	Creditors for general expenses	810	1,340
Debtors for goods	22,400	26,900	Amount owing to a customer who had overpaid his account	600	—
Furniture and fittings	10,000	10,000			

Discounts received from trade creditors during 2014 amounted to ₹ 1,500. No discounts were allowed to customers. The amount due to the customer who overpaid his account was set off against sales to him in 2014.

You are required to prepare a Trading and Profit and Loss Account for the year ended 31.12.2014 and a Balance Sheet as on that date.

22. Anand started business on 1.1.2014 with his own capital of ₹ 20,000, and an interest free loan of ₹ 20,000 from a friend.

His business makes toys, which are selling at ₹ 40 each. Anand, who has little knowledge of accountancy, produced the following information at the end of the first year's trading :

Cash received : Sale proceeds of 2,000 toys ₹ 80,000.

Cash paid : Wages ₹ 28,000; Raw materials ₹ 13,600; Rent ₹ 8,000; General expenses ₹ 4,800; Loan repaid ₹ 6,000.

You ascertain the following additional information :
(1) A further 300 toys were sold in 2014, but not paid for at the year end.
(2) ₹ 3,600 of raw materials received in the year, but not paid for.
(3) The only stock at 31.12.2014 was ₹ 1,600 raw materials.
(4) The rent covered the period from 1.1.2014 to 31.3.2015.
(5) Expenses included ₹ 800 withdrawn by Anand for his own use.
(6) The initial capital and loan of ₹ 40,000 was used to buy machinery with 4-year life and an anticipated residual value of ₹ 8,000.
(7) The wages figure included ₹ 10,000 for installing the machinery.
(8) The machinery is to be depreciated under reducing balance method @ 25% p.a. for the whole year.

Prepare a Trading and Profit and Loss Account for the year ended 31.12.2014 and a Balance Sheet as on that date.

23. Sanjay is in business but does not keep full accounting records. For the year ended 31.12.2014, he is able to provide you with the following information (all figures in rupees) :

Date	Stock	Debtors	Creditors	Furniture
1.1.2014	29,500	3,250	7,360	12,000
31.12.2014	32,710	5,010	10,140	10,500

You are able to prepare the following summary of his cash and bank transactions for 2014 :

Cash	₹	₹	Bank	₹	₹
Opening balance		490	Opening balance		9,200
Receipts —			Receipts —		
Cash Sales	53,600		Cheques from Customers	17,330	
Cheque Cashed	2,600	56,200	Paid into Bank	39,950	57,280
		56,690			66,480

Payments —			Payments —		
Purchases	3,400		Creditors	29,500	
Wages	1,020		Wages	3,710	
Other Expenses	2,260		Other Expenses	7,700	
Drawings	8,200		Rent	12,500	
Paid into Bank	39,950	54,830	Cash Withdrawn	2,600	56,010
Closing Balance		1,860	Closing Balance		10,470

You are required to prepare Trading and Profit and Loss Account for the year ended 31.12.2014 and a Balance Sheet as on that date.

24. X is a tobacco merchant. He follows the practice of paying creditors for goods purchased through his bank account and making payments in cash on all nominals accounts.
X had not kept his books on the double entry principles nor had he balanced his Cash Book.
However, the following information has been extracted from X's accounting records (all figures in Rupees).

Date	Cash	Bank	Debtors	Creditors	Investments	Stock
1.1.2014	30	1,000	1,750	3,410	6,250	2,500
31.12.2014	50	1,500	2,500	3,750	6,250	1,870

Transactions during the year 2014 were the following (all figures in Rupees) :

Salaries paid	1,500	Payments to creditors through bank and of trade expenses in cash	20,000
General expenses paid	3,500	Payments into bank - business	18,750
Payment for stationery	870	Payments into bank - additional capital	250
Payment of rent and rates	700	Payments from bank account - personal	3,250
Lighting charges paid	250	Cash payments - personal	910
Cash receipts from debtors	31,250		
Stock taken for personal use	140		

Prepare Trading and Profit and Loss Account for the year ended 31.12.2014 and Balance Sheet on that date.

[Delhi University — B.Com. (Hons.) — Adapted]

25. The following is the Balance Sheet of Sri Govind as on 30th June 2014 :

Liabilities	₹	Assets	₹
Capital Account	96,000	Buildings	65,000
Loan	30,000	Furniture	10,000
Creditors	62,000	Motor car	18,000
		Stock	40,000
		Debtors	34,000
		Cash in hand	4,000
		Cash at bank	17,000
	1,88,000		1,88,000

A riot occurred on the night of 30th June 2015 in which all books and records were lost. The cashier had absconded with the available cash. Shri Govind gives you the following information :

(a) His sales for the year ended 30th June 2015 were 20% higher than the previous years. He always sells his goods at cost plus 25%. 20% of the total sales for the year ended 30th June 2015 was for cash. There were no cash purchases.

(b) On 1st July, 2014, the stock level was raised to ₹ 60,000 and the stock was maintained at this level throughout the year.

(c) Collection from Debtors amounted to ₹ 2,80,000 of which ₹ 70,000 was received in cash. Business expenses amounted to ₹ 40,000 of which ₹ 10,000 was outstanding on 30th June 2015 and ₹ 12,000 was paid by cheques.

(d) Analysis of the pass books revealed on the following : Payment to creditors ₹ 2,75,000; Personal drawings ₹ 15,000; Cash deposited in bank ₹ 1,43,000; Cash withdrawn from bank ₹ 24,000.

(e) Gross profit as per last year's audited accounts was ₹ 60,000.

(f) Provide depreciation on building and furniture at 5% and on motor car at 20%.

(g) The amount defalcated by the cashier may be treated as recoverable from him.

Prepare the Trading and Profit and Loss Account for the year ended 30th June 2015 and Balance Sheet as on that date.

26. The following are the assets and liabilities of Sanjoy as on 31.3.2014 (all figures in ₹ '000) :
Liabilities : Capital 200; Creditors 50. **Assets :** Fixed assets : 145; Stock 40; Debtors 50; Cash 5; Bank 10.
A fire destroyed the accounting records as well as the closing cash on 31.3.2015.

However, the following information was available :

(a) Debtors and Creditors on 31.3.2015 showed an increase of 20% as compared to 31.3.2014.
(b) Credit period : Debtors 1 month; Creditors 2 months.
(c) Stock was maintained at the same level throughout the year.
(d) Cash sales constituted 20% of total sales.
(e) All purchases were for credit only.
(f) Current ratio as on 31.3.2015 was exactly 2.
(g) Total expenses excluding depreciation for the year amounted to ₹ 2,50,000.
(h) Depreciation was provided at 10% on the closing value of fixed assets.
(i) Bank and cash transactions :
(i) Payments to creditors included ₹ 50,000 by cash; (ii) Receipts from debtors included ₹ 5,90,000 by way of cheques; (iii) Cash deposited into the bank ₹ 1,20,000; (iv) Personal drawings from bank ₹ 50,000; and (v) Fixed assets purchased and paid by cheques ₹ 2,25,000.

You are required to prepare :

(a) Trading and Profit and Loss Account for the year ended 31.3.2015; and
(b) A Balance Sheet on that date. For your exercise assume that cash destroyed by fire is written off in the Profit and Loss Account.

27. The following information is supplied from which you are requested to prepare the Profit and Loss Account for the year ended 31st December, 2014 and Balance Sheet as at that date :

	1.1.2014	31.12.2014
Assets and Liabilities	₹	₹
Sundry Assets	18,000	20,000
Stock	14,000	19,000
Cash in hand	8,200	4,800
Cash at bank	2,200	8,000
Debtors	?	26,000
Creditors	12,000	9,800
Miscellaneous expenses outstanding	1,000	600

Details relative to the year's transactions are :

Receipts in the year from Debtors after discount	2,45,000	Salary and wages paid out of bank	18,000
Returns from Debtors	6,000	Miscellaneous expenses paid by cash	5,000
Bad debts	1,000	Drawings by cash	9,400
Sales — cash and credit	3,00,000	Purchase of sundry assets by cheque	2,000
Returns to creditors	3,000	Cash withdrawn from bank	21,000
Payments to creditors by cheque	2,36,200	Cash sales deposited in bank	?
Receipts from Debtors deposited into bank	2,43,000	Discount allowed by creditors	4,000
Cash purchases	10,000		

28. From the following information of M/s Pradip & Company, prepare Trading and Profit and Loss Account for the year ending on 31.3.2015 and the Balance Sheet as on that date (all figures in ₹) :

Date	Car	Furniture	Stock	Debtors	Bank	Creditors
31.3.2014	90,000	10,000	70,000	62,000	9,000	60,000
31.3.2015	90,000	10,000	90,000	46,000	16,000	?

The following further information is also provided :

(a) M/s Pradip & Company purchases goods for resale from manufacturers who allow discount of 3% on goods purchased in excess of ₹ 5,00,000 in a year. The discount for the year ended 31.3.2015 was ₹ 12,480.
(b) All goods are sold at a gross profit margin of 30% on selling price.
(c) Bank statement for the year reveals the following payments (all figures in rupees) : Creditors 9,03,520; Salaries 60,000; Car expenses 23,000; Rent 30,000; Printing and Stationery 6,400; Rates and Taxes 3,000; Carriage outwards 18,600; Travelling expenses 14,900; Delivery van purchased 1,70,000; Miscellaneous expenses 9,580; and Drawings 50,000.
(d) Depreciation on car and van @ 20% and furniture @ 10% is to be provided on balances as on 31.3.2015.

29. From the following information obtained from Mr X, a trader, who does not prepare proper accounts, prepare a Trading and Profit and Loss Account for the year ending on 31.3.2015 and the Balance Sheet as on that date:

(a) Withdrawal as per Pass Book (all figures in ₹) :

Postage and Telegrams	1,000	X's Drawings	10,000
Rents, rates, taxes and insurance	12,000	Paid for purchases	50,000
Furniture purchased on 1.4.2014	2,000	Salaries	8,000
Printing charges	1,000	Wages	8,000
Advertisement expenses	1,000		

(b) Balance at bank on 31.3.2015 was ₹ 3,000.
(c) Stock on 1.4.2014 was ₹ 24,000 and stock on 31.3.2015 was ₹ 4,000 less than of stock on 1.4.2014. Out of stock on 1.4.2014, spoiled stocks were sold for ₹ 2,000 which were not deposited into bank account.
(d) Payments for purchases include ₹ 4,000 for last year's purchase. ₹ 1,000 of previous year's purchase is still unpaid on 31.3.2015. Current year's list of unpaid invoice not ticked off in purchase register amounted to ₹ 5,000.
(e) Collections for sale were ₹ 1,00,000 which includes ₹ 12,000 in respect of previous year's sale. Balance of unticked bills of last year's sale still amounted to ₹ 8,000 on 31.3.2015. Unticked bills of the current year totalled to ₹ 20,000.
(f) Salaries ₹ 500 and Wages ₹ 500 was outstanding on 31.3.2015.
(g) Furniture on 31.3.2014 amounted to ₹ 6,000 and machinery on the same date were ₹ 50,000.
(h) Prepaid insurance on 31.3.2015 amounted to ₹ 400.
(i) Depreciation at 10% p.a. shall be provided on Furniture and at 25% p.a. on machinery.

He maintained purchases and sales register and items are ticked off on collection or payment. All collections are deposited and payments are all in cheques. Petty expenses of ₹ 1,000 were paid out of his drawings. All purchases and sales were made on credit basis.

30. On 31st December, 2014 John's books and records were destroyed by fire. The following information was available:
(a) The Balance Sheet of John as on 31st December 2013 was as follows :

Capital and Liabilities		₹	Property and Assets	₹
Capital		4,20,000	Fixtures	1,00,000
Creditors :			Stock	1,50,000
Goods	94,000		Debtors	1,20,000
Electricity charges	2,000		Rates in advance	4,500
Accounting charges	5,000	1,01,000	Cash in hand	15,000
			Cash at bank	1,31,500
		5,21,000		5,21,000

(b) The Insurance company agreed to pay ₹ 95,000 for fixtures and ₹ 1,05,000 for stock without production of accounts; the stock, however, was ₹ 1,15,000.
(c) From bank statements and the cheque books which were in his house, the following information on payments was available : (all figures in rupees)

Personal expenses	80,000	Rates	13,500
Sundry expenses	6,500	Rent	51,700
Accounting charges	8,000	Goods for resale	21,58,000
Electricity	7,500	Fixtures	20,000

(d) Total bankings for the year amounted to ₹ 24,50,200.
(e) All cash takings were banked with the exception of the following payments during the year :
(i) An Assistant's salary of ₹ 18,000 p.a.; (ii) Goods for resale averaging ₹ 10,500 per month.
(iii) Drawings varied between ₹ 20,000 and ₹ 30,000 per month.
(f) ₹ 2,500 per month for 9 months was received in cash for subletting a portion of the shop and this was not banked.
(g) During the year sales proceeds for waste paper amounting to ₹ 30,500 were paid into the bank.
(h) On 31.12.2014 (a) Debtors were ₹ 2,05,000; (b) Creditors : for goods were ₹ 90,000, for electricity ₹ 800, for accounting charges ₹ 750 and for rent ₹ 4,700; (c) Rates in advance ₹ 6,500; (d) Cash in hand ₹ 17,000;
(e) During the year a bad debt of ₹ 6,000 was incurred; (f) The rate of gross profit as a percentage of sale was 20%.

You are required to compile a Trading and Profit and Loss Account for the year ended 31st December 2014 and Balance Sheet as on that date.

31. A is importer of fancy goods, operating from rented premises, which is on lease of ₹ 1,000 per month. He prepares his accounts as on 31st December, each year. On the night of December 31st, 2014, all his books and records were destroyed in a fire.

The following was his summarized financial position as on 31st December, 2013:
Fixed Assets : Motor car ₹ 20,000; Furniture ₹ 10,000
Current Assets : Stock-in-trade (at cost) ₹ 2,00,500; Debtors ₹ 24,000; Balance at bank ₹ 27,060; Cash in hand ₹ 590; Prepaid rent ₹ 500;
Current Liabilities : Creditors for purchases ₹ 1,10,200; Accrued rent ₹ 2,000; Due for hire purchase instalments ₹ 2,790;

The following further information is also available:

(a) A buys goods for resale only from one manufacturer in Japan, who allows a rebate of 3% of the goods purchased by him in excess of ₹ 5,00,000 in a calendar year. The rebate due for the year ended 31st December, 2014 was ₹ 12,480.

(b) All goods are sold at a standard gross profit margin of 40% on selling price. Any rebate due is to be ignored.

(c) Stock at cost on 31st December, 2014 amounted to ₹ 90,200.

(d) Weekly cash expenses out of cash sales (before depositing the same into the bank) have been :
Drawings ₹ 300; Carriage outward ₹ 500; Petrol ₹ 100; General expenses ₹ 50,
Cash in hand on 31st December, 2014 amounted to ₹ 1,670.

(e) His bank statements for the year reveal the following information :

	₹		₹
Paid for purchases of goods	10,10,500	Salaries	1,12,460
Car expenses	6,680	Travelling expenses	36,800
Rent	13,000	Printing & stationery	6,400
Rates for the year ended 31.03.2015	3,200	Advertisement	12,280
Hire purchase instalments (final payment)	3,040	Insurance for business	3,000
Lorry hire charges	48,700	General expenses	36,230
Drawings	37,000	Balance as on 31.12.2014	2,31,800

(f) Depreciation on motor car and furniture is to be provided @ 30% and @ 15% respectively.

Prepare Trading and Profit and Loss Account for the year ended on 31st December 2014 and Balance Sheet as on that date.

32. From the following data, you are required to prepare a Trading and Profit and Loss Account for the year ended 31st March, 2015 and a Balance Sheet as on that date. All workings should form a part of your answer.

	1.4.2014	31.3.2015
Assets and Liabilites	₹	₹
Creditors	15,770	12,400
Sundry expenses outstanding	600	330
Sundry assets	11,610	12,040
Stock in trade	8,040	11,120
Cash in hand and cash at bank	6,960	8,080
Trade Debtors	?	17,870

Details relating to transactions in the year :	₹		₹
Cash and discount credited to Debtors	64,000	Cash purchases	1,030
Sales return	1,450	Cash expenses	9,570
Bad debts	420	Paid by cheque for machinery purchased	430
Sales (cash and credit)	71,810	Household expenses drawn from bank	3,180
Discount allowed by trade creditors	700	Cash paid into bank	5,000
Purchases returns	400	Cash drawn from bank	9,240
Additional capital paid into bank	8,500	Cash in hand on 31.3.2010	1,200
Realisation from Debtors — paid into bank	62,500	Cheque issued to trade creditors	60,270

Guide to Answers

Multiple Choice

1. C 2. C 3. C 4. C 5. C.

Practical Questions

1. **Closing Capital ₹ 36,000; Profit before adjustment ₹ 12,700; Net Profit ₹ 9,875; Balance Sheet ₹ 40,675.**
2. **Opening Capital ₹ 65,000; Closing Capital ₹ 63,000; Profit Before Adjustment ₹ 4,000; Net Profit (trading) ₹ 3,800; Profit on Sale of Furniture ₹ 4,000; Statement of Affairs ₹ 1,02,800.**
3. **Opening Capital ₹ 22,500; Closing Capital ₹ 29,120; Bank Balance as per Cash Book ₹ 4,930; Profit Before Adjustment ₹ 7,420; Net Profit ₹ 5,800; Balance Sheet ₹ 32,800.**
4. **Closing Capital ₹ 1,36,000; Profit Before adjustment ₹ 66,000; Net profit ₹ 56,875; Divisible profit ₹ 53,475; K ₹ 32,085; D ₹ 21,390; Statement of Affairs ₹ 1,56,875; K's Capital ₹ 78,225; D's Capital ₹ 48,650.**
5. **Opening Capital ₹ 20,010; Closing Capital ₹ 27,250; Profit Before Adjustment ₹ 14,240; Net Profit ₹ 13,535; Current Accounts : Ram ₹ 4,067; Shyam ₹ 1,094; Jadu ₹ 1,384; Balance Sheet : ₹ 36,545.**
6. **Closing Capital ₹ 53,600; Profit Before Adjustment ₹ 23,840; Net Profit ₹ 22,940. Divisible Profit ₹ 19,400; Capital Accounts : A ₹ 34,300; B 15,467; C ₹ 2,933; Balance Sheet ₹ 63,400.**

7. **Combined Closing Capital (before adjustments) : 2013 — ₹ 74,000; 2014 — ₹ 98,000. Divisible Profit : 2013 — ₹ 28,000; 2014 ₹ 27,500. Balance Sheet Total of 2014 : ₹ 1,16,500.**
8. **Combined Closing Capital — ₹ 1,25,000; Combined Opening Capital — ₹ 88,000. Net Profit — ₹ 44,125; Divisible Profit — ₹ 39,625. Total of Statement of Affairs — ₹ 1,44,625.**
9. **Combined Closing Capital — ₹ 12,800; Combined Opening Capital — ₹ 14,000. Net Profit — ₹ 2,750; Divisible Profit — ₹ 2,100. Total of Statement of Affairs — ₹ 22,750.**
10. **Sales : Variety A — ₹ 96,000; Variety B — ₹ 2,00,000.**
11. **Rate of Gross Profit in 2013 — 45%. Value of Closing Stock of 2014 — ₹ 88,000.**
12. **Value of Closing Stock : Product A — ₹ 30,000; Product B — ₹ 40,000; Product C — ₹ 10,000; Gross Profit : A — ₹ 32,500; B — ₹ 39,400; C — ₹ 24,600.**
13. **(i) Opening Stock — ₹ 1,37,500; (ii) Closing Stock — ₹ 22,916; (iii) Total Purchases — ₹ 4,35,416; (iv) Debtors — ₹ 33,333 and Creditors — ₹ 1,08,854.**
14. **Credit Sales : ₹ 2,25,100; Cash Sales (₹ 1,14,700 + 9,600) = ₹ 1,24,300; Total Sales : ₹ 3,49,400. Purchases : ₹ 1,16,600.**
15. **Gross Profit : ₹ 35,300; Net Profit : ₹ 21,000; Balance Sheet Total : ₹ 80,000.**
16. **Gross Profit : ₹ 620; Net Loss : ₹ 55; Balance Sheet Total : ₹ 4,570; Opening Capital : ₹ 5,025.**
17. **Gross Profit : ₹ 90,480; Net Profit : ₹ 46,980; Balance Sheet Total : ₹ 1,39,580.**
18. **Capital ₹ 42,100; Credit Sales ₹ 39,600; Credit Purchases ₹ 15,000; Cash Sales ₹ 19,200; Gross Profit ₹ 45,240; Net Profit ₹ 23,490; Balance Sheet 69,790**
19. **Capital ₹ 95,000; Cash collected from Debtors ₹ 2,71,000; Credit Sales ₹ 2,70,000; Credit purchases ₹ 2,30,400; Gross Profit ₹ 44,600; Net Profit ₹ 3,300; Balance Sheet ₹ 1,23,000.**
20. **Closing bank balance ₹ 34,020; Gross Profit ₹ 1,21,300; Net Profit ₹ 96,480; Credit Sales ₹ 25,000; Credit purchases ₹ 1,82,700; Balance Sheet ₹ 1,01,440.**
21. **Net Profit — ₹ 53,720; Balance Sheet total — ₹ 68,850.**
22. **Net Profit — ₹ 35,500; Balance Sheet total — ₹ 72,300.**
23. **Net Profit — ₹ 11,530; Balance Sheet total — ₹ 60,550.**
24. **Net Profit — ₹ 4,350; Balance Sheet total — ₹ 12,170.**
25. **Net Profit — ₹ 24,650; Balance Sheet total — ₹ 2,40,650.**
26. **Net Profit — ₹ 2,43,000; Balance Sheet total — ₹ 4,53,000. Total Sales — ₹ 9,00,000; Total Purchases — ₹ 3,60,000.**
27. **Opening Debtors ₹ 18,000; Cash Sales deposited into Bank ₹ 40,000; Opening Capital ₹ 47,600; Net Profit ₹ 29,400; Balance Sheet ₹ 77,800.**
28. **Gross Profit : ₹ 3,84,000; Net Profit : ₹ 1,78,000; Balance Sheet Total : ₹ 3,69,000.**
29. **Gross Profit : ₹ 46,500; Net Profit : ₹ 9,100; Balance Sheet Total : ₹ 96,100.**
30. **Gross Profit : ₹ 5,78,750; Net Profit : ₹ 4,88,300; Balance Sheet Total : ₹ 6,65,000.**
31. **Gross Profit : ₹ 6,84,200; Net Profit : ₹ 3,77,680; Balance Sheet Total : ₹ 4,96,960.**
32. **Gross Profit : ₹ 14,810; Net Profit : ₹ 4,290; Balance Sheet Total : ₹ 49,110.**

23

Accounting for Sale on Approval

Introduction

With a view of pushing up the sales or for introducing a new product in the market, goods are sometimes sent to the customers on sale or approval basis. This means that a business delivers the goods to the customers with the option to retain or reject them within a specified period. A contract of goods on sale or return permits the buyer to return the goods for a full refund (then cash is received) or allow for an adjustment to be made to the amount owed. Generally, these transactions take place between a manufacturer (or a wholesaler) and a retailer. When the goods are transferred from the wholesaler to the retailer, under a sale or return basis, it implies a change in the possession of goods only and not a transfer of the ownership of goods. The ownership is passed only when the retailer gives his approval or if the goods are not returned within that specified period. The retailer (customer) does not incur any liability when the goods are merely sent to him.

The Sale of Goods Act, 1893, therefore, provides that when goods are sent on sale or approval basis, the sale will take place or the property in the goods passes to the buyer :

(i) When he signifies his approval or acceptance to the seller, or

(ii) Does any other act adopting the transactions, or

(iii) If, without signifying his approval or acceptance, the buyer retains the goods without giving notice of rejection, then, if a time has been fixed for the return of the goods, on the expiry of such time, and if no time is fixed, on the expiration of a reasonable time. *[Section 24]*

Under a sale or return agreement, revenue is not recognised from the sale until all of the following criteria are met :

(1) The sales price is fixed or determinable at the date of sale.

(2) The buyer has paid or will pay the seller, and the obligation is not contingent upon resale of the product.

(3) The buyer's obligation to the seller would not be changed by theft or damaged to the merchandise.

(4) The buyer has an economic substance apart from the seller.

(5) The seller does not have sufficient obligations for future performance to directly bring about the resale of the product by the buyer.

Economics of Sale or Return

Goods sent on sale or return are beneficial to either party, i.e., the seller gets a larger sale and the buyer is able to make a right choice. But in every bargain, the economies and diseconomies go hand in hand. Since some of the provisional purchasers may return the commodity, the actual sales fall below the target. Also some of the units returned may not be in their original condition. Therefore, the cost of marketing and bringing back the replaced units to their original quality should be put under to the total selling cost. Since no hire charges are generally made on these goods, the fixation of the price of the product should take into consideration the above mentioned factors.

Accounting Record

Accounting entries depend on the fact whether the business sends goods on sale or approval basis — (i) casually; (ii) frequently; and (iii) numerously.

(i) When the Business Sends Goods Casually on Sales or Return

When the transactions are few, the seller, while sending the goods, treats them as an ordinary sale. If the goods are accepted, or not returned, or the business receives no intimation within that specified time limit, no further entry is required to be passed. Because, a transaction for sale or return becomes entry after the expiry of that specified period. If the goods are returned within a specified time limit, a reverse entry is passed to cancel the previous transaction. If, at the year-end, goods are still lying with the customers and the specified time limit is yet to expire, the original entry for sales is cancelled and the value of the goods lying with the customers ***must be reduced from the selling price to the cost price***, and treated as an ordinary stock for Balance Sheet purposes.

Journal Entries

1. When goods are sent on approval or on sale or return basis

Customers/Sundry Debtors Account   Dr. [Invoice price]
    To Sales Account

---

2. When goods are rejected or returned within the specified time

Sales/Return Inwards Account   Dr. [Invoice price]
    To Customers/Sundry Debtors Account

---

3. When goods are accepted at invoice price or not returned within the specified time limit

[No Entry]

---

4. When goods are accepted at a higher price than the invoice price

Customers/Sundry Debtors Account   Dr. [Difference in price]
    To Sales Account

---

5. When goods are accepted at a lower price than the invoice price

Sales Account   Dr. [Difference in price]
    To Customers/Sundry Debtors Account

---

6. At the year-end, when goods are lying with customers and the specified time limit is yet to expire

Sales Account   Dr. [Invoice price]
    To Customers/Sundry Debtors Account

These goods should be considered as stock with customers and the following adjustment entry is to be passed:

Stock with Customers on Sale or Return Account   Dr. [Cost price or market price whichever is less]
    To Trading Account

It should be noted that no entry is to be passed for goods returned by the customers on a subsequent date.

Illustration 1

Capital Electronics sends goods to his customers on Sale or Return. The following transactions took place during 2014:

2014		₹
Sept. 15	Sent goods to customers on sale or return basis at cost plus $33^1/_3$%	1,00,000
Oct. 20	Goods returned by customers	40,000
Nov. 25	Received letters of approval from customers	40,000
Dec. 31	Goods with customers awaiting approval	20,000

Capital Electronics records sale or return transactions as ordinary sales. You are required to pass the necessary Journal Entries in the books of Capital Electronics assuming that accounting year closes on 31st December, 2014.

Solution **In the books of Capital Electronics**

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

Date	Particulars		L.F.	₹	₹
2014 Sept. 15	Sunday Debtors A/c	Dr.		1,00,000	
	To Sales A/c				1,00,000
	(Being the goods sent to customers on sale or return basis)				
Oct. 20	Return Inwards A/c (Note 1)	Dr.		40,000	
	To Sundry Debtors A/c				40,000
	(Being the goods returned by custormers to whom goods were sent on sale or return basis)				
Dec. 31	Sales A/c	Dr.		20,000	
	To Sundry Debtors A/c (Note 3)				20,000
	(Being the cancellation of original entry of sale in respect of goods on sale or return basis)				
Dec. 31	Stock with Customers on Sale or Return A/c	Dr.		15,000	
	To Trading A/c (Note 4)				15,000
	(Being the adjustment for cost of goods lying with customers awaiting approval)				

Tutorial Notes :

(1) Alternatively, Sales Account can be debited in place of Return Inwards Account.

(2) No entry is required for receiving letter of approval from customer.

(3) Alternatively, Debtors Suspense Account can be credited in place of Sundry Debtors Account.

(4) Cost of goods with customers = ₹ 20,000 $\times \frac{100}{133.33}$ = ₹ 15,000.

Illustration 2

S.S. Ltd. sends out its goods to dealers on Sale or Return. All such transactions are, however, treated as actual sales and are passed through the Day Book. Just before the end of the accounting year on 31.12.2014, 200 such goods have been sent to a dealer at ₹ 250 each (cost ₹ 200 each) on sale or return and debited to his account. Of these goods, on 31.12.2014, 50 were returned and 70 were sold, for the other goods date of return has not yet expired.

Pass necessary adjustment entries on 31.12.2014.

Solution **In the books of S.S. Ltd.**

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

Date	Particulars		L.F.	₹	₹
2014 Dec. 31	Return Inwards A/c (Note 1)	Dr.		12,500	
	To Sundry Debtors A/c				12,500
	(Being the adjustment for 50 units of goods returned by customers to whom goods were sent on sale or return basis)				
Dec. 31	Sales A/c (₹ 250 x 80)	Dr.		20,000	
	To Sundry Debtors A/c (Note 2)				20,000
	(Being the cancellation of original entry for sale in respect of 80 units of goods not yet returned or approved by customers)				
Dec. 31	Stock with Customers on Sale or Return A/c	Dr.		16,000	
	To Trading A/c				16,000
	(Being the cost of goods sent to customers on sale or return basis not yet approved, adjusted)				

Tutorial Notes :

(1) Alternatively, Sales Account can be debited in place of Return Inwards Account.

(2) Alternatively, Debtors Suspense Account can be credited in place of Sundry Debtors Account.

Illustration 3

Modern Electrical Ltd. sends electrical heaters costing ₹ 100 each to their customers on Sale or Return. These are, however, treated like actual sales and passed through the Sales Day Book. A few days before the end of financial year, 120 such heaters were sent out at a invoice price of ₹ 150 each. Of these, 10 are accepted by the customers at ₹ 140 each. There was no report as to the rest of the articles. You are required to pass necessary Journal Entries at the end of the accounting period.

Solution **In the books of Modern Electricals Ltd.**

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
?	Sales A/c (₹ 10 x 10) Dr. To Sundry Debtors A/c (Being the adjustment for reduction in the selling price of 10 heaters @ ₹ 10 each)		100	100
?	Sales A/c (₹ 150 x 110) Dr. To Sundry Debtors A/c (Note 1) (Being the cancellation of original entry for sale in respect of 110 heaters not yet returned or approved by customers)		16,500	16,500
?	Stock with Customers on Sale or Return A/c Dr. To Trading A/c (Being the cost of goods sent to customers on sale or return basis not yet approved, adjusted)		11,000	11,000

Tutorial Note : (1) Alternatively, Debtors Suspense Account can be credited in place of Sundry Debtors Account.

Illustration 4

Calcutta Company sends out its gas containers to dealers on Sale or Return. All such transactions are, however, treated as actual sales and are passed through the Day Book. Just before the end of the financial year, 100 gas containers, which cost them ₹ 900 each have been sent to the dealer on 'sale or return' and have been debited to his account at ₹ 1,200 each. Out of this only 20 gas containers are sold at ₹ 1,500 each.

You are required to pass necessary adjustment entries for the purpose of Profit and Loss Account and Balance Sheet.

Solution **In the books of Calcutta Company**

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
?	Sundry Debtors A/c Dr. To Sales A/c (Being the adjustment for excess price of 20 gas containers @ ₹ 300 each)		6,000	6,000
?	Sales A/c Dr. To Sundry Debtors A/c (Being the cancellation of original entry for sale in respect of 80 gas containers @₹ 1,200 each)		96,000	96,000
?	Stock with Customers on Sale or Return A/c Dr. To Trading A/c (Being the adjustment for cost of 80 gas containers lying with customers awaiting approval)		72,000	72,000

Illustration 5

P & Co. has credited certain items of sales on Approval aggregating ₹ 10,000 to the Sales Account. Of these, goods to the value of ₹ 3,000 have been returned and taken into stock at cost of ₹ 1,500 though the record of return was omitted in the accounts; and in respect of another parcel of ₹ 1,000 (sale price being cost plus 100%) the period of approval did not expire on the closing date. Show adjustment and correcting entries in the books of the trader.

Solution **In the books of P & Co.**

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Return Inwards A/c Dr. To Sundry Debtors A/c (Being the goods returned by customer taken into stock but not recorded in the books of account, now adjusted)		3,000	3,000
	Sales A/c Dr. To Sundry Debtors A/c (Being the cancellation of original entry for sale in respect of goods not yet approved by the customers)		1,000	1,000

	Stock with Customer on Sale or Return A/c Dr. To Trading A/c (Being adjustment for cost of goods lying with customers awaiting approval)		500	500

Illustration 6

On 1st November, 2014, M/s Tini and Tubai Traders sent goods valuing ₹ 1,50,000 at invoice price to the customers on sale or return basis. On 10th December, goods worth ₹ 40,000 were returned by the customers. On 23rd December, intimation was received that goods worth ₹ 80,000 has been accepted by the customers but at a reduced price of 5% which was agreed by the Traders. The customers could not yet decide anything about the rest of the goods.

Show the journal entries in the books of M/s Tini and Tubai Traders at the end of financial year 31st December, 2014. Goods are invoiced to the customers at 25% above cost.

Solution **In the books of M/s Tini and Tubai Traders**

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2014 Dec. 31	Sales A/c (Note 3) Dr. To Sundry Debtors A/c (Being the adjustment for reduction in the selling price @ 5%)		4,000	4,000
	Sales A/c (₹ 1,50,000 – ₹ 40,000 – ₹ 80,000) Dr. To Sundry Debtors A/c (Being the cancellation of original entry for sale in respect of goods sent to customers on approval basis)		30,000	30,000
	Stock with Customers on Sale or Return A/c Dr. To Trading A/c (Note 4) (Being the cost of goods sent to customers, on approval basis not yet approved, adjusted)		24,000	24,000

Working Notes :

(1) It is assumed that goods sent on approval basis was recorded as normal sales.
(2) It is assumed that entries for sale and returned by customers have already been passed.
(3) It is assumed that no entry has been passed for price adjustment in respect of goods accepted by the customers.
(4) Cost of goods with customers = 100/125 × ₹ 30,000 = ₹ 24,000.

Illustration 7

Guha Traders sends out the goods on Sale or Approval to customers and includes the same in sales account. On 31st December, 2014, the stock in hand amounted to ₹ 40,000 and the Sundry Debtors balance stood at ₹ 75,000 which included ₹ 5,000 being invoice value of goods sent on 'sale or return' against which no intimation was received during the year. These goods were sent out at 25% above cost and were sent to S. Dutta — ₹ 2,000 and R. Mitra — ₹ 3,000.

Make necessary adjustment entries and show how these items will appear in the Balance Sheet on 31st December, 2014.

Solution **In the books of Guha Traders**

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2014 Dec. 31	Sales A/c (₹ 2,000 + ₹ 3,000) Dr. To Sundry Debtors A/c (Note 1) (Being the cancellation of original entry for sale in respect of goods sent to customers — S. Dutta and R. Mitra, on approval basis)		5,000	5,000
	Stock with Customers on Sale or Return A/c (Note 2) Dr. To Trading A/c (Being the cost of goods sent to customers on approval basis not yet approved, adjusted)		4,000	4,000

Balance Sheet as on 31st December, 2014 [Extract]

Liabilities	₹	Assets	₹	₹
		Sundry Debtors ₹ (75,000 – 5,000)		70,000
		Stock-in-hand	40,000	
		Add : Stock with Customers on Sale or Return	4,000	44,000

Tutorial Notes :

(1) Alternatively, Debtors Suspense Account can be credited in place of Sundry Debtors Account.
(2) Cost of goods with customers = 100/125 x ₹ 5,000 = ₹ 4,000.

Illustration 8

A & Co. sends out goods on approval to a few customers and includes the same in the Sales Account. On 31.3.2013 the Sundry Debtors balance stood at ₹ 1,00,000 which included ₹ 7,000 goods sent on approval against which no intimation was received during the year. These goods were sent out at 25% over and above cost price and were sent to Mr. X — ₹ 4,000 and Mr. Y — ₹ 3,000.

Mr. X sent intimation of acceptance on 30th April and Mr. Y returned the goods on 10th April, 2013.

Make the adjustment entries and show how these items will appear in the Balance Sheet on 31st March, 2013. Show also the entries to be made during April, 2013. Value of closing stock as on 31st March, 2013 was ₹ 60,000.

[I.C.W.A. (Inter) — Adapted]

Solution

In the books of A & Co.
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2013 March 31	Sales A/c	Dr.		7,000	
	To Sundry Debtors A/c (Note 1)				7,000
	(Being the cancellation of original entry for sale in respect of goods lying with customers awaiting approval)				
March 31	Stock with Customers on Sale or Return A/c	Dr.		5,600	
	To Trading A/c (Note 2)				5,600
	(Being the adjustment for cost of goods lying with customers awaiting approval)				
April 30	Sundry Debtors A/c	Dr.		4,000	
	To Sales A/c				4,000
	(Being goods costing ₹ 3,200 sent to Mr. X on sale or return basis has been accepted by him)				

Balance Sheet of A & Co. as on 31st March, 2013

Liabilities	₹	Assets	₹	₹
		Sundry debtors (₹ 1,00,000 – ₹ 7,000)		93,000
		Stock-in-trade	60,000	
		Add : Stock with customers on Sale or Return	5,600	65,600
				1,58,000

Tutorial Notes :

(1) Alterantively, Debtors Suspense Account may be credited in place of Sundry Debtors Account.

(2) Cost of goods lying with customers = 100/125 x ₹ 7,000 = ₹ 5,600.

(3) No entry is required on 10th April, 2014 for goods returned by Mr. Y. Goods should be included physically in the stock-in-trade.

(ii) When the Business Sends Goods Frequently on Sale or Return

When the number of transactions are moderate, a separate specially ruled Sale or Return Day Book is maintained to incorporate all the relevant details relating to Sale or Return transactions. This Day Book is divided into 4 main columns — (1) Goods Sent on Approval; (2) Goods Returned; (3) Goods Approved; and (4) Balance.

At the time of sending the goods on a sale or return basis, all information is recorded in the first column. It is a memorandum record and nothing is transferred to the actual books of account.

When goods are returned by the customers, it is recorded in the second column. It is also a memorandum record and nothing is transferred to the actual books of account.

When goods are approved, it is recorded in the third column. A periodical total of this column is credited to Sales Account in the General Ledger. In the Debtors Ledger the respective Customers' Account is debited.

In the fourth column, the balance of goods at invoice price is recorded. It represents the balance of goods with customers, awaiting approval.

The balance amount is calculated as follows:

Balance Value of Goods Sent on Sale or Return
Less Value of Goods Returned
Less Value of Goods approved.

At the time of preparing the Final Accounts, an adjustment entry is required for these goods which is as follows:

Goods with Customers on Sale or Return Account Dr. [Cost or market price, whichever is lower]
To Trading Account

***The format of this Sale or Return Book is given below*:**

Sale or Return Day Book

Date	(1) Goods Sent on Approval		(2) Goods Returned		(3) Goods Approved			(4) Balance	
	Particulars	₹	Particulars	₹	Particulars	S.L. Folio	₹	Value (₹)	Remarks

No entry is made from this column in the General Ledger or Debtors Ledger

No entry is made from this column in the General Ledger or Debtors Ledger

Entry for sale is made in the General Ledger as well as in the Debtors Ledger

Cost or market price whichever is lower is adjusted at the time of preparing the Final Accounts, debiting Stock with Customers on Sale or Return Account and crediting Trading Account

(iii) When the Business Sends Goods Numerously on Sale or Return

When the transactions are numerous, a business maintains the following books : (a) Sale or Return Day Book; (b) Sale or Return Day Book; and (c) Sale or Return Ledger. It is important to remember is that these are all ***Memorandum Books***.

In this case, when the goods are sent to the customers on a sale or return basis, they are recorded in the Sale or Return Day Book. Thereafter, in the Sale or Return Ledger, all the customers are individually debited and the Sale or Return Account is credited with the periodical total of the Sale or Return Day Book.

When the goods are returned by the customers within the specified time, they are recorded initially in the Sale or Return Day Book. Thereafter, in the Sale or Return Ledger, the Sale or Return Account is debited with the periodical total of the Sale or Return Day Book and the individual customers are credited. The above records are all memoranda and hence can not find a place in the regular books.

When the business receives information about the acceptance of the goods or no intimation is received within the specified time, they are recognised as sales and are recorded in the original Sales Day Book. Periodically, the total of the Sales Day Book is credited to Sales Account and debited to the Individual Customers Account. To cancel the earlier memoranda entries, individual customers are credited and the Sale or Return Account is debited. The entries for the approved goods are shown below :

In the Memorandum Sale or Return Ledger		In the Regular General Ledger	
Sale or Return Account To Individual Customer's Account	Dr.	Individual Customer's Account To Sales Account	Dr.

At the year end, in the Sale or Return Ledger, the sum of the debit balances of the Individual Customers' Account must be equal to the credit balance of the Sale or Return Account. It represents stock with customers awaiting approval at invoice price. To adjust the cost of such goods with customers in the Final Accounts, the following entry is passed :

Stock with Customers on Sale or Return Account Dr. [Cost or market price, whichever is less]
To Trading Account

Illustration 9

Hindusthan Automobiles Ltd. sent out motor cars on Sale or Return. They maintained a separate set of books for this type of business. During the month of April, 2013 they sent out motor cars on Sale or Return as follows:

2013	Name of the Customers	₹	2013	Remarks
April 2	Y & Co. Ltd.	1,00,000	April 7	Returned
April 16	X & Co. Ltd.	1,50,000	April 20	Retained
April 20	Y & Co. Ltd.	1,60,000	April 25	Returned
April 28	Y & Co. Ltd.	2,00,000		No intimation recd. as to approval and car not yet returned

Show Day Books and Ledger Accounts. ***[I.C.W.A. — Adapted]***

Solution

[Memorandum Records]

Sale or Return Day Book

Date	Particulars	Folio No.	Amount (₹)
2013 April 2	Y & Co. Ltd.		1,00,000
April 16	X & Co. Ltd.		1,50,000
April 20	Y & Co. Ltd.		1,60,000
April 28	Y & Co. Ltd.		2,00,000
	TOTAL		6,10,000

Sale or Return Sold and Returned Day Book

Date	Particulars	Sale or Return L.F.	Sales L.F.	Goods Sold ₹	Goods Returned ₹
2013 April 7	Y & Co. Ltd.			—	1,00,000
April 20	X & Co. Ltd.			1,50,000	—
April 25	Y & Co. Ltd.			—	1,60,000
	TOTAL			1,50,000	2,60,000

Sale or Return Ledger

Dr. **Sale or Return Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013 April 30	To Sundries : Sales	1,50,000	2013 April 30	By Sundries : (Goods sent on sale or return basis)	6,10,000
April 30	To Sundries : Returned	2,60,000			
April 30	To Balance c/d	2,00,000			
		6,10,000			6,10,000
			May 1	By Balance b/d	2,00,000

Dr. **Y & Co. Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013 April 2	To Sale or Return A/c	1,00,000	2013 April 7	By Sale or Return A/c	1,00,000
April 20	To Sale or Return A/c	1,60,000	April 25	By Sale or Return A/c	1,60,000
		2,60,000			2,60,000

Dr. **X & Co. Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013 April 16	To Sale or Return A/c	1,50,000	2013 April 20	By Sale or Return A/c	1,50,000
April 28	To Sale or Return A/c	2,00,000		By Balance c/d	2,00,000
		3,50,000			3,50,000
May 1	To Balance b/d	2,00,000			

Tutorial Note : Balance of Sale or Return Account represents goods with customers on Sale or Return at invoice price, awaiting approval.

Illustration 10

A firm sends goods on sale or return basis. Customers having the choice of returning the goods within a month.

During May 2014, the following are the details of goods sent :

Date (May)	2	8	12	18	20	27
Customers	P	B	Q	D	E	R
Value (₹)	15,000	20,000	28,000	3,000	1,000	26,000

Within the stipulate time, P and Q returned the goods and B, D and E signified that they have accepted the goods.

Show in the books of the firm, the Sale or Return Account and Customers for Sale or Return Account on 15th June, 2014.

Solution

Dr. **Sale or Return Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 May 31	To Sundries : Sales	24,000	2014 May 31	By Sundries (Goods sent on sale or return basis)	93,000
June 15	To Sundries : Returned	43,000			
June 15	To Balance c/d	26,000			
		93,000			93,000
			June 16	By Balance b/d	26,000

Dr. P Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 May 2	To Sale or Return A/c	15,000	2014 May ?	By Sale or Return A/c	15,000

Dr. B Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 May 8	To Sale or Return A/c	20,000	2014 May ?	By Sale or Return A/c	20,000

Dr. Q Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 May 12	To Sale or Return A/c	28,000	2014 May ?	By Sale or Return A/c	28,000

Dr. D Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 May 18	To Sale or Return A/c	3,000	2014 May ?	By Sale or Return A/c	3,000

Dr. E Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 May 20	To Sale or Return A/c	1,000	2014 May ?	By Sale or Return A/c	1,000

Dr. R Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 May 27	To Sale or Return A/c	26,000	2014 May 15	By Balance c/d	26,000
June 16	To Balance b/d	26,000			

THEORETICAL QUESTIONS

1. If the goods are sent on sale or approval basis, when will the sale take place or the property in the goods passes to the buyer ?
2. Under a sale or return agreement, when revenue is recognised ?
3. What are the benefits of selling goods on sale or approval basis ?

OBJECTIVE QUESTIONS

Multiple choice

Select the best choice to complete each statement or answer each question below :

1. Under a sale or return basis, when goods are transferred from wholeseller to retailer, it implies a change
   A in the possession of the goods only
   B in the ownership of the goods
   C in the possession and the ownership of goods
2. Under a sale or return basis, the property in the goods passes to the buyer
   A when he gives his approval subject to certain conditions
   B when he gives his approval unconditionally
   C when a bill receivable is accepted
3. Goods sent on sale or return basis are beneficial to the
   A seller only
   B buyer only
   C seller and the buyer
4. Under sale or return agreement, revenue is recognised
   A at the time of delivery of goods
   B when the buyer signifies his approval but sale price has not be fixed
   C when the buyer signifies his approval and the sale price has been fixed
5. When the transaction are few, the seller, while sending the goods on sale or return basis treats them as
   A ordinary sale
   B no sale
   C profit

PRACTICAL QUESTIONS

1. A Gas Company sends out its gas stoves to dealers on Sale or Return. All such transactions are, however, treated like actual sales and are passed through the Day Book. Just before the end of the financial year, 100 stoves which cost them ₹ 150 each, are sent to a dealer on sale or return and are debited to his account at ₹ 200 each out of which only 20 stoves are sold at ₹ 180 each.
Show Journal Entries to adjust these transactions for the purpose of Company's Profit and Loss Account and Balance Sheet.
2. X Ltd. sends out its gas stoves to dealers on Sale or Return. All such transactions are, however, treated like actual sales and are passed through the Day Book. Just before the end of the financial year, 100 stoves, which cost them ₹ 150 each, are sent to a dealer on Sale or Return and are debited to his account at ₹ 200 each, out of which only 20 stoves are sold at ₹ 220 each. Show the entries in the Journal of the Company to adjust these transactions for the purpose of preparing the Final Accounts for the year ended December 31, 2014.
3. In preparing the final accounts of a company it is found that Sundry Debtors of ₹ 42,000 includes ₹ 4,000 representing price of goods sent out on approval for which the date of return has not yet expired.
Give the adjustment entries assuming that the goods were invoiced at a price of 25% above cost. How will the related items appear in the Balance Sheet of the Company ?
4. A merchant sells goods to his customers on "sale or return" basis treating all such transactions as actual sale at the time of despatch. On 10.12.2014, just before the end of accounting year on 31.12.2014, the merchant sent some goods costing ₹ 6,000 at 20% profit on sale, and was passed through Sales Day Book. Out of these, goods to the value of ₹ 2,000 have been returned on 15.12.2014. The merchant received sales approval from customers on 20.12.2014 for goods valued at ₹ 2,000. For the remaining goods with the customers, approval was pending on 31.12.2014. Record the transactions in the books of the merchant.
5. Messrs. Sound of Music supplied goods on Sale or Return basis, the particulars of which are as under:

Date of Despatch	Customer's Name	Amount (₹)	Other Particulars
2013 March, 10	ABC Co.	2,600	2013 March 14 — Returned
March 15	XYZ Co.	3,400	17 — Retained
March 20	PQR Co.	1,900	25 — Goods worth ₹ 800 returned
March 27	XYZ Co.	2,200	No intimation till 31.03.2013
March 28	PQR Co.	1,700	-do-

The books of Messrs. Sound of Music are closed on 31st March each year.
You are required to show Day Books and Ledger Accounts. ***[C.A. (Inter) — Adapted]***

6. A Mehta who keeps a special set of books for this type of business sends out goods on sale or return as follows :

Date	Particulars	₹	Date	Particulars	₹
1.1.2013	B. Bose	500	4.1.2013	All retained	
9.1.2013	C. Chatterjee	250	10.1.2013	Returned	150
				Retained	100
16.1.2013	D. Dutta	700	19.1.2013	All retained	
23.1.2013	C. Chatterjee	250	25.1.2013	All returned	
30.1.2013	B. Bose	400		No intimation received as to sale and goods not yet returned	
31.1.2013	E. Edward	500			

Show Day Books, Goods on Sale or Return Account, and Ledger Accounts for January, 2013.
What does the balance on the Sale or Return Account represent ?

Guide to Answers

Multiple Choice

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

Practical Questions

1. **Invoice value of goods not yet approved — ₹ 16,000; Customers are to be credited for price change — ₹ 400; Cost of goods with customers on Sale or Return — ₹ 12,000.**
2. **Invoice value of goods not yet approved — ₹ 16,000; Customers are to be debited for excess price charged — ₹ 400; Cost of goods with customers on Sale or Return — ₹ 12,000.**
3. **Cost of goods with customers on approval — ₹ 3,200.**

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Self-Balancing Ledger

Classification of Ledgers

In the case of a small business, all the accounts can be accommodated in one ***single ledger***. For a big business, when numerous transactions take place every day and a number of book-keepers are to work at the same time, it becomes necessary to maintain several ledgers. Therefore, in such a case, ledgers are subdivided into various categories. The division of the ledgers will vary according to the nature and size of the business, but the broadest division is as follows :

(i) Creditors Ledger/Bought Ledger: This ledger contains the accounts of all the creditors for goods purchased. Entries are made in this ledger mainly from Purchases Day Book, Cash Book, Return Outward Book and Bills Payable Book, etc.

(ii) Debtors Ledger/Sales Ledger: This ledger contains the accounts of all debtors for goods sold. Entries are made in this ledger mainly from Sales Day Book, Cash Book, Return Inward Book and Bills Receivable Book, etc.

(iii) General Ledger: This ledger contains all other accounts. It is used to denote all ledgers, other than Debtors Ledger and Creditors Ledger, however subdivided. In this context, it should be noted that Cash Book which functions as a Cash Account is deemed to be a part of the General Ledger.

When General Ledger, Creditors Ledger and Debtors Ledger are maintained by a concern, quite often, the debit and credit entries relating to a transaction are posted in different ledger. For example, goods sold to X for ₹. 5,000 on credit. X Account will be debited in the Debtors Ledger but the corresponding credit will be made in the Sales Account appearing in the General Ledger. Similarly, goods purchased on credit from Y for ₹. 4,000. Purchase Account will be debited in the General Ledger but the corresponding credit will be made in the Y Account appearing in the Creditors Ledger.

If the above two transactions are posted in the respective ledgers, it will appear as follows :

In the General Ledger

Dr. **Sales Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
			?	By X Account	5,000

Dr. **Purchases Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Y Account	4,000			

In the Debtors Ledger

Dr. **X Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Sales Account	5,000			

In the Creditors Ledger

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

Date	Particulars	₹	Date	Particulars	₹
			?	By Purchases Account	4,000

In this case, if we want to prove the accuracy of posting of any one ledger, it will be necessary to take out the balances of all accounts of all the ledgers (General Ledger, Debtors Ledger and Creditors Ledger); a small mistake in one ledger will lead to checking of the balances of all the ledgers.

In such a situation, the detection and rectification of the error involves considerable labour and time. Sometimes, it may delay the preparation of the Final Accounts.

To minimize the trouble and time, sometimes the system of ***Sectional Balancing*** or ***Self-Balancing*** of Ledger is employed.

Sectional Balancing System

Under this system, in the General Ledger, two additional accounts

(i) Total Debtors Account / Sales Ledger Control Account / Debtors Ledger Control Account; and

(ii) Total Creditors Account / Purchases Ledger Control Account / Creditors Ledger Control Account are kept, so that double entry is completed in the General Ledger itself.

The customers', and suppliers' individual accounts are kept in the respective ledgers.

At the end of each month, the total of Sales Day Book will be debited to 'Total Debtors Account' and credited to 'Sales Account' in the General Ledger — thus completing double entry in the General Ledger itself. Similarly, total amount received from customers, total discount allowed to them, total returns inwards, total bills receivable will be credited to 'Total Debtors Account' and debited to the respective accounts appearing in the General Ledger.

Again, the monthly total of Purchases Day Book will be credited to 'Total Creditors Account' and debited to 'Purchases Account' in the General Ledger. Similarly, total amount paid to creditors, total discount received from them, total returns outwards, total bills payable accepted will be debited to Total Creditors Account and credited to the respective accounts in the General Ledger.

In the 'Debtors Ledger' individual customer's account is debited with credit sales and credited with payments, discount allowed, bills receivable, etc. Similarly in the 'Creditors Ledger' individual supplier's account is credited with credit purchases and debited with payments, discount received, bills payable, etc.

The accuracy of individual customer's account can be checked by comparing the total of their balance with balances of the ***Total Debtors Account*** in General Ledger.

In the same manner, the accuracy of individual supplier's account can be checked by comparing the total of their balance with the balance of the ***Total Creditors Account***.

The summaries of entries are shown below :

Books of Original Entry	General Ledger	Debtors Ledger
Sales Day Book **Cash Book Credit** (For noting charges as cheques dishonoured) **Journal Proper** (for interest etc.)	Total Debtors Account Dr. To Sales Account To Cash Account To Interest Account etc.	Individual customer's account is debited for each item.
Sales Returns Book **Bills Receivable Book** **Cash Book Debit** (Discount allowed) **Journal Proper** (for bad debts)	Sales Returns Account Dr. Cash Account Dr. Discount Allowed Account Dr. Bad Debts Account Dr. To Total Debtors Account	Individual customer's account is credited for each item.

Books of Original Entry	General Ledger	Creditors Ledger
Purchases Day Book **Cash Book Debit** (for other charges, allowances, etc.) **Journal Proper** (for overdue interest)	Purchases Account Dr. Cash Account Dr. Interest Account Dr. To Total Creditors Account	Individual supplier's account is credited for each item.
Purchases Returns Book **Bills Payable Book** **Cash Book Credit** **Journal Proper** (for allowances)	Total Creditors Account Dr. To Purchases Returns Account To Bills Payable Account To Cash Account To Discount Received Account	Individual supplier's account is debited for each item.

Students should note that, under this system, double entry will be completed only in the General Ledger and Trial Balance can be prepared for General Ledger only. No Trial Balance can be prepared in the Debtors Ledger or Creditors Ledger.

Temporary Adverse Balances

It must be noted that, in practice, Debtors Ledger may contain a few accounts showing credit balances (e.g., where allowances are made for defective goods or empties are returned by the customers after full payment has been made). In such a situation, balances should be brought down on both sides of the 'Total Debtors Account' in respect of the total debit balances and the total credit balances. Likewise, the 'Total Creditors Account' may have both balances . For example, advance payment made to the suppliers for the goods to be received in future or allowances to be received for defective goods or empties return after full payment.

Debtors Ledger Control Account / Total Debtors Account will contain the totals of :

Sl.No.	Debit side	Sl.No.	Credit side
1.	Opening debit balances	1.	Opening credit balances (if any)
2.	Credit sale made during the period	2.	Cash and cheque received from debtors during the year
3.	Dishonoured bills and cheques (if any)	3.	Discount allowed to debtors
4.	Cash paid to debtors (if any)	4.	Returns inwards and allowances
5.	Transfer (if any)	5.	Bills receivables
6.	Other items (if any)	6.	Bad debt written-off
		7.	Transfer (if any)
		8.	Other items (if any)

Creditor Ledger Control Account / Total Creditors Account will contain the totals of :

Sl.No.	Debit side	Sl.No.	Credit side
1.	Opening debit balances (if any)	1.	Opening credit balances
2.	Cash and cheque paid to creditors during the period	2.	Credit purchase of goods during the period
3.	Returns outwards	3.	Bills payable renewed
4.	Discount received	4.	Bills payable dishonoured
5.	Bills payable	5.	Transfer (if any)
6.	Transfer (if any)	6.	Other items (if any)
7.	Other items (if any)		

It is to be noted that at any time :

(i) the balance in the Debtors Control Account should be equal to the total balances of individual debtors.

(ii) the total balance in the Creditors Control Account should be equal to the balances of individual creditors.

Purposes of Using Control Accounts

The various purposes of using Control Accounts are as follows :

1. Control accounts provide a check on the accuracy of entries made in the personal accounts in the Debtors ledger as well in the Creditors ledger. Regular comparison of the balances on the Debtors Control Account with the total of Individual Personal Account balances in the Debtors ledger will help to detect if any errors have occurred. Similarly, comparison of the balances on the Creditors Control Account with the total of Individidial Personal Account balances in Creditors ledger will help to detect if any errors have occurred.

2. Control accounts assist in locating the errors. A regular comparison of the balances of the Control Accounts with individual balances will quickly fix up the errors. This means that the volumes of transactions to be checked will be lowered and this will make it easier to locate errors.
3. Control accounts can assist in speeding up the preparation of final accounts by providing the total debtors and total creditors balances.
4. Control accounts can be used to calculate missing figures. For example, if we know the opening debtor balance and closing debtors balance and the amount collected from debtors during the accounting period, we can calculate the amount of credit side.
5. Control accounts provide an internal check. The staff posting the entries to the Control Accounts will act as a check on different staff(s) posting entries in the Debtors ledger and Creditors ledger.

Illustration 1

The Balance Sheet of H on 1st January 2015 disclosed the following assets and liabilities.

Liabilities	₹	Assets	₹
Capital	4,00,000	Freehold Premises	2,00,000
Total Creditors	1,00,000	Furniture & fittings	50,000
		Stock-in-trade	40,000
		Total Debtors	60,000
		Cash at bank	1,00,000
		Cash in hand	50,000
	5,00,000		5,00,000

List of Debtors : X ₹ 30,000; Y ₹ 20,000; Z ₹ 10,000.

List of Creditors : A ₹ 40,000; B ₹ 30,000; C ₹ 30,000

Mr. H. keeping his ledgers under Sectional Balancing System. You are required to enter the following transactions in the proper subsidiary books, post them in the respective ledger and extract a Trial Balance for General Ledger as on 31st January 2015. The following transactions occurred during the month of January, 2015:

Jan.		₹	Jan.		₹
2	Bought goods from A	20,000	25	Bought goods from B	10,000
3	Paid to C by cheque	10,000	26	Sold goods to Z	10,000
8	Sold goods to X	25,000	28	Paid rent in cash	1,000
16	Received a cheque from Z	8,000	30	Paid to A by cheque	30,000
20	Bought goods from C	15,000	31	Paid to B by cheque	12,000
24	Sold goods to Y	11,000	31	Paid salary in cash	2,000

Solution

Sales Day Book

Date	Particulars	Outward Invoice	L.F.	Details ₹	Total ₹
8.1.2015	X				25,000
24.1.2015	Y				11,000
26.1.2015	Z				10,000
					46,000

In the General Ledger :

Total Debtors Account Dr. ₹. 46,000

To Sales Account ₹. 46,000

Purchases Day Book

Date	Particulars	Inward Invoice	L.F.	Details ₹	Total ₹
2.1.2015	A				20,000
20.1.2015	C				15,000
25.1.2015	B				10,000
					45,000

In the General Ledger :

Purchases Account Dr. ₹. 45,000

To Total Creditors Account ₹. 45,000

Dr. Cash Book (without narration) Cr.

Date	Particulars	Cash ₹	Bank ₹	Date	Particulars	Cash ₹	Bank ₹
2015				2015			
Jan. 1	To Balance b/d	50,000	1,00,000	Jan. 3	By C A/c	—	10,000
Jan. 16	To Z A/c	—	8,000	Jan. 28	By Rent A/c	1,000	—
				Jan. 30	By A A/c	—	30,000
				Jan. 31	By B A/c	—	12,000
				Jan. 31	By Salary A/c	2,000	—
				Jan. 31	By Balance c/d	47,000	56,000
		50,000	1,08,000			50,000	1,08,000

General Ledger

Dr. Freehold Premises Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/d	2,00,000	31.1.2015	By Balance c/d	2,00,000

Dr. Furniture & Fittings Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/d	50,000	31.1.2015	By Balance c/d	50,000

Dr. Stock-in-Trade Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/d	40,000	31.1.2015	By Balance c/d	40,000

Dr. Total Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/d	60,000	31.1.2015	By Bank A/c (Z)	8,000
31.1.2015	To Sales A/c	46,000	31.1.2015	By Balance c/d	98,000
		1,06,000			1,06,000

Dr. Total Creditors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.1.2015	To Bank A/c		1.1.2015	By Balance b/d	1,00,000
	(C ₹ 10,000; A ₹ 30,000; B ₹ 12,000)	52,000	31.1.2015	By Purchases A/c	45,000
	To Balance c/d	93,000			
		1,45,000			1,45,000

Dr. Capital Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/d	4,00,000	31.1.2015	By Balance c/d	4,00,000

Dr. Sales Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.1.2015	To Balance b/d	46,000	31.1.2015	By Total Debtors A/c	46,000

Dr. Purchases Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.1.2015	To Total Creditors A/c	45,000	31.1.2015	By Balance c/d	45,000

Dr. Rent Account Cr.

Date	Particulars	₹	Date	Particulars	₹
28.1.2015	To Cash A/c	1,000	31.1.2015	By Balance c/d	1,000

Dr. Salary Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.1.2015	To Salary A/c	2,000	31.1.2015	By Balance c/d	2,000

Trial Balance of H as at 31st January, 2015

S.N.	Head of Accounts	L.F.	Dr. ₹	Cr. ₹
1.	Freehold Premises		2,00,000	
2.	Furniture and Fittings		50,000	
3.	Stock-in-trade		40,000	
4.	Total Debtors		98,000	
5.	Cash at Bank		56,000	

6.	Cash in hand		47,000	
7.	Total creditors			93,000
8.	Capital Account			4,00,000
9.	Sales			46,000
10.	Purchases		45,000	
11.	Rent		1,000	
12.	Salary		2,000	
	TOTAL		5,39,000	5,39,000

Debtors Ledger

Dr. **X Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/d	30,000	31.1.2015	By Balance c/d	55,000
8.1.2015	To Sales A/c	25,000			
		55,000			55,000

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

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/d	20,000	31.1.2015	By Balance c/d	31,000
24.1.2015	To Sales A/c	11,000			
		31,000			31,000

Dr. **Z Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/d	10,000	16.1.2015	By Bank A/c	8,000
26.1.2015	To Sales A/c	10,000	31.1.2015	By Balance c/d	12,000
		20,000			20,000

Creditors Ledger

Dr. **A Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
30.1.2015	To Bank A/c	30,000	1.1.2015	By Balance b/d	40,000
31.1.2015	To Balance c/d	30,000	2.1.2015	By Purchases A/c	20,000
		60,000			60,000

Dr. **B Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.1.2015	To Bank A/c	12,000	1.1.2015	By Balance b/d	30,000
31.1.2015	To Balance c/d	28,000	25.1.2015	By Purchases A/c	10,000
		40,000			40,000

Dr. **C Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
3.1.2015	To Bank A/c	10,000	1.1.2015	By Balance b/d	30,000
31.1.2015	To Balance c/d	35,000	20.1.2015	By Purchases A/c	15,000
		45,000			45,000

Check :		Total Debtors (₹)		Total Creditors (₹)
	X	55,000	A	30,000
	Y	31,000	B	28,000
	Z	12,000	C	35,000
TOTAL		98,000		93,000

Illustration 2

From the following information, prepare a Total Debtors Account as appearing in the General Ledger in the Books of M/s Singh and Company:

Debit balance as on 1.7.2014, ₹ 87,200; Credit balance as on 1.7.2014 in Debtors Account ₹ 600.

Transactions during 6 months ended on 31.12.2014 : Total sales were ₹ 94,000 including cash sales of ₹ 4,000. Debtors whose balance were in credit were paid off ₹ 600. Payments received by cheques from Debtors ₹ 60,000; Payments received by cash from Debtors ₹ 48,000; Payment received by bills receivable ₹ 26,000.

Bills receivable received from Debtors were dishonoured for ₹ 6,000 and noting charges of ₹ 60 were paid. Cheques received from customers were dishonoured for ₹ 800. Out of bills receivable received and included in ₹ 26,000 above, bills of ₹ 5,000 were endorsed to suppliers.

Bad debts written-off during the period were ₹ 1,000. Discount allowed for prompt payment were ₹ 700 and bad debts written off in 2012 and now recovered from debtors amounted to ₹ 900.

Interest debited for delay in payments were ₹ 1,250. On 31.12.2014 provision for doubtful debts was created for ₹ 2,100.

M/s Trade Syndicates Account appeared in Debtors Ledger and also in Creditors Ledger. The balance in Creditors Ledger was ₹ 900 and the same was transferred to Debtors Ledger. Goods of ₹ 2,760 were rejected by the customers.

Solution

In the General Ledger of M/s. Singh & Company

Dr. Total Debtors Accounts Cr.

Date	Particulars	₹	Date	Particulars	₹
1.7.2014	To Balance b/f	87,200	1.7.2014	By Balance b/f	600
31.12.2014	To Sales (₹ 94,000 – ₹ 4,000)	90,000	31.12.2014	By Bank	60,000
"	To Cash	600	"	By Cash	48,000
"	To Bills Receivable (dishonoured)	6,000	"	By Bills receivable	26,000
"	To Bank (noting charges)	60	"	By Bad debts	1,000
"	To Bank (cheque dishonoured)	800	"	By Discount allowed	700
"	To Interest	1,250	"	By Total Creditors A/c – Transfer	900
			"	By Sales Return	2,760
			"	By Balance c/d	45,950
		1,85,910			1,85,910

Tutorial Notes :

(1) Bad debts of 2012 recovered in 2014 will not appear in the Total Debtors Account. It should be credited to Profit and Loss Account.

(2) Bills Receivable of ₹ 5,000 endorsed to suppliers has nothing to do with Total Debtors Account, because at the time of endorsement, Suppliers Account is debited and Bills Receivable Account is credited.

Illustration 3

The following details were extracted from the books of a company for the 6 months ended 31.3.2015 (all figures in ₹):

Debtor balances total on 1.10.2014	1,927	Purchases returns	182
Supplier balances total on 1.10.2014	1,215	Interest charged to debtors	5
Cash paid to suppliers	7,613	Debtor's cheque dishonoured	76
Cash received from debtors	12,993	Discount allowed	356
Purchases	8,849	Bills payable accepted (including renewals)	891
Discount received	286	Bills payable withdrawn upon renewal	200
Bad debts written-off	56	Interest on bills payable renewed	3
Sales returns	93	Sales	13,308

The total of the balances extracted from the Trade Ledgers on 31.3.2015 were : Sales Ledger ₹ 1,808; Bought Ledger ₹ 1,290.

Prepare Total Debtors Account and Creditors Account from the details given above and show whether the balance agree with the balances per schedule as extracted from the Trade Ledgers as on 31.3.2015.

Solution

Dr. Total Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.10.2014	To Balance b/d	1,927	31.3.2015	By Cash	12,993
31.3.2015	To Interest charged	5	"	By Bad debts	56
"	To Bank (cheque dishonoured)	76	"	By Sales returns	93
"	To Sales (credit)	13,308	"	By Discount allowed	356
			"	By Balance c/d	1,818
		15,316			15,316

Dr. Total Creditors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Cash	7,613	1.10.2014	By Balance b/f	1,215
"	To Discount received	286	31.3.2015	By Purchases	8,849
"	To Purchases returns	182	"	By Bills payable (renewed)	200
"	To Bills payable	891	"	By Interest on bills payable (renewed)	3
"	To Balance c/d	1,295			
		10,267			10,267

31.3.2015	Debtors balance as per schedule	1,808	31.3.2015	Creditors balance as per schedule	1,290
	Debtors bal. as per Total Account	1,818		Creditors bal. as per Total Account	1,295
	Difference	10		Difference	5

From the above, it is clear that the total accounts do not agree with the balance as per schedule.

Illustration 4

Modern Traders operates a computerised accounting system for its debtors and creditors ledgers. The control accounts for the month of March 2015 are in balance and incorporate the following totals :

Debtors Ledger :		**Creditors Ledger :**	
Balance at 1 March, 2015	₹	Balance at 1 March, 2015	₹
Debit	3,86,430	Credit	1,84,740
Credit	190	Debit	520
Sales	1,63,194	Purchases	98,192
Cash received	1,58,288	Cash paid	1,03,040
Discount allowed	2,160	Discount received	990
Returns inwards	590	Returns outwards	1,370
Credit balance at 31 March, 2015	370	Debit balance at 31 March, 2015	520

Although the control accounts agree with the underlying ledgers, a number of errors have been found, and there are also several adjustments to be made. These errors and adjustments are detailed below:

(1) Four sales invoices totalling ₹ 1,386 have been omitted from the records.
(2) A cash refund of ₹ 350 paid to a customer, A Sen, was mistakenly treated as a payment to a supplier with the same name.
(3) A contra settlement offsetting a balance of ₹ 870 due to supplier against the debtors ledger account for the same party is to be made.
(4) Bad debts totalling ₹ 1,360 are to be written-off.
(5) During the month, a settlement was reached with a supplier over a disputed account. As a result, the supplier issued a credit note for ₹ 2,000 on March 26. No entry has yet been made for this.
(6) A purchases invoice for ₹ 1,395 was keyed in as ₹ 1,359.
(7) A payment of ₹ 2,130 to a supplier, B Rao, was mistakenly entered to the account of R Rao.

You are required to : (i) prepare the Debtors Ledger Control Accounts; (ii) prepare Creditors Ledger Control Accounts; as they should appear after allowing, where necessary, for the errors and adjustments listed above.

Solution

Dr. **Debtors Ledger Control Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.3.2015	To Balance b/d	3,86,430	1.3.2015	By Balance b/d	190
31.3.2015	To Sales (₹ 1,63,194 + 1,386)	1,64,580	31.3.2015	By Cash	1,58,288
	To Creditors Ledger Control A/c (Refund)	350		By Discount Allowed	2,160
	To Balance c/d	370		By Bad Debts	1,360
				By Returns Inwards	590
				By Creditors Ledger Control A/c (Transfer)	870
				By Balance c/d	3,88,272
		5,51,730			5,51,730

Dr. **Creditors Ledger Control Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.3.2015	To Balance b/d	520	1.3.2015	By Balance b/d	1,84,740
31.3.2015	To Cash	1,03,040	31.3.2015	By Purchases (₹ 98,192 + 36)	98,228
	To Discount Received	990		By Debtors Ledger Control A/c (Refund)	350
	To Allowances	2,000		By Balance c/d	520
	To Debtors Ledger Control A/c (Transfer)	870			
	To Returns Outwards	1,370			
	To Balance c/d	1,75,048			
		2,83,838			2,83,838

Balancing and Reconciling Control Accounts

The Control Account should be balanced at regular intervals (at least once in a month). This balance must be checked with the total of individual personal account balances in the Debtors ledger / Creditors ledger.

The balance of the Control Account may not agree with the total of individial personal account balances because of the following reasons :

1. Wrong amount has been posted in the Control Account because of casting error in the day book.
2. Transaction has been recorded in the Control Account without posting to individual personal accounts.
3. Wrong balancing of individual personal accounts in the Debtors / Creditors ledger.
4. A transposition error may occur in an individual balance, e.g., ₹ 240 has been posted as ₹ 420.

Special Problems

Illustration 5

At 31st December, 2014 the balance on the Debtors Control Account in Sourav's general ledger was ₹ 39,982. The total of the list of balances on the customers' personal accounts was ₹ 39,614.

Sourav has discovered the following errors :

(i) An invoice of ₹ 288 was entered correctly in the general ledger, but no entry was made in the personal account.
(ii) A payment of ₹ 1,300 was accepted in full settlement of a balance of ₹ 1,309. No entry was made to record the discount.
(iii) A credit note issued to a credit customer for ₹ 120 was incorrectly treated as an invoice.
(iv) An addition error on a personal account meant that the balance was understated by ₹ 27.
(v) A customer had lodged a payment of ₹ 325 directly to Sourav's bank account. The balance on the personal account was adjusted, but no entry was made in the general ledger.
(vi) An invoice for ₹ 644 was posted as ₹ 466 in the general ledger.
(vii) A credit balance of ₹ 47 on a customer's account was treated as a debit balance.

Required :

(a) Show the Debtors Control Account, including the necessary correcting entries and the corrected balance.
(b) Prepare a Reconciliation of the list of balances to the corrected balance on the Debtors Control Account.
(c) State the correct Debtors balance for inclusion in the final accounts and indicate where it should be reported on the Balance Sheet.

Solution

(a) In the General Ledger

Dr. Debtors Control Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Dec. 31	To Balance b/d	39,982	Dec. 31	By Discount Allowed A/c	9
	To Sales A/c (Invoice Error)	178		By Sales A/c (₹ 120 x 2)	240
				By Bank A/c (Direct payment)	325
				By Balance c/d	39,586
		40,160			40,160

(b) Reconciliation Statement of Debtors Control Account

Particulars		₹	₹
List of balance (Total)			39,614
Add:	Invoice omitted	288	
	Addition error on a personal account	27	315
			39,929
Less:	Discount omitted	9	
	Credit Note wrongly treated as invoice	240	
	Credit balance of a customer treated as debit balance (₹ 47 x 2)	94	343
Correct Total			39,586

(c) The correct ledger balances of ₹ 39,586 should be shown in the Balance Sheet as ***Current Assets***.

Illustration 6

You are assisting in the preparation of the year end accounts of A & Co. The balance on the Creditors Ledger Control Account in the general ledger is ₹ 45,505. The total amount of the list of balances on the Suppliers' Personal Account is ₹ 46,886.

You have noted the following :

(i) An invoice from a supplier for ₹ 739 has been entirely omitted from the accounting records.
(ii) A credit note received from a supplier for ₹ 266 was entered in the day book as an invoice.
(iii) No entries have been made in respect of an agreement to offset a credit balance of ₹ 864 in the Creditors ledger against a debit balance in the Debtors ledger.
(iv) Payments to a supplier totalling ₹ 1,800 have been recorded in the general ledger, but no entries have been made in the supplier's personal account.
(v) A payment of ₹ 17,500 was made to settle a balance of ₹ 17,585. The balance on the supplier's personal account was fully written off, but only the payment of ₹ 17,500 was entered in the general ledger.

(vi) A payment of ₹ 340 to a supplier was recorded in the cheques issued day book as ₹ 430.
(vii) A credit balance of ₹ 167 on a supplier's account was listed as a debit balance.

Required :

(a) Prepare the Creditors Ledger Control Account including the necessary adjusting entries and the corrected balance. (**NB** : You must present your answer in a format which clearly indicates whether such entry is a debit entry or a credit entry.)
(b) Prepare the Reconciliation of the list of balances to the corrected balance on the Creditors Ledger Control Account.
(c) State the correct payables balance for inclusion in the final accounts and where it should be reported.

Solution

(a) In the General Ledger

Dr. Creditors Ledger Control Account Cr.

Date	Particulars	₹	Date	Particulars	₹
?	To Purchases (₹ 266 x 2)	532	?	By Balance b/d (Given)	45,505
	To Debtors Ledger Control A/c	864		By Purchases A/c	739
	To Discount Received A/c	85		By Bank A/c (Payment overstated)	90
	To Balance c/d	44,853			
		46,334			46,334

(b) Reconciliation Statement of Creditors Ledger Control Account

Particulars		₹	₹
List of balances (Total)			46,886
Add:	(i) Purchase invoice omitted	739	
	(ii) Payment overstated	90	
	(iii) Balance incorrectly listed (₹ 167 x 2)	334	1,163
			48,049
Less:	(i) Credit Note recorded as invoice in the day book (₹ 266 x 2)	532	
	(ii) Offset	864	
	(iii) Payment omitted	1,800	3,196
Adjusted List of Balances			44,853

(c) The correct ledger balances of ₹ 44,853 should be shown in the Balance Sheet as ***Current Liabilities***.

Illustration 7

As at 31 March, 2015, the balance on the sales ledger control account of ITC Ltd was ₹ 1,56,300, whilst the total of the list of balances on the sales ledger was ₹ 1,51,835. At the same time, the balance on the purchase ledger control account was ₹ 1,70,690. The total of the list of balances on the purchase ledger as at that date was ₹ 1,37,645 — this is after deducting debit balances of ₹ 900 (Telco Ltd) and ₹ 16,200 (Reliance Ltd).

You are also given the following information :

(1) The debit balance on the account of Telco Ltd arose as a result of posting a payment of ₹ 4,500 as ₹ 5,400.
(2) The debit balance on the account of Reliance Ltd represent a payment in advance for goods to be delivered and invoiced in April 2015.
(3) The purchase day book for 29 March 2015 had been incorrectly cast, overcasting the total by ₹ 1,260.
(4) A purchase of ₹ 7,050 from HPCL had not been posted to HPCL's account in the purchase ledger.
(5) An invoice received from H M Ltd for ₹ 15,000 had been entered in the purchase day book as ₹ 1,500.
(6) A bad debt of ₹ 3,695 written-off the Sare Gama Ltd in the sales ledger had been posted to the purchase ledger control account.
(7) Discount received amounting to ₹ 19,370 had been posted to the relevant accounts in the purchase ledger but no posting had been made to either the purchase ledger control account or the discount received account.
(8) A contra entry of ₹ 770 between the accounts of Tisco Ltd in the sales and purchase ledger had not been posted to either the sales ledger control account or the purchase ledger control account.

You are required to :

(a) Prepare a Sales Ledger Control Account Reconciliation and a Purchase Ledger Control Account Reconciliation as at 31 March 2015.
(b) Prepare any journal entries required to reflect the information contained in (1) to (8) above.
(c) Calculate the amouts to be shown on the Balance Sheet as at 31 March 2015 in respect of trade debtors and trade creditors.

Solution **Reconciliation Statement of Sales Ledger Control Account**

Particulars	₹	₹
Balance as per Sales Ledger Control Account		1,56,300
Less: (6) Bad Debts written-off (wrongly posted)	3,695	
(8) Tisco Ltd — Contra	770	4,465
Adjusted Balance		1,51,835
List of Balance		1,51,835

Reconciliation Statement of Purchases Ledger Control Account

Particulars	₹	₹
Balance as per Purchases Ledger Control Account		1,70,690
Add: (5) Correction of H M Ltd's invoice		13,500
		1,84,190
Less: (3) Overcasting of Purchase Day Book total	1,260	
(6) Bad Debts wrongly posted	3,695	
(8) Tisco Ltd. — Contra	770	
(7) Discount Received not recorded in the General Ledger	19,370	25,095
Adjusted Balance		1,59,095
List of Balances		1,37,645
Correct Telco Balance		900
Purchase from HPCL not posted		7,050
HM Ltd's invoice of ₹ 15,000 recorded as 1,500		13,500
Adjusted List of Balances		1,59,095

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

Date	Particulars		₹	₹
	Purchase Ledger Control A/c	Dr.	1,260	
	To Purchases A/c			1,260
	(Being the overcasting of purchases day book, now adjusted)			
	Purchase Ledger Control A/c	Dr.	19,370	
	To Discount Received A/c			19,370
	(Being the discount received not posted in the general ledger, now adjusted)			
	Purchase Ledger Control A/c	Dr.	3,695	
	To Sales Ledger Control A/c			3,695
	(Being the adjustment for bad debts written-off)			
	Purchases A/c	Dr.	13,500	
	To Purchase Ledger Control A/c			13,500
	(Being invoice of ₹ 15,000 wrongly recorded as ₹ 1,500, now rectified)			
	Purchase Ledger Control A/c	Dr.	770	
	To Sales Ledger Control A/c			770
	(Being the contra for Tisco Ltd. Account)			

Amount to be Shown in the Balance Sheet

Trade Debtors	₹	Trade Creditors	₹
Adjusted Sales Ledger Control Account balance	1,51,835	Adjusted Purchase Ledger Control Account bal.	1,59,095
Add: Advance from Reliance Ltd	16,200	Add: Debit balance of Reliance Ltd	16,200
	1,68,035		1,75,295

Self-Balancing System

When ledgers are kept under Sectional Balancing System, the double entry is not completed in the Debtors Ledger and Creditors Ledger. As a result, no Trial Balance can be prepared from these ledgers.

Self-Balancing is a system of ledgers keeping by means of which each ledger can be balanced independently with the other ledgers. Under this system, a 'General Ledger Adjustment Account' is prepared in the Debtors Ledger as well as in the Creditors Ledger to complete double entry in these ledgers. In the General Ledger, double entry is completed by preparing the following two accounts :

(i) Debtors Ledger Adjustment Account (in reality Total Debtors Account)

(ii) Creditors Ledger Adjustment Account (in reality Total Creditors Account).

Now, we explain the procedures for passing entries in the different Ledgers and Adjustment Accounts from the various books of original entry.

1. Books of Original Entry used for Self Balancing Debtors Ledger

(a) Sales Day Book: The monthly total of Sales Day Book is posted to the credit side of the Sales Account in the General Ledger. In the Debtors Ledger, Individual Customer's Account is debited datewise. If we want to make both the Debtors Ledger and General Ledger Self- balancing, the following entry is to be passed:

In the General Ledger:
Debtors Ledger Adjustment Account Dr.
In the Debtors Ledger:
To General Ledger Adjustment Account

(b) Returns Inwards Book: The monthly total of Returns Inwards Book is posted to the debit side of the Returns Inwards Account in the General Ledger. In the Debtors Ledger, Individual Customer's Account is credited. If we want to make both the Debtors Ledger and General Ledger Self-balancing, the following entry is to be passed:

In the Debtors Ledger:
General Ledger Adjustment Account Dr.
In the General Ledger:
To Debtors Ledger Adjustment Account

(c) Bills Receivable Book: The monthly total of Bills Receivable Book is posted to the debit side of Bills Receivable Account in the General ledger. In the Debtors Ledger, Individual Customer's Account is credited. If we want to make both the ledgers self-balancing, the following entry is to be passed:

In the Debtors Ledger:
General Ledger Adjustment Account Dr.
In the General Ledger:
To Debtors Ledger Adjustment Account

(d) Cash Book: In the Debtors Ledger, cash collected from debtors is posted to the credit side of the Individual Customer's Account. To make both the ledgers self-balancing, the following entry is to be passed:

In the Debtors Ledger:
General Ledger Adjustment Account Dr.
In the General Ledger:
To Debtors Ledger Adjustment Account
Similar entries are to be passed for discount allowed, bad debts, and so forth.

(e) Others: The following entry is to be passed for Bills Receivable dishonoured, interest charged, notary charges and cash paid.

In the General Ledger:
Debtors Ledger Adjustment Account Dr.
In the Debtors Ledger:
To General Ledger Adjustment Account

The summaries of entries are given below:

Books of Original Entry	General Ledger	Debtors Ledger
Sales Day Book **Cash Book Credit** (For noting charges and cheques dishonoured) **Journal Proper** (for interest etc.)	The totals, in each case, are ***debited to the 'Debtors Ledger Adjustment Account';*** Credit is given to Sales Account, Cash Account and other Nominal Accounts.	Individual customer's account is debited for each item. The totals are posted to the ***credit of the 'General Ledger Adjustment Account'.***
Sales Returns Book **Bills Receivable Book** **Cash Book Debit** **Journal Proper** (allowances, etc.)	The totals, in each case, are ***credited to the 'Debtors Ledger Adjustment Account';*** Debit is given to Sales Returns Account, Cash Account and other Nominal Accounts.	Individual customer's account is credited for each item. The totals are posted to the ***debit of the 'General Ledger Adjustment Account'.***

2. Books of Original Entry used for Self-balancing Creditors Ledger

(a) Purchases Day Book The monthly total of Purchases Day Book is posted to the debit side of the Purchases Account in the General Ledger. In Creditors Ledger, Individual Supplier's Account is credited. If we want to make both the Creditors Ledger and General Ledger Self-balancing, the following entry is to be passed:

In the Creditors Ledger:
General Ledger Adjustment Account Dr.
In the General Ledger:
To Creditors Ledger Adjustment Account

(b) Returns Outwards Book The monthly total of Returns Outwards Book is posted to the credit side of the Returns Outwards Account in the General Ledger. In the Creditors Ledger, Individual Supplier's Account is debited. If we want to make both the ledgers Self-balancing, the following entry is to be passed:

In the General Ledger:
Creditors Ledger Adjustment Account Dr.
In the Creditors Ledger:
To General Ledger Adjustment Account

(c) Bills Payable Book: The monthly total of Bills Payable Book is posted to the credit side of Bills Payable Account in the General Ledger. In the Creditors Ledger, Individual Supplier's Account is debited. If we want to make both the ledgers Self-balancing, the following entry is to be passed:

In the General Ledger:
Creditors Ledger Adjustment Account Dr.
In the Creditors Ledger:
To General Ledger Adjustment Account

(d) Cash Book: In the Creditors Ledger, cash paid to creditors is posted to the debit side of the Individual Suppplier's Account. If we want to make both the ledgers Self-balancing, the following entry is to be passed:

In the General Ledger:
Creditors Ledger Adjustment Account Dr.
In the Creditors Ledger:
To General Ledger Adjustment Account
Similar entry is to be passed for discount received from suppliers.

(e) Others: The following entry is to be passed for Bills Payable dishonoured, interest paid, notary charges, cash received from suppliers, etc.

In the Creditors Ledger:
General Ledger Adjustment Account Dr.
In the General Ledger:
To Creditors Ledger Adjustment Account

The summaries of entries are given below:

Books of Original Entry	General Ledger	Creditors Ledger
Purchases Day Book **Cash Book Debit** (for over charges, allowances, etc.) **Journal Proper** (for overdue interest)	The totals, in each case, are ***credited to the 'Creditors Ledger Adjustment Account';*** Debit is given to Purchases Account, Cash Account and other Nominal Accounts.	Individual supplier's account is credited for each item. The totals are posted to the ***debit of the 'General Ledger Adjustment Account'.***
Purchases Returns Book **Bills Payable Book** **Cash Book Credit** **Journal Proper** (for allowances)	The totals, in each case, are ***debited to the 'Crediors Ledger Adjustment Account';*** Credit is given to Purchases Returns Account, Bills Payable Account, Cash Account and other Nominal Accounts.	Individual supplier's account is debited for each item. The totals are posted to the ***credit of the 'General Ledger Adjustment Account'.***

Temporary adverse balances should be brought down on both sides of the Adjustment Accounts in respect of the total debit balances and the total credit balances.

Advantages of Self-Balancing Ledger

1. Since errors can be localized, delay in detection is minimised, thereby saving labour and time of the book-keepers.
2. Arithmatic accuracy of each ledger can be proved independently.
3. A complete Trial Balance can be prepared without balancing subsidiary ledgers, thus facilitating the quick preparation of Final Accounts.
4. A number of book-keepers can work on different ledgers.
5. Each ledger is of a suitable size.

Though Self-Balancing System is employed mainly in connection with Debtors and Creditors Ledgers, this system can be used in Plant Ledgers, Share Registers, etc.

The students should note the following alternative terms used for different ledgers :

(i) The General Ledger is also called as Nominal Ledger
(ii) The Debtors Ledger is also called as Sales Ledger or Customers' Ledger.
(iii) The Creditors Ledger is also called as Purchases Ledger or Suppliers' Ledger or Bought Ledger.

The specimen of Adjustment/Control Accounts in the General Ledger are given below :

In the General Ledger

Dr. Debtors Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/f		1.1.2015	By Balance b/d (if any)	
31.1.2015	To General Ledger Adjustment A/c :		31.1.2015	By General Ledger Adjustment A/c :	
	Sales (credit)			Sales Returns	
	Cheques and B/R dishonoured			Cash and cheque received	
	Interest charged			Bills receivable	
	Notary charges			Discount allowed	
	Cash paid			Bad debts	
				Transfer (if any)	
31.1.2015	To Balance c/d (if any)		31.1.2015	By Balance c/d	

Dr. Creditors Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/d (if any)		1.1.2015	By Balance b/d	
31.1.2015	To General Ledger Adjustment A/c :		31.1.2015	By General Ledger Adjustment A/c :	
	Cash & cheques paid			Purchases (credit)	
	Returns outwards			Cheques and B/P dishonoured	
	Discount received				
	Bills payable accepted				
	Transfer (if any)				
31.1.2015	To Balance c/d		31.1.2015	By Balance c/d (if any)	

In the Debtors Ledger

Dr. General Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/d (if any)		1.1.2015	By Balance b/d	
31.1.2015	To Debtors Ledger Adjustment A/c :		31.1.2015	By Debtors Ledger Adjustment A/c :	
	Sales returns			Sales (credit)	
	Cash and cheque received			Interest charged	
	Discount allowed			Cheques and B/R dishonoured	
	Bills receivable received			Notary charges	
	Bad debts			Cash paid	
	Transfer (if any)				
31.1.2015	To Balance c/d		31.1.2015	By Balance c/d (if any)	

In the Creditors Ledger

Dr. General Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/d		1.1.2015	By Balance b/d (if any)	
31.1.2015	To Creditors Ledger Adjustment A/c :		31.1.2015	By Creditors Ledger Adjustment A/c :	
	Purchases (credit)			Returns outwards	
	Cheques and B/P dishonoured			Cash and cheques paid	
				Discount received	
				Bills payable accepted	
31.1.2015	To Balance c/d (if any)		31.1.2015	By Balance c/d	

Illustration 8

Samaresh keeps his Ledger on Self-balancing system. From the following particulars, you are required to write up the Individual Debtor's Account and the General Ledger Adjustment Account (in Sales Ledger) during the month of January 2015. Also prepare a Trial Balance in Sales Ledger.

(i) Individual Debtors balances on 1.1.2015 : A – ₹ 1,530; B – ₹ 1,620; C – ₹ 1,890; D – ₹ 1,170.

(ii) Transactions during the month (all figures in ₹) :

2.1.2015	Sold Goods to A	1,710	19.1.2015	Recd. from A, a B/R, accepted by X payable on 25.1.2015	1,200
9..1.2015	Received from B on A/c	300			
11.1.2015	Recd. from A in full settl. of his bal. on 1.12015	1,500	22.1.2015	Received from B	900
12.1.2015	Sold goods to B	600	25.1.2015	A's bill returned dishonoured	
14.1.2015	B returned goods (damaged in transit)	180	28.1.2015	D is insolvent, 30% is recd. as final settlement	
18.1.2015	Recd. from C and allowed discount ₹ 90	1,800	30.1.2015	Sold goods to C	1,020

Solution

In the Sales Ledger

Dr. A Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/f	1,530	11.1.2015	By Cash A/c	1,500
2.1.2015	To Sales A/c	1,710	11.1.2015	By Discount allowed A/c	30
25.1.2015	To B/R (dishonoured) A/c	1,200	19.1.2015	By Bills receivable A/c	1,200
			31.1.2015	By Balance c/d	1,710
		4,440			4,440

Dr. B Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/f	1,620	9.1.2015	By Cash A/c	300
12.1.2015	To Sales A/c	600	14.1.2015	By Returns inwards A/c	180
			22.1.2015	By Cash A/c	900
			31.1.2015	By Balance c/d	840
		2,220			2,220

Dr. C Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/f	1,890	18.1.2015	By Cash A/c	1,800
31.1.2015	To Sales A/c	1,020	18.1.2015	By Discount allowed A/c	90
			31.1.2015	By Balance c/d	1,020
		2,910			2,910

Dr. D Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/f	1,170	28.1.2015	By Cash (30% of ₹ 1,170)	351
			31.1.2015	By Bad Debts A/c	819
		1,170			1,170

Dr. General Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.1.2015	To Sales Ledger Adjustment A/c :		1.1.2015	By Balance b/d (Note 1)	6,210
	Cash (Note 2)	4,851		By Sales Ledger Adjustment A/c :	
	Discount allowed (Note 4)	120		Sales (Note 3)	3,330
	Returns inwards	180		Bills receivable dishonoured	1,200
	Bills receivable	1,200			
	Bad debts	819			
31.1.2015	To Balance c/d	3,570			
		10,740			10,740

Trial Balance of the Sales Ledger as at 31st January, 2015

Head of Accounts	Dr. ₹	Cr. ₹
A Account	1,710	
B Account	840	
C Account	1,020	
General Ledger Adjustment Account		3,570
	3,570	3,570

Working Notes :

(1) Total Debtors Balance

		₹
	A	1,530
	B	1,620
	C	1,890
	D	1,170
		6,210

(2) Total Cash Received

		₹
9.1.2015	B	300
11.1.2015	A	1,500
18.1.2015	C	1,800
22.1.2015	B	900
28.1.2015	D	351
		4,851

(3) Total Sales

		₹
2.1.2015	A	1,710
12.1.2015	B	600
30.1.2015	C	1,020
		3,330

(4) Discount Allowed (Total)

		₹
11.1.2015	A	30
18.1.2015	C	90
		120

Illustration 9

Following are the balances of creditors in the ledger of a trader as on 1.1.2015. A - ₹ 1,360; B - ₹ 1,440; C - ₹ 1,320; D - ₹ 1,680; E - ₹ 1,040; F - ₹ 1,520. Following transactions occurred during January :

2015			₹	2015			₹
Jan.	2	Bought goods from A	1,480	Jan.	22	Bought goods from D	1,280
	8	Paid to F on account	720		25	Returned goods to G	184
	9	Bills accepted from A (disc. recd. ₹. 40)	760		27	Paid to B (discount received ₹ 48)	1,392
	11	Returned goods to E	240		28	Bought goods from E	1,760
	12	Bought goods from G	1,600		28	Paid to G (discount received ₹ 56)	1,360
	14	Paid to E (discount recd. ₹ 8)	792		29	Bills accepted from F (discount recd. ₹ 32)	800
	19	Bought goods from B	1,200		30	Bought goods from F	1,280
	21	Paid to D (discount recd. ₹ 80)	1,600		31	Paid to A on account	560

You are required to prepare Individual Creditor's Accounts, General Ledger Adjustment Account (in the Purchases Ledger) and Purchases Ledger Adjustment Account (in the General Ledger).

Solution

In the Purchases Ledger

Dr. A Account Cr.

Date	Particulars	₹	Date	Particulars	₹
9.1.2015	To Bills Payable A/c	760	1.1.2015	By Balance b/d	1,360
9.1.2015	To Discount Received A/c	40	2.1.2015	By Purchases A/c	1,480
31.1.2015	To Bank A/c	560			
31.1.2015	To Balance c/d	1,480			
		2,840			2,840

Dr. B Account Cr.

Date	Particulars	₹	Date	Particulars	₹
27.1.2015	To Bank A/c	1,392	1.1.2015	By Balance b/d	1,440
27.1.2015	To Discount Received A/c	48	19.1.2015	By Purchases A/c	1,200
30.1.2015	To Balance c/d	1,200			
		2,640			2,640

Dr. C Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.1.2015	To Balance c/d	1,320	1.1.2015	By Balance b/d	1,320

Dr. D Account Cr.

Date	Particulars	₹	Date	Particulars	₹
21.1.2015	To Bank A/c	1,600	1.1.2015	By Balance b/d	1,680
21.1.2015	To Discount Received A/c	80	22.1.2015	By Purchases A/c	1,280
31.1.2015	To Balance c/d	1,280			
		2,960			2,960

Dr. E Account Cr.

Date	Particulars	₹	Date	Particulars	₹
11.1.2015	To Returns Outwards A/c	240	1.1.2015	By Balance b/d	1,040
14.1.2015	To Bank A/c	792	28.1.2015	By Purchases A/c	1,760
14.1.2015	To Discount Received A/c	8			
31.1.2015	To Balance c/d	1,760			
		2,800			2,800

Dr. F Account Cr.

Date	Particulars	₹	Date	Particulars	₹
8.1.2015	To Bank A/c	720	1.1.2015	By Balance b/d	1,520
29.1.2015	To Bills Payable A/c	800	30.1.2015	By Purchases A/c	1,280
29.1.2015	To Discount Received A/c	32			
31.1.2015	To Balance c/d	1,248			
		2,800			2,800

Dr. G Account Cr.

Date	Particulars	₹	Date	Particulars	₹
25.1.2015	To Returns Outwards A/c	184	12.1.2015	By Purchases A/c	1,600
28.1.2015	To Bank A/c	1,360			
28.1.2015	To Discount Received A/c	56			
		1,600			1,600

Dr. General Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/d	8,360	31.1.2015	By Purchases Ledger Adj. A/c:	
31.1.2015	To Purchases Ledger Adj. A/c:			Bank	6,424
	Credit purchases	8,600		Discount received	264
				Bills payable	1,560
				Returns outwards	424
			31.1.2015	By Balance c/d	8,288
		16,960			16,960

Trial Balance of the Purchases Ledger as at 31st January, 2015

S.N.	Head of Accounts	L.F.	Dr. ₹	Cr. ₹
1.	A Account			1,480
2.	B Account			1,200
3.	C Account			1,320
4.	D Account			1,280
5.	E Account			1,760
6.	F Account			1,248
7.	General Ledger Adjustment Account		8,288	
			8,288	8,288

Working Notes :

(1) Total Creditors Balance as on 1.1.2015

	₹
A	1,360
B	1,440
C	1,320
D	1,680
E	1,040
F	1,520
	8,360

(2) Total Cash Paid

	₹
8.1.2015	720
14.1.2015	792
21.1.2015	1,600
27.1.2015	1,392
28.1.2015	1,360
31.1.2015	560
	6,424

(3) Purchases (credit)

	₹
2.1.2015	1,480
12.1.2015	1,600
19.1.2015	1,200
22.1.2015	1,280
28.1.2015	1,760
30.1.2015	1,280
	8,600

(4) Bills Payable

	₹
9.1.2015	760
29.1.2015	800
	1,560

(5) Discount Received

	₹
9.1.2015	40
14.1.2015	8
21.1.2015	80
27.1.2015	48
28.1.2015	56
29.1.2015	32
	264

(6) Returns Outwards

	₹
11.1.2015	240
25.1.2015	184
	424

In the General Ledger

Dr. Purchases Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.1.2015	To General Ledger Adjustment A/c:		1.1.2015	By Balance b/d	8,360
	Bank	6,424	31.1.2015	By General Ledger Adjustment A/c :	
	Discount received	264		Credit purchases	8,600
	Bills payable	1,560			
	Returns outwards	424			
31.1.2015	By Balance c/d	8,288			
		16,960			16,960

Temporary Adverse Balances

It should be noted that in practice, Debtors Ledger may contain a few accounts showing credit balances (e.g., where allowances are made for defective goods or empties are returned by the customers after full payment has been made). In this case, balances should be brought down on the both sides of the Debtors Ledger Adjustment / Control Account in respect of the total debit balances and the total credit balances. Likewise, Creditors Ledger Account may contain a few accounts showing debit balances (e.g., advance payment made to the Suppliers for goods to be received in future or allowance to be received for defective goods etc). In this case also, balances should be brought down on the both sides of the Creditors Ledger Adjustment / Control Account is respect of the total credit balances and the total debit balances.

Illustration 10

X deals in specialised electronic equipment. The following information is extracted from his records for the three months ended on 31.12.2014 (all in ₹).

		October	November	December
Balances on purchases ledger on 1.10.2014	(Dr.)	6,250		
	(Cr.)	3,20,000		
Purchases at retail price		15,00,000	20,00,000	18,00,000
Purchases returns at retail prices		40,000	60,000	50,000
Cheques sent to creditors		10,02,000	14,80,000	13,00,000
Discounts received		25,000	38,000	27,000
Temporary debit balances at month end		4,100	5,700	2,200

X buys his goods at 20% less than the retail price. You are required to prepare Purchases Ledger Control Account for each of the above three months for the period in question.

Solution

In the General Ledger

Dr. Purchases Ledger Control Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.10.2014	To Balance b/d	6,250	1.10.2014	By Balance b/d	3,20,000
31.10.2014	To General Ledger Control A/c :		31.10.2014	By General Ledger Control A/c :	
	Purchases returns (₹ 40,000 *less* 20%)	32,000		Purchases (₹ 15,00,000 *less* 20%)	12,00,000
	Cheques issued	10,02,000	31.10.2014	By Balance c/d	4,100
	Discounts received	25,000			
31.10.2014	To Balance c/d	4,58,850			
		15,24,100			15,24,100
1.11.2014	To Balance b/d	4,100	1.11.2014	By Balance b/d	4,58,850
30.11.2014	To General Ledger Control A/c :		30.11.2014	By General Ledger Control A/c :	
	Purchases returns (₹ 60,000 *less* 20%)	48,000		Purchases (₹ 20,00,000 *less* 20%)	16,00,000
	Cheques issued	14,80,000	30.11.2014	By Balance c/d	5,700
	Discounts received	38,000			
30.11.2014	To Balance c/d	4,94,450			
		20,64,550			20,64,550
1.12.2014	To Balance b/d	5,700	1.12.2014	By Balance b/d	4,94,450
31.12.2014	To General Ledger Control A/c :		31.12.2014	By General Ledger Control A/c :	
	Purchases returns (₹ 50,000 *less* 20%)	40,000		Purchases (₹ 18,00,000 *less* 20%)	14,40,000
	Cheques issued	13,00,000	31.12.2014	By Balance c/d	2,200
	Discounts received	27,000			
31.12.2014	To Balance c/d	5,63,950			
		19,36,650			19,36,650

Tutorial Note : Since trade discount is not recorded in double entry book-keeping, the entries in the Control Accounts should be net of trade discount.

Illustration 11

From the books of X Limited you ascertain that on 1.1.2014, the Debtors Ledger balance was ₹ 40,000 and the Suppliers Ledger balance was ₹ 31,155. The following particulars were available for the year ended 31.12.2014 :

	₹		₹
Sales	3,18,700	Bills receivable dishonoured	1,300
Purchases	1,99,800	Returns inwards	5,000
Cash received from debtors	2,76,000	Returns outwards	2,600
Cash paid to creditors	1,26,500	Bad debts	1,600
Discount allowed	11,600	Cash recd. in respect of debts previously written-off bad	600
Bills payable matured during the year	49,000	Discount received	7,300
Bills receivable received	20,300	Bills payable accepted	60,000

From the above particulars, you are required to show the Debtors Ledgers Control Account, the Suppliers Ledgers Control Account as they would appear in the General Ledger of X Limited for the year ended 31.12.2014.

Solution

In the General Ledger of X Limited

Dr. Debtors Ledger Control Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d	40,000	31.12.2014	By General Ledger Adj. A/c :	
31.12.2014	To General Ledger Adj. A/c :			Cash received	2,76,000
	Sales	3,18,700		Discount allowed	11,600
	Bills receivable dishonoured	1,300		Bills receivable	20,300
				Returns inward	5,000
				Bad debts	1,600
			31.12.2014	By Balance c/d	45,500
		3,60,000			3,60,000

Dr. Suppliers Ledger Control Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To General Ledger Adj. A/c :		1.1.2014	By Balance b/d	31,155
	Cash paid	1,26,500	31.12.2014	By General Ledger Adj. A/c :	
	Returns outwards	2,600		Purchases (credit)	1,99,800
	Discount received	7,300			
	Bills payable accepted	60,000			
31.12.2014	To Balance c/d	34,555			
		2,30,955			2,30,955

Tutorial Note : Bad debt recovery and reserve for bad debts do not affect the debtors balance. Therefore, these are to be ignored in Adjustment Accounts. Similarly, bills payable matured ₹ 49,000 during the year will not affect Adjustment Accounts.

Illustration 12

The following information is available from the books of a trader from 1.1.2015 to 31.3.2015 :

(1) Total sales amounted to ₹ 60,000, including the sale of old furniture for ₹ 1,200 (Book value ₹ 3,500). The total cash sales were 80% less than the credit sales.

(2) Cash collected from debtors amounted to 60% of the aggregate of the opening debtors and credit sales for the period. Debtors were allowed cash discount for ₹ 2,600.

(3) Bills receivable drawn during the three months totalled to ₹ 6,000 of which bills amounting to ₹ 3,000 were endorsed in favour of suppliers. Out of these endorsed bills receivable, a bill for ₹ 600 was dishonoured for non-payment as the party became insolvent, his estate realising nothing.

(4) Cheques received from Sundry Customers for ₹ 6,000 were dishonoured; a sum of ₹ 500 is irrecoverable; bad debts written-off in the earlier years realised ₹ 2,500.

(5) Sundry Debtors as on 1.1.2015, stood at ₹ 40,000.

You are required to show the Debtors Ledger Adjustment Account in the General Ledger.

Solution

In the General Ledger

Dr. Debtors Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/d	40,000	31.3.2015	By General Ledger Adjustment A/c :	
31.3.2015	To General Ledger Adjustment A/c :			Cash received (Note 2)	53,400
	Credit Sales (Note 1)	49,000		Discount allowed	2,600
	Bills receivable dishonoured	600		Bad debts (₹ 500 + ₹ 600)	1,100
	Cheques dishonoured	6,000		Bills receivable	6,000
			31.3.2015	By Balance c/d	32,500
		95,600			95,600

Working Notes : (1) Cash sales were 80% less than the credit sales. If credit sales are 100, then cash sales are 20. Therefore, when total sales is ₹ 120 then credit sale is 100, i.e., 5/6 of total sales. Total sales is ₹ 60,000 – ₹ 1,200 = ₹ 58,800. Therefore, credit sales are ₹ 58,800 x 5/6 = ₹ 49,000.

(2) Aggregate of opening value of debtors and credit sales = ₹ (40,000 + 49,000) = ₹ 89,000. Therefore, cash realised from debtors is 60% of ₹ 89,000 = ₹ 53,400.

More than One Debtors Ledger

Where a business enterprise has got many Debtors Accounts, it may maintain more than one Debtors Ledger. The division of Debtors Ledger may be alphabetical or geographical, etc..

Alphabetical Sub-division	Geographical Sub-division
Debtors : A to G Debtors : H to P Debtors : Q to T Debtors : U to Z	Debtors : East Zone Debtors : South Zone Debtors : North Zone Debtors : West Zone

The same procedures described above, as applied to Self-balancing of Ledgers, to be followed even when ledgers are subdivided. In this case, each ***Debtors Ledger*** will contain a General Ledger Adjustment Account. In the General Ledger, there will be a separate Debtors Ledger Adjustment Account for each ***group of ledger***.

Where Debtors Ledger is sub-divided, it is necessary to rule the books of original entry accordingly. For example, Sales Day Book would be ruled as follows:

Sales Day Book

Date	Invoice No.	Particulars	Folio	Debtors A to G	Debtors H to P	Debtors Q to T	Debtors U to Z

Illustration 13

X Ltd. divides its Debtors Ledger into two sections, A-L, and M-Z, each being Self-balancing. The following details have been extracted from the books of the company for the month of March, 2015:

		A – L	M – Z
Ledger Balances : 1st March	Dr.	1,11,125	67,970
Ledger Balances : 1st March	Cr.	980	210
Ledger Balances : 31st March	Dr.	1,51,445	59,815
Ledger Balances : 31st March	Cr.	1,645	595
Credit sales for the month		79,100	23,870
Cash received		34,090	31,395
Discount allowed		455	175
Returns Inwards		2,275	770
Bad Debts written-off		280	70
Bills Receivable		2,345	—
Bad debts recovery		300	200

Prepare necessary Adjustment Accounts.

Solution

In the General Ledger

Dr. Debtors Ledger Adjustment Account Cr.

Date	Particulars	A – L (₹)	M – Z (₹)	Date	Particulars	A – L (₹)	M – Z (₹)
1.3.2015	To Balance b/d	1,11,125	67,970	1.3.2015	By Balance b/d	980	210
31.3.2015	To General Ledger Adjustment A/c :			31.3.2015	By General Ledger Adjustment A/c:		
	Sales (credit)	79,100	23,870		Cash received	34,090	31,395
					Discount allowed	455	175
					Returns Inwards	2,275	770
					Bad Debts	280	70
					Bills Receivable	2,345	—
31.3.2015	To Balance c/d	1,645	595	31.3.2015	By Balance c/d	1,51,445	59,815
		1,91,870	92,435			1,91,870	92,435

In Debtors Ledger (A – L)

Dr. **General Ledger Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.3.2015	To Balance b/d	980	1.3.2015	By Balance b/d	1,11,125
31.3.2015	To Debtors Ledger Adj. A/c :		31.3.2015	By Debtors Ledger Adj. A/c:	
	Cash received	34,090		Sales (credit)	79,100
	Discount allowed	455	31.3.2015	By Balance c/d	1,645
	Returns Inwards	2,275			
	Bad debts	280			
	Bills Receivable	2,345			
31.3.2015	To Balance c/d	1,51,445			
		1,91,870			1,91,870

In Debtors Ledger (M – Z)

Dr. **General Ledger Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.3.2015	To Balance b/d	210	1.3.2015	By Balance b/d	67,970
31.3.2015	To Debtors Ledger Adjustment A/c:		31.3.2015	By Debtors Ledger Adjustment A/c:	
	Cash received	31,395		Sales (credit)	23,870
	Discount allowed	175	31.3.2015	By Balance c/d	595
	Returns Inwards	770			
	Bad debts	70			
31.3.2015	To Balance c/d	59,815			
		92,435			92,435

Illustration 14

The Trial Balance of a firm when abstracted shows a difference of ₹ 27. From the undermentioned figure prepare Sales and Bought Ledger Adjustment Accounts and show in which ledger the error arises.

Jan 1st : Balance in Bought Ledger ₹ 11,805; Balance in Sales Ledger ₹ 20,201.

Dec..31st	₹		₹
Bad debts written-off	320	Purchases returns	288
Bills receivable	1,200	Sales	57,360
Bills payable	5,940	Sales returns	2,166
Cash paid for purchases	37,350	Bought Ledger (Dr. balances)	15
Cash received from customers	60,260	Bought Ledger (Cr. balances)	8,317
Discount allowed	1,050	Sales Ledger (Dr. balances)	12,727
Purchases	40,325	Sales Ledger (Cr. balances)	189
Discount received	250		

Solution

In the General Ledger

Dr. **Sales Ledger Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
Jan. 1	To Balance b/d	20,201	Dec. 31	By General Ledger Adjustment A/c :	
Dec. 31	To General Ledger Adjustment A/c :			Bad debts	320
	Sales	57,360		Bills receivable	1,200
Dec. 31	To Balance c/d	189		Cash received	60,260
				Discount allowed	1,050
				Sales returns	2,166
			Dec. 31	By Balance c/d	12,754
		77,750			77,750

Dr. **Bought Ledger Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
Dec. 31	To General Ledger Adjustment A/c :		Jan.1	By Balance b/f	11,805
	Bills payable	5,940		By General Ledger Adjustment A/c :	
	Cash paid to creditors	37,350		Purchases	40,325
	Discount received	250	Dec. 31	By Balance c/d	15
	Purchase returns	288			
Dec. 31	To Balance c/d	8,317			
		52,145			52,145

Working Notes : Debit balance of Sales Ledger is ₹ 12,754, but the balance has been given as ₹ 12,727. Therefore, in Sales Ledger, an error of ₹ 27 arises.

Transfer between Subsidiary Ledgers

Sometimes, a business enterprise may purchase from and sell to the same person on credit. In that case, the person is a creditor as well as a debtor of the business unit. Where no separate ledger is maintained, both credit purchases and credit sales are recorded in the same account. But in the case of the Self-balancing Ledgers, for such a person, two separate accounts are maintained to record credit purchases and credit sales.

One account is maintained in the Debtors Ledger to record credit sales and another in the Creditors Ledger to record credit purchases. Where this occurs it is the common practice to settle both accounts by transferring the balance of the smaller account to the account with the higher balance. In effect, the smaller account is closed. It should be noted that this transfer affects not only the two personal accounts adjusted, but also Debtors Ledger Adjustment Account, Creditors Ledger Adjustment Account and the two General Ledger Adjustment Accounts.

Suppose that, in the books of Y, at 31st January, 2015, X Account in Creditors Ledger shows a balance of ₹ 5,000 and in Debtors Ledger a balance of ₹ 7,500. For settlement of two accounts the following entries are necessary.

In the books of Y
Journal **Dr.** **Cr.**

Date	Particulars		₹	₹
31.1.2015	X A/c (In the Creditors Ledger)	Dr.	5,000	
	To X A/c (In the Debtors Ledger)			5,000
	(Being the balance of X's Account in the Creditors Ledger transferred to his account in the Debtors Ledger)			
	Creditors Ledger Adjustment A/c (In the General Ledger)	Dr.	5,000	
	To General Ledger Adjustment A/c (In the Creditors Ledger)			5,000
	General Ledger Adjustment A/c (In the Debtors Ledger)	Dr.	5,000	
	To Debtors Ledger Adjustment A/c (In the General Ledger)			5,000

Illustration 15

Write up the Sales Ledger Adjustment Account as would appear in the General Ledger from the following particulars :

Particulars		₹
Opening Balance of Debtors	Dr.	25,200
Opening Balance of Debtors	Cr.	800
Sales		62,400
Returns		6,340
Cash Received		40,100
Discount Allowed		2,600
Bad Debts written off		7,420
Provision for Doubtful Debts		11,000
Bad Debts previously written off, now received		600
Allowances		840
Bills Receivable		2,600
Bills Dishonoured		1,000
Trade Discount		300
Transfer from Bought Ledger		2,400
Closing Balance of Debtors	Dr.	27,980
Closing Balance of Debtors	Cr.	2,480

Solution

In the General Ledger

Dr. **Sales Ledger Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Balance b/d	25,200	?	By Balance b/d	800
	To General Ledger Adjustment A/c :			By General Ledger Adjustment A/c :	
	Sales (Note 1)	62,400		Return (from Customers)	6,340
	Bills Dishonoured	1,000		Cash received	40,100
	To balance b/d	2,480		Discount allowed	2,600
				Bad Debts (written off)	7,420
				Allowance	840
				Bills Receivable	2,600
				Transfer from Bought Ledger	2,400
				By Balance c/d	27,980
		91,080			91,080

Working Notes:

(1) Assumed to be all on credit..

Tutorial Notes :

(1) Provision for doubtful debts will affect the debtors balance so it will not affect the Adjustment Account.

(2) Bad Debts previously written off, now received will not affect the debtors balance, so it is also ignored.

(3) Trade discount is not accounted for. Therefore, it will not affect debtors balance.

Illustration 16

From the following particulars for the year ended 31st March, 2015 extracted from the books of X Ltd., prepare Sales Ledger Adjustment Account in the General Ledger :

Particulars		₹
Sales Ledger Balances : 1st April, 2014	Dr.	12,500
Sales Ledger Balances : 1st April, 2014	Cr.	300
Sales during the year (including cash sales of ₹ 2,000)		60,400
Cash received from customers		40,100
Return by customers		5,750
Discount Allowed		2,600
Bad Debts written off		5,680
Bad Debts previously written off recovered in cash during the year		900
Provision for bad debts		5,950
Allowances to customers		740
Bills Receivable from customers		3,400
Bills Dishonoured		700
Transfer from Sales Ledger to Purchase Ledger		2,500
Payment to clear Credit balances on Sales Ledger Accounts		100
Closing Credit Balances		1,440

Solution

In the General Ledger of X Ltd.

Dr. Sales Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d	12,500	1.4.2014	By Balance b/d	300
31.3.2015	To General Ledger Adjustment A/c :		31.3.2015	By General Ledger Adjustment A/c :	
	Sales (credit)	58,400		Cash received	40,100
	Bills dishonoured	700		Returned by customers	5,750
	payment to customers	100		Discount allowed	2,600
	To Balance c/d	1,440		Bad Debt (written off)	5,680
				Allowance to customers	740
				Bills receivable	3,400
				Transfer from Sales to Purchase Ledger	2,500
				By Balance c/d	12,070
		73,140			73,140

Tutorial Notes :

(1) Bad debt recovered will not affect debtors balance. Therefore, it has been ignored.

(2) Provision for bad debts will not affect debtors balance. Therefore, it has been ignored.

Illustration 17

The following details extracted from the Books of Mr Abu for the period ended on 31st December 2014 :

Jan. 1 : Sales Ledger balances ₹ 12,400; Provision for doubtful debts ₹ 1,000.

Dec.. 31st	₹		₹
Sales (including cash sales ₹ 4,000)	23,000	Bills receivable as endorsed dishonoured	120
Cash received from customers	18,500	Bills receivable discounted	500
Bills receivable received	3,000	Bad debts written-off	50
Returns from customers	380	Interest charged to customers	10
Bills endorsed	480	Bad debts previously written-off recovered	60
Bills dishonoured	300	Transferred from Bought Ledger	150
Cheques dishonoured	100	Sundry charges debited to consumers	20

Prepare the necessary Adjustment Accounts.

Solution

In the General Ledger of Mr Abu

Dr. Sales Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d	12,400	31.12.2014	By General Ledger Adj. A/c :	
31.12.2014	To General Ledger Adj. A/c :			Cash received	18,500
	Sales (credit)	19,000		Bills receivable received	3,000
	Bills dishonoured	300		Returns from customers	380

	Cheque dishonoured	100		Bad debts	50
	B/R as endorsed dishonoured	120		Transfer from Bought Ledger	150
	Interest charged to customers	10	31.12.2014	By Balance c/d	9,870
	Sundry charges debited to customers	20			
		31,950			31,950

In the Sales Ledger

Dr. General Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Sales Ledger Adjustment A/c :		1.1.2014	By Balance b/d	12,400
	Cash received	18,500	31.12.2014	By Sales Ledger Adjustment A/c :	
	Bills receivable received	3,000		Sales (credit)	19,000
	Returns from customers	380		Bills dishonoured	300
	Bad debts	50		Cheque dishonoured	100
	Transfer from Bought Ledger	150		B/R as endorsed dishonoured	120
31.12.2014	To Balance c/d	9,870		Interest charged to customers	10
				Sundry charges debited to customers	20
		31,950			31,950

Tutorial Notes :

(1) Provision for bad debts will not affect the debtors balance so it will not affect the adjustment accounts.

(2) Bills receivable discounted will not affect the debtors balance, so it is to be ignored.

(3) Bad debts previously written-off, now recovered will not affect the debtors balance, so it is also ignored.

Illustration 18

From the following particulars, as extracted from the books of a trader, prepare the General Ledger Adjustment Account as it would appear in the Sales Ledger on December 31, 2014 :

Particulars	₹
January 01, 2014	
Sales Ledger Balances	62,710
Provision for Doubtful Debts	1,720
December 31, 2014	
Sales	1,08,290
Bills accepted by Debtors	14,430
Bills dishonoured	540
Cash and Cheque received from customers	88,625
Cheques dishonoured	220
Goods returned by customers	4,710
Transfer from Bought Ledger	780
Bad Debts written off	1,610
Cash Discount allowed	2,460
Interest on customers' overdue accounts	330
Carriage charged to customers	1,220
Bad Debts previously written off, now recovered	850

Solution

In the Sales Ledger

Dr. Genera Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Sales Ledger Adjustment A/c :		1.1.2014	By Balance b/d	62,710
	Bills receivable	14,430		By Sales Ledger Adjustment A/c :	
	Cash and cheques received	88,625		Sales (Note 1)	1,08,290
	Goods returned by customers	4,710		Bills dishonoured	540
	Transfer from Bought Ledger	780		Cheques dishonoured	220
	Bad Debts (written off)	1,610		Interest on overdue balance	330
	Discount allowed	2,460		Carriage charged to customers	1,220
	To Balance c/d	60,695			
		1,73,310			1,73,310

Working Note :

(1) It is assumed to be all on credit.

Tutorial Note :

(1) Bad debts recovered will not be taken into consideration at the time of preparation of Adjustment Account.

Illustration 19

Mr. Patel maintains his ledgers on self-balancing system. The transactions from 1.1.2015 to 30.4.2015 are given below.

You are required to prepare the General Ledger Adjustment Account as will appear in the Debtor's Ledger:

(1) Opening balance (1.1.2015) Debtors' Ledger ₹ 78,000.

(2) Cash sales : ₹ 12,000 (being 10% of total sales).

(3) Collection from customers (other than collections on bills receivable) amounted to ₹ 1,10,000 which included the following:

(a) A sum of ₹ 3,000 realised from the estate of an insolvent (at 0.60 paise per rupee);

(b) ₹ 6,500 received from a customer as advance for sale;

(c) ₹ 4,000 received from a debtor after adjustment of an advance of ₹ 2,000 made in December 2014;

(d) ₹ 1,250 received from a party where account was written-off in earlier years;

(4) Interest charged to customers on overdue accounts ₹ 2,600.

(5) Bills receivable drawn during the period of ₹ 18,500.

(6) Bills receivable collected during the period ₹ 10,600 (including ₹ 5,900 collected on bills receivable drawn during November and December 2014).

(7) Bills receivable dishonoured on maturity ₹ 1,700.

(8) Bills receivable endorsed to suppliers — ₹ 6,000 out of which bills receivable for ₹ 2,000 discounted by creditors at 5% duly met at maturity. Bills receivable for ₹ 3,000 were dishonoured on maturity (noting charges being ₹ 20) and bills receivable amounting to ₹ 1,000 will mature in May 2015.

(9) Returns inwards ₹ 11,600.

(10) Transfer from creditors ledger ₹ 6,900.

Solution

In the Debtors Ledger

Dr. General Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/d (Note 1)	2,000	1.1.2015	By Balance b/d (Note 3)	78,000
30.4.2015	To Debtors Ledger Adjustment A/c:		30.4.2015	By Debtors Ledger Adjustment A/c:	
	Cheques received	1,08,750		Credit Sales (Note 4)	1,08,000
	(₹ 1,10,000 – 1,250)			Interest charged	2,600
	Bad debts (Note 2)	2,000		Bills receivable (dishonoured)	1,700
	Bills receivable	18,500		B/R endorsed & dishonoured	3,020
	Returns inward	11,600		(Noting charges ₹ 20)	
	Transfer	6,900	30.4.2015	By Balance c/d (Note 5)	6,500
30.4.2015	To Balance c/d (Balancing figure)	50,070			
		1,99,820			1,99,820

Working Notes :

(1) ₹ 2,000 represents temporary adverse balance in the debtors' account.

(2) 60% of the debt which is realised is ₹ 3,000. Therefore, the total amount due is ₹ 3,000 / 60% = ₹ 5,000. In effect, bad debt is ₹ (5,000 – 3,000) = ₹ 2,000.

(3) Debtors balance of ₹ 78,000 appears on the credit side of General Ledger Adjustment Account in the Debtors' Ledger.

(4) Cash sale is 10% of total sales which is ₹ 12,000. Therefore, credit sale is 90% of total sales, which is ₹ 12,000 / 10 x 90 = ₹ 1,08,000.

(5) Advance received from a customer to be carried forward as adverse balance.

Illustration 20

From the following extracted from the books of Mr X, prepare the necessary adjustment accounts in the General Ledger:

1.1.2014 — Debtors Ledger balance ₹ 1,37,000; Creditors Ledger balance ₹ 1,64,000

Transactions during the year:	₹		₹
Credit purchases	62,500	Cash sales	50,000
Credit sales	69,500	Sundry charges debited to customers	500
Cash received from customers	77,000	Allowances from creditors	1,600
Cash paid to suppliers	92,000	Bills payable dishonoured	9,000
Returns from customers	2,000	Discount allowed to debtors	1,300
Returns outwards	2,000	Cash purchases	30,900
Discount received	1,800	Bills receivable dishonoured	2,100
Bad debts written-off	7,200	Bad debts written-off, now recovered	900
Acceptances received from customers	25,500	Transfer from Bought Ledger to Sales Ledger	1,500
Bills payable accepted	36,000	Bills receivable discounted	3,000

Solution **In the General Ledger of Mr X**

Dr. **Debtors Ledger Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/f	1,37,000	31.12.2014	By General Ledger Adj. A/c :	
31.12.2014	To General Ledger Adj. A/c :			Cash received	77,000
	Sales (credit)	69,500		Returns from customers	2,000
	Sundry charges	500		Bad debts written-off	7,200
	Bills receivable dishonoured	2,100		Bills receivable	25,500
				Discount allowed	1,300
				Transfer	1,500
			31.12.2014	By Balance c/d	94,600
		2,09,100			2,09,100

Dr. **Creditors Ledger Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To General Ledger Adj. A/c :		1.1.2014	By Balance b/d	1,64,000
	Cash paid	92,000		By General Ledger Adj. A/c :	
	Returns outward	2,000		Purchases (credit)	62,500
	Discount received	1,800		Bills payable dishonoured	9,000
	Bills payable accepted	36,000			
	Allowances from creditors	1,600			
	Transfer	1,500			
31.12.2014	To Balance c/d	1,00,600			
		2,35,500			2,35,500

Tutorial Notes :

(1) Cash sales or Cash purchases will not affect Debtors and Creditors balance respectively, so it is to be ignored.

(2) Bills receivable discounted will not affect Debtors balance, so it should be ignored.

Illustration 21

K. Hassan has three ledgers in use : a Sales Ledger, a Bought Ledger and a Nominal Ledger, all of which are kept in Self-balancing system. From the following particulars, prepare Sales Ledger Adjustment Account in the General Ledger and Nominal Ledger Adjustment Account in the Bought Ledger (all figures in ₹).

2014 April 1 : Balance of Creditors — (Dr.) 150; (Cr.) 4,500; Balance of Debtors — (Cr.) 250; (Dr.) 8,700

2015 March 31 :

Credit purchases	45,000	B/R endorsed to supplier (all these bills were duly honoured)	300
B/R drawn on customers (excluding bill renewed)	3,000	B/R dishonoured and fresh bills drawn with interest of ₹ 200	1,200
Bills payable accepted	2,000	Cash paid to suppliers	25,000
Sales (including cash sales of ₹ 5,000)	60,000	Allowances to customers	100
Return outward	1,500	Allowances received	150
Interest on customers account over due for payment	300	Bad debts written-off	150
Sales returns	450	Bad debts reserve	500
Cash and cheques received from customers	32,000	Credit bal. transferred from Sales Ledger to Bought Ledger	100
Credit bal. transferred from Bought Ledger to Sales Ledger	85	Purchases Ledger balances (Dr.)	84
Cheques dishonoured	500	Sales Ledger balances (Cr.)	112

Solution **In the General Ledger of K. Hassan**

Dr. **Sales Ledger Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d	8,700	1.4.2014	By Balance b/d	250
31.3.2015	To General Ledger Adjustment A/c :		31.3.2015	By General Ledger Adjustment A/c :	
	Credit Sales	55,000		B/R ₹ (3,000 + 1,200)	4,200
	Interest on overdue amount	300		Sales return	450
	Cheques dishonoured	500		Cheque and Cash received	32,000
	Bills dishonoured	1,000		Allowances to customers	100
	Interest charged	200		Bad debts written-off	150
	Credit balance transferred to Bought Ledger (Note 1)	100		Credit balance transferred from Bought Ledger (Note 2)	85
31.3.2015	To Balance c/d	112	31.3.2015	By Balance c/d	28,677
		65,912			65,912

In the Bought Ledger of K. Hassan

Dr. **Nominal Ledger Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d	4,500	1.4.2014	By Balance b/d	150
31.3.2015	To Bought Ledger Adjustment A/c :		31.3.2015	By Bought Ledger Adjustment A/c :	
	Credit purchases	45,000		Bills payable accepted	2,000
	Credit balance transferred from			Return outward	1,500

	Sales Ledger (Note 1)	100		Allowance received	150
				Cash paid	25,000
				Bills endorsed	300
				Credit balance transferred to Sales Ledger (Note 2)	85
31.3.2015	To Balance c/d	84	31.3.2015	By Balance c/d	20,499
		49,684			49,684

Working Notes :

(1) For credit balance transferred from Sales Ledger to Bought Ledger ₹ 100 will increase both debtors and creditors balance by ₹ 100. This is because, sundry debtors have debit balance but opposite (i.e., credit) balance is being transferred.

(2) For credit balance transferred from Bought Ledger to Sales Ledger ₹ 85 will reduce both debtors and creditors balance by ₹ 85. This is because sundry creditors have credit balance and such balance is being transferred.

(3) Bad debts reserve will not affect the adjustment account.

Illustration 22

Prepare a Sales Ledger Adjustment Account and a Purchase Ledger Adjustment Account in the General Ledger, for the year ended 31st March, 2015 from the following information (all figures in ₹) :

Customers' Account debit balance as on 1.4.2014	23,000	Goods returned by debtors	20,000
Customers' Account credit balance as on 1.4.2014	2,000	Cash discount allowed to debtors	6,000
Suppliers' Account credit balance as on 1.4.2014	40,000	Cash discount received from creditors	1,300
Suppliers' Account debit balance as on 1.4.2014	5,400	Trade discount received from the suppliers	80,000
Credit sales during the year	2,94,000	Bad debts written-off during the year	4,000
Credit purchases during the year	2,78,000	Bad debts recovered during the year	800
Cash sales during the year	2,26,000	Transfer from creditors ledger to debtors ledger	2,400
Cash purchases during the year	58,000	Bills receivable dishonoured	3,200
Cheques received from credit customers	1,80,000	Bills payable dishonoured	1,800
Cash received from credit customers	20,000	Cheques recd from debtors returned dishonoured	7,500
Cheques issued to the creditors during the year	2,10,000	Cheques issued to creditors returned dishonoured	2,900
Goods returned to the creditors	14,000	Customers' Account credit balance as on 31.3.2015	3,100
Bills payable accepted during the year	18,000	Suppliers' Account debit balance as on 31.3.2015	4,200
Bills received during the year	15,000		

Solution **In the General Ledger of ...**

Dr. **Sales Ledger Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d	23,000	1.4.2014	By Balance b/d	2,000
31.3.2015	To General Ledger Adjustment A/c :		31.3.2015	By General Ledger Adjustment A/c :	
	Credit Sales	2,94,000		Cheque received	1,80,000
	Bills receivable (dishonoured)	3,200		Cash received	20,000
	Cheque dishonoured	7,500		Bills receivable	15,000
31.3.2015	To Balance c/d	3,100		Sales return	20,000
				Discount allowed	6,000
				Bad debts	4,000
				Transfer	2,400
			31.3.2015	By Balance c/d	81,400
		3,30,800			3,30,800

Dr. **Purchases Ledger Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d	5,400	1.4.2014	By Balance b/d	40,000
31.3.2015	To General Ledger Adjustment A/c :		31.3.2015	By General Ledger Adjustment A/c :	
	Cheque issued	2,10,000		Credit purchases	2,78,000
	Bills payable accepted	18,000		Bills payable dishonoured	1,800
	Discount received	1,300		Cheque issued dishonoured	2,900
	Goods returned	14,000	31.3.2015	By Balance c/d	4,200
	Transfer	2,400			
31.3.2015	To Balance c/d	75,800			
		3,26,900			3,26,900

Tutorial Note : Trade discount received from suppliers is not recorded in the books of accounts. Therefore, it will not affect the Adjustment Accounts.

Illustration 23

Indian Radicals Limited has three ledgers — Debtors' Ledger, Creditors' Ledger and General Ledger, which are kept under Self-balancing system. From the following particulars, prepare the relevant Adjustment Accounts that would appear in each of the Ledgers (all figures in ₹) :

Particulars	₹	Particulars	₹
Debtors Ledger balance on 1.1.2014 (Dr.)	16,000	Sundry charges for dishonoured bills payable	100
Debtors Ledger balance on 1.1.2014 (Cr.)	2,000	Bills receivable drawn	10,000
Creditors Ledger balance on 1.1.2014 (Dr.)	1,800	Bills receivable dishonoured	2,500
Creditors Ledger balance on 1.1.2014 (Cr.)	14,000	Bills receivable discounted	4,000
Purchases (including cash purchases ₹ 2,000)	36,500	Bills receivable endorsed	4,500
Sales (including cash sales ₹ 8,000)	80,000	Bills receivable as endorsed dishonoured	1,000
Cash paid to creditors	21,000	Bad debts	400
Collection from debtors	62,000	Provision for doubtful debts	1,500
Discount allowed	300	Transfer from Debtors' Ledger to Creditors' Ledger	500
Discount received	400	Debtors' Ledger balance on 31.12.2014 (Cr.)	1,300
Returns inwards	2,500	Creditors' Ledger balance on 31.12.2014 (Dr.)	1,200
Returns outwards	1,500	Transfer from Creditors Ledger to Debtors' Ledger	700
Acceptance matured	5,000	Bills payable accepted (including renewed	
Acceptance dishonoured	3,000	bills and interest thereon)	14,000
Acceptance renewed	2,000	Interest on renewed bills	500

Solution

In the General Ledger of Indian Radical Limited

Dr. Debtors Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d	16,000	1.1.2014	By Balance b/d	2,000
31.12.2014	To General Ledger Adj. A/c :		31.12.2014	By General Ledger Adj. A/c :	
	Credit sales (Note 4)	72,000		Collection from debtors	62,000
	Bills receivable (dishonoured)	2,500		Discount allowed	300
	B/R endorsed dishonoured	1,000		Returns inwards	2,500
31.12.2014	To Balance c/d	1,300		Bills receivable drawn	10,000
				Bad debts	400
				Trans. to Creditors Ledger (Note 3)	500
				Transfer from Creditors Ledger	700
			31.12.2014	By Balance c/d	14,400
		92,800			92,800

Dr. Creditors Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d	1,800	1.1.2014	By Balance b/d	14,000
31.12.2014	To General Ledger Adj. A/c :		31.12.2014	By General Ledger Adj. A/c:	
	Cash paid	21,000		Purchases (credit)	34,500
	Discount received	400		Bills payable dishonoured	3,000
	Returns outwards	1,500		Sundry charges	100
	Bills payable renewed	2,000		B/R endorsed dishonoured (Note 1)	1,000
	Bills receivable endorsed	4,500		Interest on renewed bills	500
	Trans. from Debtors Ledger (Note 3)	500		Bills payable cancelled for renewal	2,000
	Trans. to Debtors Ledger	700		(Note 2)	
	Bills payable accepted*	12,000	31.12.2014	By Balance c/d	1,200
31.12.2014	To Balance c/d	11,900			
		56,300			56,300

* excluding renewal

In the Debtors Ledger

Dr. General Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d	2,000	1.1.2014	By Balance b/d	16,000
31.12.2014	To Debtors Ledger Adj. A/c :		31.12.2014	By Debtors Ledger Adj. A/c :	
	Collection from Debtors	62,000		Credit Sales (Note 4)	72,000
	Discount allowed	300		Bills receivable dishonoured	2,500
	Returns inwards	2,500		Bills receivable endorsed	
	Bills receivable	10,000		dishonoured (Note 1)	1,000
	Bad debts	400	31.12.2014	By Balance c/d	1,300
	Transferred to Creditors Ledger	500			
	Transferred from Creditors Ledger	700			
31.12.2014	To Balance c/d	14,400			
		92,800			92,800

In the Creditors Ledger

Dr. General Ledger Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d	14,000	1.1.2014	By Balance b/d	1,800
31.12.2014	To Creditors Ledger Adj. A/c :		31.12.2014	By Creditors Ledger Adj. A/c :	
	Credit purchases	34,500		Cash paid	21,000
	Bills payable dishonoured	3,000		Discount received	400
	Sundry charges	100		Returns outward	1,500
	B / R endorsed dishonoured (Note 1)	1,000		B / P renewed	2,000
	Interest on renewed bill	500		B/R endorsed	4,500
	B / P cancelled for renewal (Note 2)	2,000		Transferred from Debtors Ledger	500
31.12.2014	To Balance c/d	1,200		Transferred to Debtors Ledger	700
				B / P accepted (excl. renewed)	12,000
			31.12.2014	By Balance c/d	11,900
		56,300			56,300

Working Notes :

(1) Bills receivable endorsed dishonoured will increase both debtors and creditors balances.

(2) For renewal, bills payable is to be cancelled first by debiting Bills Payable Account and crediting Creditors Account.

(3) Both transfer from Debtors Ledger to Creditors Ledger and from Creditors Ledger to Debtors Ledger will decrease both debtors and creditors balances at the same time.

(4) Cash sales, provision for doubtful debts, bills receivable discounted will not affect Adjustment Account.

(5) Cash purchases, acceptance matured will not affect Adjustment Account.

Rectification of Errors relating to Self-Balancing System

We have already discussed in Chapter 16, the details procedures of rectification of errors. The same procedures are to be applied here with some modifications.

For rectification of errors relating to Self-balancing system, the following steps should be followed:

Step 1 Rectify the errors in the usual manner, as if the ledgers are not kept under self-balancing system.

Step 2 Assess the nature of the error. If it is affecting the totals of some subsidiary books, (e.g., sales day book, purchases day book, returns inwards book, returns outwards book, bills receivable book, bills payable book) it is to be rectified by passing a self-balancing entry. No self-balancing entry is required if it is not affecting the totals of subsidiary books.

Illustration 24

The following errors were detected on 31st December, 2014.

(i) Purchases Day Book was undercast by ₹ 500; (ii) Sales Day Book was undercast by ₹ 300; (iii) A cheque of ₹ 2,000 issued to Karmakar & Co was recorded as having been issued to M/s K. M. Kar & Co; (iv) Goods worth ₹ 250 returned by Das & Co, were entered in the Day Book as ₹ 2,500.

You are required to show all the Journal entries necessary to rectify the above errors assuming that the ledgers are maintained on self-balancing system.

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

Date	Particulars		₹	₹
2014 Dec.31	(a) Purchases A/c	Dr.	500	
(i)	To Suspense A/c			500
	(Being the undercasting in Purchase Day Book, now rectified)			
	(b) General Ledger Adjustment A/c (In the Creditors Ledger)	Dr.	500	
	To Creditors Ledger Adjustment A/c (In the General Ledger)			500
	(Being the necessary adjustment for undercasting error in the Purchases Day Book)			
(ii)	(a) Suspense A/c	Dr.	300	
	To Sales A/c			300
	(Being the undercasting in Sales Day Book, now rectified)			
	(b) Debtors Ledger Adjustment A/c (In the General Ledger)	Dr.	300	
	To General Ledger Adjustment A/c (In the Debtors Ledger)			300
	(Being the adjustment for undercasting error in the Sales Day Book)			
(iii)	Karmakar & Co A/c	Dr.	2,000	
	To K.M. Kar & Co A/c			2,000
	(Being cheque issued to Karmakar & Co wrongly debited to K.M. Kar & Co, now rectified)			

(iv)	(a) Das & Co A/c Dr. To Returns Inwards A/c (Being goods worth ₹ 250 returned by Das & Co were entered in the Day Book as ₹ 2,500, now rectified)	2,250	 2,250
	(b) Debtors Ledger Adjustment A/c (In the General Ledger) Dr. To General Ledger Adjustment A/c (In the Debtors Ledger) (Being adjustment for excess credit to Debtors for goods returned)	2,250	 2,250

Illustration 25

Following errors are detected after opening Suspense Account but before preparing Final Accounts:

1. Goods of the value of ₹ 100 returned by Sharma were entered in the Sales Day Book and posted therefrom to the credit of his account.
2. An amount of ₹ 150 entered in the Sales Returns Book, has been posted to the debit of Philip, who returned the goods.
3. A sale of ₹ 200 made to Ghanshyam was correctly entered in the Sales Day Book but wrongly posted to the debit of Radheshyam (a customer) as ₹ 20.
4. No entry appeared for Bad Debts aggregating ₹ 450 except writing-off the individual debtors in the Sales Ledger.
5. The total of ''Discount Allowed'' column in the Cash Book for the month of September amounting to ₹ 250 was not posted.

Rectify by journal entries under (a) Single Ledger and (b) Self-balancing Ledgers.
Ignore narrations.

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

Date	Particulars		₹	₹
	(a) Rectification under Single Ledger			
1.	Sales A/c	Dr.	100	
	Sales Returns A/c	Dr.	100	
	To Suspense A/c			200
2.	Suspense A/c	Dr.	300	
	To Philip A/c			300
3.	Ghaneshyam A/c	Dr.	200	
	To Radheshyam A/c			20
	To Suspense A/c			180
4.	Bad Debts A/c	Dr.	450	
	To Suspense A/c			450
5.	Discount A/c	Dr.	250	
	To Suspense A/c			250
	(b) Rectification under Self-Balancing System			
1.	(i) Sales A/c	Dr.	100	
	Sales Return A/c	Dr.	100	
	To Suspense A/c (In Debtors Ledger)			200
	(ii) General Ledger Adjustment A/c (In Debtors Ledger)	Dr.	200	
	To Debtors Ledger Adjustment A/c (In General Ledger)			200
2.	Suspense A/c	Dr.	300	
	To Philip A/c (In Debtors Ledger)			300
3.	Ghaneshyam A/c	Dr.	200	
	To Radheshyam A/c			20
	To Suspense A/c (In Debtors Ledger)			180
4.	(i) Bad Debts A/c	Dr.	450	
	To Suspense A/c (In Debtors Ledger)			450
	(ii) General Ledger Adjustment A/c (In Debtors Ledger)	Dr.	450	
	To Debtors Ledger Adjustment A/c (In General Ledger)			450
5.	(i) Discount A/c	Dr.	250	
	To Suspense A/c (In Debtors Ledger)			250
	(ii) General Ledger Adjustment A/c (In Debtors Ledger)	Dr.	250	
	To Debtors Ledger Adjustment A/c (In General Ledger)			250

Key Points

- Under Sectional Balancing System, two additional accounts are kept in General Ledger. These are : (i) Total Debtors Account; and (ii) Total Creditors account.
- The balance in the Debtors Control Account should be equal to the total balances of individual debtors.
- The total balance in the Creditors Control Account should be equal to the balances of individual creditors.
- Control accounts provide an internal check. The staff posting the entries to the Control Accounts will act as a check on different staff(s) posting entries in the Debtors ledger and Creditors ledger.
- Self-Balancing is a system of ledgers keeping by means of which each ledger can be balanced independently with the other ledgers.

THEORETICAL QUESTIONS

1. State the purposes of using Control Accounts.
2. (a) What is 'Self-Balancing Ledger' ? (b) Why adjustments are necessary in the Self-Balancing System?
3. State the advantages of Self-Balancing System.
4. What is Sectional Balancing System ? State the advantages of Sectional Balancing.
5. On account of the very large number of his transactions, a merchant keeps a separate Bought Ledger and a separate Sold Ledger as also a General Ledger. What matters would you expect to find in each of the above ledgers ? How would you make each of the above ledgers Self-Balancing ?
6. It is said that "In a business of any magnitude it is desirable to raise total accounts in respect of Debtors and Creditors Ledgers". What are these total accounts and why is it desirable to raise them ?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below :

1. When carrying out the reconciliation of the balance on the Debtors' Ledger Control Account with the list of balance from debtors ledger, X found the following :
   (i) total of the sales day book was overcast by ₹ 900;
   (ii) a sales invoice for Ram was posted to Raman's Account;
   (iii) an invoice to a customer for ₹ 650 has been recorded as ₹ 560 in the sales day book.
   Which of the errors will require an entry in the general ledger ?
   A all three
   B (i) and (ii) only
   C (i) and (iii) only
   D (ii) and (iii) only
2. Which of the following statements is / are correct ?
   (i) the debtors ledger control account balance ***must be correct*** if it agrees with the total of the list of balances from the receivable ledger;
   (ii) if there is a different between the balance on the debtors ledger control account and the total of the list of balances from the debtors ledger, the balance in the control account is always correct;
   A both (i) and (ii)
   B neither (i) nor (ii)
   C (i) only
   D (ii) only
3. Kabir's book keeper has prepared the following trade creditors ledger reconciliation :

	₹
Balance on general ledger control account	78,553
Less: Discount not recorded in general ledger	128
	78,425
Add: Debit balance of ₹ 100 included on list of balances as credit balance	200
Total list of balances	78,625

What is the correct trade creditors balance to be reported in the Balance Sheet ?

A ₹ 78,425
B ₹ 78,553
C ₹ 78,625
D ₹ 78,753

4. Sriram has prepared the following reconciliation of the balance on the debtors ledger control account in his general ledger to the total of the list of balances on customer's personal accounts :

	₹
Balance on debtors ledger control account	35,776
Less: Balance omitted from list of balances	452
	35,324
Add: Sales day book undercast	900
	36,224

What is the correct balance of debtors to be reported on the Balance Sheet ?

A ₹ 35,324
B ₹ 35,776
C ₹ 36,224
D ₹ 36,676

5. Consider the following statements about control accounts.
   (i) Control accounts can help to speed up the preparation of draft accounts by providing the balance sheet value for trade debtors and trade creditors.
   (ii) Control accounts are used in double entry book-keeping only.

	(i)	(ii)
A	True	False
B	True	True
C	False	True
D	False	False

6. While preparing the creditors ledger reconciliation for a client, you noted the following errors :
   (i) An invoice for ₹ 215 from a supplier was not entered in the accounting records.
   (ii) An invoice for ₹ 465 was recorded as ₹ 456 in the purchase day book.

   Which of the errors will cause a difference between the balance on the control account in the general ledger and the total of the list of balances from the personal ledger ?

A (i) only
B (ii) only
C both (i) and (ii)
D neither (i) nor (ii)

7. Praveen prepared the following creditors ledger reconciliation statement.

	₹
Balance on general ledger control account	46,865 (Credit)
Payment entered twice in general ledger control account	573 (Credit)
	47,438 (Credit)
Purchase day book overcast	900 (Debit)
Total of list of balances	46,538 (Credit)

How should the payable ledger balance be reported in the Balance Sheet ?

A ₹ 46,538 as a current asset
B ₹ 46,538 as a current liability
C ₹ 46,865 as a current asset
D ₹ 46,865 as a current liability

8. On checking the list of balances on the creditors ledger accounts, it was found that the total is ₹ 2,250 more than the balance on the creditors control account in the general ledger.

   Which of the following erros could, by itself, account for this difference ?

A The total of contra entries against debtor accounts is overstated by ₹ 1,125.
B Purchases day book has been overcast by ₹ 2,250.
C A credit note to the value of ₹ 1,125 has been omitted from a creditors ledger account.
D A creditors ledger account with a debit balance of ₹ 1,125 has been treated as a credit balance.

The following information relates to questions 9 and 10.

Robin is preparing a reconciliation of the balance on the creditors ledger control account in the general ledger to the total of the list of balances of individual accounts in the creditors ledger. He has discovered the following:

(i) A debit balance on a suppliers' account was listed as a credit balance.

(ii) An invoice for ₹ 376 was entered in the purchase day book as ₹ 387.

9. Which of the errors will require an adjustment to the creditors ledger control account in the general ledger?
   - **A** neither (i) nor (ii)
   - **B** (i) only
   - **C** (ii) only
   - **D** both (i) and (ii)
10. Which of the errors will require an adjustment to the list of balances ?
    - **A** neither (i) nor (ii)
    - **B** (i) only
    - **C** (ii) only
    - **D** both (i) and (ii)

PRACTICAL QUESTIONS

Sectional Balancing System

1. From the following information, prepare: (i) Total Debtors Account; and (ii) Total Creditors Account.

1.1.2015 : Balance of Sundry Debtors ₹ 32,000; Balance of Sundry Creditors ₹ 37,000.

30.6.2015 : Balances of other Accounts	₹		₹
Credit purchases	9,000	Bills receivable received	6,000
Credit sales	19,600	Returns inwards	1,750
Cash sales	1,500	Returns outwards	1,200
Cash purchases	1,000	Rebate allowed to debtors	550
Paid to creditors	19,750	Rebate allowed by creditors	300
Discount received	650	Provision for doubtful debts	320
Cash received from debtors	15,600	Bad debts	900
Discount allowed	400	Bills receivable dishonoured	750
Bills payable accepted	3,000	Bad debts, previously written off, now recovered	500

2. From the following informations, prepare Total Debtors Account in the General Ledger. (all figures in ₹)

Debtors - opening balances : Dr.	2,00,000	Bills receivable received	1,00,000
Debtors - opening balances : Cr.	10,000	Bills receivable discounted	40,000
Discount allowed	30,000	Provision for bad debts	10,000
Cash and cheques receipts	8,00,000	Bad debts recovered	5,000
Credit sales	10,00,000	Transfer from Debtors to Creditors Ledger	5,000
Returns inwards	20,000	Transfer from Creditors to Debtors Ledger	6,000
Bad debts	15,000	Closing credit balance in Debtors	30,000

3. Prepare Total Accounts from the following particulars in the General Ledger. (all figures in ₹)

1.1.2015	Balance on Bought Ledger (Dr.)	1,740	Cash received from customers	1,52,420
	Balance on Bought Ledger (Cr.)	23,880	Discount allowed thereon	5,640
	Balance on Sales Ledger (Dr.)	29,240	Cash paid to suppliers	1,16,860
	Balance on Sales Ledger (Cr.)	480	Discount received thereon	3,320
31.1.2015	Purchases	1,32,360	Cash paid to customers	260
	Purchases returns	5,120	Bills receivable	8,240
	Sales	1,74,980	Bills payable	4,500
	Sales returns	2,340	Bills receivable dishonoured	500
	Bought Ledger balances (Dr.)	1,540	Sales Ledger balances (Cr.)	36,700

4. From the following information prepare Total Debtors Account and Total Creditors Account in the General Ledger of ABC Ltd. (all figures in ₹)

Debtors on 1.1.2015	4,575	Cash paid to suppliers	3,070
Creditors on 1.1.2015	5,490	Discount received	67
Transactions for the year :		Allowances from creditors	28
Credit purchases	2,050	Acceptances received from Debtors	850
Credit sales	2,270	Acceptances given to creditors	1,200
Returns inwards	40	Bills receivable dishonoured	120
Returns outwards	60	Bills payable dishonoured	300
Cash received from customers	2,550	Bad debts written-off	250
Discount allowed	45	Sundry charges debited to customers	35

5. HP Ltd has prepared the following sales ledger control account for December 2014 :

Dr. **Sales Ledger Control Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Dec. 1	Balance b/d	32,168	Dec. 31	Bank	59,861
Dec. 31	Sales	45,972		Discount allowed	2,563
	Returned cheque	123		Returns inwards	1,879
				Balance c/d	13,960
		78,263			78,263
2015					
Jan. 1	Balance b/d	13,960			

The following errors are then discovered:

(1) The sales day book total has been overcast by ₹ 2,500.

(2) The returns inwards figure should have been ₹ 1,789.

(3) There is a contra entry with the purchase ledger of ₹ 560, representing an account settled with a supplier, which has been omitted.

(4) An account for J M Ltd was credited with a cheque for ₹ 769; this should have been credited to J B M and Son.

Redraft the sales ledger control account making the entries necessary to show the correct balance to be brought down.

6. You are carrying out a reconciliation between the balance on the trade debtors control account (which is ₹ 64,969) and the total of the list of the balances on the customers' personal accounts (which is ₹ 65,132). You have found the following reasons for the difference :

(i) A sales invoice for ₹ 320 was entered in the sales day book as ₹ 230.

(ii) The total of the sales returns day book was understated by ₹ 900.

(iii) A credit note for ₹ 460 was treated as an invoice when the entries were being made in the personal ledger.

(iv) A customer paid ₹ 1,700 in full settlement of a balance of ₹ 1,715. The discount was correctly recorded in the personal ledger, but was not entered in the control account.

(v) The total value of cheques received from customers was ₹ 67,908 but ₹ 67,980 was posted to the control account.

(vi) A debit balance of ₹ 20 on a customer's account was omitted.

(vii) A credit balance of ₹ 53 on a customer's account was treated as a debit balance.

Required :

(a) Show the trade debtors control account, including any necessary correcting entries and the corrected closing balance.

(b) Prepare a reconciliation of the total of the list of balances on the customers' personal accounts to the corrected balance on the trade debtors control account.

(c) State the amount to be reported in the final accounts for trade debtors and indicate how this balance will be reported.

7. You are employed as a Trainee Accountant in Robin and Co. One of your task is to prepare the monthly reconciliation of the balance on the creditors control account in the general ledger (₹ 98,524) to the list of balances from the creditors ledger (₹ 97,264).

When preparing the reconciliation at 31st December, 2014, you have noted the following :

(i) One of the suppliers agreed to accept ₹ 1,500 in payment of a balance of ₹ 1,514. The full balance of ₹ 1,514 was deducted from the supplier's personal account, but only the cheque issued was recorded in the general ledger.

(ii) There is an ongoing agreement to offset balances with Rahul, who is both a customer and a supplier. The amount for December is ₹ 2,856. No entries have yet been made.

(iii) A credit balance of ₹ 623 on the account of Anil was listed as a debit balance.

(iv) An invoice for ₹ 462 received from Mukesh was incorrectly recorded in the purchase day book as a credit note.

(v) Your company makes direct payments to Amar. The payment of ₹ 974 made in December has not been recorded.

(vi) An invoice for ₹ 760 from Zahir was entered in the purchase day book as ₹ 670.

Required :

(a) Show the Creditors Control Account in the general ledger, including the necessary adjusting entries and the corrected balance. (**NB**: You must present your answer in a format which clearly indicates whether each entry is a debit entry or a credit entry.)

(b) Prepare a reconciliation of the total of the list of balances on the Creditors Control Account in the General Ledger.

(c) State the correct creditors balance for inclusion in the final accounts and indicate where it should be reported on the Balance Sheet.

8. The sales ledger supervisor of H Ltd has been taken ill and the inexperienced ledger clerk is having problems balancing the ledgers for the month of February 2015. He presents you with the following information and asks for your help.

The balances on the individual accounts at 28 February are :

	₹
R & Sons	100
S Ltd	1,160
C Lion & Co Ltd	2,835
Sea Food Ltd	490
A Ltd	195
B Ltd	235
C Ltd	180
D Ltd	740
	5,935

The balance brought forward on the control account for 1 February is ₹ 6,830.

The clerk says he has entered the following items on the customers' accounts to get the above balances:

	₹	₹	₹	₹
R & Sons	250	190	—	—
S Ltd	490	960	40	—
C Lion & Co ltd	365	745	15	125
Sea Food Ltd	45	85	—	30
A Ltd	—	25	—	—
B Ltd	70	50	—	—
C Ltd	230	30	—	—
D Ltd	510	290	30	
	1,960	2,375	85	155

When he enters the above totals in the sales ledger control account it does not balance to the total of the customer's accounts.

On investigation you find that :

(a) Sales to S Ltd have been mistakenly entered on S Lal's account in the creditors ledger.

(b) A contra has been entered on the account of B Ltd for ₹ 65 against his account on the creditors ledger. This has not been recorded on the control account.

(c) An invoice for ₹ 210 in respect of C Lion & Co Ltd has been omitted from the list of sales and is not included in the individual account balances on 28 February.

(d) The account for Mr C Rao showing a balance of ₹ 165 has been removed from the sales ledger as the debt has been proven to be bad.

(e) The cheque from R & Son has been returned by the bank marked 'refer to drawer'.

(f) A credit note for ₹ 450 has been posted to the account of D Ltd but not to the control account.

(g) The cash received from C Lion & Co had not been entered in the customer account.

(h) The chief accountant has been looking at the account of G Ltd. You have reason to believe the customer account showing a credit balance of ₹ 185 is locked in his filing cabinet.

You are required to :

(a) complete the sales ledger control account; and

(b) reconcile the list of individual debtors account balances to the control account balance.

9. The following information has been taken from the books of Southern Chemicals in respect of the year ended 31 March, 2015 :

	₹
Sales ledger control account balance at 1 April, 2014	49,251
Return by credit customers	6,144
Credit sales	5,44,382
Cash sales	36,243
Settlement discounts allowed to credit customers	1,316
Cash received from credit customers	5,26,139

The following additional information has been established :

(a) The list of balances on the sales ledger at 31 March, 2015 totals to ₹ 62,183; a similar list at 31 March, 2014, agreed with the sales ledger control account at their date.

(b) Credit balances on the sales ledger at 31 March, 2015 amounting to ₹ 1,066 were entered as debit balances on the list extracted at that date.

(c) An amount of ₹ 62, received during the year from Salmon & Co., a supplier, in settlement of a debit balance on the bought ledger was entered in the sales ledger column in the cash book, and was posted to the account of Solomon Brothers in the sales ledger.

(d) Cash received from customers includes ₹ 315 in respect of a debt which was written-off at 31 March, 2014. This has not been posted to the sales ledger as no account exists.

(e) A sub-total of ₹ 3,456 in the sales day book total column has been carried forward as ₹ 3,654.

(f) A total in the sales ledger column of the cash book has been undersummed by ₹ 100.

(g) An amount of ₹ 39 received during the year from H Co Ltd., has been posted to the account of B & Co. (Holdings) Ltd.

(h) It was agreed during the year that an amount of ₹ 52 owing by M B & Sons would be settled by contra with a similar balance on their account in the bought ledger. No entries have yet been made in respect of this contra.

You are required to prepare the sales ledger control account for the year ended 31 March, 2015 and to reconcile the balance with the list of debtors' balances.

Self Balancing System

10. M/s XYZ Limited maintains its books under the Self-balancing system. From the following particulars at the close of the year, write up the necessary adjustment accounts as they would appear in the General Ledger :

Closing Debtor's balance as per General Ledger Adjustment Account (Cr.) ₹ 60,000; Credit sales ₹ 40,000; Cash sales ₹ 10,000; Purchases (50% on credit) ₹ 30,000; Payment to creditors ₹ 7,500; Discount allowed ₹ 1,500; Discount received ₹ 500; Payment from customers ₹ 20,000; Bad debts ₹ 5,000.

Closing Creditor's balance as per General Ledger Adjustment Account(Dr.) ₹ 30,000; Bills payable accepted ₹ 5,000; Bills receivable received ₹ 3,000.

Discount allowed to Debtors amounting to ₹ 500 was recorded as Discount received from creditors.

11. Prepare Purchase and Sales Ledger Adjustment Account as would appear in the Nominal Ledger from the following particulars :

On 1st Jan 2014 : Balance on Purchases Ledger ₹ 174(Dr.) 2,388 (Cr.);
Balance on Sales Ledger ₹ 2,924 (Dr.) 48 (Cr.)

31.12.2014	Purchases	13,036	Purchases returns	512
	Cash paid to suppliers	11,686	Discounts received thereon	336
	Sales	17,498	Sales returns	234
	Cash received from customers	15,248	Discount allowed thereon	564
	Bills payable	450	Bills receivable	824
	Transfer from purchases to sales ledger	152	Purchases ledger balances (Dr.)	154
	Sales ledger balances (Cr.)	84		

12. You have been furnished with the following information by M/s Mehra & Sons, New Delhi :

Opening Balances : Bought Ledger : Credit Balances ₹ 2,70,900; Debit Balances ₹ 29,000; Sales Ledger : Debit Balances ₹ 3,27,000

	₹		₹
Purchases returns	2,700	Cheques issued in favour of creditors	8,32,800
Acceptance of Bills payable	1,00,000	Credit sales	18,27,000
Credit purchases	9,27,600	Discount received	22,500
Receipts from Debtors	13,42,000	Bills receivable	6,00,000
Discount allowed	7,500		

You have to prepare :

(i) Bought Ledger Adjustment Account in General Ledger;

(ii) Sales Ledger Adjustment Account in General Ledger; and

(iii) General Ledger Adjustment Account in the Sales Ledger.

13. X Co. Ltd. have three Ledgers — Debtors Ledger, Creditors Ledger and General Ledger which are all kept under self-balancing. From the following particulars, prepare the relevant adjustment accounts that would appear in the General Ledger.

Particulars	₹	Particulars	₹
Debtors balance on 1.1.2014 (Dr.)	15,000	Bills receivable drawn	7,500
Debtors balance on 1.1.2014 (Cr.)	1,000	Bills receivable dishonoured	2,000
Creditors balance on 1.1.2014 (Dr.)	600	Bills receivable discounted	1,500
Creditors balance on 1.1.2014 (Cr.)	12,800	Bills receivable endorsed to creditors	4,300
Purchases (including cash ₹ 1,500)	36,000	Bills receivable as endorsed to creditors dishonoured	1,000
Sales (including cash ₹ 3,000)	75,000	Bad Debt	800
Cash paid to creditors	21,000	Provision for bad debts	1,100
Collection from debtors	62,000	Transfer from Debtors Ledger to Creditors Ledger	500
Discount allowed	260	Bills payable accepted	4,000
Discount received	320	Debtors balance on 31.12.2014 (Cr.)	300
Returns inwards	2,400	Creditors balance on 31.12.2014 (Dr.)	200
Returns outwards	1,600		

14. Prepare Bought Ledger Adjustment Account and Sales Ledger Adjustment Account as would appear in the General Ledger of Sonali Enterprises for the year ended 31.12.2014 from the following information (all figures in ₹) :

Debtor balance on 1.1.2014 ₹ 15,000; Creditors balance on 1.1.2014 ₹ 17,100

Sales (including cash sales of ₹ 19,000)	45,000	Bills receivable dishonoured (incl. endorsed ₹ 300)	1,400
Purchases (including cash purchases ₹ 12,000)	30,000	Bad debts recovered	375
Cash paid to suppliers in full settlement of ₹ 19,800	19,000	Purchase returns	2,500
Cash recd. from customers in full settlement of ₹ 17,400	16,900	Sales returns	1,600
Bills payable accepted	1,300	Bad debts	750
Bills receivable received	2,900	Reserve for bad and doubtful debts	2,000
Bills receivable endorsed	800		

Included in the Debtors was an amount of ₹ 1,500 due from Barnali from whom goods worth ₹ 1,050 had been purchased. Barnali agreed to set off her claim against the amount due from her.

15. From the following information prepare Sales Ledger Adjustment Account and Bought Ledger Adjustment Account in the General Ledger :

On 1.1.2014 : Balance on Bought Ledger (Dr.) ₹ 5,000; (Cr.) ₹ 48,000; Balance on Sold Ledger (Dr.) ₹ 70,940; (Cr.) ₹ 1,120

		₹		₹
31.12.2014	Purchases	2,70,000	Reserve for doubtful debts	4,580
	Purchases returns	10,000	Cash paid to customers	920
	Total sales	3,84,000	Discount received	3,600
	Cash sales	20,000	Bills receivable received	20,000
	Sales returns	5,000	Bills payable issued	11,200
	Cash received from customers	3,12,000	Bills receivable dishonoured	3,000
	Discount allowed	5,600	Bought Ledger balance (Dr.)	5,200
	Cash paid to suppliers	2,40,000	Sales Ledger balance (Dr.)	91,600
	Transfer from Sales to Bought Ledger	10,400		

16. From the following particulars as extracted from the books of Wadia and Co., who keeps a Debtors Ledger, a Creditors Ledger and a General Ledger on self balancing system, show how the Debtors and Creditors Ledger Adjustment Accounts will appear in the General Ledger for the year 2014 (all figures in ₹):

1.1.2014	Debtors balance	45,750	Creditors balance	54,900
31.12.2014	Credit purchase	20,500	Credit sales	22,700
	Returns inwards	400	Returns outwards	600
	Cash received from customers	25,500	Discount allowed to customers	450
	Cash paid to creditors	30,700	Discount received from creditors	670
	Acceptances received from debtors	8,500	Creditors bill accepted	12,000
	Bills receivable returned dishonoured	1,200	Bills payable dishonoured	3,000
	Bad debts written-off	2,500	Misc. Exp. wrongly debited to Customers A/c	345
	Allowances from creditors	275		

17. From the following particulars, which have been extracted from the books of Gulzar and Co., for the year ended 31.12.2014 prepare General Ledger Adjustment Account in the Creditors Ledger Account and Debtors Ledger Adjustment Account in the General Ledger :

		₹		₹
1.1.2014	Debtors balance (Dr.)	20,000	Debtors balance (Cr.)	300
	Creditors balance (Dr.)	200	Creditors balance (Cr.)	15,000
31.12.2014	Purchases (including cash ₹ 4,000)	12,000	Sales (including cash ₹ 6,000)	25,000
	Paid to suppliers in full settlement of ₹ 9,000	8,500	Recd. from customers in full settlement of ₹ 15,000	14,100
	Bills payable accepted (incl. renewals)	2,000	Bills payable withdrawn upon renewals	500
	Interest on Bills payable renewed	20	Bills receivable received	3,000
	Bills receivable endorsed	800	Bills receivabled as endorsed dishonoured	300
	Bills receivable discounted	1,400	Bills receivable dishonoured	400
	Interest charged on dishonoured bills	30	Transfer from one ledger to another	600
	Returns to creditors	700	Debtors balance on 31.12.2014 (Cr.)	450
	Creditors balance on 31.12.2014 (Cr.)	10,870		

18. Messrs Pioneer and Co. are maintaining accounts on self-balancing system. On 31.12.2014 the General Ledger discloses the following balances :

(Sales Ledger Adjustment Account (Dr.) ₹ 35,235; Purchases Ledger Adjustment Account (Cr.) ₹ 15,530.

On scrutinising the ledgers, the following mistakes were notices :

(a) A credit purchase of ₹ 4,350 has been credited to the Sales Ledger Adjustment Account though the payment has been debited to the Purchase Ledger Adjustment Account. However, in the subsidiary books, these two entries have been entered only in the Purchase Ledger.

(b) ₹ 1,000 paid to Mr Holdger for goods purchased have been debited to the Sales Ledger Adjustment Account. In the subsidiary books, the party's account shows a debit balance in the Sales Ledger and a credit balance in the Purchase Ledger.

(c) ₹ 4,750 were due from Mr Albert in the Sales Ledger as against ₹ 7,740 due to him for purchases made and entered in the Purchase Ledger.

(d) The Sales Ledger balances disclose the sums aggregating ₹ 740 have to be written off as bad debts and discounts.

Prepare the necessary journal entries in the General Ledger and other Subsidiary Books.

Guide to Answers

Multiple choice

1. C 2. B; 3. A 4. D 5. A 6. D 7. B 8. D 9. C 10. D.

Practical Questions

1. **Balance of Total Debtors Account is ₹ 27,150 (Dr.)**
   Total Creditors Account is ₹ 21,100 (Cr.).
2. **Balance of Total Debtors Account is ₹ 2,44,000.**
3. **Balance of : Total Debtors Account is ₹ 72,560 (Dr.);**
   Total Creditors Account is ₹ 26,240 (Cr.).
4. **Balance of : Total Debtors Account is ₹ 3,265 (Dr.);**
   Total Creditors Account is ₹ 3,415 (Cr.).
5. **Balance of Sales Ledger Control Account is ₹ 10,990.**
6. **(a) Correct balance of Trade Debtors Control Account is ₹ 64,216.**
   (c) ₹ 64,216 will be shown as a current liability in the Balance Sheet.
7. **(a) Correct balance of Creditors Control Account is ₹ 95,694.**
   (c) ₹ 95,694 will be shown as a current liability in the Balance Sheet.
8. **Final Balance of Sales Ledger Control Account is ₹ 5,895;**
   Reconciliation : ₹ (5,935 + 490 + 210 + 190) *Less* ₹ (745 + 185) = ₹ 5,895.
9. **Final Balance of Sales Ledger Control Account is ₹ 60,061;**
   Reconciliation : ₹ (62,183 + 62) *Less* ₹ (232 + 52) = ₹ 60,061.
10. **Discount allowed was wrongly recorded as discount received. Therefore, the final debtors balance will be (₹ 60,000 – 500) = ₹ 59,500 and that of creditors balance will be (₹ 30,000 + 500) = ₹ 30,500.**
11. **Balance of Sales Ledger Adjustment Account ₹ 3,436 (Dr.)**
    Balance of Purchase Ledger Adjustment Account ₹ 2,268 (Cr.)
12. **Balance of Sales Ledger Adjustment Account ₹ 2,04,500 (Dr.)**
    Balance of Bought Ledger Adjustment Account ₹ 2,11,500 (Cr.)
13. **Balance of Debtors Ledger Adjustment Account ₹ 15,840 (Dr.)**
    Balance of Creditors Ledger Adjustment Account ₹ 16,180 (Cr.)
14. **Balance of Bought Ledger Adjustment Account ₹ 9,950 (Cr.)**
    Balance of Sales Ledger Adjustment Account ₹ 18,700 (Dr.)
15. **Balance of Sales Ledger Adjustment Account ₹ 91,600 (Dr.)**
    Balance of Bought Ledger Adjustment Acoount ₹ 43,000 (Cr.)
16. **Balance of : Debtors Ledger Adjustment Account is ₹ 31,955;**
    Creditors Ledger Adjustment Account is ₹ 34,155.
17. **Balance of : General Ledger Adjustment Account in the Creditors Ledger is ₹ 350 (Dr.);**
    Debtors Ledger Adjustment Account is ₹ 21,280.
18. **No answer is required.**

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Insurance Claims

Introduction

A business may suffer abnormal losses due to different reasons such as fire, theft, burglary, strike, etc. Among them, the most common which destroys or causes severe damage to the assets like stock, building, plant, machinery, furniture, etc., is fire. When a fire takes place, the business naturally incurs heavy losses and, in turn, the normal business operations are disrupted. There may arise a tremendous strain on the working capital if the business does not possess adequate funds to replace the assets so destroyed. To cover the risk of loss from such events, a business may take on an insurance policy with an Insurance Company.

The business has to pay insurance premium at regular intervals as per the terms of the agreement — the insurance premium is charged to the Profit and Loss Account as an expense at the year-end. The insurance policy matures on the occurrence of any such mishap and the business is entitled to recover from the insurance company, the full value of the insurance policy or the actual cost of the assets lost, whichever is lower. When a business suffers a loss from an insured event, it has to notify the insurance company regarding the loss of the assets and to file a claim for compensation against those losses. Such claims are known as Insurance Claims. When a fire takes place, to file a claim with the Insurance Company for the loss of assets damaged or destroyed, a set of procedures is to be followed. Apart from the legal formalities, one of the most important problems that a business has to face is the determination of the amount of the claim to be lodged.

Types of Claims

A business takes a fire insurance policy to cover (i) the loss of assets including stock; and (ii) loss of profit (consequential loss). A business may take insurance policy for loss of cash due to theft or misappropriation.

When a fixed asset is destroyed, the computation of loss is simple. The value of such assets on the date of fire can be ascertained from the books of account of the business because most of them usually maintain proper records of the fixed assets. Fixed assets are recorded in the books of accounts at their acquisition cost, which becomes the basis for calculation of claim for the loss of fixed assets.

When a stock is destroyed the computation of loss is not so simple because the prices of different items of stock are seldom stable and are acquired at varying rates. For most of the businesses, particularly for trading concerns, stock taking is not maintained up to date. Therefore, at the time of accident no readymade value of stock is available. If the Stock Register is maintained properly, the value of stock lost by fire can be ascertained from it. However, the business may face a problem, even when the Stock Register is maintained up to date, if the books of account are also destroyed along with the stock.

Loss of Stock Policy

There are two steps for determination of claim for loss of stock:

(1) Ascertainment of the value of stock on the date of fire; and

(2) Ascertainment of actual amount of claim to be lodged.

1. Ascertainment of the Value of Stock on the Date of Fire

When it is not possible to ascertain the exact value of stock (destroyed by fire) from the Stock Register, the value of stock on the date of fire can be ascertained by constructing a Memorandum Trading Account for a period starting from the first day of the accounting period and ending on the date of fire. The following is a specimen of the Memorandum Trading Account.

Memorandum Trading Account

Dr. For the period from 1st day of the accounting year to the date of fire Cr.

Particulars	₹	Particulars	₹
To Opening Stock		By Sales	
To Purchases A/c		Less: Return Inwards	
Less: Return Outwards		By Closing Stock	
To Direct Expenses A/c		(Balancing figure)	
To Carriage Inward A/c			
To Wages A/c			
To Gross Profit (% on sales)			

The different items of the above Memorandum Trading Account are gathered as follows:

Debit Side

(i) Opening Stock: It is nothing but the closing stock of the last accounting period. Therefore, it can be ascertained from the Balance Sheet of the last accounting period.

(ii) (a) Purchases: These can be ascertained from the Purchase Day Book (credit purchases) and Cash Book (cash purchases).

(b) Return Outwards: It can be ascertained from the Return Outwards Book.

(iii) Direct Expenses: These can be ascertained from the Cash Book.

(iv) Carriage Inwards: It can be ascertained from the Cash Book.

(v) Wages: These can be ascertained from the Wages Register and Cash Book.

(vi) Gross Profit: It is calculated on sales, based on ***usual*** gross profit percentage of the last few years.

In the examination, sometimes readymade gross profit percentage may not be available. In that case, it is to be calculated on the basis of given information. Generally, information is related to last accounting year. At the time of calculation of gross profit percentage on sales, all the necessary adjustments must be made for:

(i) the slow moving items;

(ii) goods distributed as free sample;

(iii) goods taken by the proprietor/partners for personal use; and

(iv) over-valuation or under-valuation of stock.

Credit Side

(i) (a) Sales: These can be ascertained from the Sales Day Book (credit sales) and Cash Book (cash sales).

(i) (b) Return Inwards: It can be ascertained from the Return Inwards Book.

The difference between the debit side total and credit side total of the Memorandum Trading Account represents the estimated ***closing stock on the date of fire***.

2. Ascertainment of Actual Amount of Claim to be Lodged

The amount of loss to be compensated by the insurance company is always stipulated in the insurance policy, but under no circumstances, the claim for loss can exceed over the actual loss suffered by the business. When the business is fully compensated by the insurance company for the loss of stock, the insurance company becomes the owner of the stock, salvaged (saved), if any.

The Memorandum Trading Account shows the value of stock which is supposed to exist at the time of fire. Therefore, to ascertain the actual amount of claim to be lodged, we have to deduct the value of stock salvaged from the estimated value of closing stock on the date of fire, as ascertained from the Memorandum Trading Account. The actual amount of claim to be lodged is as follows:

Statement of Claim for Loss of Stock as on ...

	₹
Book value of Stock (as per Memorandum Trading Account)	****
Less: Salvaged (Retained by the business)	****
	****
Loss of Stock (claim to be lodged)*	****
	****

* Subject to average clause (discussed after Illustration 5)

Illustration 1

A fire occurred in the premises of Mr X on June 15, 2015 and a considerable part of the stock was destroyed. The value of the stock saved was ₹ 4,000.

The books disclosed that on 1st April, 2015 the stock was valued at ₹ 45,000; the purchases up to the date of fire amounted to ₹ 1,25,000 and the sales to ₹ 1,80,000. On investigation, it was found that during the past five years, the average gross profit on sales was 30%.

You are required to prepare a statement showing the amount Mr X should claim from the insurance company in respect of stock destroyed by the fire.

[B.Com (Delhi — Adapted]

Solution

Mr. X

Dr. Memorandum Trading Account for the period 1st April to 15th June, 2015 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	45,000	By Sales	1,80,000
To Purchases A/c	1,25,000	By Closing Stock (Balancing figure)	44,000
To Gross Profit (30% on sales of ₹ 1,80,000)	54,000		
	2,24,000		2,24,000

Statement of Claim for Loss of Stock as on 15th June, 2015

Particulars	₹
Book value of Stock	44,000
Less: Salvaged	4,000
Claim to be Lodged	40,000

Illustration 2

The godown of Purple Ltd. caught fire on 15th June, 2015. Records saved from fire showed the following particulars:

Particulars	₹	Particulars	₹
Stock at cost on 1st January, 2014	60,000	Sales less returns for the year 2014	7,20,000
Stock at cost on 31st December, 2014	84,000	Purchases less returns from January 1 to June 15, 2015	1,80,000
Purchases less returns for the year 2014	5,08,000	Sales less returns from January 1 to June 15, 2015	2,46,000
Wages for the year 2014	20,000	Wages from January 1 to June 15, 2015	16,200

Gross profit remained at a uniform rate. The stocks salvaged was worth ₹ 7,200 and it was retained by Purple Ltd.

The godown was insured. Show the amount of claim.

Solution

Purple Ltd.

Dr. Memorandum Trading Account for the period 1st January to 15th June, 2015 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	84,000	By Sales	2,46,000
To Purchases A/c	1,80,000	By Closing Stock (Balancing figure)	1,08,000
To Wages A/c	16,200		
To Gross Profit (30% on sales of ₹ 2,46,000)	73,800		
	3,54,000		3,54,000

Statement of Claim for Loss of Stock as on 15th June, 2015

Particulars	₹
Book value of Stock	1,08,000
Less: Salvaged	7,200
Claim to be Lodged	1,00,800

Working Notes:

Dr. (1) Trading Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	60,000	By Sales	7,20,000
To Purchases A/c	5,08,000	By Closing Stock	84,000
To Wages A/c	20,000		
To Gross Profit (Balancing figure)	2,16,000		
	8,04,000		8,04,000

(2) Rate of gross profit = ₹ 2,16,000/₹ 7,20,000 x 100 = 30%.

Illustration 3

The fire insurance policy taken out by Sultan Limited included stock purchased by the company for re-sale and stock sent to the company on approval for which a pro-forma invoice was sent by the supplier.

A disastrous fire took place at the warehouse on 1.10.2015 and you have been asked to prepare the claim for submission to the insurance company. Unfortunately, many of the records of Sultan Limited were destroyed by the fire, but the following information was available :

(a) Value of stock salvaged after the fire ₹ 68,640.

(b) Goods supplied on approval and lost in the fire ₹ 4,000.

(c) Sales for nine months to 30.9.2015, ₹ 6,26,500.

(d) Purchases for nine months to 30.9.2015, ₹ 6,02,100.

(e) Stock (as per accounts) at 31.12.2014, ₹ 1,65,206 — but on examination of the stock sheets it was found that the stock had been undervalued by ₹ 7,534.

(f) The average rate of gross profit during last few years were 20% — it was expected that this rate would have been maintained during the year 2015.

Show the claim that you would submit to the insurance company.

Solution

Sultan Limited

Dr. Memorandum Trading Account for the period 1st January to 30th September, 2015 Cr.

Particulars		₹	Particulars	₹
To Opening Stock	1,65,206		By Sales	6,26,500
Add: Undervalued Stock	7,534	1,72,740	By Closing Stock (Balancing figure)	2,73,640
To Purchases		6,02,100		
To Gross Profit (20% of ₹ 6,26,500)		1,25,300		
		9,00,140		9,00,140

Statement of Claim for Loss of Stock as on 30th September, 2015

Particulars	₹
Book Value of Stock	2,73,640
Less: Salvage	68,640
	2,05,000
Add : Goods received on approval and destroyed by fire	4,000
Claim to be Lodged	2,09,000

Illustration 4

On 31st August, 2015 the premises and stock of a firm were totally destroyed by fire, the books of accounts, however, were saved. In order to make a claim on their fire policy, they ask you to advise on the basis of the following information. The stock in hand has always been valued at 5% below cost :

Particulars	2012-13 (₹)	2013-14(₹)	2014-15 (₹)	2015-16 (₹)
Opening Stock as valued	22,800	30,400	36,100	39,900
Purchases less returns	91,000	1,10,000	1,20,000	41,000
Sales less returns	1,40,000	1,70,000	1,86,000	75,000
Wages	28,400	31,200	34,200	12,000
Closing Stock	30,400	36,100	39,900	?

Prepare a statement for submission to the insurance company in support of your claim for loss of stock. The company closes its books of account every year on 31st March.

[C.S. (Inter) — Adapted]

Solution

Dr. Memorandum Trading Account for the period 1st April to 31st August, 2015 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	42,000	By Sales	75,000
To Purchases less Returns	41,000	By Closing Stock (Balancing figure)	35,000
To Wages	12,000		
To Gross Profit (20% of ₹ 75,000)	15,000		
	1,10,000		1,10,000

Statement of Claim for Loss of Stock as on 31st August, 2015

Particulars	₹
Book Value of Stock	35,000
Less: Salvage	Nil
Claim for Loss of Stock	35,000

Working Notes :

Dr. (1) Trading Account for the year ended 31st March, 2013, 2014 and 2015 Cr.

Particulars	2012-13 ₹	2013-14 ₹	2014-15 ₹	Particulars	2012-13 ₹	2013-14 ₹	2014-15 ₹
To Opening Stock (Note 2)	24,000	32,000	38,000	By Sales less Returns	1,40,000	1,70,000	1,86,000
To Purchases less Returns	91,000	1,10,000	1,20,000	By Closing Stock (Note 2)	32,000	38,000	42,000
To Wages	28,400	31,200	34,200				
To Gross Profit (Balancing figure)	28,600	34,800	35,800				
	1,72,000	2,08,000	2,28,000		1,72,000	2,08,000	2,28,000

(2) Stock is valued at 5% below cost. It means stock is shown in the accounts at 95%. Therefore, actual value of stock is :

(i) Opening stock of 2012-13 — ₹ 22,800 / 95 × 100 = ₹ 24,000
(ii) Closing stock of 2012-13 — ₹ 30,400 / 95 × 100 = ₹ 32,000
(iii) Closing stock of 2013-14 — ₹ 36,100 / 95 × 100 = ₹ 38,000
(iv) Closing stock of 2014-15 — ₹ 39,900 / 95 × 100 = ₹ 42,000.

(3) Rate of Gross Profit :

2012-13 — ₹ 28,600 / ₹ 1,40,000 × 100 = 20.43%
2013-14 — ₹ 34,800 / ₹ 1,70,000 × 100 = 20.47%
2014-15 — ₹ 35,800 / ₹ 1,86,000 × 100 = 19.25%

$$\text{Average Rate of Gross Profit} = \frac{20.43 + 20.47 + 19.25}{3} = 20.05\% \quad \text{Say, } 20\%.$$

Illustration 5

The premises of X Ltd caught fire on 22nd January, 2015 and the stock was damaged. The firm had made up accounts to 31st March each year and on 31st March, 2014, the stock at cost was ₹ 13,27,200 as against ₹ 9,62,200 on 31st March, 2013.

Purchases from 1st April, 2014 to the date of fire were ₹ 34,82,700 as against ₹ 45,25,000 for the full year 2013-14 and the corresponding sales figures were ₹ 49,17,000 and ₹ 52,00,000 respectively. You are given the following further information :

(i) In July 2014, goods costing ₹ 1,00,000 were given away for advertising purposes, no entries being made in the books.

(ii) During 2014-15, a clerk had misappropriated unrecorded cash sales. It is estimated that the defalcation averaged ₹ 2,000 per week from 1st April, 2014 until the clerk was dismissed on 21st August, 2014.

(iii) The rate of gross profit is constant.

From the above information make an estimate of the stock in hand on the date of fire.

Solution

X Limited

Dr. Memorandum Trading Account for the period 1st April, 2014 to 22nd January, 2015 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	13,27,200	By Sales	49,17,000
To Purchases	34,82,700	By Advertisement	1,00,000
To Gross Profit [20% on (₹ 49,17,000 + ₹ 40,000)]	9,91,400	By Cash Sales (Note 3)	40,000
		By Closing Stock (Balancing figure)	7,44,300
	58,01,300		58,01,300

Statement of Claim for Loss of Stock as on 22nd January 2015

Particulars	₹
Book Value of Stock	7,44,300
Less: Salvage	Nil
Loss of Stock	7,44,300

Working Notes :

Dr. (1) Trading Account for the year ended 31st March, 2014 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	9,62,200	By Sales	52,00,000
To Purchases	45,25,000	By Closing Stock	13,27,200
To Gross Profit (Balancing figure)	10,40,000		
	65,27,200		65,27,200

(2) Rate of Gross Profit = ₹ 10,40,000 / 52,00,000 × 100 = 20%.

(3) Assuming that the clerk misappropriated cash sales for 20 weeks (1.4.2013 to 21.8.2013). Therefore, total amount of misappropriation = 20 × ₹ 2,000 = ₹ 40,000.

Average Clause

The amount of insurance premium to be paid at regular intervals depends on the value of stock insured. More the value of stock insured, more is the amount of premium to be paid. To reduce the burden of insurance premium, the average stock of a business may not be adequately insured with the assumption that fire may not destroy the whole stock. When a business takes an insurance policy, the value of which is less than the value of the average stock lying in the godown, it is known as "Under-insurance".

Generally, fire insurance policies contain an "average clause" to discourage under-insurance. At the time of calculating insurance claim, this clause is applicable if the value of stock on the date of fire was ***more*** than the policy value. In the event of a ***partial*** loss, the insurance company pays a proportional amount of claim. The net claim is calculated as follows:

$$\text{Net Claim} = \text{Loss of Stock} \times \frac{\text{Policy Value}}{\text{Value of Stock on the date of fire}}$$

Example: X took out a fire insurance policy containing an average clause covering his stock for ₹ 30,000. On the date of fire the value of stock was ₹ 36,000. The loss was assessed at ₹ 24,000.

In this case, the value of stock on the date of fire was more than the policy value. Therefore, the average clause is applicable. X can recover from the insurance company:

$$₹\ 24{,}000 \times \frac{30{,}000}{36{,}000} = ₹\ 20{,}000$$

It should be noted that average clause is applied after deduction for salvage stock.

Illustration 6

On 17th June, 2015 a fire occured in the premises of M/s Taraporewalla, a bookseller. Most of the stock was destroyed, with the cost of salvaged stock being ₹ 11,200. In addition, some stock was salvaged in damaged condition and its value was estimated at ₹ 10,400. From books of account the following particulars are available:

(1) Stock at close of accounts on 31st December, 2014 was valued at ₹ 83,500.
(2) Purchases from 1.1.2015 – 17.6.2015 amounted to ₹ 1,12,000 and sales during that period amounted to ₹ 1,54,000.
(3) On the basis of past 3 years it appears that on an average gross profit of 25% is earned on sales.
(4) Stock was insured for ₹ 75,000.

Compute the amount of claim.

Solution

M/s. Taraporewalla

Dr. Memorandum Trading Account for the period 1st January to 17th June, 2015 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	83,500	By Sales	1,54,000
To Purchases A/c	1,12,000	By Closing Stock (Balancing figure)	80,000
To Gross Profit (25% on sales on ₹ 1,54,000)	38,500		
	2,34,000		2,34,000

Statement of Claim for Loss of Stock as on 17th June, 2015

Particulars	₹
Book value of Stock	80,000
Less: Salvaged (₹ 11,200 + ₹ 10,400)	21,600
Loss of Stock	58,400

The insurance policy was taken for ₹ 75,000 but the value of stock on the date of fire was ₹ 80,000. Therefore, the average clause is applicable.

Net claim $= \text{Loss of stock} \times \frac{\text{Policy Value}}{\text{Value of stock on the date of fire}}$

$$= ₹\ 58{,}400 \times \frac{75{,}000}{80{,}000} = ₹\ 54{,}750.$$

Illustration 7

A trader took out a fire policy containing an average clause covering his stock for ₹ 15,000. His practice was to base his selling price at cost plus $33\frac{1}{3}$%.

He closes his books on 30th June every year.

On 31st March, 2015, a fire occured at his premises and destroyed his stock.

The salvaged stock was worth ₹ 6,000.

During the period of 9 months preceding the fire his purchases amounted to ₹ 61,000 and sales to ₹ 84,000. His stock at 1st July, 2014 was valued at ₹ 20,000.

You are required to prepare a statement showing the amount of claim.

Solution

Dr. Memorandum Trading Account for the period 1st July 2014 to 31st March, 2015 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	20,000	By Sales	84,000
To Purchases A/c	61,000	By Closing Stock (Balancing figure)	18,000
To Gross Profit (25% on sales)*	21,000		
	1,02,000		1,02,000

* Rate of gross profit $33\frac{1}{3}$% on cost, i.e., 25% on selling price.

Statement of Claim for Loss of Stock as on 31st March, 2015

Particulars	₹
Book value of Stock	18,000
Less: Salvaged	6,000
Loss of Stock	12,000

The insurance policy was taken for ₹ 15,000; but the value of stock on the date of fire was ₹ 18,000. Therefore, the average clause is applicable.

Net claim = Loss of stock $\times \dfrac{\text{Policy Value}}{\text{Value of stock on the date of fire}}$ = ₹ 12,000 $\times \dfrac{15{,}000}{18{,}000}$ = ₹ 10,000

Illustration 8

The godown of A Ltd. caught fire on March 31, 2015. As a result stock of goods in the godown of the company were gutted. Goods worth ₹ 41,360 could, however, be saved from the accident. The following particulars are supplied to you:

	₹
Stock on January 1, 2015	60,000
Purchases to the date of fire	2,60,000
Carriage paid on purchases	1,600
Sales to the date of fire	1,80,000
Commission paid to the Purchase Manager, at 2% on purchases	
Average Gross Profit on Sales	$33^1/_3$%

The company had a fire policy of ₹ 1,60,000 covering its stock of goods in the godown. The policy is subject to Average Clause.

You are to ascertain (a) total loss of stock; and (b) the amount of insurance claim to be made.

Solution

A Ltd.

Dr. Memorandum Trading Account for the period 1st January to 31st March, 2015 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	60,000	By Sales	1,80,000
To Purchases	2,60,000	By Closing Stock (Balancing figure)	2,06,800
To Carriage on Purchases	1,600		
To Commission on Purchases	5,200		
To Gross Profit ($33^1/_3$% of ₹ 1,80,000)	60,000		
	3,86,800		3,86,800

(a) Statement of Claim for Loss of Stock as on 31st March, 2015

Particulars	₹
Book value of Stock	2,06,800
Less: Salvaged	41,360
Loss of Stock	1,65,440

The insurance policy was taken for ₹ 1,60,000 but the value of stock on the date of fire was ₹ 2,06,800. Therefore, the average clause is applicable.

(b) **Net claim** = Loss of stock $\times \dfrac{\text{Policy Value}}{\text{Value of stock on the date of fire}}$ = ₹ 1,65,440 $\times \dfrac{1{,}60{,}000}{2{,}06{,}800}$ = ₹ 28,000

Illustration 9

Due to a fire in the godown of a company on 30th September, 2015, the entire stock was burnt except some stock costing ₹ 70,000. The books were, however, saved.

From the information available, it was found that —

(i) The company's average gross profit was 25% on sales.
(ii) The stock on 31st March, 2015 valued at 10% above cost was ₹ 2,20,000.
(iii) The purchases and sales from 1st April, 2015 upto the date of fire were ₹ 3,00,000 and ₹ 6,80,000 respectively.
(iv) The wages for the period amounted to ₹ 1,44,000.
(v) The company got the stock insured for ₹ 1,20,000.
(vi) The policy had an average clause.

You are required to prepare a statement showing the amount of stock lost by fire and the amount of claim to be lodged with the insurance company. ***[C.S. (Inter) — Adapted]***

Solution

Dr. Memorandum Trading Account for the period 1st April to 30th September, 2015 Cr.

Particulars	₹	Particulars	₹
To Opening Stock (Note 1)	2,00,000	By Sales	6,80,000
To Purchases	3,00,000	By Closing Stock (Balancing figure)	1,34,000
To Wages	1,44,000		
To Gross Profit (25% of ₹ 6,80,000)	1,70,000		
	8,14,000		8,14,000

Working Note : (1) Value of Opening Stock = ₹ 2,20,000 / 110 × 100 = ₹ 2,00,000.

Statement of Claim for Loss of Stock as on 30th September, 2015

Particulars	₹
Book Value of Stock	1,34,000
Less: Salvage	70,000
Loss of Stock	64,000

The insurance policy was taken for ₹ 1,20,000 but the value of stock on the date of fire was ₹ 1,34,000. Therefore, the average clause is applicable.

Net Claim = $\text{Loss of Stock} \times \dfrac{\text{Policy Value}}{\text{Value of Stock on the Date of Fire}} = ₹\ 64{,}000 \times \dfrac{1{,}20{,}000}{1{,}34{,}000} = ₹\ 57{,}313.$

Amount of claim to be lodged = ₹ 57,313.

Illustration 10

The premises of E.F. Limited were damaged due to fire on 21st December, 2014. The company made up its accounts on 30th June, each year. On 30th June, 2014 the stock at cost was ₹ 13,272 as against ₹ 9,614 on 30th June, 2013.

The purchases for full year 2013-14 were ₹ 45,258 and that for current year up to date of fire were ₹ 34,827. Corresponding sales were ₹ 52,000 and ₹ 29,170, respectively.

In October 2014 goods costing ₹ 943 were given as samples for which no entries were made.

During August to November a clerk had misappropriated unrecorded cash sales. It is estimated that defalcation was at ₹ 20 per week for 20 weeks. A part of stock is salvaged for ₹ 300. Rate of Gross profit is constant.

The policy is for ₹ 18,800 with average clause. Ascertain the amount of claim.

Solution

E.F. Ltd.

Dr. Memorandum Trading Account for the period 1st July to 21st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	13,272	By Sales	29,170
To Purchases A/c	34,827	By Advertisement (sample)	943
To Gross Profit 20% on (₹ 29,170 + ₹ 400)	5,914	By Cash Sales (Misappropriation)	400
		By Closing Stock (Balancing figure)	23,500
	54,013		54,013

Statement of Claim for Loss of Stock as on 21st December, 2014

Particulars	₹
Book value of Stock	23,500
Less: Salvaged	300
Loss of Stock	23,200

The insurance policy was taken for ₹ 18,800 but the value of stock on the date of fire was ₹ 23,500. Therefore, the average clause is applicable.

Net claim = $\text{Loss of stock} \times \dfrac{\text{Policy Value}}{\text{Value of stock on the date of fire}}\ ₹\ 23{,}200 \times \dfrac{18{,}800}{23{,}500} = ₹\ 18{,}560.$

Working Notes:

Dr. (1) Trading Account for the year ended 30th June, 2014 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	9,614	By Sales	52,000
To Purchases A/c	45,258	By Closing Stock	13,272
To Gross Profit (Balancing figure)	10,400		
	65,272		65,272

Rate of gross profit = ₹ 10,400/₹ 52,000 x 100 = 20%.

Illustration 11

On 20th July 2015, the godown and the business premises of a merchant were affected by fire. From the accounting records salvaged, the following information is made available to you: (all figures in ₹)

Stock of goods on 1st April, 2014	1,00,000	Sales for the same period	6,00,000
Stock of goods at 10% lower than cost as on 31st Mar.,'15	1,08,000	Purchases less returns from 1st Apr. '15 to 20th July '15	1,40,000
Pur. of goods for the year from 1st Apr. '09 to 31st Mar. '15	4,20,000	Sales less returns for the above period	3,10,000

Sales up to 20th July 2015 included ₹ 40,000 for which goods had not been despatched. Purchases up to 20th July 2015 did not include ₹ 20,000 for which purchase invoices had not been received from suppliers, though goods have been received at the godown.

Goods salvaged from the accident were worth ₹ 12,000 and these were handed over to the insured.

Ascertain the value of the claim for the loss of goods/stock which could be preferred on the insurer.

Solution

Dr. Memorandum Trading Account for the period 1st April to 20th July, 2015 Cr.

Particulars		₹	Particulars		₹
To Opening Stock (Note 2)		1,20,000	By Sales	3,10,000	
To Purchases A/c	1,40,000		Less: Goods not yet delivered	40,000	2,70,000
Add: Goods included in stock but not recorded	20,000	1,60,000	By Closing Stock (Balancing figure)		1,00,000
To Gross Profit (@ 33-1/3% on ₹ 2,70,000)		90,000			
		3,70,000			3,70,000

Statement of Claim for Loss of Stock as on 20th July, 2015

Particulars	₹
Book value of Stock	1,00,000
Less: Salvaged	12,000
Claim to be Lodged	88,000

Working Notes:

Dr. (1) Trading Account for the year ended 31st March, 2015 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	1,00,000	By Sales	6,00,000
To Purchases A/c	4,20,000	By Closing Stock (Note 2)	1,20,000
To Gross Profit (Balancing figure)	2,00,000		
	7,20,000		7,20,000

Rate of gross profit = ₹ 2,00,000/₹ 6,00,000 x 100 = $33^1/_3$%.

(2) The closing stock on 31st March 2015 was valued at 10% less than cost. Therefore, the actual cost of closing stock will be : ₹ 1,08,000/90 x 100 = ₹ 1,20,000.

Illustration 12

The Trading Account of A & Co. for the year ending 31st March, 2014 is given below: (all figures in ₹)

To Opening Stock	68,480	By Sales less returns	1,96,000
To Purchases less returns	1,56,940	By Closing Stock	58,820
To Gross Profit c/d	29,400		
	2,54,820		2,54,820

A fire occurs in their godown on 31st December, 2014, and a considerable part of the stock of readymade garments is destroyed. The salvaged stock is worth ₹ 1,520. The stock is fully insured against fire risks.

Considering the following further particulars, prepare a statement showing the amount of claim to be lodged by A & Co. with insurer for the loss of stock.

Sales for the period ending 31st December, 2014 are ₹ 1,09,200.

The amount paid for purchases is ₹ 88,016 including a cheque for ₹ 562 which remains unpresented to the bankers up to 31.12.2014 as shown by the books of account.

Trade creditors on 31st March 2014 amount to ₹ 24,608 and on 31st December, 2014 are ₹ 22,112.

Goods worth ₹ 6,390 are returned to creditors during the period ending 31st December, 2014.

Solution

Dr. Memorandum Trading Account for the period 1st April to 31st December, 2014 Cr.

Particulars		₹	Particulars	₹
To Opening Stock		58,820	By Sales	1,09,200
To Purchases A/c (Note 1)	91,910		By Closing Stock (Balancing figure)	51,520
Less: Returns	6,390	85,520		
To Gross Profit (15% on ₹ 1,09,200)		16,380		
		1,60,720		1,60,720

Statement of Claim for Loss of Stock as on 31st December, 2014

Particulars	₹
Book value of Stock	51,520
Less: Salvaged	1,520
Claim to be Lodged	50,000

Working Notes:

Dr. (1) Sundry Creditors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 ?	To Returns A/c	6,390	2014 Apr. 1	By Balance b/d	24,608
?	To Bank A/c	88,016	?	By Purchases A/c (Balancing figure)	91,910
Dec. 31	To Balance c/d	22,112			
		1,16,518			1,16,518

(2) Rate of Gross Profit = ₹ 29,400 / ₹ 1,96,000 x 100 = 15%.

(3) Cheque not yet presented by Creditors for ₹ 562 will not affect the Creditors balance.

Illustration 13

A fire occured in the premises of Shri Romesh on 1st April 2015 and a considerable part of the stock was destroyed. The stock salvaged was worth ₹ 1,12,000. Shri Romesh had taken a fire insurance policy for ₹ 6,84,000 to cover the loss of stock by fire.

You are required to ascertain the insurance claim due from the insurance company for the loss of stock by fire. The following particulars are available: (all figures in ₹)

Purchases for the year 2014	37,52,000	Stock on 1st January 2014	5,76,000
Sales for the year 2014	46,40,000	Stock on 31st December 2014	9,68,000
Purchases from 1st January 2015 to 1st April 2015	7,28,000	Wages paid during the year 2014	4,00,000
Sales from 1st January 2015 to 1st April 2015	9,60,000	Wages paid during 1st January 2015 to 1st April 2015	72,000

Shri Romesh had in June 2014 consigned goods worth ₹ 2,00,000 which were lost in an accident. As there was no insurance the loss was borne by him in full.

Stocks at end of each year for and till the end of calendar year 2013 had been valued at cost less 10%. From 2014 however, there was a change in the valuation of closing stock which was ascertained by adding 10% to its cost.

Solution

Dr. Memorandum Trading Account for the period 1st January to 1st April, 2015 Cr.

Particulars	₹	Particulars	₹
To Opening Stock (Note 3)	8,80,000	By Sales	9,60,000
To Purchases A/c	7,28,000	By Closing Stock (Balancing figure)	9,12,000
To Wages	72,000		
To Gross Profit (@ 20% on ₹ 9,60,000)	1,92,000		
	18,72,000		18,72,000

Statement of Claim for Loss of Stock as on 1st April, 2015

Particulars	₹
Book value of Stock	9,12,000
Less: Salvaged	1,12,000
Loss of Stock	8,00,000

The insurance policy was taken for ₹ 6,84,000 but the value of stock on the date of fire was ₹ 9,12,000. Therefore, the average clause is applicable.

$$\textbf{Net claim} = \text{Loss of stock} \times \frac{\text{Policy Value}}{\text{Value of stock on the date of fire}} = ₹\,8{,}00{,}000 \times \frac{6{,}84{,}000}{9{,}12{,}000} = ₹\,6{,}00{,}000.$$

Working Notes:

Dr. (1) Trading Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Opening Stock (Note 2)	6,40,000	By Sales	46,40,000
To Purchases	37,52,000	By Accidental Loss (not covered by insurance)	2,00,000
To Wages	4,00,000	By Closing Stock (Note 3)	8,80,000
To Gross Profit (Balancing figure)	9,28,000		
	57,20,000		57,20,000

Rate of Gross Profit = ₹ 9,28,000 / ₹ 46,40,000 x 100 = 20%.

(2) On 31.12.2013, stock was valued at cost less 10%, i.e., at 90% of cost. Therefore, the actual value of stock will be : ₹ 5,76,000 / 90 x 100 = ₹ 6,40,000.

(3) On 31.12.2014, stock was valued at cost plus 10%, i.e., at 110% of cost. Therefore, the actual cost of stock will be : ₹ 9,68,000 / 110 x 100 = ₹ 8,80,000.

Illustration 14

A fire occured on 1st October, 2014 in the premises of X Co. Ltd. From the following figures, calculate the amount of claim to be lodged with the insurance company for loss of stock: (all figures in ₹)

Stock at cost on 1.1.2013	90,000	Purchases from 1.1.2014 to 30.9.2014	6,00,000
Stock at cost on 1.1.2014	70,000	Sales during 2013	6,00,000
Purchases during 2013	4,00,000	Sales from 1.1.2014 to 30.9.2014	8,80,000

You are informed that:

(a) In 2014 the cost of purchases has risen by 20% over the levels prevailing in 2013; (b) In 2014 the selling prices have gone up by 10% over the levels prevailing in 2013; and (c) Salvaged value is ₹ 5,000.

Solution

X & Co. Ltd.

Dr. Memorandum Trading Account for the period 1st January to 30th September, 2014 Cr.

Particulars		₹	Particulars		₹
To Opening Stock		70,000	By Sales: (Note 2)		
To Purchases A/c		6,00,000	Out of opening stock	1,10,000	
To Gross Profit: On opening stock (Note 2)	40,000		Out of current purchases	7,70,000	8,80,000
On current year items (Note 4)	1,82,000	2,22,000	By Closing Stock (Balancing figure)		12,000
		8,92,000			8,92,000

Statement of Claim for Loss of Stock as on 30th September, 2014

Particulars	₹
Book value of Stock	12,000
Less: Salvaged	5,000
Claim to be Lodged	7,000

Working Notes:

Dr. (1) Trading Account for the year ended 31st December, 2013 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	90,000	By Sales	6,00,000
To Purchases	4,00,000	By Closing Stock — at cost	70,000
To Gross Profit	1,80,000		
	6,70,000		6,70,000

Rate of Gross Profit = ₹ 1,80,000 / ₹ 6,00,000 x 100 = 30%.

(2) Sales out of Opening Stock	₹		₹
Let selling price in 2013	100	Selling price in 2014 gone up by 10%, i.e.,	110
Less: Profit 30%	30	Less: Cost of Sales	70
Cost of Sales in 2013	70	Gross Profit	40

(i) Sales value of opening stock = ₹ 70,000 / 70 x 110 = ₹ 1,10,000.

(ii) Gross Profit on sale of opening stock = ₹ 1,10,000 – ₹ 70,000 = ₹ 40,000.

(3) Sales and Gross Profit out of 2014 Purchases:

Selling price has gone up by 10% in 2014. So Selling price	=	₹ 110
Less: Cost of Sales — 2013 rate plus 20% : ₹ 70 + ₹ 14	=	₹ 84
Gross Profit	=	₹ 26

Rate of Gross Profit in 2014 = 26 / 110 x 100 = **23.6364%.**

(4) Total sales of 2014 = ₹ 8,80,000. Sales out of opening stock [2(i)] ₹ 1,10,000. Therefore, sale out of current purchases = ₹ 8,80,000 – ₹ 1,10,000 = ₹ 7,70,000. Gross Profit from sales of purchases of 2014 = 23.6364% of ₹ 7,70,000 = ₹ 1,82,000.

Illustration 15

From the following figures, calculate the amount of claim for loss of stock with the insurance company:

	₹
Stock at cost on 1st January, 2014	1,35,000
Stock at cost on 1st January, 2015	1,50,000
Purchases during 2014	9,15,000
Purchases from 1st January, 2015 to 30th June 2015	8,00,000
Sales during 2014	12,00,000
Sales from 1st January, 2015 to 30th June 2015	9,90,000

You are informed that —

(a) In 2015 the costs of purchases have risen by 20% above the level prevailing in 2014.
(b) In 2015 the selling prices have gone up by 10% over the level prevailing in 2014.
(c) Salvage value of stock ₹ 20,000.
(d) Fire insurance policy for ₹ 1,48,750 to cover the loss of stock by fire.

Solution

Dr. Memorandum Trading Account for the period 1st January to 30th June, 2015 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	1,50,000	By Sales (Note 2)	
To Purchases	8,00,000	Out of Opening Stock	2,20,000
To Gross Profit :		Out of Current Purchases	7,70,000
On Opening Stock (Note 2)	70,000	By Closing Stock (Balancing figure)	1,70,000
On Current year purchased item (Note 4)	1,40,000		
	11,60,000		11,60,000

Statement of Claim for Loss of Stock as on 30th June, 2015

Particulars	₹
Book Value of Stock	1,70,000
Less: Salvage	20,000
Loss of Stock	1,50,000

The insurance policy was taken for ₹ 1,48,750 but the value of stock on the date of fire was ₹ 1,70,000. Therefore, the average clause is applicable.

$$\textbf{Net Claim} = \text{Loss of Stock} \times \frac{\text{Policy Value}}{\text{Value of Stock on the Date of Fire}} = ₹\,1{,}50{,}000 \times \frac{1{,}48{,}750}{1{,}70{,}000} = ₹\,1{,}31{,}250..$$

Working Notes :

Dr. (1) Trading Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	1,35,000	By Sales	12,00,000
To Purchases	9,15,000	By Closing Stock (Given)	1,50,000
To Gross Profit (Balancing figure)	3,00,000		
	13,50,000		13,50,000

Rate of Gross Profit = ₹ 3,00,000 / ₹ 12,00,000 × 100 = 25%.

(2) Sales Out of Opening Stock

Particulars	₹	Particulars	₹
Let selling price in 2014 be	100	Selling price in 2015 gone up by 10%, i.e.,	110
Less: Profit 25%	25	Less : Cost of sales	75
Cost of Sales	75	Gross Profit	35

(i) Sale value of opening stock = ₹ 1,50,000 / 75 × 110 = ₹ 2,20,000.
(ii) Gross Profit on sale of opening stock = ₹ 2,20,000 – ₹ 1,50,000 = ₹ 70,000.

(3) Sales and Gross Profit out of 2015 Purchases:	₹
Selling price in 2015 has gone up by 10%. Therefore, selling price	110
Less: Cost of sales — 2014 rate plus 20% (₹ 75 + 15)	90
Gross Profit	20

Rate of Gross Profit in 2015 = 20/110 × 100 = **18.1818%**.

(4) Total sales of 2015 — ₹ 9,90,000. Sales out of opening stock [2(i)] ₹ 2,20,000. Therefore, sales out of current purchases = ₹ 9,90,000 – ₹ 2,20,000 = ₹ 7,70,000. Gross profit from sales of purchases of 2015 = 18.1818% of ₹ 7,70,000 = ₹ **1,40,000**.

Illustration 16

The warehouse of Cores (India) Ltd was destroyed by fire on 1.5.2014. The goods in stock were insured to a value of ₹ 25,000.

The following information is available :

Balance Sheet figures at 31.12.2013 —

Stock (including goods held by agent ₹ 700); ₹ 16,900; Debtors ₹ 31,300; Creditors ₹ 12,900.

Transactions to 30.4.2014 include —

Receipts from debtors ₹ 1,48,600; Payment to creditors ₹ 1,07,300; Bad debts ₹ 300; Discount received ₹ 100.

Balances at 30.4.2014 —

Debtors ₹ 31,000; Creditors ₹ 13,600.

The closing debtors' figure includes an amount owing from the agent for sales to date ₹ 1,800, less 10% commission and his expenses of ₹ 20. At 30.4.2014, the agent still held goods from the company valued at their selling price of ₹ 1,500.

The total sales for the period includes ₹ 600 for goods which have had the selling price reduced by 50% and ₹ 2,400 where the selling price was reduced by 20%.

The normal mark-up is 50% and, except as indicated differently above, all sales can be assumed to be at the full selling price. All of the stock in the warehouse was destroyed and there was no salvage value.

You are required to calculate the amount of insurance claim.

Solution

Cores (India) Ltd

Dr. Memorandum Trading Account for the period 1st January to 30th April, 2014 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock	16,900		By Sales (Note 1)	1,47,000	
Less: Goods held by Agent	700	16,200	Less: Sale of Goods below Normal Selling		
To Purchases (Note 2)	1,08,100		Price (Note 8)	3,000	1,44,000
Less: Goods Sent to Agent (Note 4)	1,500		By Closing Stock (Balancing figure)		24,000
	1,06,600				
Less: Cost of Goods Sold below Normal Selling Price (Note 8)	2,800	1,03,800			
To Gross Profit*		48,000			
		1,68,000			1,68,000

*Mark-up is 50%. It means profit is 50% of cost. If the cost is ₹ 100, then profit will be ₹ 50 and selling price will be ₹ 150. It means, rate of gross profit on sales is 1/3 of sales. Therefore, gross profit = 1/3 of ₹ 1,44,000 = ₹ **48,000**.

Tutorial Note : A mark-up is always at cost, whereas a margin is on selling price.

Statement of Claim for Loss of Stock as on 30th April, 2014

Particulars	₹
Book Value of Stock	24,000
Less: Salvage	—
Loss of Stock	24,000

Working Notes :

Dr. (1) Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d	31,300	?	By Cash	1,48,600
	To Sales (Balancing figure)	1,47,000	?	By Bad Debts (written off)	300
			30.4.2014	By Balance c/d (Note 5)	29,400
		1,78,300			1,78,300

Dr. **(2) Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Cash	1,07,300	1.1.2014	By Balance b/d	12,900
	To Discount Received	100	?	By Purchases (Balancing figure)	1,08,100
30.4.2014	To Balance c/d	13,600			
		1,21,000			1,21,000

Dr. **(3) Agent's Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
?	To Sales	1,800	?	By Commission (10% of ₹ 1,800)	180
			?	By Expenses	20
			30.4.2014	By Balance c/d	1,600
		1,800			1,800

Dr. **(4) Stock with Agent Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	700		By Cost of Goods Sold (Note 6)	1,200
	To Goods Sent to Agent (Balancing figure)	1,500		By Balance c/d (Note 7)	1,000
		2,200			2,200

(5) Balance of debtors at 30.4.2014 = ₹ 31,000 which include amount due from agent ₹ 1,600 (Note 3). Therefore, actual amount due from debtors = ₹ 31,000 – ₹ 1,600 = ₹ 29,400.

(6) Normal mark-up is 50%.

Let, cost =	₹ 100
Add : Profit (50%)	₹ 50
Selling price	150

When selling price is ₹ 150 then cost = ₹ 100

When selling price is Re 1 then cost = ₹ 100 / 150

When selling price is ₹ 1,800 then cost = ₹ 100 / ₹ 150 × ₹ 1,800 = ₹ **1,200**

(7) Goods held by the agent at selling price = ₹ **1,500**.

When selling price is ₹ 150 then cost = ₹ 100

When selling price is Re 1 then cost = ₹ 100 / ₹ 150

When selling price is ₹ 1,500 then cost = ₹ 100 / ₹ 150 × ₹ 1,500 = ₹ **1,000**

(8) Calculation of Cost of Goods Sold below Normal Selling Price

Sales (₹)	Normal Selling Price (₹)	Cost (₹)
600	600 / 50 x 100 = 1,200	1,200 / 150 x 100 = 800
2,400	2,400 / 80 x 100 = 3,000	3,000 / 150 x 100 = 2,000
3,000		2,800

Poor Selling Goods

It is quite possible that there may be some poor-selling goods included in the stock. These goods are generally valued at below cost and, in effect, gross profit is reduced. To determine the normal rate of gross profit, the stock and sales proceeds of these goods are to be eliminated from the total sales and stock. In this case, Trading Account is prepared in columnar form to show separately normal and abnormal items.

Illustration 17

On 1st October, 2013, the godown of XYZ Ltd was destroyed by fire. The record of the company revealed the following:

	₹
Stock on 1st April, 2012	9,50,000
Stock on 31st March, 2013	8,00,000
Purchases for the year ended 31st March, 2013	31,00,000
Sales for the year ended 31st March, 2013	40,00,000
Purchases from 1st April, 2013 to the date of fire	7,50,000
Sales from 1st April, 2013 to the date of fire	10,00,000

While valuing stock on 31st March, 2013, a sum of ₹ 10,000 was written-off on the goods, cost of which was ₹ 48,000. A part of this stock was sold in June, 2013 at a loss of ₹ 4,000 on the original cost of ₹ 24,000. The remainder of this stock was now estimated to be worth the original cost. Subject to the above exception, gross profit remained at a uniform rate throughout.

Stock salvaged was ₹ 50,000. The godown was fully insured.

Calculate the amount of the insurance claim for the loss. ***[C.S. (Inter) — Adapted]***

Solution

XYZ Ltd

Dr. Memorandum Trading Account for the period 1st April to 1st October, 2013 Cr.

Particulars	Normal Items	Abnormal Items	Total ₹	Particulars	Normal Items	Abnormal Items	Total ₹
To Opening Stock	7,62,000	48,000	8,10,000	By Sales	9,80,000	20,000	10,00,000
To Purchases	7,50,000	—	7,50,000	By Loss	—	4,000	4,000
To Gross Profit (Note 1)	1,86,200	—	1,86,200	By Closing Stock	7,18,200	24,000	7,42,200
	16,98,200	48,000	17,46,200		16,98,200	48,000	17,46,200

Statement of Claim for Loss of Stock as on 1st October, 2013

Particulars	₹
Book Value of Stock	7,42,200
Less : Salvage	50,000
Claim to be Lodged	6,92,200

Working Note :

Dr. (1) Trading Account for the year ended 31st March, 2013 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	9,50,000	By Sales	40,00,000
To Purchases	31,00,000	By Closing Stock : Normal Items (₹ 8,00,000 – ₹ 38,000)	7,62,000
To Gross Profit (Balancing figure)	7,60,000	Abnormal Items (Cost)	48,000
	48,10,000		48,10,000

Rate of Gross Profit = ₹ 7,60,000 / ₹ 40,00,000 × 100 = 19%. Gross Profit = 19% of ₹ 9,80,000 = ₹ 1,86,200.

Illustration 18

On 1st April 2015, the godown of Hindustan Ltd. was destroyed by fire. From the books of account, the following particulars are gathered: (all figures in ₹)

Stock at cost on 1st January 2014	27,570	Sales during 2014	3,51,000
Stock as per Balance Sheet on 31st December 2014	51,120	Sales from 1st January 2015 to 31st March 2015	91,500
Purchases during 2014	2,71,350	Value of goods salvaged	6,300
Purchases from 1st January 2015 to 31st March 2015	75,000		

Goods of which original cost was ₹ 3,600 had been valued at ₹ 1,500 on 31st December 2014. These were sold in March 2015 for ₹ 2,700. Except this transaction, the rate of gross profit has remained constant.

On 31st March 2015 goods worth ₹ 15,000 had been received by the godown keeper, but had not been entered in the Purchase Account.

Calculate the value of goods destroyed by fire.

Solution

Hindustan Ltd.

Dr. Memorandum Trading Account for the period 1st January to 31st March, 2015 Cr.

Particulars	Normal items	Abnormal items	Total ₹	Particulars	Normal items	Abnormal items	Total ₹
To Opening Stock	49,620	3,600	53,220	By Sales	88,800	2,700	91,500
To Purchases A/c (Note 2)	90,000	—	90,000	By Loss	—	900	900
To Gross Profit (30% of ₹ 88,800)	26,640	—	26,640	By Closing Stock	77,460	—	77,460
	1,66,260	3,600	1,69,860		1,66,260	3,600	1,69,860

Statement of Claim for Loss of Stock as on 31st March, 2015

Particulars	₹
Book value of Stock	77,460
Less: Salvaged	6,300
Value of Goods Destroyed by Fire	71,160

Working Notes:

Dr. (1) Trading Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	27,570	By Sales	3,51,000
To Purchases	2,71,350	By Closing Stock:	
To Gross Profit (Balancing figure)	1,05,300	Normal items (₹ 51,120 – 1,500)	49,620
		Abnormal items (cost)	3,600
	4,04,220		4,04,220

Rate of Gross Profit = ₹ 1,05,300/3,51,000 x 100 = 30%.

(2) Total Purchases = ₹ 75,000 + goods received but not recorded ₹ 15,000 = ₹ 90,000.

Illustration 19

On 15th June 2015, the business house of Maneka & Co. was destroyed by fire. The following particulars are given to you: (all figures in ₹)

Stock at cost 1st January 2014	4,41,000	Sales less returns year ended 31.12.2014	29,22,000
Stock at cost 31st December 2014	4,77,600	Purchases less returns Jan 1-15th June 2015	9,72,000
Purchases less returns year ended 31.12.2014	23,88,000	Sales less returns Jan 1-15th June 2015	13,87,200

In valuing stock for Balance Sheet at 31.12.2014, ₹ 13,800 had been written-off on certain stock which was a poor selling line, having cost ₹ 41,400. A portion of these goods was sold in March 2015 at a loss of ₹ 1,500 on the original cost of ₹ 20,700. The remainder of this stock is now estimated to be worth the original cost. Subject to the above exception, Gross profit remained at a uniform rate throughout. The stock salvaged from fire was valued at ₹ 34,800. You are to ascertain the amount of claim to be placed.

Solution

Maneka & Co.

Dr. Memorandum Trading Account for the period 1st January to 15th June, 2015 Cr.

Particulars	Normal items	Abnormal items	Total ₹	Particulars	Normal items	Abnormal items	Total ₹
To Opening Stock	4,50,000	41,400	4,91,400	By Sales	13,68,000	19,200	13,87,200
To Purchases	9,72,000	—	9,72,000	By Loss	—	1,500	1,500
To Gross Profit (20%)	2,73,600	—	2,73,600	By Closing Stock	3,27,600	20,700	3,48,300
	16,95,600	41,400	17,37,000		16,95,600	41,400	17,37,000

Statement of Claim for Loss of Stock as on 15th June, 2015

Particulars	₹
Book value of Stock	3,48,300
Less: Salvaged	34,800
Claim to be Lodged	3,13,500

Working Note:

Dr. (1) Trading Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	4,41,000	By Sales	29,22,000
To Purchases A/c	23,88,000	By Closing Stock:	
To Gross Profit	5,84,400	Nominal items (₹ 4,77,600 – 27,600)	4,50,000
		Abnormal items (cost)	41,400
	34,13,400		34,13,400

Rate of Gross Profit = ₹ 5,84,400/29,22,000 x 100 = 20%.

Illustration 20

On Friday, 13.5.2014, a fire at the premises of Rustam Limited destroyed a substantial part of the stock. It also destroyed some of the office records. The company has a loss of stock insurance policy under which the amount insured is ₹ 84,000. The amount of the claim for stock lost in the fire will have to be calculated from what information is available. For the accounting year ended 31.12.2013, the following figures were included in the profit calculation :

Sales ₹ 4,06,000; Purchases ₹ 3,06,000; Stock (1.1.2013) ₹ 70,000; Stock (31.12.2013) ₹ 80,000.

Notes :

(i) The stock at 1.1.2013 included ₹ 6,000 representing goods which had been reduced in value at the stock taking and were all sold during 2013 for the same reduced amount.

(ii) The stock at 31.12.2013 included ₹ 10,000 representing goods which were reduced to half-cost at the stock taking. Of these, ₹ 6,000 were sold at the reduced amount in January, 2014, ₹ 2,000 were scrapped in February 2014 without any revenue at all, and the balance had not been disposed of at the time of fire.

The cost price of stock at 13.5.2014 unaffected by the fire was ₹ 26,143 but the rest of the stock was completely destroyed, and this included the balance of the marked-down stock referred to in (ii) above.

The mix of products sold up to 13.5.2014 was substantially the same as for 2013. No writing-down of stock values takes place except at annual stocktaking and, with the exception of the items mentioned, there have been no alterations to normal selling prices.

Purchases from 1.1.2014 to 13.5.2014 total ₹ 1,45,500. Sales for the same period total ₹ 1,90,000, and there were returns from customers of ₹ 4,000.

Calculate the amount which you expect the company could claim for the loss of stock.

Solution

Rustam Limited

Dr. Memorandum Trading Account for the period 1st January to 13th May, 2014 Cr.

Particulars	Normal Items	Abnormal Items	Total ₹	Particulars	Normal Items	Abnormal Items	Total ₹
To Opening Stock	70,000	20,000	90,000	By Sales	1,84,000	6,000	1,90,000
To Purchases	1,45,500	—	1,45,500	Less: Returns	4,000	—	4,000
To Gross Profit	54,000	—	54,000		1,80,000		1,86,000
(30% of ₹ 1,80,000)				By Loss (Note 3)	—	12,000	12,000
				By Closing Stock	89,500	2,000	91,500
	2,69,500	20,000	2,89,500		2,69,500	20,000	2,89,500

Statement of Claim for Loss of Stock as on 13th May, 2014

Particulars	₹
Book Value of Stock (Total)	91,500
Less: Stock Unaffected	26,143
Loss of Stock	65,357

The policy was taken for ₹ 84,000 but the value of stock on the date of fire was ₹ 91,500. Therefore, the average clause is applicable:

$$\textbf{Net Claim} = \text{Loss of Stock} \times \frac{\text{Policy Value}}{\text{Value of Stock on the Date of Fire}} = ₹\ 65{,}357 \times \frac{84{,}000}{91{,}500} = ₹\ 60{,}000.$$

Working Notes :

Dr. (1) Trading Account for the the year ended 31st December, 2013 Cr.

Particulars	Normal Items	Abnormal Items	Total ₹	Particulars	Normal Items	Abnormal Items	Total ₹
To Opening Stock	64,000	6,000	70,000	By Sales	4,00,000	6,000	4,06,000
To Purchases	3,06,000	—	3,06,000	By Closing Stock (Note 2)	90,000	—	90,000
To Gross Profit	1,20,000	—	1,20,000				
	4,90,000	6,000	4,96,000		4,90,000	6,000	4,96,000

Rate of Gross Profit = ₹ 1,20,000 / ₹ 4,00,000 × 100 = 30%.

(2) On 31.12.2013 stock representing ₹ 10,000 were reduced to half cost. It means the actual cost of those goods were ₹ 10,000 × 2/1 = ₹ 20,000. Cost of other goods were ₹ 80,000 – ₹ 10,000 = ₹ **70,000**.
Total closing stock on 31.12.2013 = ₹ 70,000 + ₹ 20,000 = ₹ 90,000.

(3) Original cost of abnormal item = ₹ 20,000. ₹ 10,000 was reduced for stock taking purpose and further ₹ 2,000 were scrapped. Therefore, total loss = ₹ 12,000. Closing stock at reduced price = ₹ 20,000 – ₹ 6,000 – ₹ 12,000 = ₹ 2,000.

Illustration 21

On 1st April 2015, the stock of Shri Ramesh was destroyed by fire but sufficient records were saved from which following particulars were ascertained: (all figures in ₹)

Stock at cost 1st January 2014	73,500	Sales for the year ended 31st December 2014	4,87,000
Stock at cost 31st December 2014	79,600	Purchases from January 1 to March 31 2015	1,62,000
Purchases for the year ended 31st December 2014	3,98,000	Sales from January 1 to March 31 2015	2,31,200

In valuing the stock for the Balance Sheet at 31st December 2014, ₹ 2,300 had been written-off on certain stock which was a poor selling line having cost ₹ 6,900. A portion of these goods was sold in March 2015 at a loss of ₹ 250 on the original cost of ₹ 3,450. The remainder of this stock is now estimated to be worth its original cost. Subject to the above exception, gross profit had remained at a uniform rate throughout the year.

The value of stock salvaged was ₹ 5,800. The insurance policy was for ₹ 50,000 and was subject to the average clause. Work out the amount of the claim of loss by fire.

Solution

Sri Ramesh

Dr. Memorandum Trading Account for the period 1st January to 31st March, 2015 Cr.

Particulars	Normal items	Abnormal items	Total ₹	Particulars	Normal items	Abnormal items	Total ₹
To Opening Stock	75,000	6,900	81,900	By Sales	2,28,000	3,200	2,31,200
To Purchases	1,62,000	—	1,62,000	By Loss	—	250	250
To Gross Profit (20%)	45,600	—	45,600	By Closing Stock	54,600	3,450	58,050
	2,82,600	6,900	2,89,500		2,82,600	6,900	2,89,500

Statement of Claim for Loss of Stock as on 31st March, 2015

Particulars	₹
Book value of Stock (Total)	58,050
Less: Salvaged	5,800
Loss of Stock	52,250

The insurance policy was taken for ₹ 50,000 but the value of stock on the date of fire was ₹ 58,050. Therefore, the average clause is applicable:

$$\textbf{Net claim} = \text{Loss of stock} \times \frac{\text{Policy Value}}{\text{Value of stock on the date of fire}} = ₹\ 52,250 \times \frac{50,000}{58,050} = ₹\ 45,004.$$

Working Notes:

Dr. (1) Trading Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	73,500	By Sales	4,87,000
To Purchases	3,98,000	By Closing Stock: (Note 2)	
To Gross Profit	97,400	Nominal items (₹ 79,600 – 4,600)	75,000
		Abnormal items	6,900
	5,68,900		5,68,900

Rate of Gross Profit = ₹ 97,400/4,87,000 x 100 = 20%.

(2) Cost of abnormal items was ₹ 6,900. These were valued on 31st December 2014 after writing-off ₹ 2,300, i.e., at ₹ 6,900 – ₹ 2,300 = ₹ 4,600.

Illustration 22

On 1st July 2014, a fire took place in the godown of Ram Kumar which destroyed the stock. Calculate the amount of insurance claim for stock from the following details: (all figures in ₹)

Sales in 2012	2,00,000	Stock as on 1.1.2014	2,70,000
Gross Profit in 2012	60,000	Purchases from 1.1.2014 to 30.6.2014	4,00,000
Sales in 2013	3,00,000	Sales from 1.1.2014 to 30.6.2014	7,20,000
Gross Profit in 2013	60,000		

The following are also to be taken into consideration:

1. Stock as on 31st December 2013 had been undervalued by 10%.
2. A stock taking conducted in March 2014 had revealed that stock costing ₹ 80,000 was lying in a damaged condition. 50% of this stock was sold in May 2014 at 50% of cost and the balance was expected to be sold at 40% of cost.

Solution

Ram Kumar

Dr. Memorandum Trading Account for the period 1st January to 30th June, 2014 Cr.

Particulars	Normal items	Abnormal items	Total ₹	Particulars	Normal items	Abnormal items	Total ₹
To Opening Stock	2,20,000	80,000	3,00,000	By Sales	7,00,000	20,000	7,20,000
To Purchases	4,00,000	—	4,00,000	By Loss	—	44,000	44,000
To Gross Profit (30%)	2,10,000	—	2,10,000	By Closing Stock	1,30,000	16,000	1,46,000
	8,30,000	80,000	9,10,000		8,30,000	80,000	9,10,000

Statement of Claim for Loss of Stock as on 30th June, 2014

Particulars	₹
Book value of Stock	1,46,000
Less: Salvaged	Nil
Loss of Stock	1,46,000

Working Notes:

(1) Rate of Gross Profit in 2012 = ₹ 60,000 / 2,00,000 x 100 = 30%.

(2) Rate of Gross Profit in 2013 = *₹ 90,000 / 3,00,000 x 100 = 30%.

*Gross Profit as given	₹ 60,000
Add: Increase in the value of Closing stock ₹ 2,70,000 / 90 x 10	₹ 30,000
	₹ 90,000

(3) Sales of the abnormal items = 50% of (1/2 of ₹ 80,000) = ₹ 20,000.

(4) Value of abnormal items unsold = 40% of (1/2) of ₹ 80,000) = ₹ 16,000.

Illustration 23

On 30th September 2014 the stock of Fred Perry was lost in a fire accident. From the records, the following information is made available to enable you to prepare a statement of claim on the insurers: (all figures in ₹)

Stock at cost on 1st April 2013	37,500	Sales less returns for the year ended 31st March 2014	3,15,000
Stock at cost on 31st March 2014	52,000	Purchases less returns up to 30th September 2014	1,45,000
Purchases less returns for the year ended 31st March 2014	2,53,750	Sales less returns up to 30th September 2014	1,84,050

In valuing the stock on 31st March 2014, due to obsolescence 50% of the value of the stock which originally cost ₹ 6,000 has been written-off. In May 2014, three-fourths of this stock had been sold at 90% of the original cost and it is now expected that the balance of the obsolete stock is also expected to realise the same price. Subject to the above, gross profit had remained uniform throughout. The stock salvaged was worth ₹ 7,200.

Solution

Fred Perry

Dr. Memorandum Trading Account for the period 1st April to 30th September, 2014 Cr.

Particulars	Normal items	Abnormal items	Total ₹	Particulars	Normal items	Abnormal items	Total ₹
To Opening Stock	49,000	6,000	55,000	By Sales (Note 2)	1,80,000	4,050	1,84,050
To Purchases	1,45,000	—	1,45,000	By Loss	—	600	600
To Gross Profit (25%)	45,000	—	45,000	By Closing Stock	59,000	1,350	60,350
	2,39,000	6,000	2,45,000		2,39,000	6,000	2,45,000

Statement of Claim for Loss of Stock as on 30th September, 2014

Particulars	₹
Book value of Stock	60,350
Less: Salvaged	7,200
Loss of Stock	53,150

Working Notes:

Dr. (1) Trading Account for the year ended 31st March, 2014 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	37,500	By Sales	3,15,000
To Purchases	2,53,750	By Closing Stock:	
To Gross Profit	78,750	Nominal items (₹ 52,000 – 3,000)	49,000
		Abnormal items (cost)	6,000
	3,70,000		3,70,000

Rate of Gross Profit = ₹ 78,750/3,15,000 x 100 = 25%.

(2) Sales of the abnormal items = 90% of (3/4 x ₹ 6,000) = ₹ 4,050.

(3) Value of abnormal items unsold = 90% of (1/4 of ₹ 6,000) = ₹ 1,350.

Illustration 24

Victory Co. suffered a loss of stock due to fire on 31.3.2015. From the following information, prepare a statement showing claim for the loss to be submitted:

Stock on 1.1.2014	76,800	Closing stock on 31.12.2014	63,600
Purchases during the year 2014	3,20,000	Purchases from 1.1.2015 to 31.3.2015	1,08,000
Sales during the year 2014	4,05,200	Sales from 1.1.2015 to 31.3.2015	1,22,800

An item of goods purchased in 2013 at a cost of ₹ 20,000 were valued at ₹ 12,000 on 31.12.2013. Half of these goods were sold for ₹ 5,200 during 2014, and the remaining stock was valued at ₹ 4,800 on 31.12.2014. One-fourth of the original stock was sold for ₹ 2,800 in February 2015 and the remaining was valued at 60% of the original cost. With this exception of this item, the rate of gross profit remained uniform. There was an average clause in the insurance policy which was for ₹ 3,00,000. The stock salvaged was ₹ 24,000.

Solution

Victory Co.

Dr. Memorandum Trading Account for the period 1st January to 31st March, 2015 Cr.

Particulars	Normal items	Abnormal items	Total ₹	Particulars	Normal items	Abnormal items	Total ₹
To Opening Stock	58,800	10,000	68,800	By Sales	1,20,000	2,800	1,22,800
To Purchases	1,08,000	—	1,08,000	By Loss	—	4,200	4,200
To Gross Profit (18.5%)	22,200	—	22,200	By Closing Stock	69,000	3,000	72,000
	1,89,000	10,000	1,99,000		1,89,000	10,000	1,99,000

Statement of Claim for Loss of Stock as on 31st March, 2015

Particulars	₹
Book value of Stock	72,000
Less: Salvaged	24,000
Claim to be Lodged	48,000

The insurance policy was taken for ₹ 3,00,000 but the value of stock on the date of fire was ₹ 72,000, the average clause is not applicable.

Working Notes

Dr. (1) Trading Account for the year ended 31st December, 2014 Cr.

Particulars	Normal items	Abnormal items	Total ₹	Particulars	Normal items	Abnormal items	Total ₹
To Opening Stock (Note 2)	64,800	20,000	84,800	By Sales	4,00,000	5,200	4,05,200
To Purchases	3,20,000	—	3,20,000	By Loss	—	4,800	4,800
To Gross Profit	74,000	—	74,000	By Closing Stock	58,800	10,000	68,800
	4,58,800	20,000	4,78,800		4,58,800	20,000	4,78,800

Rate of Gross Profit = ₹ 74,000/4,00,000 x 100 = 18.5%.

(2) On 31.12.2013 an item costing ₹ 20,000 was valued for ₹ 12,000. This ₹ 12,000 is included in the stock of 1.1.2014 ₹ 76,800. After deducting abnormal item, the value of normal item would be ₹ 76,800 – ₹ 12,000 = ₹ 64,800.

Illustration 25

On 16th August, 2015 a fire occurred in the godown of Ganges Jute Mill and the godown was destroyed. From the following information, prepare a statement showing the claim to be lodged to the Insurance Company :

	₹
Stock of 1st January, 2014	36,000
Wages paid 2014 (Out of that ₹ 1,000 paid for construction of a stage for performing a cultural programme by the Staff Recreation Club of Jute Mill)	6,000
Carriage Inwards — 2014	3,000
Purchases for the year ended 31st December,, 2014	1,42,000
Sales for the year ended 31st December, 2014	2,03,400
Closing Stock on 31st December, 2014	32,000
Purchases from 1st January 2015 to 16th August, 2015	74,000
Sales from 1st January 2015 to 16th August, 2015	82,600

An item of stock purchased in 2013 at a cost of ₹ 10,000 was valued at ₹ 6,000 on 31st December, 2013. Half of the stock was sold in 2014 for ₹ 3,400. The remaining stock was valued at ₹ 2,000 on 31st December, 2014. One-fourth of the original stock was sold in April, 2015 for ₹ 2,600. The remaining stock was considered to be worth 40% of its original cost. Stock of the value of ₹ 15,000 was salvaged. The amount of the policy was for ₹ 42,000. There was an average clause in the policy.

Solution

Ganges Jute Mill

Dr. Memorandum Trading Account for the period 1st January to 16th August, 2015 Cr.

Particulars	Normal Items	Abnormal Items	Total ₹	Particulars	Normal Items	Abnormal Items	Total ₹
To Opening Stock	30,000	5,000	35,000	By Sales	80,000	2,600	82,600
To Purchases	74,000	—	74,000	By Loss (Revaluation)	—	1,500	1,500
To Wages (Note 7)	2,000	—	2,000	By Closing Stock	47,200	1,000	48,200
To Carriage Inwards (Note 7)	1,200	—	1,200				
To Profit on Sale of Abnormal Items (Note 5)	—	100	100				
To Gross Profit (25% of 80,000)	20,000	—	20,000				
	1,27,200	5,100	1,32,300		1,27,200	5,100	1,32,300

Statement of Claim for Loss of Stock as on 16th August, 2015

Particulars	₹
Book Value of Stock (Normal + Abnormal)	48,200
Less: Salvage	15,000
Loss of Stock	33,200

Insurance policy was taken for ₹ 42,000, but the value of stock on the date of fire was ₹ 48,200. Therefore, the average clause is applicable :

$$\textbf{Net Claim} = \text{Loss of Stock} \times \frac{\text{Policy Value}}{\text{Value of Stock on the Date of Fire}} = ₹\ 33,200 \times \frac{42,000}{48,200} = ₹\ 28,929.46$$

Working Notes :

Dr. (1) Trading Account for the year ended 31st December, 2014 Cr.

Particulars	Normal Items	Abnormal Items	Total ₹	Particulars	Normal Items	Abnormal Items	Total ₹
To Opening Stock (Note 2)	30,000	10,000	40,000	By Sales	2,00,000	3,400	2,03,400
To Purchases	1,42,000	—	1,42,000	By Loss	—	1,600	1,600
To Wages (Note 3)	5,000	—	5,000	By Closing Stock (Note 4)	30,000	5,000	35,000
To Carriage Inwards	3,000	—	3,000				
To Gross Profit	50,000	—	50,000				
	2,30,000	10,000	2,40,000		2,30,000	10,000	2,40,000

Rate of Gross Profit = ₹ 50,000 / ₹ 2,00,000 × 100 = 25%.

(2) On 31.12.2013 an item costing ₹ 10,000 was valued for ₹ 6,000. This ₹ 6,000 is included in the stock of 1.1.2014 ₹ 36,000. After deducting abnormal item, the value of normal items would be ₹ 36,000 – ₹ 6,000 = ₹ 30,000.

(3) Total wages paid in 2014 — ₹ 6,000. Out of that ₹ 1,000 paid for construction of the stage. Therefore, wages related to business = **₹ 5,000**.

(4) Closing stock on 31.12.2014 — ₹ 32,000 which includes ₹ 2,000 abnormal item (original cost ₹ 5,000). Therefore, closing stock on normal items = **₹ 30,000**.

(5) Original cost of all abnormal items = ₹ 10,000. 1/4 of this i.,e., ₹ 2,500 was sold for ₹ 2,600. Therefore, profit on sale of abnormal items = ₹ 100.

(6) Original cost of abnormal items unsold = ₹ 5,000 – ₹ 2,500 = ₹ 2,500. Present worth of unsold items = 40% of ₹ 2,500 = ₹ 1,000.

(7) Information in respect of wages and carriage inwards for 2015 has not been given. It is assumed that in 2015, these expenses were incurred, proportionately in relation to cost of goods sold as in 2014. Therefore, wages and carriage inwards have been calculated as follows :
When cost of goods is ₹ 1,50,000 (2014) then wages is ₹ 5,000 and carriage inwards ₹ 3,000
When cost of goods is Re 1 (2014) then wages is ₹ 5,000 / ₹ 1,50,000 and carriage inwards ₹ 3,000 / ₹ 1,50,000
When cost of goods is ₹ 60,000 (2015) then wages is ₹ 5,000 / ₹ 1,50,000 × ₹ 60,000 = ₹ 2,000.
and carriage inwards ₹ 3,000 / ₹ 1,50,000 × ₹ 60,000 = ₹ 1,200

Special Problems

Illustration 26

Arif operates a stationery and book shop. Separate stock records and trading accounts have not been maintained in respect of stationery and books.

On the night of 31.3.2014, a fire destroyed the shop and all the stock was lost or damaged. As the accounting books and records are kept in Mr Arif's house, they escaped destruction in the fire.

From the surviving books and other records, the following information is available :

1. The mark-up on stationery is $33^1/_3$% and on books is 50%.
2. The accounts for the year ended 30.6.2013 included the following —
   Sales for the year ₹ 1,75,320.
   Purchases during the year : Stationery ₹ 57,100; Books ₹ 68,550.
   Stock on 30.6.2013 : Stationery ₹ 5,500; Books ₹ 12,650.
   Stock on 1.7.2012 : Stationery ₹ 4,200; Books ₹ 12,100.
3. During August each year Arif holds a book sale of old stock on which he reduces his gross margin to 20%. Records of the sales of old stock in August 2013 and August 2012 show that the proceeds of these sales amounted to ₹ 6,250 and ₹ 5,400 respectively.
4. Purchases between 1.7.2013 and 31.3.2014 were — Stationery ₹ 55,640; Books ₹ 66,200.
5. The value of sales (excluding the sale of old book stock in August) between 1.7.2013 and 31.3.2014 increased by 15% in respect of books and 12.5% in respect of stationery as compared with the same period in the year ended 30.6.2013. Sales arise evenly throughout the year, except for the sale of old book stocks in August.
6. Goods salvaged from the fire realised ₹ 2,000 of which ₹ 1,500 was in respect of books and ₹ 500 in respect of stationery.
7. Adequate insurance coverage has been maintained since 1.7.2013.

You are required to prepare a statement showing the amount to be claimed from the insurance company in respect of the stationery and books destroyed in the fire.

Solution

Arif

Dr. Memorandum Trading Account for the period 1st July, 2013 to 31st March, 2014 Cr.

Particulars	Stationery ₹	Books ₹	Particulars	Stationery ₹	Books ₹
To Opening Stock	5,500	12,650	By Sales (Note 3 & 4)	62,775	82,386
To Purchases	55,640	66,200	By Closing Stock (Balancing figure)	14,059	18,926
		78,850			
Less: Cost of Books Sold at reduced margin (Note 5)		5,000			
		73,850			
To Gross Profit*	15,694	27,462			
	76,834	1,01,312		76,834	1,01,312

* Stationery : Mark-up $33^1/_3$. It means, if cost is ₹ 100 the profit will be ₹ $33^1/_3$ and sales will be ₹ $133^1/_3$. Therefore, profit on sales will be $33^1/_3$ / $133^1/_3$ or 1/4. Therefore, Gross Profit = 1/4 of ₹ 62,775 = ₹ **15,694**.

* Books : Mark-up 50%. It means, if cost is ₹ 100 then profit will be ₹ 50 and sales will be ₹ 150. Therefore, profit on sales will be 50/150 or 1/3. Therefore, Gross Profit = 1/3 of ₹ 82,386 = ₹ **27,462**.

Statement of Claim for Loss of Stock as on 31st March, 2014

Particulars	₹	₹
Stationery	14,059	
Books	18,926	32,985
Less: Salvage —		
Stationery	500	
Book	1,500	2,000
Claim to be Lodged		30,985

Working Notes :

(1) Total sales for the year : 2012-2013 = ₹ 1,75,320. However, individual sales for stationery and books have not been given. Before calculating claim for loss of stock of stationery and books, it will be necessary to calculate the sales of stationery and books.

(a) Calculation of Sales of Stationery (2012-2013)

Particulars	₹
Opening Stock (1.7.2012)	4,200
Add : Purchases	57,100
	61,300
Less: Closing Stock (30.6.2013)	5,500
Cost of Goods Sold	55,800
Sales : Cost + $33\frac{1}{3}$%* = (₹ 55,800 + ₹ 18,600)	74,400

(b) Calculation of Sales of Books (2012-2013)

Particulars	₹
Opening Stock (1.7.2012)	12,100
Add: Purchases	68,550
	80,650
Less: Closing Stock (30.6.2013)	12,650
Cost of Goods Sold	68,000
Books sold at reduced margin	5,400
Cost of books sold at reduced margin (Note 2)	4,320
Cost of books sold at normal margin (₹ 68,000 – ₹ 4,320)	63,680
Sale of books at normal margin = Cost + 50% = (₹ 63,680 + ₹ 31,840)	95,520

(c) Break-up of Total Sales

	₹
(i) Stationery (a)	74,400
(ii) Books — at reduced margin	5,400
— at normal margin (b)	95,520
	1,75,320

* A mark-up is always on cost whereas a margin is on selling price.

(2) Gross margin is 20%. It means, if the sale is ₹ 100 then profit is ₹ 20 and cost will be ₹ 80. Therefore, cost of books sold at reduced margin = ₹ **4,320**.

(3) Calculation of Sales of Stationery between 1.7.2013 – 31.3.2014

Sales = 112.5% × 9/12 (2012-2013 Sales)
= 112.5% × 9/12 × ₹ 74,400 [Note 1(a)]
= ₹ **62,775**.

(4) Calculation of Sales of Books between 1.7.2013 - 31.3.2014

Sales at Normal Mark-up = 115% × 9/12 (2012–2013 Sales)
= 115% × 9/12 × ₹ 95,520 [Note 1(b)]
= ₹ **82,386**.

(5) Cost of Books Sold at Reduced Margin

Gross margin is 20%. It means, if the sales is ₹ 100 then profit is 20 and cost is ₹ 80. Therefore, cost of books sold at reduced margin = 80/100 × ₹ 6,250 = ₹ **5,000**.

Illustration 27

The premises of Fireproof Ltd. were destroyed by fire on 30.6.2015. The following figures were ascertained:

		2012	2013	2014	1.1.2015 to 30.6.2015
Opening Stock	₹	2,000	2,200	1,180	3,402
Purchases	₹	16,000	14,500	17,000	3,500
Sales	₹	20,000	19,850	18,750	2,600
Carriage Inwards	₹	500	300	500	100
Freight Outwards	₹	600	700	300	25

In 2012, while valuing closing stock, some defective goods costing ₹ 500 were valued at ₹ 400. These were sold for ₹ 450 in 2013.

In 2013, an item costing ₹ 600 was wrongly valued at ₹ 700. This was sold for ₹ 550 in 2014.

In 2014, items costing ₹ 1,200 were valued at ₹ 1,000. 50% of these items was sold in June 2015 for ₹ 600.

Subject to this, the gross profit rate is more or less uniform. Value of salvage was ₹ 800.

Calculate the claim to be lodged.

Solution

First of all, the gross profit rate of 2012, 2013, and 2014 are to be calculated separately. For calculating respective gross profit rate, abnormal items are to be excluded. In this case, it is advantageous to prepare the Trading Account in columnar form.

Working Notes:

Dr. (1) Trading Account for the year ended 31st December, 2012 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	2,000	By Sales	20,000
To Purchases	16,000	By Closing Stock:	
To Carriage inwards	500	Nominal items (₹ 2,200 – 400)	1,800
To Gross Profit	3,800	Abnormal items (cost)	500
	22,300		22,300

Dr. Trading Account for the year ended 31st December, 2013 Cr.

Particulars	Normal items	Abnormal items	Total ₹	Particulars	Normal items	Abnormal items	Total ₹
To Opening Stock	1,800	500	2,300	By Sales	19,400	450	19,850
To Purchases (Note 1)	13,900	600	14,500	By Loss	—	50	50
To Carriage inward	300		300	By Closing Stock	480	600	1,080
To Gross Profit	3,880	—	3,880				
	19,880	1,100	20,980		19,880	1,100	20,980

Dr. Trading Account for the year ended 31st December, 2014 Cr.

Particulars	Normal items	Abnormal items	Total ₹	Particulars	Normal items	Abnormal items	Total ₹
To Opening Stock	480	600	1,080	By Sales	18,200	550	18,750
To Purchases	15,800	1,200	17,000	By Loss	—	50	50
To Carriage inward	500	—	500	By Closing Stock	2,402	1,200	3,602
To Gross Profit	3,822	—	3,822				
	20,602	1,800	22,402		20,602	1,800	22,402

Gross Profit Rate: 2012 — ₹ 3,800/20,000 x 100 = 19%; 2013 — ₹ 3,800/19,400 x 100 = 20%; and 2014 — ₹ 3,822/18,200 x 100 = 21%.

Average Gross Profit Rate (19% + 20% + 21%)/3 = 20%.

Tutorial Note:

(1) Abnormal items of 2012 were totally sold in 2013. Therefore, the closing stock (abnormal items) of 2013 ₹ 600 was purchased in 2013 itself. Purchase of normal items = (₹ 14,500 – 600) = ₹ 13,900.

(2) Abnormal items of 2013 were totally solid in 2014. Therefore, the closing stock (abnormal items) of 2014 ₹ 1,200 was purchased in 2014 itself. Purchase of normal items = ₹ (17,000 – 1,200) = ₹ 15,800.

(3) Freight outwards should not be taken in Trading Account.

Dr. Memorandum Trading Account for the period 1st January to 30th June, 2015 Cr.

Particulars	Normal items	Abnormal items	Total ₹	Particulars	Normal items	Abnormal items	Total ₹
To Opening Stock	2,402	1,200	3,602	By Sales	2,000	600	2,600
To Purchases	3,500		3,500	By Closing Stock (Balancing fig.)	4,402	600	5,002
To Carriage inward	100		100				
To Gross Profit	400		400				
	6,402	1,200	7,602		6,402	1,200	7,602

Statement of Claim for Loss of Stock as on 30th June, 2015

	₹
Book value of Stock	5,002
Less: Salvaged	800
Claim to be Lodged	4,202

Illustration 28

The factory premises of Toy Company were engulfed in fire on 31st March 2015 as a result of which a major part of stock was burnt to ashes. The stock was covered by policy for ₹ 1,00,000 subject to average clause.

The records at the office revealed following information:

1. (a) The company sold goods to dealers on one month credit at dealers' price which is catalogue price less 15%. A cash discount is allowed @ 5% for immediate payment.
   (b) The goods are also sold to Agents at catalogue price less 10% against cash payment.
   (c) Goods are sent to branches at catalogue price
   (d) Catalogue price is cost + 100%.
2. The Sales/Despatch during period up to date of fire is:
   (a) Sale to dealer (without cash discount) ₹ 3,40,000.
   (b) Sale to dealer (net of cash discount) ₹ 3,23,000.
   (c) Sale to agents ₹ 90,000
   (d) Despatch to branches ₹ 3,00,000.
3. Stock on 1st January 2015 was ₹ 2,50,000 at catalogue price.
4. Purchases at cost from 1st January to 31st March,2015 ₹ 6,25,000.
5. Salvages stock valued at ₹ 45,000.

Compute the amount of claim to be lodged.

Solution

Before solving this problem, it is necessary to compute certain basic data:
Let cost = ₹ 100, Then,
1. Catalogue price (cost + ₹ 100) = ₹ 200;
2. Agents' price (catalogue price – 10%) = ₹ 180
3. Dealers' price (catalogue price – 15%) = ₹ 170;
4. Dealers' price when cash discount is given (Dealers price – 5%) = ₹ 161.50

Dr. Memorandum Trading Account (At cost) Cr.

Particulars	₹	Particulars	₹
To Balance b/d (Note 1)	1,25,000	By Cost of Despatch to:	
To Purchases A/c	6,25,000	(i) Dealers (Note 2)	2,00,000
		(ii) Dealers (when cash discount is allowed Note 3)	2,00,000
		(iii) Agents (Note 4)	50,000
		(iv) Branches (Note 5)	1,50,000
		By Balance c/d	1,50,000
	7,50,000		7,50,000

Statement of Claim for Loss of Stock as on 31st March, 2015

	₹
Book value of Stock	1,50,000
Less: Salvaged	45,000
Loss of Stock	1,05,000

The insurance policy was taken for ₹ 1,00,000 but the value of stock on the date of fire was ₹ 1,50,000. Therefore, the average clause is applicable:

$$\textbf{Net claim} = \text{Loss of stock} \times \frac{\text{Policy Value}}{\text{Value of stock on the date of fire}} = ₹\ 1{,}05{,}000 \times \frac{1{,}00{,}000}{1{,}50{,}000} = ₹\ 70{,}000.$$

Working Notes:
(1) ₹ 2,50,000/200 x 100 = ₹ 1,25,000.
(2) ₹ 3,40,000/170 x 100 = ₹ 2,00,000;
(3) ₹ 3,23,000/161.50 x 100 = ₹ 2,00,000.
(4) ₹ 90,000/180 x 100 = ₹ 50,000.
(5) ₹ 3,00,000/200 x 100 = ₹ 1,50,000.

Illustration 29

A fire occured in the premises of M/s. Fireprone Co. on 30th May 2015. From the following particulars, relating to the period from 1st January 2015 to 30th May 2015, you are required to ascertain the amount of claim to be filled with the insurance company for the loss of stocks: (all figures in ₹)

(1) Stock as per Balance Sheet at 31st December 2014, 99,000
(2) Purchases (including purchase of a machinery costing ₹ 30,000), 1,70,000
(3) Wages (including wages for the installation of machinery ₹ 3,000), 50,000
(4) Sales (including goods sold on approval basis amounting to ₹ 49,500. No confirmation had been received in respect of two- thirds of such goods sold on approval basis), 2,75,000
(5) Sales value of goods drawn by partners, 15,000
(6) Cost of goods sent to consignees on 15th May 2015, lying unsold with them, 16,500
(7) Sales value of goods distributed as free samples, 1,500

The average rate of gross profit was 20% in the past. The selling price was increased by 20% with effect from 1st January 2015.

For valuing the stock for the Balance Sheet as at 31st December 2014 ₹ 1,000 were written-off in respect of a slow moving item, the cost of which was ₹ 5,000.

A portion of these goods were sold at a loss of ₹ 500 on the original cost of ₹ 2,500. The remainder of the stock is now estimated to be worth the original cost.

Subject to the above exceptions, the gross profit remained at a unfirom rate throughout.

The value of goods salvaged was estimated at ₹ 25,000.

The concern had taken an insurance policy for ₹ 60,000 which was subject to the average clause.

Dr. Memorandum Trading Account for the period 1st January to 31st May, 2015 Cr.

Particulars	Normal items	Abnormal items	Total ₹	Particulars	Normal items	Abnormal items	Total ₹
To Opening Stock	95,000	5,000	1,00,000	By Sales (Note 3)	2,40,000	2,000	2,42,000
To Purchases (Note 1)	1,40,000	—	1,40,000	By Stock with cust. on app. (Note 4)	22,000	—	22,000
To Wages (Note 2)	47,000	—	47,000	By Goods sent to Consignees	16,500	—	16,500
To Gross Profit : $33^1/_3$% on Sales (Note 7)	80,000	—	80,000	By Partners' Drawing (Note 5)	10,000	—	10,000
				By Free Samples	1,000	—	1,000
				By Loss	—	500	500
				By Closing Stock	72,500	2,500	75,000
	3,62,000	5,000	3,67,000		3,62,000	5,000	3,67,000

Statement of Claim for Loss of Stock as on 31st May, 2015

Particulars	₹
Book value of Stock	75,000
Less: Salvaged	25,000
Loss of Stock	50,000

The insurance policy was taken for ₹ 60,000 but the value of stock on the date of fire was ₹ 75,000. Therefore, the average clause is applicable:

$$\textbf{Net claim} = \text{Loss of stock} \times \frac{\text{Policy Value}}{\text{Value of stock on the date of fire}} = ₹\,50{,}000 \times \frac{60{,}000}{75{,}000} = ₹\,40{,}000$$

Working Notes:

(1) Total purchases = ₹ 1,70,000. This figure includes ₹ 30,000 for purchase of machinery. Therefore, actual purchase will be ₹ 1,70,000 – ₹ 30,000 = ₹ 1,40,000.

(2) Total wages = ₹ 50,000. This figure includes ₹ 3,000 for installation of machinery. Therefore, actual wages to be charged to Trading Account = ₹ 50,000 – ₹ 3,000 = ₹ 47,000.

(3) Calculation of Sales		**(4) Cost of Goods with Customers on approval**	
Particulars	₹	Particulars	₹
Total Sales	2,75,000	Total goods sent	49,500
Less: 2/3 of goods sold not yet approved	33,000	Less: 1/3 sold	16,500
	2,42,000	Goods still unsold	33,000
Less: Sale of abnormal items	2,000	Less: Gross Profit — $33^1/_3$%	11,000
Sale of normal items	2,40,000	Cost of goods unsold	22,000
(5) Cost of Goods withdrawn by Partners		**(6) Cost of Goods distributed as sample**	
Sales value of goods drawn	15,000	Sales value of goods distributed	1,500
Less: Gross Profit @ $33^1/_3$%	5,000	Less: Gross Profit @ $33^1/_3$%	500
	10,000		1,000

(7) Old rate of gross profit 20%, i.e., Cost = ₹ 80 and S.P. = ₹ 100. New selling price = ₹ 100 + 20% = ₹ 120. Therefore, Gross Profit ratio (new) = 40/120 x 100 = $33^1/_3$%.

Loss of Profit Policy

Besides insuring against loss of stocks or assets, businesses often take out loss of profit insurance to cover them against loss of profits if a fire (or other perils) interrupts their business. This insurance is designed to provide for indemnification of the insured for losses ensuing from the interruption, wholly or in part, of the normal business activities consequent upon a fire or other perils. Therefore, loss of profit insurance is an insured protection against loss of gross profit. Insuring from interruption of or interference as a result of destruction of or damage to any building or any other property of the insured premise by fire. While a fire policy covers loss of or damage to insured property, a loss of profit policy covers loss of gross profit sustained in consequence of a business interruption.

The terms of such policies vary widely, but they are usually framed to meet the requirements of the insured. A business interruption due to destruction of / or damage to property by fire is likely to result in :

(a) the reduction in turnover during the period of indemnity and

(b) the increased cost of working incurred for the purpose of avoiding or reducing the reduction in turnover.

The claim for loss of profit insurance is granted only when the insured has a valid claim in respect of the property, the loss of / or damage to which results in interruption, being admissible under a corresponding fire policy. Therefore, it is a basic condition that a business unit cannot have a loss of profit insurance policy without the presence of a fire policy covering property damage, giving rise to the loss of profit claim. The period of indemnity is the contemplated period of disorganisation for which loss of insurance policy is effected. The length of this period may vary with the nature of the business and required time to obtain new plant and machinery.

Some Important Terms / Expressions

Gross Profit For loss of profit insurance purposes Gross Profit is the sum produced by adding the amount of the insured standing charges to the Net Profit. If there is net loss, gross profit is the amount of insured standing charges less such a proportion of any net trading loss as the amount of the insured standard charges bears to all the standing charges (insured + uninsured) of the business.

Net Profit The net trading profit (exclusive of all capital receipts and accretions and all outlay properly chargeable to Capital) resulting from the business of the insured at the premises after due provision has been made for all standing and other charges including depreciation but before the deduction of any taxation chargeable on profits.

Insured Standing Charges The insured standing charges are those charges specified in the policy which the insured desires to recover in the case of an accident. It may include the following :

(i) Rent, rates and taxes (not related with the profit of the business);
(ii) Interest on debentures and loans;
(iii) Salaries of permanent staff;
(iv) Wages of skilled workers;
(v) Directors' fees;
(vi) Auditor's fees;
(vii) Advertising;
(viii) Travelling; and
(ix) Unspecified standing charges (not exceeding 5% of the amount of specified standing charges).

Turnover The money paid or payable to the insured for goods sold and delivered and for services rendered in course of the business at the premises.

Indemnity Period The period beginning with the occurrence of the Damage and ending not later than 12 months thereafter during which the results of the business shall be affected in consequence of the damage.

Rate of Gross Profit The rate of Gross Profit earned on the turnover during the financial year immediately before the date of the damage

Annual Turnover The turnover during the twelve months immediately before the date of the damage

Standard Turnover The turnover during that period in the twelve months immediately before the date of damage which corresponds with the indemnity period

to which such adjustments shall be made as may be necessary to provide for the trend of the business and for variations in or special circumstances affecting the business either before or after the damage or which would have affected the business had the damage not occurred, so that the figures thus adjusted shall represent as nearly as may be reasonably practicable the results of which but for the damage would have been obtainbed dring the relative period after the damage.

Memo 1 : If during the Indemnity Period goods shall be sold or services shall be rendered elsewhere than at the premises for the benefit of the business either by the insured or by others on his behalf the money paid or payable in respect of such sales or services shall be brought into account in arriving at the turnover during the Indemnity Period.

Memo 2 : If any standing charges of the business be not insured by this policy then in computing the amount recoverable hereunder as increase in cost of working that proportion only of the additional expenditure shall be brought into account which the sum of the net profit and the insured standard charges bears to the sum of the net profit and all standing charges.

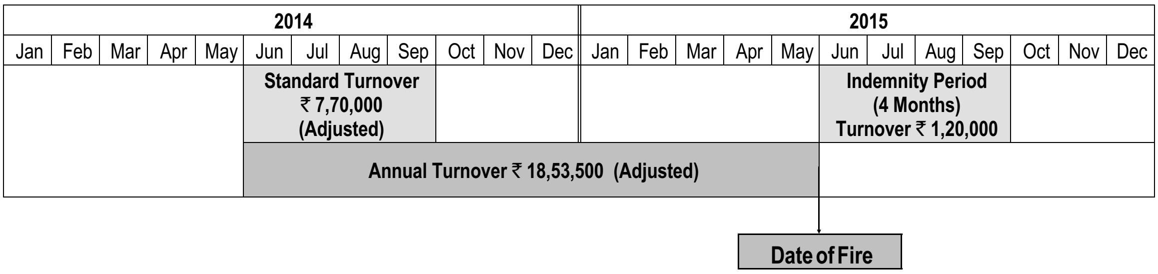
Example

From the following information calculate: (i) Standard Turnover; (ii) Short Sales; and (iii) Annual Turnover.

X Ltd. had taken a loss of profit policy for ₹ 1,50,000 being ₹ 65,000 for net profit and ₹ 85,000 for standing charges. On 1st June, 2015 there was a fire as a result of which sales suffered a lot for a period of 6 months. The indemnity period was 4 months.

Month	2014 (₹)	2015 (₹)	Month	2014 (₹)	2015 (₹)
January	1,00,000	1,10,000	July	2,00,000	25,000
February	1,00,000	1,10,000	August	1,70,000	30,000
March	1,25,000	1,37,500	September	1,50,000	40,000
April	1,25,000	1,37,500	October	1,25,000	55,000
May	1,50,000	1,65,000	November	1,25,000	75,000
June	1,80,000	25,000	December	75,000	80,000

Solution



Calculation of Standard Turnover

Particulars	₹
Sales from 1st June 2014 to 30th September 2014	7,00,000
Add : 10% for upward trend*	70,000
	7,70,000

* Sales from 1st January 2014 to 31st May 2015 are ₹ 6,00,000; for the corresponding months of 2015, Sales is ₹ 6,60,000. Therefore, increase in sales is 10%.

Calculation of Short Sales

Particulars	₹
Standard Turnover	7,70,000
Less: Sales from 1st June 2015 to 30th September 2015	1,20,000
	6,50,000

Calculation of Annual Turnover (Adjusted)

Particulars	₹
Sales for 12 months immediately preceding the month of fire (i.e., 1st June, 2014 to 31st May 2015)	16,85,000
Add: 10% increase for upward trend as noticed between 1.1.2015 and 31.5.2015	1,68,500
	18,53,500

Procedures to Ascertain Amount of Claim

The following steps are followed to arrive at the amount of a claim under loss of profit insurance :

Step 1 Calculate rate of gross profit (adjust to provide for the trend of the business, if any).

Step 2 Calculate short sales. (It is the difference between the standard sales (adjusted) and actual sales of dislocated period.

Step 3 Calculate gross profit on short sales.

Step 4 Calculate the amount of admissible additional expenses as follows :
The least of the following shall be taken as admissible additional expenses.
(i) Actual expenses incurred
(ii) Gross Profit on additional sales

(iii) Additional Expenses × $\dfrac{\text{G.P. on Annual Turnover}}{\text{G.P. on Annual Turnover + Uninsured standing charges}}$

OR

Additional Expenses × $\dfrac{\text{Net Profit + Insured standing charges}}{\text{Net Profit + All standing charges}}$

Step 5 Deduct from the sum of 3 and 4 any savings in insured standing charges during the period of indemnity.

Step 6 Apply average clause : Net Claim = Gross Claim × $\dfrac{\text{Policy value}}{\text{G.P. on Annual Turnover}}$

Illustration 30

From the following information, find the claims under a loss of profit policy: (all figures in ₹)

Sales in 2011	1,00,000	Policy value	50,000
Sales in 2012	1,20,000	Date of dislocation by fire	1.1.2015
Sales in 2013	1,44,000	Period of dislocation	3 months
Sales in 2014	1,72,800	Indemnity period	9 months
Standing charges (all insured) in 2014	7,280	Sales from 1.1.2014 to 31.3.2014	43,200
Net profit in 2014	10,000	Sales from 1.1.2015 to 31.3.2015	11,840

There was no reduction in standing charges during the dislocation period, nor were there any additional costs.

Solution

(1) Gross Profit Ratio

	₹	
Net Profit in 2014	10,000	Rate of Gross Profit $= \dfrac{\text{Gross Profit}}{\text{Sales}} \times 100$
Insured standing charges	7,280	
Gross Profit	17,280	$= \dfrac{17,280}{1,72,800} \times 100 = 10\%.$

(2) Short Sales

(a) Standard Sales (adjusted)	₹	(b) Actual Sales of dislocated period = ₹ 11,840
Sales from 1.1.2014 to 31.3.2014	43,200	Short Sales = Standard Sales – Actual Sales
Add: 20% increase	8,640	= ₹ 51,840 – ₹ 11,840 = ₹ 40,000
	51,840	
*Sales figures of 2011 to 2014 clearly indicate 20% increase every year. So standard sales are to be adjusted accordingly.		(3) Amount of Claim = Short Sales x Gross Profit ratio = ₹ 40,000 x 10% = ₹ 4,000 (The claim is payable in full, since the policy is adequate)

Illustration 31

From the following particulars, prepare a claim for loss of profits under the Consequential Loss Policy :

	₹
Date of fire — June 30, 2014; Period of Indemnity — Six months.	
Sum Insured	50,000
Turnover for the year ended June 30, 2014	2,00,000
Net Profit for the accounting year ending March 31, 2014	12,500
Standing charges for the accounting year ending March 31, 2014	28,500
Turnover for the year ending March 31, 2014	1,98,000
Turnover for the indemnity period from 01.07.2014 to 31.12.2014	56,000
Turnover for the period from 01.07.2013 to 31.12.2013	1,10,000

The turnover of the year 2011-12 had shown a tendency of increase of 10% over the turnover of the preceding year.

Solution

(1) Gross Profit Ratio

	₹	
Net Profit (2010-11)	12,500	Rate of Gross Profit $= \dfrac{\text{Gross Profit}}{\text{Sales}} \times 100$
Insured standing charges	28,500	
Gross Profit	41,000	$= \dfrac{41,000}{1,98,000} \times 100 = 20.7070\%.$

(2) Short Sales

(a) Standard Sales (adjusted)	₹	(b) Actual Sales of dislodged period = ₹ 56,000
Sales from 1.7.2013 to 31.12.2013	1,10,000	Short Sales = Standard Sales – Actual Sales
Add: 10% Increase in 2014-15	11,000	= ₹ 1,21,000 – ₹ 56,000 = ₹ 65,000
	1,21,000	

(3) Loss of Gross Profit = Short sales × Gross Profit ratio = ₹ 65,000 × 20.7070 = ₹ 13,460.

(4) Statement of Claim

Particulars	₹
Loss of Gross Profit (Note 3 — Above)	13,460
Admissible increased working cost	Nil
	13,460
Less: Saving in insured standing charges	Nil
Gross Claim	13,460

Sum assured is ₹ 50,000 but gross claim is ₹ 13,460. Therefore, the average clause will not be applicable.

Illustration 32

Bright Ltd. has a 'loss of profit' insurance policy of ₹ 12,60,000. The period of indemnity is three months. A fire occured on 31st March 2015. The following information is available (all figures in ₹) :

Sales for the year ended 31st December 2014	42,00,000	Standing charges for 2014	9,60,000
Sales for the period from 1st April 2014 to 31st Mar. 2015	48,00,000	Profit for 2014	3,00,000
Sales for the period from 1st April 2014 to 30th June 2014	10,80,000	Saving in standing charges because of fire	30,000
Sales for the period from 1st April 2015 to 30th June 2015	72,000	Additional expenses to reduce loss of turnover	60,000

Assuming no adjustment has to be made for the upward trend in turnover, compute the claim to be made on the insurance company.

Solution

(1) Gross Profit Ratio

	₹	
Net Profit in 2014	3,00,000	Rate of Gross Profit $= \frac{\text{Gross Profit}}{\text{Sales}} \times 100$
Insured standing charges	9,60,000	
Gross Profit	12,60,000	$= \frac{12,60,000}{42,00,000} \times 100 = 30\%$.

(2) Short Sales

(a) Standard Sales (adjusted)	₹	(b) Actual Sales of dislocated period = ₹ 72,000
Sales for the corresponding period in the preceding		Short Sales = Standard Sales – Actual Sales
year, i.e., 1.4.2014 to 30.6.2014	10,80,000	= ₹ 10,80,000 – ₹ 72,000 = ₹ 10,08,000

(3) Loss of Gross Profit = Short Sales x Gross Profit ratio = ₹ 10,08,000 x 30% = ₹ 3,02,400.

(4) Admissible increased working cost :

Lower of the following: (a) Actual additional expenses to reduce loss of turnover = ₹ 60,000.
(b) Gross profit on additional sales = ₹ 72,000 x 30% = ₹ 21,600.

(5) Statement of Claim

Particulars	₹
Loss of Gross Profit (Note 3)	3,02,400
Admissible increased working cost (Note 4)	21,600
	3,24,000
Less: Saving in insured standing charges	30,000
Gross Claim	2,94,000

6. Application of Average Clause

Net claim $= \text{Gross Claim} \times \frac{\text{Policy Value}}{\text{G.P. on Annual Sales}} = ₹\ 2,94,000 \times \frac{12,60,000}{30\% \text{ of } 48,00,000} = ₹\ 2,57,250$

Therefore, amount of claim under the policy = ₹ 2,57,250.

Assumptions:

(1) All standing charges are insured. (2) All sales during indemnity period have been effected by incurring additional expenses.

Illustration 33

A businessman took out a 'loss of profit policy' for ₹ 40,000 with an indemnity period of 6 months. The financial year of the business ended on 30th June. Gross profit for the last financial year was ₹ 50,000 and turnover for that period was ₹ 2,00,000. Turnover for the 12 months immediately preceding the fire was ₹ 2,20,000. A fire occured on 31st March, 2015. Turnover for 6 months immediately following the fire, compared with the turnover of corresponding months in the previous year was:

	April	May	June	July	August	September
2014 (₹)	16,000	17,000	18,000	16,000	17,000	19,000
2015 (₹)	—	6,000	9,000	14,000	16,000	18,000

₹ 1,000 was spent on putting the fire out. During the indemnity period, increase in the cost of working directly attributable to sales amounted to ₹ 8,050. All standing charges of the business were insured and paid.

From the above particulars, you are required to assess the loss and the amount payable by the insurance company as claim under the policy.

Solution

1. Gross Profit Ratio $= \dfrac{\text{Gross Profit}}{\text{Sales}} \times 100 = \dfrac{50{,}000}{2{,}00{,}000} \times 100 = 25\%.$

2. Short Sales

(a) Standard Sales (adjusted)	₹	(b) Actual Sales from April to Sept. 2015 = ₹ 63,000
Sales from 1.4.2014 to 30.9.2014	1,03,000	Short Sales = Standard Sales – Actual Sales
Add: 10% increase (Note 1)	10,300	= ₹ 1,13,300 – ₹ 63,000 = ₹ 50,300
	1,13,300	

3. Loss of Gross Profit = Short sales x Gross Profit ratio = 50,300 x 25% = ₹ 12,575.

4. Admissible increased working cost

Lower of the following:

(a) Gross Profit on additional sales = 25% of ₹ 63,000 = ₹ 15,750.

(b) $\text{Additional Expenses} \times \dfrac{\text{G.P. on Annual Turnover(Adjusted)}}{\text{G.P. on Annual Turnover (Adjusted)} + \text{Uninsured standard charges}}$

$= ₹\,8{,}050 \times \dfrac{55{,}000}{55{,}000 + \text{nil}} = ₹\,8{,}050.$

5. Statement of Claim

Particulars	₹
Loss of Gross Profit (Note 3)	12,575
Admissible insured working cost (Note 4)	8,050
Gross Claim	20,625

6. Application of Average Clause

Net claim $= \text{Gross Claim} \times \dfrac{\text{Policy Value}}{\text{G.P. on Annual Sales}} = ₹\,20{,}625 \times \dfrac{40{,}000}{55{,}000} = ₹\,15{,}000.$

7. **Total Claim**

Amount of claim under policy	= ₹ 15,000
Expenses for putting off fire	= ₹ 1,000
	₹ 16,000

Tutorial Note: Insurance company is liable to pay all expenses for putting off fire.

Working Note:

(1) Calculation of Upward Trend in Turnover

Turnover for the 12 months immediately preceding fire was ₹ 2,20,000 and Sales of the previous accounting period were ₹ 2,00,000. Increase in Sales ₹ 20,000. Therefore, % of increase = 20,000/2,00,000 x 100 = 10%.

Illustration 34

A fire occured on 1st February 2015 in the premises of Pioneer Ltd., a retail store, and business was partially disorganised up to 30th June 2015. The company was insured under a 'loss of profit' for ₹ 1,25,000 with a six months period indemnity. From the following information, compute the amount of claim under the loss of profit policy. (all figures in ₹)

Actual turnover from 1st February to 30th June 2015	80,000	Turnover from 1st February to 30th June 2014	2,00,000
Turnover from 1st February 2014 to 31st January 2015	4,50,000	Net profit for last financial year	70,000
Insured standing charges for last financial year	56,000	Total standing charges for last financial year	64,000
Turnover for the last financial year	4,20,000		

The company incurred additional expenses amounting to ₹ 6,700 which reduced the loss in turnover. There was also a saving during the indemnity period of ₹ 2,450 in the insured standing charges as a result of the fire.

There had been a considerable increase in trade since the date of the last annual accounts and it has been agreed that an adjustment of 15% be made in respect of the upward trend in turnover.

Solution

(1) Gross Profit Ratio

	₹	
Net Profit for last financial year	70,000	Rate of Gross Profit $= \frac{\text{Gross Profit}}{\text{Sales}} \times 100$
Insured standing charges	56,000	
Gross Profit	1,26,000	$= \frac{\text{Rs } 1,26,000}{\text{Rs } 4,20,000} \times 100 = 30\%.$

(2) Short Sales

	₹	
(a) Standard Sales (adjusted)	₹	(b) Actual Sales of disorganised period = ₹ 80,000
Sales from 1.2.2014 to 30.6.2014	2,00,000	Short Sales = Standard Sales – Actual Sales
Add: 15% increase (expected)	30,000	= ₹ 2,30,000 – ₹ 80,000 = ₹ 1,50,000
	2,30,000	

(3) Loss of Gross Profit = Short Sales x Gross Profit ratio = ₹ 1,50,000 x 30% = ₹ 45,000.

(4) Annual Turnover

Particulars	₹
Turnover for 12 months immediately preceding the month of fire i.e. from 1.2.2014 to 31.1.2015	4,50,000
Add: 15% expected increase	67,500
	5,17,500
Gross Profit on Annual Turnover = 30% of 5,17,500	1,55,250

(5) Admissible increased working cost:

Lower of the following:

(a) Gross Profit on additional Sales = 30% of ₹ 80,000 = ₹ 24,000.

(b) $\text{Additional Expenses} \times \frac{\text{G.P. on Annual Turnover}}{\text{G.P. on Annual Turnover + Uninsured Standing Charges}}$

$= ₹\, 6,700 \; \frac{1,55,250 \text{ (Note 4)}}{1,55,250 + 8,000*} = ₹\, 6,372$ *(Total standing charges – Insured standing charges)

(6) Statement of Claim

Particulars	₹
Loss of Gross Profit (Note 3)	45,000
Admissible increased working cost (Note 5)	6,372
	51,372
Less: Saving in insured standing charges	2,450
Gross claim	48,922

(7) Application of Average Clause

$\textbf{Net Claim} = \text{Gross Claim} \times \frac{\text{Policy Value}}{\text{Gross Profit on Annual Turnover}} = ₹\, 48,922 \times \frac{1,25,000}{1,55,250} = ₹\, 39,390$

Amount of claim under the policy = ₹ 39,390.

Assumption : (1) All sales during indemnity period have been effected by increasing additional expenses only.

Illustration 35

From the following information, you are required to work out the claim under the 'loss of profit' insurance policy.

(1) Cover — Gross profit ₹ 1,00,000.

(2) Indemnity period — Six months.

(3) Damage — due to a fire accident on 28th December, accounting year ends on 31st December.

(4) Net profit plus all standing charges in the prior accounting year — ₹ 1,30,000.
(5) Standing charges uninsured — ₹ 25,000.
(6) Turnover of the last accounting year was ₹ 5,00,000, the rate of gross profit being 25%.
(7) The annual turnover — namely the turnover for 12 months immediately preceding the fire — ₹ 5,20,000.
(8) As a consequence of fire, there was a reduction in certain insured standing charges at the rate of ₹ 25,000 per annum.
(9) The standard turnover was ₹ 2,60,000.
(10) Increased costs of working during the period of indemnity were ₹ 20,000.
(11) Turnover during the period of indemnity was ₹ 1,00,000 and out of this, turnover of ₹ 80,000 was maintained due to increased costs of working.

Solution

1. Gross Profit Ratio = 25% (given).
2. Short Sales = Standard Sales – Actual Sales = (₹ 2,60,000 (given) – ₹ 1,00,000) = ₹ 1,60,000.
3. Loss of Gross Profit = Short Sales x Gross Profit Ratio = ₹ 1,60,000 x 25% = ₹ 40,000.
4. Annual Turnover = ₹ 5,20,000. Gross Profit on Annual Turnover = ₹ 5,20,000 x 25% = ₹ 1,30,000.
5. **Admissible Increased Working Cost:**
   Lower of the following:
   (a) Gross Profit on additional Sales = 25% of ₹ 80,000 = ₹ 20,000.
   (b) $\text{Additional Exp.} \times \dfrac{\text{G.P. on Annual Turnover (Adjusted)}}{\text{G.P. on Annual Turnover (Adjusted)} + \text{Uninsured standing charges}}$

$$= ₹\ 20,000 \times \frac{1,30,000}{1,30,000 + 25,000} = ₹\ 16,774$$

(6) Statement of Claim

Particulars	₹
Loss of Gross Profit (Note 3)	40,000
Add: Admissible Increased Working Cost (Note 5)	16,774
	56,774
Less: Saving in Standing Charges (6 months)	12,500
Gross Claim	44,274

(7) Application of Average Clause

$$\text{Net Claim} = \text{Gross Claim} \times \frac{\text{Policy Value}}{\text{G.P. on Annual Sales}} \quad ₹\ 44,274 \times \frac{1,00,000}{1,30,000} = ₹\ 34,057$$

Assumption: (1) Annual Turnover and Standard Turnover as given in the problem have already been adjusted for upward trend.

Illustration 36

The premises of a company was partly destroyed by fire on 1st March 2015, as a result of which the business was disorganised from 1st March to 31st July, 2015. Accounts are closed on 31st December every year. The Company is insured under a 'loss of profit' policy for ₹ 7,50,000. The period of indemnity specified in the policy is 6 months. From the following information, you are required to compute the amount of claim under the loss of profit policy. (all figures in ₹)

Turnover for the year 2014	40,00,000	Standard turnover for the corresponding period in the preceding year i.e. from 1.3.2014 to 31.7.2014	20,00,000
Net profit for the year 2014	2,40,000	Annual turnover for the year immediately preceding the fire i.e. from 1.3.2014 to 28.2.2015	44,00,000
Insured standing charges	4,80,000	Increased cost of working	1,50,000
Uninsured standing charges	80,000	Reduction in turnover avoided through increase in working cost	4,00,000
Turnover during the period of disloc. i.e. from 1.3.15 to 31.7.15	8,00,000		
Savings in insured standing charges	30,000		

Owing to reasons acceptable to the insurer, the "Special circumstances clause" stipulates for: (a) Increase of turnover (standard and annual) by 10% and (b) Increase of rate of gross profit by 2%.

Solution

(1) Gross Profit Ratio

	₹	
Net Profit in 2014	2,40,000	$\text{Rate of Gross Profit} = \dfrac{\text{Gross Profit}}{\text{Sales}} \times 100$
Insured standing charges	4,80,000	$= \dfrac{7,20,000}{40,00,000} \times 100 = 18\%.$
Gross Profit	7,20,000	Revised Rate of G.P. = 18% + 2% increase = 20%.

(2) Short Sales

(a) Standard Sales (adjusted)	₹	(b) Actual Sales of dislocated period = ₹ 8,00,000
Sales from 1.3.2014 to 31.7.2014	20,00,000	Short Sales = Standard Sales – Actual Sales
Add: 10% increase (agreed)	2,00,000	= ₹ 22,00,000 – ₹ 8,00,000 = ₹ 14,00,000
	22,00,000	

(3) Loss of Gross Profit = Short Sales x Gross Profit Ratio = ₹ 14,00,000 x 20% = ₹ 2,80,000.

(4) Annual Turnover

Particulars	₹
Turnover for 12 months immediately preceding the month of fire, i.e. from 1.3.2014 to 28.2.2014	44,00,000
Add: 10% increase (agreed)	4,40,000
	48,40,000
Gross Profit on Annual turnover = 20% of ₹ 48,80,000 = ₹ 9,68,000	

(5) Admissible Increased Working Cost:

Lower of the following:

(a) Gross Profit on additional Sales = 20% of ₹ 4,00,000 = ₹ 80,000.

(b) $\text{Additional Exp.} \times \dfrac{\text{G.P. on Annual Turnover}}{\text{G.P. on Annual Turnover + Uninsured standing charges}}$

$$= ₹\ 1,50,000 \times \frac{9,68,000}{9,68,000 + 80,000} = ₹\ 1,38,550$$

(6) Statement of Claim

Particulars	₹
Loss of Gross Profit (Note 3)	2,80,000
Add: Admissible Increased Working Cost (Note 5) being lower	80,000
	3,60,000
Less: Saving in Insured standing charges	30,000
Gross Claim	3,30,000

(7) Application of Average Clause

$$\text{Net Claim} = \text{Gross Claim} \times \frac{\text{Policy Value}}{\text{G.P. on Annual Sales}} = ₹\ 3,30,000 \times \frac{7,50,000}{9,68,000} = ₹\ 2,55,682$$

Illustration 37

A fire occured in the premises of a businessman on 31st January 2015, which destroyed stock. However, stock worth ₹ 5,940 was salvaged. The company's insurance policy covers the following:

Stock — ₹ 6,00,000; Loss of profit (including standing charges) — ₹ 3,75,000; and Period of indemnity — 6 months.

The summarised Profit and Loss Account for the year ended 31st December, 2014 is as follows: (all figures in ₹)

Dr. Profit and Loss Account for the year ended 31st December, 2014 Cr.

To Opening Stock	6,18,750	By Sales	30,00,000
To Purchases	27,18,750	By Closing Stock	7,87,500
To Standing charges	2,51,250		
To Variable expenses	1,20,000		
To Net Profit	78,750		
	37,87,500		37,87,500

The transactions for the month of January, 2015 were: (i) Turnover — ₹ 1,50,000; and (ii) Payment to creditors — ₹ 1,60,020. *Trade Creditors*: 1st January, 2015 — ₹ 2,26,000; 31st January, 2015 — ₹ 2,30,980.

The company's business was disrupted until 30th April, 2015, during which period the reduction in the turnover amounted to ₹ 2,70,000 as compared with the corresponding turnover of same period in the previous year.

You are required to submit the claim for insurance for loss of stock and loss of profit.

Solution

Loss of Stock

Dr. Memorandum Trading Account for the period 1st January to 31st January, 2015 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	7,87,500	By Sales	1,50,000
To Purchases (Note 3)	1,65,000	By Closing Stock (Balancing figure)	8,25,000
To Gross Profit @ 15% on Sales (Note 2)	22,500		
	9,75,000		9,75,000

Statement of Claim for Loss of Stock as on 31st January, 2015

Particulars	₹
Book value of Stock	8,25,000
Less: Salvaged	5,940
Loss of Stock	8,19,060

The insurance policy for loss of stock was taken for ₹ 6,00,000 but the value of stock on the date of fire was ₹ 8,25,000. Therefore, the average clause is applicable.

$$\text{Net claim} = \text{Loss of stock} \times \frac{\text{Policy Value}}{\text{Value of stock on the date of fire}} = ₹\ 8{,}19{,}060 \times \frac{6{,}00{,}000}{8{,}25{,}000} = ₹\ 5{,}95{,}680$$

Working Notes:

Dr. (1) Trading Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	6,18,750	By Sales	30,00,000
To Purchases	27,18,750	By Closing Stock	7,87,500
To Gross Profit	4,50,000		
	37,87,500		37,87,500

(2) Rate of Gross Profit = ₹ 4,50,000 / ₹ 30,00,000 x 100 = 15%.

Dr. (3) Trade Creditors Account Cr.

Particulars	₹	Particulars	₹
To Bank A/c	1,60,020	By Balance b/d	2,26,000
To Balance c/d	2,30,980	By Purchases (credit)	1,65,000
	3,91,000		3,91,000

Loss of Profit

(1) Gross Profit Ratio

	₹
Net Profit in 2014	78,750
Insured standing charges	2,51,250
Gross Profit	3,30,000

$$\text{Rate of Gross Profit} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100 = \frac{3{,}30{,}000}{30{,}00{,}000} \times 100 = 11\%.$$

(2) Short Sales = ₹ 2,70,000 (given).

(3) Amount of Claim = Short Sales x Gross Profit Ratio = ₹ 2,70,000 x 11% = ₹ 29,700. (The claim is payable in full, since the policy is adequate).

Illustration 38

A "loss of profit" policy was taken for ₹ 80,000. Fire occured on 15th March, 2015. Indemnity period was for three months. Net profit for 2014 year ending on 31st December was ₹ 56,000 and standing charges (all insured) amounted to ₹ 49,600. Determine insurance claims from the following details available from quarterly sales tax returns:

Sales	2012 (₹)	2013 (₹)	2014 (₹)	2015 (₹)
From 1st January to 31st March	1,20,000	1,30,000	1,42,000	1,30,000
From 1st April to 30th June	80,000	90,000	1,00,000	40,000
From 1st July to 30th September	1,00,000	1,10,000	1,20,000	1,00,000
From 1st October to 31st December	1,36,000	1,50,000	1,66,000	1,60,000

Sales from 16.3.2014 to 31.3.2014 were ₹ 28,000. Sales from 16.3.2015 to 31.3.2015 were ₹ Nil.
Sales from 16.6.2014 to 30.6.2014 were ₹ 24,000 and Sales from 16.6.2015 to 30.6.2015 were ₹ 6,000.

Solution

(1) Gross Profit Ratio

	₹
Net Profit in 2014	56,000
Insured standing charges	49,600
Gross Profit	1,05,600

$$\text{Rate of Gross Profit} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100 = \frac{1{,}05{,}600}{^{*}5{,}28{,}000} \times 100 = 20\%.$$

*(₹ 1,42,000 + ₹ 1,00,000 + ₹ 1,20,000 + ₹ 1,66,000)

(2) Short Sales

(a) Standard Sales (adjusted)	
Indemnity period : 16.3.2015 to 15.6.2015.	
Standard sales are to be calculated on the basis of sales of corresponding period of the previous year, i.e., 16.3.2014 to 15.6.2014. In this problem, however, sales value for this period has not been given directly. Therefore, it is to be calculated part by part from the given information :	₹
(i) Sales for the period 16.3.2014 to 31.3.2014 (given)	28,000
(ii) Sales for the period 1.4.2014 to 15.6.2014 (Note 1)	76,000
	1,04,000
Add: Upward trend in Sales 10% (Note 2)	10,400
	1,14,400
(b) Actual Sales of disorganised period	₹
Sales value from 16.3.2015 to 15.6.2015 has not been given directly. So it is also to be calculated part by part from the given information:	
(i) Sales for the period 16.3.2015 to 31.3.2015	Nil
(ii) Sales for the period 1.4.2015 to 15.6.2015 (Note 3)	34,000
	34,000
Short Sales = Standard Sales – Actual Sales = ₹ 1,44,400 – ₹ 34,000 = ₹ 80,400	

(3) Loss of Gross Profit = Short Sales x Gross Profit Ratio = ₹ 80,400 x 20% = ₹ 16,080.

(4) Application of Average Clause

$$\text{Net Claim} = \text{Gross Claim} \times \frac{\text{Policy Value}}{\text{Gross Profit on Annual Turnover}}$$

$$= ₹\ 16{,}080 \times \frac{80{,}000}{1{,}19{,}680} = ₹\ 10{,}749 \text{ (approx.)}$$ Amount of claim under the policy = ₹ 10,749.

Working Notes:

(1) Sales for the period 1.4.2014 to 30.6.2014 (given)	1,00,000
Less: Sales for the period 16.6.2014 to 30.6.2014 (given)	24,000
Sales for the period 1.4.2014 to 15.6.2014	76,000

(2) Calculation of Upward Trend in Sales

(a) Total Sales of 2013 = ₹ 4,80,000 less total sales of 2012 = ₹ 4,36,000. Increase of Sales in 2013 over 2012 = ₹ 44,000.
Therefore, % of increase = ₹ 44,000 / ₹ 4,36,000 x 100 = 10.09%.

(b) Total Sales of 2014 = ₹ 5,28,000 less total Sales of 2013 = ₹ 4,80,000. Increase of Sales in 2014 over 2012 = ₹ 48,000.
Therefore, % of increase = ₹ 48,000 / ₹ 4,80,000 x 100 = 10%.

Average Percentage of increase = (10.09% + 10%) / 2 = 10% (Approx.)

(3) Annual Sales	₹	₹
Sales from 16.3.2014 to 31.3.2014	28,000	
Sales from 1.4.2014 to 30.6.2014	1,00,000	
Sales from 1.7.2014 to 30.9.2014	1,20,000	
Sales from 1.10.2014 to 31.12.2014	1,66,000	
Sales from 1.1.2015 to 5.3.2015 (₹ 30,000 – Nil between 16.3.2015 to 31.3.2015)	1,30,000	
Sales for 12 months just before fire		5,44,000
Add: 10% increase (upward trend)		54,400
Adjusted sales of 12 months just before fire		5,98,400
Gross Profit on Annual Sales = ₹ 5,98,400 x 20% =		1,19,680

Cash Losses

Cash is the most liquid of all assets. Therefore, it is subject to loss or theft. It is necessary to establish a sound system of internal control to safeguard cash. One way of controlling cash is to prove frequently that the amount of cash in hand agrees with the accounting records. When a discrepancy is anticipated, the value of suspected losses can be calculated as follows :

Step 1 To calculate the cost of goods sold by applying the formula :

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

Step 2 To calculate the theoretical value of sales by applying the mark-up rate (i.e., percentage of profit on cost) to the cost of goods sold.

Step 3 To deduct recorded sales from theoretical sales and to calculate the shortfall in recorded sales, and hence cash.

Illustration 39

The owner of a departmental store suspects that receipts from cash sales are being stolen. He ascertains the following for the month of July, 2015 :

Stock at 1.7.2015 : ₹ 15,762; Purchases during July, 2015 : ₹ 68,570; Recorded sales : ₹ 80,840; Stock at 31.7.2015 : ₹ 17,056.

All goods are sold at a price to yield a gross profit of 20% on selling price.

Calculate the value of any cash discrepancy for submission to the insurance company.

Solution

Dr. Memorandum Trading Account for the period 1st July to 31st July, 2015 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	15,762	By Sales (Note 1)	84,095
To Purchases	68,570	By Closing Stock	17,056
To Gross Profit	16,819		
	1,01,151		1,01,151

Statement of Claim for Loss of Cash as on 31st July, 2015

	₹
Theoretical Value of Sales	84,095
Less: Recorded Sales	80,840
Claim to be Lodged	3,255

Working Note :

(1) Cost of goods sold = Opening Stock + Purchases – Closing Stock
= ₹ (15,762 + 68,570 – 17,056)
= ₹ 67,276.

Gross Profit is 20% on Sales. Therefore, cost of goods sold = 80% of Sales.

Sales = ₹ 67,276 / 80 × 100 = ₹ 84,095.

Illustration 40

Roshan & Co. sells goods in cash as well as on credit. A riot occurred on the night of 18.2.2015. Though stock and books of account were saved, the owner suspects that there is a discrepancy between recorded cash sales and actual cash sales. The firm wishes to submit a claim for the loss of cash.

The following information is available :

(a) The firm's accounting year ends on 31st December, and the Balance Sheet at that date in 2015 showed stock ₹ 66,000, debtors ₹ 54,000 and creditors ₹ 42,000.

(b) During the period 1.1.2015 to 18.2.2015, the following transactions took place —

	₹		₹
Receipts from Debtors	97,000	Discount Received	400
Discount Allowed	1,000	Cash Sales	30,000
Payments to Creditors	68,000	Withdrawal of Stock by the Owner	600

(c) The firm's ledger shows that on 18.2.2015, debtors and creditors were ₹ 57,000 and ₹ 39,000 respectively.

(d) A stock-take, carried out immediately after the riot, showed the value of stock to be ₹ 28,050.

(e) The firm makes a gross profit of 25% on the selling price of its goods.

You are required to prepare a Statement showing the Loss of Cash.

Solution

Dr. Memorandum Trading Account for the period 1st January to 18th February, 2015 Cr.

Particulars		₹	Particulars		₹
To Opening Stock		66,000	By Sales		
To Purchases	65,400		Cash (Balancing figure)	36,000	
Less: Drawings	600	64,800	Credit (Note 2)	1,01,000	1,37,000
To Gross Profit (Note 3)		34,250	By Closing Stock		28,050
		1,65,050			1,65,050

Statement of Claim for Loss of Cash as on 18th February, 2015

	₹
Theoretical Value of Cash Sales	36,000
Less: Recorded Sales	30,000
Claim to be Lodged	6,000

Working Notes :

(1) Creditors Account

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Feb. 18	To Bank A/c	68,000	Jan. 1	By Balance c/d	42,000
	To Discount Received A/c	400	Feb. 18	By Purchases (Balancing figure)	65,400
	To Balance c/d	39,000			
		1,07,400			1,07,400

(2) Debtors Account

Date	Particulars	₹	Date	Particulars	₹
2015			2015		
Jan. 1	To Balance b/d	54,000	Feb. 18	By Bank A/c	97,000
Feb. 18	To Sales (Credit — Balancing figure)	1,01,000		By Discount Allowed A/c	1,000
				By Balance c/d	57,000
		1,55,000			1,55,000

(3) Cost of goods sold = Opening Stock + Purchases – Closing Stock = ₹ (66,000 + 64,800 – 28,050) = ₹ **1,02,750**.
Gross Profit is 25% on Sales. Therefore, Cost of goods sold is 75% of Sales. Sales = ₹ 1,02,750 / 75 × 100 = ₹ 1,37,000.
Gross Profit = 25% on ₹ 1,37,000 = ₹ **34,250.**

Key Points

- A business takes a fire insurance policy to cover (i) the loss of assets including stock; and (ii) loss of profit (consequential loss). A business may take insurance policy for loss of cash due to theft or misappropriation.
- There are two steps for determination of claim for loss of stock: (1) Ascertainment of the value of stock on the date of fire; and (2) Ascertainment of actual amount of claim to be lodged.
- Net Claim = Loss of Stock x $\dfrac{\text{Policy Value}}{\text{Value of Stock on the date of fire}}$
- **Indemnity Period** is the period beginning with the occurrence of the Damage and ending not later than 12 months thereafter during which the results of the business shall be affected in consequence of the damage.
- The turnover during the twelve months immediately before the date of the damage is known as the **Annual Turnover**.
- The turnover during that period in the twelve months immediately before the date of damage which corresponds with the indemnity period is called the ***Standard Turnover***.

THEORETICAL QUESTIONS

1. Explain the various steps for ascertaining the loss of stock by fire.
2. How is the gross profit computed for the purpose of insurance on loss of profit?
3. Write short notes on:
   (a) Average clause; (b) Indemnity period; (c) Annual sales; (d) Short sales; and (e) Increased cost of working.
4. Explain the different steps for ascertaining the amount of claim for loss of profit.
5. Why is it necessary to insure the assets of the business while taking up a policy on loss of profit?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below :

1. When a fire takes place, the business naturally incurs heavy
   A expenditure
   B losses
   C none of these

2. A business takes a fire insurance policy to cover the loss of asets including
   A liabilities
   B stock
   C none of these
3. Gross profit is calculated on sales, based on usual gross profit percentage of the
   A last few years
   B last year
   C none of these
4. Fire insurance policies may contain an "average clause" to
   A discourage under-insurance
   B encourage under-insurance
   C none of these
5. The terms of loss of profit policies are usually framed to meet the requirements of the
   A insurer
   B insured
   C none of these

PRACTICAL QUESTIONS

Loss of Stock

1. A fire occured on 15th April, 2015 and destroyed the business premises of Johnson & Co. The books of account and stock amounting to ₹ 18,000 were saved and the following information was available from the books:

Year ended 31st December	2010	2011	2012	2013	2014
Sales (₹)	8,60,000	7,10,000	6,00,000	5,50,000	4,80,000
Gross Profit (₹)	2,15,000	2,13,000	2,10,000	1,87,000	1,72,800

The stock on 31st December, 2014 was valued at ₹ 97,000. The purchases, sales and productive wages from 1st January, 2015 to 14th April, 2015 were ascertained at ₹ 75,000, ₹ 1,59,000 and ₹ 30,000 respectively.
Prepare a statement in support of the claim for loss of stock against the insurance company.

2. There was a fire in godown of Spark Ltd. on 1.7.2015. Stock worth ₹ 30,000 was saved. The goods were insured and fully covered.
   (i) An average gross profit of 20% on sales is maintained by the company.
   (ii) The stock is valued at 10% above cost.
   The purchases and sales for first 6 months of the year were ₹ 2,10,000 and ₹ 4,50,000 respectively. Stock on January 1, 2015 was ₹ 1,48,500. the wages for that period amounted to ₹ 90,000.
   Find out the cost of stock burnt.
3. M owns a retail stationery shop which is partly destroyed by fire on 27th June 2015. The stock is insured for ₹ 10,500 and is subject to average clause. The opening Balance Sheet drawn on January 1, 2015 includes, inter alia, the following items:
   Stock — ₹ 12,500; Trade creditors — ₹ 3,500.
   On examination of the books of account for the subsequent period up to the date of fire, the following particulars are obtained:
   Sales — ₹ 88,800; Payment to creditors for goods — ₹ 75,000; Trade creditors as on 27.6.2015 — ₹ 1,800.
   An inspection of stock after the fire shows that items undamaged are ₹ 7,000. The normal rate of gross profit is 25% on purchases but the stock on January 1, 2015 includes items of discontinued lines costing ₹ 3,800 which are all sold during the next two months at cost.
   You are required to compute the amount of claim to be made to the insurer.
4. The premises of Bombay Sports House caught fire on 1st April, 2015 and its stock was damaged. The firm made up accounts to 31st May each year. The following information is available: (all figures in ₹)

	1st June 2013 to 31st May 2014	1st June 2014 to 1st April 2015
Stock at commencement conventionally valued at 10% above cost	1,05,754	1,45,992
Purchases	4,52,580	3,48,270
Sales	5,20,000	4,91,700

In December 2014, goods which cost ₹ 10,000 were given away to Gymkhana Secretaries of various colleges for advertising purposes. No entry was made in the books. During the same month a salesman misappropriated unrecorded cash sales of ₹ 4,000. The rate of gross profit is constant. From the above, make an estimate of stock in hand on the date of fire.

5. The premises of Eagle Pen Company caught fire on 22nd October 2014 and the stock was damaged. The firm made up accounts to 31st December each year, and on 31st December 2013 the stock at cost was ₹ 13,272 as against ₹ 9,614 on 31st December 2012.

   Purchases from 1st January 2014 to the date of fire were ₹ 34,827 as against ₹ 45,258 for the full year 2013 and the corresponding sales figures were ₹ 49,170 and ₹ 52,000 respectively.

   You are given the following further information:

   (a) In April 2014 goods which cost ₹ 1,000 were given away for advertising purposes, with no entries being made in the books.

   (b) During 2014 a clerk misappropriated unrecorded cash sales. It is estimated that the defalcation averaged ₹ 20 per week from 1st January 2014 until the clerk was dismissed on 21st May 2014.

   (c) The rate of gross profit is constant.

   From the foregoing information make an estimate of the stock on hand on the date of fire.

6. A fire occured on 15th September 2015 in the premises of X Co. Ltd. From the following figures, calculate the amount of claim to be lodged with the insurance company for loss of stock:

	₹		₹
Stock at cost as on 1st January 2014	20,000	Purchases from 1st January 2015 to 1st Sept. 2015	88,000
Stock at cost as on 1st January 2015	30,000	Sales — 2014	60,000
Purchases — 2014	40,000	Sales from 1st January 2015 to 15th Sept. 2015	1,05,000

   During the current year cost of purchases has risen by 10% above last year's level. Selling prices have gone up by 5%. Salvage value of stocks after fire was ₹ 2,000.

7. A fire on October 1, 2015 destroyed the stocks of a firm. The business records were saved and from them the following particulars were ascertained:

	₹		₹
Stock at cost on April 30, 2014	44,300	Sales for the year to April 30, 2015	1,52,500
Stock at cost on April 30, 2015	37,550	Purchases from May 1, 2015 to September 30, 2015	37,350
Purchases for the year to April 30, 2015	1,03,850	Sales from May 1, 2015 to September 30, 2015	59,000

   In valuing the stock on April 30, 2015 ₹ 800 were written-off a particular line of goods which originally cost ₹ 1,800 and which were sold in June 2015 for ₹ 1,750. Except this transaction, the ratio of gross profit remained unchanged throughout.

   The value of stock salvaged from the fire was ₹ 5,105. You are required to calculate the amount of claim to be presented to the insurance company in respect of the loss of stock.

8. On 1st April, 2015 the godown of Stone Ltd. was destroyed by fire. The records of the company revealed the following particulars:

	₹		₹
Stock on 1st January, 2014	75,000	Sales during 2014	4,00,000
Stock on 31st December, 2014	80,000	Purchases from 1st January, 2015 to the date of fire	75,000
Purchases during 2014	3,10,000	Sales from 1st January, 2015 to the date of fire	1,00,000

   In valuing closing stock of 2014, ₹ 5,000 were written-off whose cost was ₹ 4,800. Part of this stock was sold in 2015 at a loss of ₹ 400, ₹ 2,400. Stock salvaged was ₹ 5,000. The godown and the cost of which was fully insured.

   Indicate from above, amount of the claim to be made against the insurance company.

9. The premises of a company was destroyed by fire on 15th June, 2015. The records were, however, saved which from the following particulars were available (all figures in ₹):

Stock at cost as on 1st January 2014	30,000	Sales less returns for the year ended Dec. 31, 2014	2,50,000
Stock at cost as on 31st December 2014	40,000	Purchases less returns from 1.1.2015 to 15.6.2015	85,000
Purchases less returns for the year ended Dec. 31, 2014	2,00,000	Sales less returns from 1.1.2015 to 15.6.2015	1,20,000

   ₹ 2,500 were written-off a certain stock, which was a poor selling line, while valuing the stock for the Balance Sheet as at December 31, 2014. The cost of such stock was ₹ 4,000. A portion of this stock was sold in March 2015 at a loss of ₹ 500 on the original cost of ₹ 2,000. The balance of this stock is now estimated to be worth the original cost. Excepting the above, the gross profit remained at a uniform rate throughout. The stock saved was ₹ 5,000. You are required to ascertain the amount of loss of stock which is to be claimed from the insurance company.

10. A fire occured in the godown of M/s. Krishna Traders on 31st March 2015. The stock as on 31st December 2014 was valued at ₹ 5,88,000. From the following particulars relating to the period from 1st January 2015 to 31st March 2015, you are required to ascertain the amount of claim to be lodged with the insurance company in respect of the value of goods destroyed by fire:
    (1) The purchases during the above period amounted to ₹ 2,13,000 of which goods costing ₹ 30,000 were received on 8th May, 2015.
    (2) Goods costing ₹ 15,000 were found defective and were sold for ₹ 9,000. The goods in question had been included in the closing stock as at 31st December 2014, at cost.
    (3) The closing stock as at 31st December 2014 was undervalued by ₹ 12,000.
    (4) The sales during the above period amounted to ₹ 2,79,000 of which "sales on approval" basis amounted to ₹ 30,000. No intimation was received from the customers in respect of 60% of the goods sold on approval basis.
    (5) On 20th February 2015, goods costing ₹ 68,000 were sent to consignee and the same were lying unsold with them.
    (6) The accounting year of the firm ends on 31st December every year and the sales and gross profits of the preceding 5 years are as under:

Year	Sales (₹)	Gross Profit (₹)
2010	13,97,500	3,49,375
2011	11,53,750	3,46,125
2012	9,75,000	3,25,000
2013	8,93,750	3,03,875
2014	9,75,000	3,37,050

    The gross profit during the period of fire should be taken on the basis of the weighted average of last five years' profits, giving more weightage to the results of the later years.
    (7) The value of the goods salvaged was estimated at ₹ 1,20,000.
    (8) The insurance policy taken out by the company was for ₹ 3,00,000. The policy was subject to average clause.
11. A fire occurred in the premises of Malcom Marshall & Co on 15.5.2012 causing destruction of a large part of the stock. The firm had taken a fire insurance policy for ₹ 5,47,200 to cover the loss of stock by fire. From the records saved, the following particulars were ascertained :

	₹
Purchases for the year 2011	30,01,600
Sales for the year 2011	37,12,000
Purchases from 1st January 2012 to 15th May 2012	5,82,400
Sales from 1st January 2012 to 15th May 2012	7,68,000
Stock on 1st January 2011	4,60,800
Stock on 31st December 2011	7,74,400
Wages paid during 2011	3,20,000
Wages paid during 1st January 2012 to 15th May 2012	57,600
Stock salvaged was	89,600

    In 2011 some goods were destroyed by fire. The cost of such goods were ₹ 1,60,000. These goods were not covered by any insurance policy.
    In valuing the stock on 31st December, 2011 stocks costing ₹ 34,000 were found to be poor selling line and ₹ 6,000 in relation to such stock were written-off. A portion of these goods (original cost ₹ 5,000) were sold in April, 2012 at a loss of ₹ 1,000 on original cost. The remainder of this stock was now estimated to be worth the original cost. Subject to the above exception, gross profit has remained at a uniform rate throughout.
    You are required to ascertain the insurance claim available to the firm.

Loss of Profit

12. On 31st December 2014, a fire damaged the premises of Shanker Ltd. and the business of the company got disorganised till 31st March, 2015. The company was insured under a loss of profit for ₹ 1,95,000 with a six month's period indemnity. The company's account for the year ended 31st October, 2014 showed a turnover of ₹ 5,25,000 with a net profit of ₹ 60,000. The amount of standing charges covered by the insurance and debited in that year was ₹ 1,50,000. The turnover for the twelve months ended 31st December, 2014 was ₹ 5,85,000. The turnover during the period the business was dislocated amounted to ₹ 60,000 while during the corresponding period in the preceding year it was ₹ 1,27,500. A sum of ₹ 15,000 was spent as additional expenses to mitigate the effect of the loss, there being no saving, however, in standing charges as a result of fire.
    Prepare a claim to be submitted in respect of the consequential loss policy.
13. There was a serious fire in the premises of M/s. Fortunate on 1st September, 2014. Their business activities were interrupted till 31st December, 2014 when normal trading conditions were re- established. M/s Fortunate are insured under the loss of profit policy for ₹ 42,000, the period of indemnity being six months.

You are able to ascertain the following information:

(1) The net profit for the year ended 31st December 2013 was ₹ 20,000;

(2) The annual insurable standing charges amounted to ₹ 30,000 of which ₹ 2,000 were not included in the definition of insured standing charges under the policy;

(3) The additional cost of working in order to mitigate the damage caused by the fire amounted to ₹ 600, and, but for this expenditure, the business would have had to shut down;

(4) The saving in insured charges in consequence of the fire amounted to ₹ 1,500;

(5) The turnover for the period of four months ended April 30th, August 31st and December 31st in each of the years 2013 and 2014 was as under:

	April 30 (₹)	August 31 (₹)	December 31 (₹)
2013	65,000	80,000	95,000
2014	70,000	80,000	15,000

You are required to compute the relevant claim under the terms of the loss of profit policy.

14. A fire occurred on 1st July 2014 in the premises of Arolite Ltd., and business was disorganised up to 30th November 2014.

From the books of account, the following information was extracted (all figures in ₹) :

Actual turnover from 1st July 2014 to 30th Nov. 2014	60,000	Turnover for the last financial year	5,00,000
Turnover from 1st July 2013 to 30th Nov. 2013	2,00,000	Turnover for the year ending 30th June 2014	5,50,000
Net Profit for the last financial year	90,000	Total standing charges for the year	72,000
Insured standing charges for the last financial year	60,000		

The company incurred additional expenses amounting to ₹ 9,000 which reduced the loss in turnover. There was also a saving of ₹ 2,486 during the indemnity period.

The company holds a "Loss of profit" policy for ₹ 1,65,000 having an indemnity period for 6 months. There was a considerable increase in trade and it was agreed that an adjustment of 20% be made in respect of upward trend in turnover. Compute claim under "Loss of profit insurance".

15. On 1st November 2014, a severe fire broke out in the premises of Good Luck Co. Ltd. The indemnity period lasted for 4 months during which the sales of the Company were reduced to ₹ 2,00,000 only. The company closes its accounts on 30th June each year. The Profit and Loss Account for the year ended 30th June 2014 is given below:

	₹		₹
Opening Stock	5,00,000	Sales	47,50,000
Purchases	30,00,000	Closing Stock	2,50,000
Variable Expenses	7,87,500		
Standing charges	3,62,500		
Net Profit	3,50,000		
	50,00,000		50,00,000

The Company took a loss of profit policy for a sum of ₹ 6,00,000. The sales of the company for the 12 months ending the date of fire were ₹ 50,00,000 and for the 4 months from 1st November, 2013 to 29th February 2014 were ₹ 15,00,000. It was noted that the sales for the first four months of the year under indemnity were 20% higher than the previous year. Compute the claim for loss of profit.

16. From the following information, compute a consequential loss claim:

Financial year ends on 31st December : Turnover ₹ 2,00,000; Indemnity period — 6 months.

Period of interruption — 1st July to 31st October.

Net profit — ₹ 18,000. Standing charges — ₹ 42,000 out of which ₹ 10,000 have not been insured.

Sum assured — ₹ 50,000. Standard turnover — ₹ 65,000.

Turnover in the period of interruption — ₹ 25,000 out of which ₹ 6,000 was from a rented place at ₹ 600 p.m.

Annual turnover — ₹ 2,40,000. Savings in standing charges — ₹ 4,725 per annum.

Date of fire — night of 30th June.

It was agreed between the insurer and the insured that the business trends would lead to an increase of 10% in the turnover.

17. From the following details, determine the amount of claim under a loss of profit policy :

Indemnity period	4 months
Date of fire	1.4.2014
Dislocation continued upto	1.8.2014
	₹
Sum insured	60,000
Sales for the last accounting year	2,40,000

Net profit for the last accounting year	34,000
Standing charges for the last accounting year all insured	26,000
Sales for the dislocation period, i.e., 1.4.2014 to 1.8.2014	30,000
Sales for the year 1.4.2013 to 31.3.2014	3,20,000
Sales for the corresponding period in the preceding year, i.e., 1.4.2013 to 1.8.2013	1,00,000

The policy contains special circumstances clause which stipulates for increase of turnover (standard and annual) by 10% as there is an upward trend in the business.

18. Calculate the amount of claim for consequential loss from the following information :
    (i) The policy is for ₹ 4,90,000 with a six months period of indemnity.
    (ii) On 1st July, 2014 fire broke out and sales of 3 months were affected.
    (iii) Sales for 12 months ended 30th June, 2014 amounted to ₹ 5,00,000.
    (iv) A sum of ₹ 1,000 was spent as additional expenses to mitigate the effect of loss.
    (v) After debiting insured standing charges of ₹ 25,000, the net profit for the year 2013 amounted to ₹ 2,00,000.
    (vi) Sales for the year 2013 amounted to ₹ 4,50,000.
    (vii) Accounts are closed each year on 31st December.
    (viii) Sales for 3 months ending 30th September, 2013 were ₹ 1,00,000.
    (ix) Sales for 3 months ending 30th September, 2014 were ₹ 40,000.
19. Mitra & Co. has taken out a policy against consequential loss, the amount of the policy being ₹ 60,000 for 2013-14 and the indemnity period being 18 months. A fire occurred on 1st September, 2013 in the premises of Mitra & Co., which interrupted business for a period of 12 months. The Profit and Loss Account for the year ended 31st March, 2013 showed a sale of ₹ 2,40,000 and a profit of ₹ 20,000 after debiting ₹ 30,000 standing charges of which ₹ 2,000 were not insured. You have ascertained the turnover for the various periods as :

Year		2012	2013	2014
5 Months ended 31st August	(₹)	1,00,000	1,10,000	20,000
7 Months ended 31st March	(₹)	1,40,000	1,40,000	10,000

Additional expenses totalled ₹ 7,800 and the saving in expenses was ₹ 1,500.
Compute the claim for loss of profit in respect of the policy.

Guide to Answers

Multiple Choice

1. B 2. B 3. A 4. A 5. B.

Practical Questions

1. **Rate of gross profit on sales — 25%; 30%; 35%; 34%; 36%. Average rate of gross profit — 32%; Stock on the date of fire — ₹ 93,880; Insurance claim ₹ 75,880.**
2. **Insurance claim — ₹ 75,000 – ₹ 30,000 = ₹ 45,000. It is assumed that in the preceding years there was no difference between the amount of opening stock and closing stock. Thus the gross profits of all the years were same, i.e., 20%.**
3. **Insurance claim — ₹ 5,250.**
4. **Gross profit on sales — 20%; Stock in hand on the date of fire ₹ — 74,430.**
5. **Stock in hand on the date of fire — ₹ 7,443.**
6. **Rate of gross profit on sales — 50%; Insurance claim — ₹ 64,000.**
7. **Insurance claim ₹ 27,575.**
8. **Rate of gross profit on sales — 25%; Insurance claim — ₹ 79,100.**
9. **Rate of gross profit on sales — 25%; Total stock on the date of fire — ₹ 36,625; Insurance claim — ₹ 31,625.**
10. **Average rate of gross profit — (500 / 15) = $33^1/_3$%. Loss of stock — ₹ 4,00,000. Net Claim (after average clause) — ₹ 2,30,769.**
11. **Rate of Gross Profit — 23.4375%; Loss of Stock — ₹ 7,40,863; Net Claim — ₹ 4,88,162.**
12. **Upward trend — 80/7%; Short sales — ₹ 82,071; Rate of gross profit — 40%; Additional expenses incurred — ₹ 15,000; Loss of profit = ₹ 47,828. Net claim after average clause — ₹ 39,857.**
13. **Gross profit — 20% (₹ 48,000/2,40,000). Short sales — ₹ 80,000; Additional expenses admissible — ₹ 576; Loss of profit — ₹ 15,076; Net claim — ₹ 12,922.**
14. **Rate of gross profit — ₹ 30%; Short sales — ₹ 1,80,000; Additional expenses admissible — ₹ 8,486; Gross claim — ₹ 60,000; Net claim — ₹ 50,000.**
15. **Short sales — ₹ 16,00,000; Claim for loss of profit — ₹ 1,92,000.**
16. **Rate of gross profit (after adjustment) — 28% for loss of stock; Value of stock on the date of fire — ₹ 83,200; Claim for loss of stock will be limited to ₹ 80,000.**
    Gross profit for loss of profit — 20%; Short sales (after adjustment) — ₹ 2,28,000; Groff profit on short sales ₹ 45,600 + Additional expenses ₹ 12,000 = Total claim ₹ 57,600. Average clause is not applicable.
17. **Gross profit ratio = 25%. Short sales ₹ 80,000. Amount of net claim = ₹ 13,636 (after applying average clause).**
18. **Gross profit ratio = 50%. Short sales ₹ 60,000. Net claim = ₹ 31,000 (the average clause will not be applicable).**
19. **Gross profit = 20%. Short sales — ₹ 2,45,000. Amount of insurance claim = ₹ 53,500. Increased cost of workings (admissible) ₹ 6,000.**

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Profit and Loss Appropriation Account

Meaning of Partnership

Partnership is the relation that exists between or among persons carrying on business in common with a view to earn profit. The partnership form of enterprise is very common and popular because (1) it is easy to form; (2) it allows several individuals to combine their talents and skills in a particular business venture; (3) it provides a means of obtaining more capital than a single individual can obtain; and, (4) it allows the sharing of risks for rapidly growing businesses.

In India partnership is governed by The Indian Partnership Act, 1932. Section 4 of this Act defines partnership as ***'the relationship between persons who have agreed to share the profit of a business carried on by all or any of them acting for all'.***

From the foregoing definition, it is clear that partnership consists of three essential elements:

1. The partnership must be the result of an agreement between two or more persons.
2. The agreement must be to share profits or losses of the business.
3. The business must be carried on by all or any of them acting for all.

In the absence of any of these essentials, a partnership cannot be formed.

Persons who enter into a partnership are individually called ***partners***, and collectively, ***a firm***.

A partnership may be formed when a sole proprietor of an existing business agrees with one or more persons to combine assets and/or skills. Persons may also start a new business that has not existed before. Partnerships are common in wholesale businesses, in small retail stores, and in personal service businesses. Partnerships are also often used for professional businesses such as accounting and audit firms, law firms and medical clinics.

Features of Partnership

The following are the features of partnership:

1. There should be two or more persons to form a partnership. But the number of persons must not exceed 20, and in case of banking business, it must not exceed 10. It should be noted that if the number of

persons exceeds the above limit, the partnership becomes illegal and it cannot enter into a contract with a third party or file a legal suit.

2. The persons must agree to share the profits or losses of the business.
3. The business must be carried on by all or any of them acting for all. Each partner is a co-owner of the partnership assets and liabilities. Each partner is considered as an agent of the partnership firm capable of transacting business in the name of the partnership. In effect, any partner can bind the other partners when acting within the scope of the partnership activities.
4. The liability of the partners is unlimited. A partner is both jointly and severally liable to third parties. At any point of time, if the assets of a partnership firm are not sufficient to pay its liabilities, creditors may take action against the personal assets of any or all of the partners.
5. In the eyes of the law, partners and the firm are not separate entities.
6. A partnership legally terminates as a business entity each time there is a change in the constitution, for instance, change in the profit sharing ratio, admission, retirement or death of a partner. A partnership agreement should include provisions for changes in the constitution so that the business is not interrupted.

Partnership Deed

Since partnership is an agreement between two or more persons, it is advisable that a Partnership Deed or Partnership Agreement, showing the terms and conditions, should be drawn up and signed by all the partners. The Partnership Deed may be entered into orally or written on paper. Though the Partnership Act does not make it obligatory that a firm must have a Partnership Deed in writing, yet it is better to have it in black and white to avoid confusion in future. A Partnership Deed, generally, includes the following :

1. The name of the partners;
2. The name of the firm under which it is to work;
3. The nature of business to be carried on by the firm;
4. The conduct and the powers of the partners;
5. When termination is certain, the term of duration of partnership;
6. The amount of capital to be contributed by each partner;
7. The restrictions on working of each partner;
8. Methods of division of profits or losses;
9. Salary, commission, interest on capital payable to the partners;
10. Interest on drawings to be charged on withdrawals;
11. Interest on loan payable to a partner;
12. Valuation of goodwill when there is a change in the constitution of the firm;
13. Methods to be followed when there is a change in the constitution of the firm;
14. Methods of keeping books of account; and
15. Arbitration clause, that is, the procedure to be followed in the event of dispute.

Kinds of Partners

General and Limited Partners

Ordinarily, each partner is equally liable for any debts or other obligations incurred by any of the partners in the name of the business, that is, each partner is personally liable to creditors for all debts of the partnership if the other partners fail to meet their obligations under the agreement. Such partners are known as ***general partners*** and the partnership, a ***general partnership***. But by the virtue of the provisions of the Partnership Act, some partner or partners may have limited liability — to the extent of their respective capital contribution. Such partners are called ***limited partners*** and the firm is known as ***limited partnership***. It goes without saying that the liability of only some of the partners can be unlimited. In other words, every limited partnership must have at least one general partner.

For having limited liability, the rights of a limited partner are also limited. He cannot take part in the management of the business. He cannot control the books of account, but can inspect or advise the other partners. He cannot dissolve partnership. Therefore, a limited partner is an inactive partner, who only contributes capital and merely shares profits or losses of the firm; he has no right to interfere if he dislikes the way the business is being carried on. Limited partners must be identified as such to creditors and others doing business with the partnership firm.

Active or Ordinary Partners are those who take active part in the conduct of the business.

Sleeping, Dormant or Silent Partners are those who do not take any part in the conduct of the business. They only provide money into the business as capital and share profits and losses in the agreed ratio.

Nominal or Ostensible Partners are those who do not contribute any capital and without having any interest in the business, lend their name to the business.

Minor Partners

A partner, who has not attained the age of maturity is called a minor partner. A minor partner can be admitted only into the benefits of the partnership but is not personally liable, like other partners, for any debts of the firm.

Partner in Profits only, Subpartner, Holding out

A partner who is entitled to the profits of the business without making himself responsible for losses, is called a ***partner in profits*** only. A partner may enter into a contract with a third party (an outsider) to share his profit. In such a case, the third party is called a ***subpartner***.

As per Section 28 of the Partnership Act, anybody, who, by spoken or written words or by conduct, represents himself or knowingly permits himself to be represented as a partner in a firm is liable as a partner in that firm to a person who has on the faith of any such representation given credit to the firm. A person, who, thus represents himself or allows himself to be represented as a partner is said to be ***'holding out'*** as a partner under the principle of estoppel.

Registration of Partnership Firm

The registration of a partnership firm is not compulsory under the Indian Partnership Act. However, a firm may be registered at any time by sending by post or delivering a statement in the prescribed form to the ***Registrar of Firms*** of the area in which any place of business of the firm is situated or proposed to be situated.

The statement must contain the following information:

(i) the firm's name;
(ii) the principal place of business;
(iii) the names of its other places of business;
(iv) the date of joining of each partner;
(v) the full name and address of the partners; and
(vi) the duration of the firm.

The aforesaid statement must be signed by all the partners and must be accompanied by the prescribed fees. After satisfying himself, the Registrar will record an entry of this statement in the Register of Firms.

Consequences of Non-Registration

As per the provision of Section 69 of the Indian Partnership Act, non-registration of a partnership gives rise to a number of disabilities, such as:

(i) No partner can bring a suit in any court against the firm or his co-partners.
(ii) The firm cannot file a suit against third party for breach of contract, and like matters.

Partners' Capital Accounts

At the formation of a new partnership, the partnership agreement provides for a fixed amount of capital to be contributed by each partner from his private resources. In the Balance Sheet of a partnership firm, there are several capital accounts—one for each partner.

In this connection, the following important points may be noted:

1. Capital contribution by the partners may not be equal or as per their profit sharing ratio. The ratio of the capital contribution is to be decided by the partners mutually or as per the Partnership Deed.
2. Capital contribution by the partners may not only be in the form of cash—it can be in the shape of other assets also.
3. A partner, on the strength of his expert knowledge or qualification, may not bring in any physical capital.
4. The ratio of the partners' capitals may be changed by mutual consent. It generally changes when there is a change in the constitution, that is, change in the profit sharing ratio; admission, retirement or death of a partner.
5. Along with other physical assets (also goodwill), if a partner brings any liability to the business, the net amount (assets – liabilities) will represent his capital contribution.

Fixed and Fluctuating Capital Accounts

1. Fixed Capital Accounts

Under this method, for each partner, two accounts are opened. The first account, Partners' Capital Account shows the Partners' original contribution to the business as capital. This method is adopted when it is desired to keep Partners' Capital Account at the original figures. The balance of this account is only changed when there is a change in the constitution or when a partner draws money from the business against his capital. The other account, known as Partners' Current Account, is opened to record the transactions between the partners and the firm, that is, salary, interest on capital, drawings, and so on.

2. Fluctuating Capital Accounts

When the partnership firm decides not to keep separate current accounts for the partners, all the entries in regard to partners' drawings, salaries, interest and share of profit are passed through the Capital Accounts of the partners. In such a case, the Capital Accounts of the partners keep on fluctuating. There is one danger in this method. If a partner draws more than what he is entitled to, regarding share of profit, salaries, etc., there will be a depletion of capital. When the partners maintain the fluctuating capital method, no maximum limit can be put on the partners' drawings by the division between the Capital and Current Accounts.

Therefore, when the partners maintain the fixed capital method, the firm may distinguish between permanent capital and endeavour profits (amount entitled minus drawings) by keeping separate Capital and Current Accounts for each partner. Alternatively, when the firm maintains the fluctuating capital method, partners maintain only the Capital Accounts for each partner combining the above two accounts.

The Proprietary Theory and Partnership

From a legal viewpoint, the partnership is not separate from the partners. But, from the accounting viewpoint, the partnership is a separate business entity.

The proprietorship section of a partnership Balance Sheet contains the following :

1. Capital Account for each partner — to show each partner's fixed stake in the partnership for the original capital brought into the partnership.
2. Partners' Loan Account—to reflect any loan provided by a partner to the firm over and above the agreed capital.
3. Current Account for each partner — to show each partners' fluctuating stake in the partnership for the transactions between the partners and the partnership. The transactions are generally as under :
   (a) Salary to the partners;
   (b) Interest on capital to the partners;
   (c) Commission to any or all the partners;
   (d) Drawings of the partners;
   (e) Interest on drawings of the partners; and
   (f) Share of profits to the partners.

The Appropriation of Net Income

In the case of a sole proprietorship, the whole of the net profit is credited to the proprietor's capital and the Capital Account is debited for any drawings. A distinction is required, in the case of a partnership business, for computing and demonstrating the division of the profit or loss among the partners. Therefore, a new section, known as Profit and Loss Appropriation Account, is added to the Profit and Loss Account, which is an essential part of the partnership accounts. This account will show how the net profit of the business is being apportioned among partners. The Profit and Loss Appropriation Account includes interest on capital, interest on partner's loan, salaries to partners, commission to partners, interest on drawings and the share of profit. This account may also include any reserve that has been created by the business but will not include any drawings made by the partners.

This account is credited with the net profit (taken from Profit and Loss Account) and the interest on drawing charged to the partners (which is a loss to the partners but an income for the firm) and debited with interest on capital, salaries to partners, commission to partners, share of profit, transfer to reserve, etc. A specimen of this account is as under:

(Assuming that there are two partners; A and B. A is entitled to salary and B is entitled to commission.)

Dr. Profit and Loss Appropriation Account for the year ended ... Cr.

Particulars	₹	Particulars	₹
To Reserve A/c — transferred to Reserve	***	By Profit and Loss A/c — Net profit	***
To Interest on Capital A/c		By Interest on Drawings A/c	
A — **		A — **	
B — **	***	B — **	***
To Interest on Partners' Loan A/c	***		
To Partners' Salary A/c — A	***		
To Partners' Commission A/c — B	***		
To Share of Profit A/c (balancing figure)			
A — ** B — **	***		
	***		***

The manner in which the net income is to be distributed between the partners is normally detailed in the Partnership Deed and it is final. In the absence of specific agreement on a particular matter, the provisions of Section 13 of the Indian Partnership Act, 1932 is applicable.

The main provisions of this section are given below:

(a) A partner is not entitled to receive remuneration for taking part in the conduct of the business.

(b) The partners are entitled to share equally the profits earned, and shall contribute equally to the losses sustained by the firm.

(c) Interest on partners' loan is to be allowed @ 6%p.a.

(d) Interest on capital (if payable under agreement) is payable out of profit only.

In this connection, we must remember that:
Any amount payable to a partner (except rent), such as interest on capital, interest on loan, salaries, commission, etc., should be treated as appropriation and it should not be charged against profit.

Interest on Capital

As has already been stated, partners are not entitled to any interest on capital, unless specifically provided in the Partnership Deed.

The idea for providing the interest on capital is to compensate the opportunity cost suffered by the partners by not investing the money elsewhere in securities with little or no risk. When the partners contribute unequal capitals but profits are shared equally or where the profit-sharing ratio is different from capital contribution ratio, the charge of interest against the firm on capital contributed by each partner is justified to mitigate differential advantage of one partner over the other.

The amount of interest on capital is to be calculated on time basis after taking into consideration the withdrawal or introduction of capital. The Profit and Loss Appropriation Account is debited and Partners' Capital/Current Accounts is credited with the interest on capital.

In this context, it should be noted that interest on capital is chargeable to a firm to the extent of available profit only, since interest on capital is an appropriation of profits.

For example, X and Y are partners sharing profits and losses in the ratio 3:2. They earn ₹ 15,000 as profit before allowing interest on capital @ 10% p.a. X's capital was ₹ 1,20,000 and Y's capital was ₹ 60,000. Now, interest payable to the partners comes to ₹ 18,000 (X—₹ 12,000 and Y—₹ 6,000). In the absence of any special provision in this regard in the Partnership Deed, X will get ₹ 10,000 and Y will get ₹ 5,000 only, i.e., ₹ 15,000 will be divided in the ratio of interest actually payable to partners.

However, by agreement, partners may waive the above limitation and in such a case, the resultant loss (after providing whole interest) would be borne by the partners in the profit-sharing ratio.

The Profit And Loss Appropriation Account will appear as follows:

Dr. Profit and Loss Appropriation Account for the year ended ... Cr.

Particulars		₹	Particulars		₹
To Interest on Capital A/c			By Profit and Loss A/c — Net profit		15,000
X	10,000				
Y	5,000	15,000			
		15,000			15,000

When there is an agreement between the partners :

Dr. Profit and Loss Appropriation Account for the year ended ... Cr.

Particulars		₹	Particulars		₹
To Interest on Capital A/c			By Profit and Loss A/c — Net profit		15,000
X	12,000		By Share of Loss X	1,800	
Y	6,000	18,000	Y	1,200	3,000
		18,000			18,000

Partners' Salaries, Commission, etc

Like interest on capital, partners are also not allowed any salary or commission, unless specifically provided for in the agreement. The Partnership Deed may, however, provide for the salaries to a partner or partners in the following circumstances:

1. When some partners do most of the work of operating the business.
2. When one or more of the partners look after the entire sales operation.
3. When there are junior or sleeping partners, they may be remunerated by way of a fixed salary plus a small percentage of profits.
4. When the business is managed by the partners who have different expert knowledge or qualification, such partners are remunerated for their labour put into this business.
5. When some of the partners devote the whole of their time to the business while the other partners do not, it is desirable to ascertain true profit after charging managerial remuneration, which would have been incurred if the business were managed by outsiders.

Interest on capital is paid to the partners as a compensation for their contribution of capital; similarly, salaries are paid to the partners as a compensation for their labour. Since these salaries are not the result of an employer-employee relationship, these are merely in the nature of preferential shares of the divisible profit.

The amount of salaries should be debited to Profit and Loss Appropriation Account and credited to Partners' Capital or Current Accounts.

Partners' Drawings

For meeting personal needs, partners may require to draw money from the firm in varying amounts. They can also draw money against their salary, commission and interest on capital (provided the partnership deed expressly states that).

In addition to the above, partners are allowed to draw money in anticipation of their share of profits. These amounts are termed as ***'Drawings'***. When drawings are made, Drawings Account or Current Account in the name of each partner is debited and Cash or Bank is credited. At the end of the accounting period Partners' Drawings Accounts are closed by transferring those to Partners' Capital Accounts by crediting Drawings Accounts and debiting Capital Accounts.

Calculation of Interest on Drawings

Subject to the partnership agreement, partners are allowed to withdraw money from the firm to meet their personal expenses. Generally, they withdraw money against their salary, commission, etc. In addition, partners are allowed to withdraw money in anticipation of their share of profits. These amounts are termed as ***Drawings***.

When drawings are made in cash, the following entry is passed :

Drawings Account Dr.
To Bank / Cash

When drawings are made in kind, the following entry is passed :

Drawings Account Dr.
To Purchases Account

At the end of the accounting year, the balance of the Drawings Account is closed by transferring it to the Capital Account (when fluctuating capital system is used) or Current Account (when fixed capital system is used). To limit the amount of drawings by the partners, the partnership agreement provides for charging of interest on drawings. If there is no partnership agreement or partnership agreement is silent in this aspect, no interest is charged on partners' drawings.

Interest on drawings is an income of the ***firm*** and it is credited to Profit and Loss Appropriation Account.

Fixed Amount of Money is Withdrawn for 12 Months

The partners may decide to withdraw fixed amount of money every month. For the purpose of calculation of interest on drawings, it is to be seen whether the fixed amount is withdrawn at the beginning of each month or at the end of each month or at the middle of each month.

Calculation of interest on drawings is to be made according to situation. The different situations are shown below :

Situation 1 : When fixed amount is withdrawn at the beginning of each month for 12 months

In this case, the interest on total drawings will be equal to interest of ***6.5 months*** at an agreed rate per annum.

The above factor of 6.5 months has been calculated as follows :

First withdrawal is made on the 1st day of the **1st** month. It means that this amount is outstanding for 12 months. Similarly, ***second*** withdrawal is made on the 1st day of the ***2nd*** month. It means that this amount is outstanding for 11 months.

Similarly, ***third*** withdrawal is made on the 1st day of the ***3rd*** month. It means that this amount is outstanding for 10 months.

In the same way, ***twelfth*** withdrawal is made on the 1st day of the ***12th*** month. It means that this amount is outstanding for 1 month.

If the average is taken, it will be as follows :

$$\text{Average Period} = \frac{[12+11+10+9+8+7+6+5+4+3+2+1]}{12}$$

$$= \frac{78}{12} = 6.5 \text{ Months}$$

Alternatively, the average period can be calculated as follows :

Average Period =

$$\frac{\text{Outstanding Period after 1st withdrawal} + \text{Outstanding Period after last withdrawal}}{2}$$

$$= \frac{12 \text{ months} + 1 \text{ month}}{2} = \frac{13 \text{ months}}{2} = 6.5 \text{ Months}$$

$$\textbf{Interest on Drawings} = \textbf{Total Drawings} \times \frac{\textbf{Rate of Interest}}{\textbf{100}} \times \frac{\textbf{6.5}}{\textbf{12}}$$

Situation 2 : When fixed amount is withdrawn at the end of each month for 12 months

In this case, interest on total drawings will be equal to interest of $5^1/_2$ months at an agreed rate p. a.

The above factor of $5^1/_2$ months has been calculated as follows :

First withdrawal is made on the last day of the ***1st*** month. It means that this amount is outstanding for 11 months.

Similarly ***second*** withdrawal is made on the last day of the ***2nd*** month. It means that this amount is outstanding for 10 months.

Similarly, ***third*** withdrawal is made on the last day of the ***3rd*** month. It means that this amount is outstanding for 9 months.

Similarly, ***twelfth*** withdrawal is made on the last day of ***12th*** month. It means that this amount is outstanding for 0 months. If the average is taken, it will be as follows :

$$\text{Average Period} = \frac{[\,11 + 10 + 9 + 8 + 7 + 6 + 5 + 4 + 3 + 2 + 1 + 0\,]}{12}$$

$$= \frac{76}{12} = 5.5 \text{ Months}$$

Alternatively, the average period can be calculated as follows :

Average Period =

$$\frac{\text{Outstanding Period after 1st withdrawal} + \text{Outstanding Period after last withdrawal}}{2}$$

$$= \frac{11 \text{ months} + 0 \text{ month}}{2} = \frac{11 \text{ months}}{2} = 5.5 \text{ Months}$$

$$\textbf{Interest on Drawings} = \textbf{Total Drawings} \times \frac{\textbf{Rate of Interest}}{\textbf{100}} \times \frac{\textbf{5.5}}{\textbf{12}}$$

Situation 3 : When fixed amount is withdrawn at the middle of each month for 12 months

In this case, interest on total drawings will be equal to interest of 6 months at an agreed rate per annum. The above factor of 6 months has been calculated as follows :

First withdrawal is made at the middle of ***1st*** month. It means that this amount is outstanding for 11.5 months. Similarly, ***second*** withdrawal is made at the middle of ***2nd*** month. It means that this amount is outstanding for 10.5 months. Similarly, ***third*** withdrawal is made at the middle of ***3rd*** month. It means that this amount is outstanding for 9.5 months. Smilarly, ***twelvfh*** withdrawal is made at the middle of the ***12th*** month. It means that this amount is outstanding for 0.5 months.

If the average is taken, it will be as follows :

Average Period =

$$\frac{[\,11.5 + 10.5 + 9.5 + 8.5 + 7.5 + 6.5 + 5.5 + 4.5 + 3.5 + 2.5 + 1.5 + 0.5\,]}{12}$$

$$= \frac{72}{12} = 6 \text{ Months}$$

Alternatively, the average period can be calculated as follows :

Average Period =

$$\frac{\text{Period of outstanding after 1st withdrawal} + \text{Period of outstanding after last withdrawal}}{2}$$

$$= \frac{11.5 \text{ months} + 0.5 \text{ month}}{2} = \frac{12 \text{ months}}{2} = 6 \text{ Months}$$

Interest on Drawings = Total Drawings $\times \frac{\text{Rate of interest}}{100} \times \frac{6}{12}$

The above matters can be explained with the help of the following example:

Suppose A, B and C are partners sharing profits equally. During the year 2010 the following amounts were withdrawn by the partners in anticipation of profits:

A @ ₹ 100 p.m. at the beginning of each month; B @ ₹ 100 p.m. at the end of each month; C @ ₹ 100 p.m. at the middle of each month; and Rate of interest on drawings is 10% p.a.

Now applying the above rules the interest on drawings will be as follows:

A: 1,200 × 10/100 × 6.5/12 = ₹ 65;

B: 1,200 × 10/100 × 5.5/12 = ₹ 55; and

C: 1,200 × 10/100 × 6/12 = ₹ 60.

Alternatively,

A is withdrawing at the beginning of each month, so for the *first month's* withdrawal, he will pay interest @ 10% p.a. for 12 months on ₹ 100. Similarly, for the second month's withdrawal, he will pay interest for 11 months and so on. For the *last month's* withdrawal, he will have to pay interest for 1 month. B is withdrawing at the end of each month, so for *first month's* withdrawal, he will have to pay interest @ 10% p.a. for 11 months on ₹ 100.

Similarly for *second month's* withdrawal, he will have to pay interest @ 10% p.a. for 10 months and so on. For *last month's* withdrawal, he will pay interest for zero month.

C is withdrawing at the middle of each month, so for *first month's* withdrawal, he will have to pay interest @ 10% p.a. for 11.5 months on ₹ 100. similarly, for *second month's* withdrawal, he will have to pay interest @ 10% p.a. for 10.5 months and so on.

For *last month's* withdrawal, he will have to pay interest for 1/2 month.

Calculation of Interest on Drawings (Month-wise)

Month's withdrawals	A			B			C		
1st	100 x 10/100 x 12/12	=	10.00	100 x 10/100 x 11/12	=	9.17	100 x 10/100 x 11.5/12	=	9.58
2nd	100 x 10/100 x 11/12	=	9.17	100 x 10/100 x 10/12	=	8.33	100 x 10/100 x 10.5/12	=	8.75
3rd	100 x 10/100 x 10/12	=	8.33	100 x 10/100 x 9/12	=	7.50	100 x 10/100 x 9.5/12	=	7.92
4th	100 x 10/100 x 9/12	=	7.50	100 x 10/100 x 8/12	=	6.67	100 x 10/100 x 8.5/12	=	7.08
5th	100 x 10/100 x 8/12	=	6.67	100 x 10/100 x 7/12	=	5.83	100 x 10/100 x 7.5/12	=	6.25
6th	100 x 10/100 x 7/12	=	5.83	100 x 10/100 x 6/12	=	5.00	100 x 10/100 x 6.5/12	=	5.42
7th	100 x 10/100 x 6/12	=	5.00	100 x 10/100 x 5/12	=	4.17	100 x 10/100 x 5.5/12	=	4.58
8th	100 x 10/100 x 5/12	=	4.17	100 x 10/100 x 4/12	=	3.33	100 x 10/100 x 4.5/12	=	3.75
9th	100 x 10/100 x 4/12	=	3.33	100 x 10/100 x 3/12	=	2.50	100 x 10/100 x 3.5/12	=	2.92
10th	100 x 10/100 x 3/12	=	2.50	100 x 10/100 x 2/12	=	1.67	100 x 10/100 x 2.5/12	=	2.08
11th	100 x 10/100 x 2/12	=	1.67	100 x 10/100 x 1/12	=	0.83	100 x 10/100 x1.5/12	=	1.25
12th	100 x 10/100 x 1/12	=	0.83	100 x 10/100 x 0/12	=	0	100 x 10/100 x .5/12	=	0.42
Total			65.00			55.00			60.00

Fixed Amount of Money is withdrawn in Each Quarter

The partner may decide to withdraw fixed amount of money each quarter. For the purpose of calculation of interest on drawings, it is to be seen whether the fixed amount is withdrawn at the beginning of each quarter or at the end of each quarter or at the middle of each quarter.

Calculation of interest on drawings is to be made according to situation. The different situations are shown below :

Situation 1 : When Fixed Amount of Money is Withdrawn at the Beginning of Each Quarter

In this cas,e the interest on total drawings will be equal to interest of 7.5 months at an agreed rate per annum. The above factor of 7.5 months has been calculated as follows :

$$\text{Average Period} = \frac{(4 + 3 + 2 + 1)}{4} = \frac{10}{4} \text{ Quarter or 2.5 Quarter}$$

If it is converted into months, it will be 2.5 Quarter x 3 months = **7.5 months**.

Situation 2 : When Fixed Amount of Money is Withdrawn at the End of Each Quarter

In this case, the interest on total drawings will be equal to interest of 4.5 months at an agreed rate per annum.

The above factor of 4.5 months has been calculated as follows :

$$= \frac{[3 + 2 + 1 + 0]}{4} = \frac{6}{4} = 1 \text{ Months}$$

Situation 3 : When Fixed Amount of Money is Withdrawn at the Middle of Each Quarter

In this case, the interest on total drawings will be equal to interest of 6 months at an agreed rate per annum.

The above factor of 6 months has been calculated as follows :

$$\text{Average Period} = \frac{(3.5 + 2.5 + 1.5 + 0.5)}{4} = \frac{8}{4} \text{ Quarter or 2 Quarter}$$

If it is converted into months, it will be : 2 Quarters × 3 Months = **6 Months**.

The above matters can be explained with the help of the following example :

Let us assume that there aare three partners X, Y Z in a firm. The profit sharing ratio is 2 : 2 : 1.

During year 2013, the following amounts were withdrawn by the partners in antiticpation of profits:

X : ₹ 3,000 per quarter at the beginning of each quarter.

Y : ₹ 3,000 per quarter at the end of each quarter.

Z : ₹ 3,000 per quarter at the middle of each quarter.

The rate of interest is 10% p.a. Now applying the above rules, the interest on drawings will be as follows :

Total drawings of each partner is ₹ 12,000.

Interest on drawings of X :

$$₹\ 12{,}000 \times \frac{10}{100} \times \frac{7.5}{12} = ₹\ 750$$

Alternatively, it can be calculated as follows :

Calculation of Interest on Drawings Chargeable to X

Date of Withdrawal	Amount (₹)	Period in Months	Interest (₹)
1.1.2013	3,000	12	₹ 3,000 x $\frac{10}{100}$ x $\frac{12}{12}$ = 300
1.4.2013	3,000	9	₹ 3,000 x $\frac{10}{100}$ x $\frac{9}{12}$ = 225
1.7.2013	3,000	6	₹ 3,000 x $\frac{10}{100}$ x $\frac{6}{12}$ = 150
1.10.2013	3,000	3	₹ 3,000 x $\frac{10}{100}$ x $\frac{3}{12}$ = 75
			750

Interest on drawings of Y :

$$₹\ 12{,}000 \times \frac{10}{100} \times \frac{4.5}{12} = ₹\ 450$$

Alternatively, it can be calculated as follows :

Calculation of Interest on Drawings Chargeable to Y

Date of Withdrawal	Amount (₹)	Period in Months	Interest (₹)
31.3.2013	3,000	9	₹ 3,000 x $\frac{10}{100}$ x $\frac{9}{12}$ = 225
30.6.2013	3,000	6	₹ 3,000 x $\frac{10}{100}$ x $\frac{6}{12}$ = 150
30.9.2013	3,000	3	₹ 3,000 x $\frac{10}{100}$ x $\frac{3}{12}$ = 75
31.12.2013	3,000	0	₹ 3,000 x $\frac{10}{100}$ x $\frac{0}{12}$ = 0
			450

Interest on drawings of Z :

₹ 12,000 $\times \frac{10}{100} \times \frac{6}{12}$ = ₹ 600

Alternatively, it can be calculated as follows :

Calculation of Interest on Drawings Chargeable to Z

Date of Withdrawal	Amount (₹)	Period in Months	Interest (₹)
15.2.2013	3,000	10.5	₹ 3,000 x $\frac{10}{100}$ x $\frac{10.5}{12}$ = 262.50
15.5.2013	3,000	7.5	₹ 3,000 x $\frac{10}{100}$ x $\frac{7.5}{12}$ = 187.50
15.8.2013	3,000	4.5	₹ 3,000 x $\frac{10}{100}$ x $\frac{4.5}{12}$ = 112.50
15.11.2013	3,000	1.5	₹ 3,000 x $\frac{10}{100}$ x $\frac{1.5}{12}$ = 37.50
			600.00

Different Amount of Money is Withdrawn at Different Time

The partners may withdraw different amount of money at different time. In this case, interest on drawings can be calculated by adopting any of the following method s:

(i) Simple Method or (ii) Product method.

Simple Method : Under this method interest of each drawing is calculated separately after taking into consideration the amount, time period and rate of interest. Time period is the difference between the date of closing the books of accounts and the date of withdrawal. Total interest chargeable to partners is the sum total of interest of all withdrawals.

$$\textbf{Interest} = \textbf{Amount} \times \textbf{Rate of interest} \times \frac{\textbf{Period in months}}{\textbf{12}} \left(\textbf{or } \frac{\textbf{Period in days}}{\textbf{365}}\right)$$

Formula for calculating interest of each withdrawal :

Illustration 1

Ms B Gupta, a partner of a firm withdrew the following amount of money at different dates. Calculate the interest on drawings if the rate of interest is 10% p.a. and date of closing the books of account is 31st December, 2014.

Date	Amount withdrawn (₹)
1.2.2014	10,000
31.3.2014	12,000
31.8.2014	15,000
30.9.2014	10,000
1.11.2014	20,000

Solution

Calculation of Interest on Drawings will be as follows :

Calculation of Interest on Drawings Chargeable to Ms B Gupta

Date of Withdrawal	Amount	Period in Months	Interest (₹)
1.2.2014	10,000	11	$10{,}000 \times \frac{10}{100} \times \frac{11}{12} = 916.67$
31.3.2014	12,000	9	$10{,}000 \times \frac{10}{100} \times \frac{9}{12} = 900.00$
31.8.2014	15,000	4	$10{,}000 \times \frac{10}{100} \times \frac{4}{12} = 500.00$
30.9.2014	10,000	3	$10{,}000 \times \frac{10}{100} \times \frac{3}{12} = 250.00$
1.11.2014	20,000	2	$10{,}000 \times \frac{10}{100} \times \frac{2}{12} = 333.33$
			2,900.00

Product Method : Under this method, for each withdrawal, the amount of money is multiplied by the period in months to find out the product. The product of all withdrawals are added to get the total products. To calculate the interest, the following formula is applied :

$$\text{Interest} = \text{Sum of Products} \times \text{Rate of Interest} \times \frac{1}{12}$$

Illustration 2

Let us take the data of previous example.

Solution

Calculation of Products

Date of Withdrawal	Amount	Period in MOnths	Product (Amount x Months)
1.2.2014	10,000	11	1,10,000
31.3.2014	12,000	9	1,08,000
31.8.2014	15,000	4	60,000
30.9.2014	10,000	3	30,000
1.11.2014	20,000	2	40,000
			3,48,000

$$\text{Interest on Drawings} = ₹\ 3{,}48{,}000 \times \frac{10}{100} \times \frac{1}{12} = ₹\ 2{,}900.$$

Students should note that interest will be same under both the methods. In the examination, you can follow any of the methods unless it is mentioned in the question specifically.

For calculating interest on drawings, students should remember the following :

(i) When a partner draws a fixed sum at the beginning of each month for 12 months, interest on total drawings will be equal to interest of 6.5 months at an agreed rate per annum.

(ii) When a partner draws a fixed sum at the end of each month for 12 months, interest on total drawings will be equal to interest of 5.5 months at an agreed rate per annum.

(iii) When a partner draws a fixed sum at the middle of each month for 12 months, interest on total drawings will be equal to interest of 6 months at an agreed rate per annum.

(iv) When a partner draws a fixed sum at the beginning of each quarter for all quarters, interest on total drawings will be equal to interest of 7.5 months at an agreed rate per annum.

(v) When a partner draws a fixed sum at the end of each quarter for all quarters, interest on total drawings will be equal to 4.5 months at an agreed rate per annum.

(vi) When a partner draws a fixed sum at the middle of each quarter for all quarters, interest on total drawings will be equal to 6 months at an agreed rate per annum.
(vii) When the dates of drawings are given and the interest is to be charged at an agreed rate per annum, interest will be calculated on the basis of time.
(viii) When the dates of drawings are not given and the interest is to be charged at an agreed rate per annum, interest will be calculated for 6 months.
(ix) When the rate is given without the word 'per annum', interest will be charged without considering the time factor.

Partners' Loan Accounts

If the business is short of cash, a partner may make a temporary loan to the partnership with the intention that the amount concerned should ultimately be repaid. When a partner provides a loan to the firm, it should be credited to a separate Loan Account and should not be mixed up with the Partners' Capital Accounts. It is important to distinguish Loan and Capital Account of partners for the following reasons:

1. As per the provision of the Indian Partnership Act, partners' loan is repayable on dissolution in priority to capital.
2. In the absence of any agreement, partners are entitled to get 6% interest p.a. on loan whereas they are not entitled to interest on capital.

Loan arrangements should be evidenced by legal documents necessary to show that a loan arrangement exists between the partnership firm and individual partner(s).

Occasionally, a partner may receive money from partnership with the intention of repaying that in the future. Such a transaction may be debited to the Partners' Loan Account rather than Partners' Drawings Account. Loans payable to partners are shown as liabilities in the Balance Sheet, whereas loans receivable from partners are shown as assets in the Balance Sheet.

Interest on Partners' Loans

Generally, partners' loans carry interest at a fixed rate, as may be mentioned in the Partnership Deed. However, if the Partnership Deed is silent on this point, a partner 'is entitled to interest thereon at the rate of 6% p.a.' [Section 13(d)].

There is some difference of opinion as to whether the interest on loan should be charged to Profit and Loss Account or to Profit and Loss Appropriation Account.

It may be argued that interest on loan paid to partners is like any other operating expense of the firm and should be charged to the Profit and Loss Account but according to the provision of the Indian Partnership Act, any amount payable to a partner (except rent) should be treated as appropriation of profit and it should not be charged against profit.

We are in favour of treating interest on loan as Appropriation

When interest on Loan falls due, the following entries to be passed:

If interest is paid in cash

Profit and Loss Appropriation Account (Interest Account) Dr.
    To Cash Account

If interest is not paid in cash

Profit and Loss Appropriation Account (Interest Account) Dr.
    To Partners' Capital or Current Account

Again, here, it may be argued that interest due on loan should be credited to Loan Account and not to the Partners' Capital or Current Account because in case of dissolution of partnership, partners' loans have priority in repayment over partners' capitals. ***But in our view, outstanding interest on loan should not be added with the original loan on the following grounds:***

(i) At the time of dissolution, loan has priority over capital but no where in the Act has it been provided that the ***interest on loan*** has the same priority over capital.
(ii) There is no provision in the Act to pay ***compound interest*** on Loan.

Sharing of Profits

Generally, the Partnership Deed provides the ratio in which profits and losses of the firm should be shared by the partners. If the Partnership Deed is silent on this point, the profit should be shared ***equally***, irrespective of capital contribution.

At the time of distribution of profit, proper care should be taken in respect of the provision of the Indian Partnership Act and terms and conditions of the partnership deed.

Illustration 3

Ram, Rahim and Karim are partners in a firm. They have no agreement in respect of profit-sharing ratio, interest on capital, interest on loan advanced by partners and remuneration payable to partners. In the matter of distribution of profits they have put forward the following claims :

(i) Ram, who has contributed maximum capital demands interest on capital at 10% p.a. and share of profit in the capital ratio. But Rahim and Karim do not agree.

(ii) Rahim has devoted full time for running the business and demands salary at the rate of ₹ 500 p.m. But Ram and Karim do not agree.

(iii) Karim demands interest on loan of ₹ 2,000 advanced by him at the market rate of interest which is 12% p.a.

How shall you settle the dispute and prepare Profit and Loss Appropriation Account after transferring 10% of the divisible profit to Reserve. Net profit before taking into account any of the above claims amounted to ₹ 45,000 at the end of the first year of their business.

Solution

There is no partnership deed. Therefore, the following provisions of The Indian Partnership Act are to be applied for settling the dispute.

(i) No interest on capital is payable to any partner. Therefore, Ram is not entitled to interest on capital.
(ii) No remuneration is payable to any partner. Therefore, Rahim is not entitled to any salary.
(iii) Interset on loan is payable @ 6% p.a. Therefore, Karim is to get interest @ 6% p.a. on ₹ 2,000.
(iv) The profits should be distributed equally.

Dr. Profit and Loss Appropriation Account for the year ended . . . Cr.

Particulars	₹	Particulars	₹
To Interest on Karim Loan A/c (₹ 2,000 x 6/100)	120	By Profit and Loss A/c (Net profit)	45,000
To Reserve A/c – 10% of ₹ (45,000 – 120)	4,488		
To Share of Profit A/c : Ram : ₹ 13,464; Rahim : ₹ 13,464; Karim : ₹ 13,464	40,392		
	45,000		45,000

Illustration 4

A and B are partners sharing profits and losses in the ratio of their effective capital. They had ₹ 1,00,000 and ₹ 60,000 respectively in their Capital Accounts as on 1st January, 2014.

A introduced a further capital of ₹ 10,000 on 1st April, 2014 and another ₹ 5,000 on 1st July, 2014. On 30th September 2014 A withdrew ₹ 40,000.

On 1st July, 2014, B introduced further capital of ₹ 30,000.

The partners drew the following amounts in anticipation of profit.

A drew ₹ 1,000 per month at the end of each month beginning from January, 2014. B drew ₹ 1,000 on 30th June, and ₹ 5,000 on 30th September, 2014.

12% p.a. interest on capital is allowable and 10% p.a. interest on drawings is chargeable. Date of closing 31.12.2014.

Calculate: (a) Profit-sharing ratio; (b) Interest on capital; and (c) Interest on drawings.

Solution

(a) Calculation of Effective Capital

A	B
₹ 1,00,000 invested for 3 months ,i.e., ₹ 3,00,000 invested for 1 month.	₹ 60,000 invested for 6 months, i.e., ₹ 3,60,000 invested for 1 month.
₹ 1,10,000 invested for 3 months, i.e., ₹ 3,30,000 invested for 1 month.	₹ 90,000 invested for 6 months, i.e., ₹ 5,40,000 invested for 1 month.
₹ 1,15,000 invested for 3 months ,i.e., ₹ 3,45,000 invested for 1 month.	₹ 9,00,000
₹ 75,000 invested for 3 months, i.e., ₹ 2,25,000 invested for 1 month.	
₹ 12,00,000	**The profit- sharing ratio will be** 12 : 9 or 4 : 3

(b) Calculation of Interest on Capital

A	B
₹ 12,00,000 x 12/100 x 1/12 = ₹ 12,000	₹ 9,00,000 x 12/100 x 1/12 = ₹ 9,000

(c) Calculation of Interest on Drawings	
₹ 12,000 x 10/100 x 5.5/12 = ₹ 550	₹ 1,000 x 10/100 x 6/12 = ₹ 50 ₹ 5,000 x 10/100 x 3/12 = ₹ 125

Illustration 5

A, B and C are partners in a firm with capitals of ₹ 50,000, ₹ 40,000 and ₹ 20,000 respectively. They share profits and losses as : (i) Up to ₹ 10,000, in the ratio of 4:3:3; (ii) Above ₹ 10,000, equally.

The net profit of the firm for the year ended 31st December, 2014 amounted to ₹ 40,200 and the drawings of the partners were: A — ₹ 6,000 B — ₹ 5,000 C — ₹ 3,000.

You are required to prepare the Profit and Loss Appropriation Account for the year ended 31.12.2014 and Capital Accounts of the partners assuming: (a) partners capitals are fixed; and (b) partners' capitals are fluctuating, after considering the following adjustments:

(1) interest on partners' capitals to be paid @ 10% p.a.;
(2) interest on drawings to be charged @ 5% p.a.;
(3) A to receive salary of ₹ 5,000 p.a.; and
(4) B and C to get commission @ 10% each on the net profit.

Solution

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2014 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Interest on Capital A/c			By Profit and Loss A/c — Net profit		40,200
(A—₹ 5,000; B—₹ 4,000; C—₹ 2,000)		11,000	By Interest on Drawings A/c		
To Partners' Salary A/c : A		5,000	A — 5% on ₹ 6,000 for 6 months	150	
To Commission A/c :			B — 5% on ₹ 5,000 for 6 months	125	
(B — ₹ 4,020; C — ₹ 4,020)		8,040	C — 5% on ₹ 3,000 for 6 months	75	350
To Share of Profit A/c (Note 1)					
(A—₹ 6,170; B—₹ 5,170; C—₹ 5,170)		16,510			
		40,550			40,550

(a) Fixed Capital Method

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
31.12.2014	To Balance c/d	50,000	40,000	20,000	1.1.2014	By Balance b/d	50,000	40,000	20,000

Dr. Partners' Current Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
31.12.2014	To Drawings A/c	6,000	5,000	3,000	31.12.2014	By Interest on Capital A/c	5,000	4,000	2,000
"	To Interest on Drawings A/c	150	125	75	"	By Partners' Salary A/c	5,000	—	—
"	To Balance c/d	10,020	8,065	8,115	"	By Commission A/c	—	4,020	4,020
					"	By Sh. of Profit A/c (Note 1)	6,170	5,170	5,170
		16,160	13,190	11,190			16,170	13,190	11,190

(b) Fluctuating Capital Method

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
31.12.2014	To Drawings A/c	6,000	5,000	3,000	1.1.2014	By Balance b/d	50,000	40,000	20,000
"	To Interest on Drawings A/c	150	125	75	31.12.2014	By Interest on Capital A/c	5,000	4,000	2,000
"	To Balance c/d	60,020	48,065	28,115	"	By Partners' Salary A/c	5,000	—	—
					"	By Commission A/c	—	4,020	4,020
					"	By Share of Profit A/c (Note 1)	6,170	5,170	5,170
		66,170	53,190	31,190			66,170	53,190	31,190

Working Note:

(1) Profit is shared as under :	A	B	C
Up to ₹ 10,000 (4:3:3)	4,000	3,000	3,000
Above ₹ 10,000, i.e., ₹ 6,510 (1:1:1)	2,170	2,170	2,170
Share of profit	6,170	5,170	5,170

Illustration 6

A and B are partners with capitals of ₹ 40,000 and ₹ 20,000 respectively. They share profits and losses in proportion to their capitals after charging interest on capital @ 5% and a partners' salary of ₹ 30,000 p.a. to B. From 1.1.2014, A decides to retire from the firm's full active work in the partnership and it is accordingly agreed that :

(i) B shall in future be entitled to a partnership salary of ₹ 50,000 p.a.;
(ii) Interest is to be allowed on capital @ 5% p.a.;
(iii) C, the manager of the firm, shall be introduced as a partner, without capital, as and from 1.1.2014, with a salary of ₹ 75,000 p.a. The excess of over ₹ 40,000 (his previous salary as manager) being chargeable against A.
(iv) C shall be entitled to 1/10th of the profits after charging interest on capital and partnership salary;
(v) The balance of the profit is to be divided as 3/5th to A and 2/5th to B.

The profits during the year 2014 were ₹ 2,50,000. Show Profit and Loss Appropriation Account and Partners' Capital Accounts under Fluctuating Method. Assuming that the salaries have been drawn during the year. Drawings of the partners (excluding salaries) were : A—₹ 50,000; B—₹ 30,000; and C—₹ 10,000.

Solution

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Interest on Capital A/c : A — ₹ 2,000; B — ₹ 1,000	3,000	By Profit and Loss A/c — Net profit	2,50,000
To Partners' Salaries A/c : B — ₹ 50,000; C — ₹ 40,000 (Note 2)	90,000		
To Share of Profit A/c : (Note 1) A — ₹ 84,780; B — ₹ 56,520; C — ₹ 15,700	1,57,000		
	2,50,000		2,50,000

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
31.12.2014	To C Capital A/c (Note 2)	35,000	—	—	1.1.2014	By Balance b/d	40,000	20,000	—
"	To Drawings (Note 3)	50,000	80,000	85,000	31.12.2014	By Interest on Capital A/c	2,000	1,000	—
"	To Balance c/d	41,780	47,520	5,700	"	By Partners' Salaries A/c	—	50,000	40,000
					"	By Share of Profit A/c	84,780	56,520	15,700
					"	By A Capital A/c (Note 2)	—	—	35,000
		1,26,780	1,27,520	90,700			1,26,780	1,27,520	90,700

Working Note : (1) Calculation of Share of Profit	₹
C — 1/10th of ₹ (2,50,000 – 3,000 – 90,000)	15,700
A — 3/5th of ₹ (2,50,000 – 3,000 – 90,000 – 15,700)	84,780
B — 2/5th of ₹ (2,50,000 – 3,000 – 90,000 – 15,700)	56,520

(2) C will get salary of ₹ 75,000. But only ₹ 40,000 is to be charged to the partnership firm and the balance is to be adjusted against A's Capital Account.

(3) 'Drawings' of B and C includes their salaries.

Illustration 7

A and B are in partnership as general traders, sharing profits and losses equally after allowing A a salary of ₹ 40,000 p.a. On 1.1.2014, their capital account balances were : A—₹ 1,00,000; B—₹ 80,000. Their current account balances were: A—₹ 30,000 (Cr.); B—₹ 20,000 (Cr.). On 1.7.2014, they admitted C as a partner. From that date, profits were to be shared among A, B and C in the ratio of 2 : 2 : 1. C alone is to receive a salary of ₹ 30,000 p.a.

It was agreed that from 1.7.2014, A would transfer ₹ 20,000 from his Capital Account to a Loan Account on which interest would be paid at 10% p.a. C brought his private car into the firm at a valuation of ₹ 50,000.

No entries to reflect the foregoing matters were made in the books before the end of the accounting year on 31.12.2014.

The following information is available for the year ended 31.12.2014 : Sales (spread evenly throughout the year) ₹ 8,00,000; Cost of Sales ₹ 3,50,000; Rent and rates ₹ 1,00,000; Salaries ₹ 1,40,000; General expenses ₹ 60,000.

The car is to be depreciated over 4 years on the straight line basis; it is assumed it will have a nil residual balance.

Of the general expenses, ₹ 20,000 was incurred in the six months ended 30.6.2014. All sales produce a uniform rate of gross profit.

Prepare : (1) the Trading and Profit and Loss Account for the year ended 31.12.2014; (2) the Profit and Loss Appropriation Account for the year ended 31.12.2014; and (3) the Partners' Capital and Current Accounts as on 31.12.2014.

Solution

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Cost of Sales	3,50,000	By Sales	8,00,000
To Gross Profit c/d	4,50,000		
	8,00,000		8,00,000

	1.1.2014 to 30.6.2014	1.7.2014 to 31.12.2014		1.1.2014 to 30.6.2014	1.7.2014 to 31.12.2014
To Rent and Rates	50,000	50,000	By Gross Profit b/d	2,25,000	2,25,000
To Salaries	70,000	70,000			
To General Expenses	20,000	40,000			
To Depreciation on Car	—	6,250			
To Profit & Loss Appropriation A/c — Net Profit	85,000	58,750			
	2,25,000	2,25,000		2,25,000	2,25,000

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2014 Cr.

Particulars		1.1.2014 to 30.6.2014	1.7.2014 to 31.12.2014	Particulars	1.1.2014 to 30.6.2014	1.7.2014 to 31.12.2014
To Interest on Loan A/c	A	—	1,000	By Profit and Loss A/c	85,000	58,750
To Partners' Salaries A/c (Note 1)	A	20,000	—			
	C	—	15,000			
To Share of Profit A/c	A	32,500	17,100			
	B	32,500	17,100			
	C	—	8,550			
		85,000	58,750		85,000	58,750

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
1.7.2014	To Partner's Loan A/c—A	20,000	—	—	1.1.2014	By Balance b/d	1,00,000	80,000	—
31.12.2014	To Balance c/d	80,000	80,000	50,000	31.12.2014	By Motor Car A/c	—	—	50,000
		1,00,000	80,000	50,000			1,00,000	80,000	50,000

Dr. Partners' Current Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
31.12.2014	To Balance c/d	1,00,600	69,600	23,550	1.1.2014	By Balance b/d	30,000	20,000	—
					31.12.2014	By Partners' Salary A/c	20,000	—	15,000
					"	By Interest on Loan A/c	1,000	—	—
					"	By Share of Profit A/c	49,600	49,600	8,550
		1,00,600	69,600	23,550			1,00,600	69,600	23,550

Working Note : (1) A will get salary for half year only, which is half of ₹ 40,000, i.e., ₹ 20,000.

Illustration 8

A, B, C and D are partners in a garage comprising (i) petrol sales,(ii) repairs and servicing, and (iii) second-hand car dealing. A is responsible for petrol sales, B for repairs and servicing; and C for second-hand car dealing, while D acts purely in an advisory capacity.

The partnership agreement provides for the following :

(i) Each partner is to receive commission of the net profit of the partner's own department as under — A — 10%; B — 15% and C — 20%.

(ii) A total salary of ₹ 11,000 is payable to D which is to be allocated among the above three departments in the ratio of 3 : 4 : 4 respectively.

(iii) 50% of the net profit of each department after charging commission and salary will be distributed to A, B and C as under —

Petrol Sales	*Repairs and Servicing*	*Second-hand Car Dealing*
A, B and C — Equally	A : B : C = 2 : 2 : 1	A : B : C = 3 : 2 : 1.

(iv) The balance of the profit of the firm will be shared equally by all partners after charging interest on capital @ 10% p.a.

The net profits of the departments for the year ended 31.12.2014 were as under :

Petrol sales : ₹ 20,000; Repairs and Servicing — ₹ 40,000; Second-hand car dealing — ₹ 50,000.

The partners' capitals are :

A — ₹ 40,000; B — ₹ 30,000; C — ₹ 25,000; D — ₹ 10,000.

You are required to prepare the Profit and Loss Appropriation Account for the year ended 31.12.2014.

Solution

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2014 Cr.

Particulars	Petrol Sales	Repairs and Servicing	Second-hand Car Dealing	Particulars	Petrol Sales	Repairs and Servicing	Second-hand Car Dealing
To Partners' Commission A/c :				By Net Profit	20,000	40,000	50,000
A (10%)	2,000						
B (15%)		6,000					
C (20%)			10,000				
To Partners' Salaries A/c — D (3 : 4 : 4)	3,000	4,000	4,000				
To Partners' Capital A/c (Share of Profit):							
A	2,500	6,000	9,000				
B	2,500	6,000	6,000				
C	2,500	3,000	3,000				
To Balance c/d (50%)	7,500	15,000	18,000				
	20,000	40,000	50,000		20,000	40,000	50,000
To Interest on Capital A/c (A—₹ 4,000; B—₹ 3,000; C—₹ 2,500; D—₹ 1,000)			10,500	By Balance b/d ₹ (7,500 + 15,000 + 18,000)			40,500
To Share of Profit A/c (A—₹ 7,500; B—₹ 7,500; C—₹ 7,500; D—₹ 7,500)			30,000				
			40,500				40,500

Illustration 9

A, B and C are partners in a firm with capital contributions of ₹ 50,000, ₹ 40,000 and ₹ 30,000 respectively.

Their partnership agreement provides for the following :

(a) Interest on capitals and drawings are to be charged @ 10% p.a.;

(b) B and C are to be paid salaries @ ₹ 500 p.a.;

(c) Interest on partners' loan is to carry @ 10% p.a.;

(d) The remaining profits are to be divided —
40% to A; 30% to B; 20% to C; and 10% carried to a Reserve Account.

The net profit for the year ended 31.12.2014 was ₹ 50,000.

A withdrew ₹ 1,000 per month at the beginning of each month, B withdrew ₹ 1,000 per month at the middle of each month, and C withdrew ₹ 1,000 per month at the end of each month.

No entries had been made in the books of account to record the following :

(1) The partners commenced business on 1.1.2013 on which date A provided in addition to capital, ₹ 10,000 as loan to the firm. Interest on that loan is outstanding till 31.12.2014. This has to be paid now at compound rate of interest.

(2) The firm has made a recovery of bad debts of ₹ 18,000. The amount has already been withdrawn by the partners in their profit-sharing ratio.

You are required to prepare the Profit and Loss Appropriation Account for the year ended 31.12.2014 and the Partners' Capital Accounts.

Solution

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars		₹
To Interest on Capital A/c (A — ₹ 5,000; B — ₹ 4,000; C — ₹ 3,000)	12,000	By Profit and Loss A/c (Net Profit)		50,000
To Partners' Salaries A/c (B — ₹ 6,000; C — ₹ 6,000)	12,000	By Interest on Drawings A/c :		
To Interest on Loan A/c — A (Note 1)	2,100	A — ₹ 12,000 x 10/100 x 6.5/12	650	
To Reserve A/c (Note 2)	2,570	B — ₹ 12,000 x 10/100 x 6/12	600	
To Share of Profit A/c (Note 2) (A — ₹ 10,280; B — ₹ 7,710; C — ₹ 5,140)	23,130	C — ₹ 12,000 x 10/100 x 5.5/12	550	1,800
	51,800			51,800

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2014					2014				
Dec. 31	To Drawings A/c (Note 4)	20,000	18,000	16,000	Jan. 1	By Balance b/d	50,000	40,000	30,000
	To Interest on Drawings A/c	650	600	550	Dec. 31	By Interest on Capital A/c	5,000	4,000	3,000
	To Balance c/d	54,730	45,110	31,590		By Partners' Salaries A/c	—	6,000	6,000

						By Interest on Loan A/c	2,100	—	—
						By Share of Profit A/c	10,280	7,710	5,140
						By Recovery of Bad Debts A/c (Note 3)	8,000	6,000	4,000
		75,380	63,710	48,140			75,380	63,710	48,140

Working Notes :

(1) Interest for the year 2013 @ 10% p.a. on ₹ 10,000 = ₹ 1,000; Interest for the year 2014 @ 10% p.a. on ₹ 11,000 (₹ 10,000 + 1,000 outstanding interest) = ₹ 1,100. Therefore, total interest is to be paid for 2 years = ₹ (1,000 + 1,100) = ₹ 2,100.

(2) Divisible profit is ₹ 25,700 (₹ 50,000 + 1,800 – 12,000 – 12,000 – 2,100). It is to be divided as under :
A — 40% of ₹ 25,700 = ₹ 10,280; B — 30% of ₹ 25,700 = ₹ 7,710; C — 20% of ₹ 25,700 = ₹ 5,140; and transfer to reserve — 10% of ₹ 25,700 = ₹ 2,570.

(3) The profit sharing ratio is 4 : 3 : 2, on which basis the recovery of bad debts is shared, i.e., A — ₹ 8,000; B — ₹ 6,000; and C — ₹ 4,000.

(4) The drawings include recovery of bad debts.

Illustration 10

A, B and C are in partnership as general traders, sharing profits and losses equally after allowing A, a salary of ₹ 40,000 p.a.

On 1.1.2014, their account balances were :

	Capital Accounts	Current Accounts
A	1,00,000	20,000 (Cr.)
B	80,000	10,000 (Cr.)
C	75,000	5,000 (Dr.)

From 1.7.2014, A decided to retire from the firm's full active work in the partnership. It is accordingly agreed that from 1.7.2014 —

(a) A would transfer ₹ 20,000 from his Capital Account to a Loan Account on which interest would be paid @ 15% p.a.;

(b) A will not be entitled to any salary, but B and C are to receive salary of ₹ 25,000 p.a. and ₹ 15,000 p.a. respectively.

The net profit for the year ended 31.12.2014 was ₹ 1,02,000.

No entry has been made in the books in regard to the following :

(a) On 1.7.2014, C brought his private car into the firm at a valuation of ₹ 50,000. The car is to be depreciated over 4 years on the straight line basis. It is assumed that it will have a residual value of ₹ 10,000.

(b) 1/5th of the general expenses of ₹ 12,000, which have been debited in the Profit and Loss Account, is related to the next accounting period.

Partners are entitled to interest on capital @ 12% p.a. No interest is allowed or charged on current accounts or on drawings. The drawings of the partners were : A ₹ 30,800; B ₹ 20,600; C ₹ 13,000.

You are required to prepare Profit and Loss Appropriation Account for the year ended 31.12.2014. Also show their Capital and Current Accounts.

Solution

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Interest on Loan A/c (A — @ 15% p.a. on ₹ 20,000 for 6 months)	1,500	By Net Profit (Note 1)	99,400
To Partners' Salaries A/c (for 6 months) (A — ₹ 20,000; B ₹ 12,500; C — ₹ 7,500)	40,000		
To Interest on Capital A/c (Note 2)	32,400		
To Share of Profit A/c (A — ₹ 8,500; B — ₹ 8,500; C — ₹ 8,500)	25,500		
	99,400		99,400

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2014					2014				
July 1	To A Loan A/c	20,000	—	—	Jan. 1	By Balance b/d	1,00,000	80,000	75,000
Dec. 31	To Balance c/d	80,000	80,000	1,25,000	July 1	By Motor Car A/c	—	—	50,000
		1,00,000	80,000	1,25,000			1,00,000	80,000	1,25,000

Dr. Partners' Current Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2014					2014				
Jan. 1	To Balance b/d	—	—	5,000	Jan. 1	By Balance b/d	20,000	10,000	—
Dec. 31	To Drawings A/c	30,800	20,600	13,000	Dec. 31	By Interest on Loan A/c	1,500	—	—

"	To Balance c/d	30,000	20,000	10,000	"	By Partners' Salaries A/c	20,000	12,500	7,500
					"	By Interest on Capital A/c	10,800	9,600	12,000
					"	By Share of Profit A/c	8,500	8,500	8,500
		60,800	40,600	28,000			60,800	40,600	28,000

Working Notes : **(1) Ascertainment of Correct Net Profit**

Particulars	₹
Net Profit (as given)	1,02,000
Less: Depreciation of Car (1/4 x (₹ 50,000 – 10,000) x 6/12]	5,000
	97,000
Add: Unexpired General Expenses (1/5 x ₹ 12,000)	2,400
	99,400

(2) Interest on Capital

	₹	₹
A : @ 12% p.a. on ₹ 1,00,000 for 6 months	6,000	
@ 12% p.a. on ₹ 80,000 for 6 months	4,800	10,800
B : @ 12% p.a. on ₹ 80,000 for 1 year		9,600
C : @ 12% p.a. on ₹ 75,000 for 1 year	9,000	
@ 12% p.a. on ₹ 50,000 for 6 months	3,000	12,000
		32,400

Illustration 11

A and M are two partners sharing profits and losses in the ratio of 3 : 2 respectively. On 31.12.2013 their capital accounts stood at ₹ 55,000 and ₹ 45,000 after distribution of net profit of ₹ 15,000 and due consideration of drawings of the partners for ₹ 6,000 and ₹ 4,000 respectively. After closing the books, the following discrepancies were discovered :

(i) An item in the inventory was valued at ₹ 12,800 but had a realisable value of ₹ 8,300.

(ii) ₹ 2,400 paid for insurance premium for the year ending on 31.3.2014 had been debited to Profit and Loss Account.

(iii) Interest on capital at 5% on partners' capital as at the beginning of the year and interest on drawings of partners at 8% p.a. were left out of consideration.

Ascertain the correct net profit of the firm and redistribute the profit by preparing a Profit and Loss Appropriation Account and determine the balance of Partners' Capital Accounts.

Solution

Ascertainment of Opening Capital Balances on which Interest is to be Charged

Particulars	A	M
Capital at the end (31.12.2013)	55,000	45,000
Less: Profit of ₹ 15,000 distributed in the ratio of 3 : 2	9,000	6,000
	46,000	39,000
Add: Drawings during the period	6,000	4,000
Opening Capital of the Partners (1.1.2013)	52,000	43,000

Dr. Profit and Loss Adjustment Account Cr.

Particulars	₹	Particulars			₹
To Closing Stock A/c (₹ 12,800 – 8,300)	4,500	By Partners' Capital A/cs :	A	9,000	
To Profit and Loss Appropriation A/c (Correct net profit)	11,100		M	6,000	15,000
		By Prepaid Insurance A/c (₹ 2,400 / 4)			600
	15,600				15,600

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2013 Cr.

Particulars		₹	Particulars		₹
To Interest on Capital A/c :	A	2,600	By Profit and Loss Adjustment A/c		11,100
	M	2,150	By Interest on Drawings A/c :		
To Share of Profit A/c :	A	4,050		A	240
	M	2,700		M	160
		11,500			11,500

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	M	Date	Particulars	A	M
2013				2013			
Dec. 31	To Profit and Loss Adjustmemt A/c (written back)	9,000	6,000	Dec. 31	By Balance b/d	55,000	45,000
				"	By Interest on Capital A/c	2,600	2,150
				"	By Share of Profit A/c	4,050	2,700
"	To Interest on Drawings A/c	240	160				
"	To Balance c/d	52,410	43,690				
		61,650	49,850			61,650	49,850

Working Notes :

(1) Interest on Capital

A : ₹ 52,000 × 5 / 100 = ₹ 2,600.

M : ₹ 43,000 × 5 / 100 = ₹ 2,150.

(2) Interest on Drawings

A : ₹ 6,000 × 8 / 100 × 1/2 = ₹ 240*.

M : ₹ 4,000 × 8 / 100 × 1/2 = ₹ 160*.

(*Date of drawings has not been given. Therefore, it has been calculated for 1/2 year.)

Illustration 12

Weak, Able and Lazy are in partnership sharing profits and losses in the ratio of 2 : 1 : 1. It is agreed that interest on capital will be allowed @ 5 per cent per annum and interest on drawings will be charged @ 4 per cent per annum. No interest will be charged/allowed on current accounts.

The following are the particulars of the Capital, Current and Drawings Accounts of the partners:

Particulars	Weak ₹	Able ₹	Lazy ₹
Capitals (1st January 2014)	75,000	40,000	30,000
Current Accounts (1st January 2014)	10,000	5,000	(Dr.) 5,000
Drawings	15,000	10,000	10,000
Interest on Drawings (2014)	500	190	350

The draft accounts for 2014 showed a net profit of ₹ 60,000 before taking into account interest on capital and drawings and subject to following rectification of errors:

(a) Life insurance premium of Weak amounting to ₹ 750 paid by the firm on 31st December, 2014 has been charged to Miscellaneous Expenditure Account.

(b) Repairs of machinery amounting to ₹ 10,000 has been debited to Plant Account and depreciation thereon charged @ 20 per cent.

(c) Travelling expenses of ₹ 3,000 of Able for a pleasure trip to U.K. paid by the firm on 30th June 2014 has been debited to Travelling Expenses Account.

You are required to prepare the Profit and Loss Appropriation Account for the year ended 31st December, 2014 and the Partners' Current Accounts for the year.

Solution

Working Notes: (1) Ascertainment of Adjusted Net Profit

	₹	₹
Net Profit as per books of account		60,000
Add: Life insurance premium of Weak	750	
Travelling expenses of Able	3,000	
Depreciation wrongly charged (20% on ₹ 10,000)	2,000	5,750
		65,750
Less: Repairs wrongly debited to Plant		10,000
Adjusted Net Profit		55,750

(2) Ascertainment of Actual Drawings

Weak — ₹ 15,000 + ₹ 750 = ₹ 15,750; Able — ₹ 10,000 + ₹ 3,000 = ₹ 13,000; Lazy — ₹ 10,000.

(3) Ascertainment of Actual Interest on Drawings of Able

₹ 190 + 4% on ₹ 3,000 for 6 months = ₹ 190 + ₹ 60 = ₹ 250

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Interest on Capital A/c: (Weak—₹ 3,750; Able—₹ 2,000; Lazy—₹ 1,500)	7,250	By Net Profit (as above)	55,750
To Share of Profit A/c: (Weak—₹ 24,800; Able—₹ 12,400; Lazy—₹ 12,400)	49,600	By Interest on Drawings A/c (Weak—₹ 500; Able—₹ 250; Lazy—₹ 350)	1,100
	56,850		56,850

Dr. Partners' Current Accounts Cr.

Date	Particulars	Weak	Able	Lazy	Date	Particulars	Weak	Able	Lazy
1.1.2014	To Balance b/d	—	—	5,000	1.1.2014	By Balance b/d	10,000	5,000	—
31.12.2014	To Drawings A/c (Note 2)	15,750	13,000	10,000	31.12.2014	By Interest on Capital A/c	3,750	2,000	1,500
"	To Interest on Drawings A/c	500	250	350	"	By Share of Profit A/c	24,800	12,400	12,400
"	To Balance c/d	22,300	6,150	—	"	By Balance b/d	—	—	1,450
		38,550	19,400	15,350			38,550	19,400	15,350

Guarantee of Profits to or by a Partner

Sometimes, under the agreement of the partnership, one partner may be guaranteed a minimum amount of profit either by another partner or by the firm, while distributing the profits of the business. Such a guarantee is fairly common in professional firms. A useful employee may be given an offer to become a partner while at the same time being guaranteed an amount equal to the employee's existing remuneration. The guaranteed amount may include or exclude the incoming partner's interest on capital or salary. If nothing is mentioned in the question, it is usually taken to be the residual profit share that is guaranteed. We consider the above two situations.

Guarantee by the Firm

When all the partners guarantee that one of the partners should be credited with a minimum amount of profit, we are to calculate the following two figures separately (as a working note) :

(1) share of profit as per the profit sharing ratio; and (2) minimum guaranteed amount.

The higher of the above two will be credited to the partner. The balance of the profit (total profit minus profit credited to the guaranteed partner) will be shared by the remaining partners in their profit-sharing ratio.

Guarantee by one of the Partners

When one of the partners guarantees another a minimum amount of profit, the adjustment is to be done through the Partners' Capital Accounts. The following are the steps to be followed:

First, to distribute the profits among the partners in the usual profit-sharing ratio as if there is no guarantee.

Secondly, if the share of the guaranteed partner falls short of the minimum amount, the difference is to be deducted from the original share of profit of the partners giving guarantee and the same should be added with the original share of profit of the guaranteed partner.

Illustration 13

Ram and Rahim are in partnership sharing profits and losses in the ratio of 3:2. As Ram, on account of his advancing years, feels he cannot work as hard as before, the chief clerk of the firm, Ratan, is admitted as a partner with effect from 1st January, 2014, and becomes entitled to 1/10th of the net profits and nothing else, the mutual ratio between Ram and Rahim remaining unaltered.

Before becoming a partner, Ratan was getting a salary of ₹ 500 p.m. together with a commission of 4% on the net profits after deducting his salary and commission. It is provided in the partnership deed that the share of Ratan's profits as a partner in excess of the amount to which he would have been entitled if he had continued as the chief clerk, should be taken out of Ram's share of profits. The net profit for the year ended December 31, 2014, amounts to ₹ 1,10,000. Draw up the Profit and Loss Appropriation Account for the year ended December 31, 2014 showing the distribution of net profit amongst the partners.

Solution **Amount due to Ratan as a Chief Clerk**

	₹
Salary	6,000
Commission 4/104 x (₹ 1,10,000 — ₹ 6,000)	4,000
	10,000
Share of Profit as a partner (1/10th of 1,10,000)	11,000
Excess chargeable to Ram	1,000

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Share of Profit A/c		By Profit and Loss A/c (Net profit)	1,10,000
Ram 3/5 x (₹ 1,10,000 – ₹ 10,000) less ₹ 1,000	59,000		
Rahim 2/5 x (₹ 1,10,000 – ₹ 10,000)	40,000		
Ratan 1/10 x (₹ 1,10,000)	11,000		
	1,10,000		1,10,000

Illustration 14

A and B were in partnership sharing profits and losses in the ratio 3:2. In appreciation of the service of clerk C, who was in receipt of a salary of ₹ 2,400 p.a. and a commission of 5% on the net profit after charging such salary and commission, they took him into partnership as from 1st April, 2014, giving him 1/8th share of profits.

The agreement provided that any excess over his former remuneration to which C becomes entitled will be borne by A and B in the ratio of 2:3. The profit for the year ended 31st March, 2015 amounted to ₹ 44,400.

Prepare a Profit and Loss Appropriation Account showing the distribution of profit amongst all the partners.

Solution **Statement Showing the Excess Amount Payable to C** ₹

Amount due to C as partner (1/8th of ₹ 44,400)		5,550
Amount payable as a clerk:		
Salary	2,400	
Commission 5/105 (₹ 44,400–₹ 2,400)	2,000	4,400
Excess chargeable to A and B in the ratio 2:3		1,150

A's share of excess = 2/5th of ₹ 1,150 = ₹ 460; B's share of excess of ₹ 1,150 = ₹ 690.

Dr. **Profit and Loss Appropriation Account for the year ended 31st March, 2015** **Cr.**

Particulars	₹	₹	Particulars	₹	₹
To Share of Profit A/c			By Profit and Loss A/c (Net profit)		44,400
A — 3/5th × (₹ 44,400–₹ 4,400)	24,000				
Less: Share of Excess	460	23,540			
B — 2/5th × (₹ 44,400–₹ 4,400)	16,000				
Less: Share of Excess	690	15,310			
C — ₹ 4,400 + 460 + 690		5,550			
		44,400			44,400

Illustration 15

A and B are two partners sharing profits and losses in the ratio 4 : 1. A, in addition, is entitled to a commission at a certain percentage of net profit (such commission is to be charged in arriving at the net profit).

First, ₹ 2,000 of the net profit to be ignored; Next, ₹ 2,000 of the net profit to carry 10% commission;

Next, ₹ 2,000 of the net profit to carry 15% commission; and

Next, ₹ 2,000 of the net profit to carry 20% commission.

Assuming that the profit for the year ended 31.12.2014, before computing A's commission is ₹ 7,700, prepare the Profit and Loss Appropriation Account for the period.

Solution

Commission, in this case, is payable on net profit after charging such commission. Accordingly, if 'P' is the net profit after charging commission and 'C' is the total commission payable, profit before charging commission for the firm will be 'P + C'. In this instance, P + C = ₹ 7,700.

Commission as given in the problem is at varying rates and also at different slabs of net profit.

On the first ₹ 2,000 of net profit, commission is nil. On the next ₹ 2,000 of net profit, commission @ 10% will be equal to ₹ 200.

On further ₹ 2,000 of net profit, commission @ 15% will be equal to ₹ 300.

Thus, if net profit after charging commission is ₹ 6,000, aggregate commission will be amounted to ₹ 500 and profit before charging commission is ₹ 6,500.

Total profits before charging commission = ₹ 7,700. On first 6,000 profit commission is ₹ 500. It means on first 6,500 profits (before commission), commission is ₹ 500. On the balance profit (₹ 7,700 – ₹ 6,500) = ₹ 1,200 commission is to be paid @20% after charging such commission. Therefore, commission on such profit = 20/120 x ₹ 1,200 = ₹ 200. So, total commission will be ₹ 500 + ₹ 200 = ₹ 700.

Dr. **Profit and Loss Appropriation Account for the year ended 31st December, 2014** **Cr.**

Particulars		₹	Particulars		₹
To Commission to Partners A/c — A		700	By Profit and Loss A/c (Net profit)		7,700
To Share of Profit A/c					
(A — 4/5 of ₹ 7,000; B — 1/5 of ₹ 7,000)		7,000			
		7,700			7,700

Illustration 16

Three Chartered Accountants A, B and C entered into a partnership subject to the following terms :

(a) That the profit sharing ratio among A, B and C will be 3 : 2 : 1 respectively.

(b) That the gross fees earned by A, B and C shall be equal to their average gross fees of the preceding 3 years when they were carrying on the profession individually.

(c) That C's share of profit shall not be less than ₹ 30,000 p.a.

Other information :

(i) The net profits for the first year is ₹ 1,50,000.

(ii) Average gross fees of the preceding 3 years : A — ₹ 1,20,000; B — ₹ 50,000; C — ₹ 30,000.

(iii) Actual gross fees earned during the year : A — ₹ 1,26,000; B — ₹ 32,000; C — ₹ 30,000.

You are required to prepare the Profit and Loss Appropriation Account.

Solution

In this problem, each partner gives a guarantee that fees to be earned by him during the year will not be less than average gross fees of the preceding 3 years. In case of any shortfall, his account will be charged by that amount. A and C have earned more than or equal to average gross fees of the preceding 3 years. But for B, there is a deficiency of ₹ 18,000 (₹ 50,000 – ₹ 32,000). In effect, B's account is to be debited by ₹ 18,000.

Secondly, C's share of profit shall not be less than ₹ 30,000. Therefore, first the net profit will be distributed in the agreed ratio, i.e., 3 : 2 : 1. The net profit is ₹ 1,68,000 (₹ 1,50,000 + ₹ 18,000) which will be shared by A, B and C as follows : A—₹ 84,000; B—₹ 56,000 and C—₹ 28,000. Since the share of C is less by ₹ 2,000 (₹ 30,000 – ₹ 28,000), first ₹ 30,000 is to be set aside for C, the balance will be shared by A and B in the ratio of 3 : 2.

Dr. Profit and Loss Appropriation Account for the year ended . . . Cr.

Particulars	₹	Particulars	₹
To Share of Profit A/c A — ₹ 82,800; B — ₹ 55,200; C — ₹ 30,000	1,68,000	By Profit and Loss A/c (Net Profit) By B Capital A/c (deficiency)	1,50,000 18,000
	1,68,000		1,68,000

Illustration 17

A and B are two partners in a firm with respective capital contributions of ₹ 1,92,000 and ₹ 1,08,000 respectively. On 1.1.2014, A and B offered partnerships to C and D on the following terms :

(1) C and D should introduce capital of ₹ 1,00,000 and ₹ 80,000 respectively.

(2) All partners would be entitled to interest on capital @ 10% p.a. on opening balances of the new partnership.

(3) A and B are to receive salaries @ ₹ 20,000 p.a. and @ ₹ 12,000 p.a. respectively.

(4) The minimum dues of C and D would be ₹ 20,000 p.a. and ₹ 24,000 p.a. respectively (inclusive of their interest on capitals).

(5) Profits after charging partners'salaries and interest on capitals would be shared as 3 : 3 : 2 : 2 among A, B, C and D respectively.

You are required to prepare a statement to ascertain the net income that must be earned by the new firm during the year ended 31.12.2014 so that A and B receive equal shares of profit and A receives an aggregate of ₹ 60,000 inclusive of interest on capital, salary and share of profit.

Solution Statement Showing the Net Income that must be Earned

Particulars	A (₹)	B (₹)	C (₹)	D (₹)
Interest on capital to be paid @ 10%	19,200	10,800	10,000	8,000
Salary to be paid	20,000	12,000	—	—
Share of profit to be paid	*20,800	#20,800	*10,000	*16,000
	$60,000	43,600	$20,000	$24,000

* Balancing figure; # same as A; $ as given.

Therefore, the minimum net income that should be earned = ₹ (60,000 + 43,600 + 20,000 + 24,000) = ₹ **1,47,600**.

Working Notes :

(1) Minimum amount payable to A is ₹ 60,000. Interest on capital to be paid ₹ 19,200 and salary to be paid ₹ 20,000. The balance ₹ (60,000 – 19,200 – 20,000) = ₹ 20,800 is to be paid by way of share of profit.

(2) As per terms and conditions A and B will get equal profit. Therefore, B's share of profit will be ₹ 20,800 which is equal to A's share of profit.

(3) Minimum amount payable to C is ₹ 20,000. Interest on capital to be paid ₹ 10,000. The balance (₹ 20,000 – ₹ 10,000) = ₹ 10,000 is to be paid by way of share of profit.

(4) Minimum amount payable to D is ₹ 24,000. Interest on capital to be paid ₹ 8,000. The balance (₹ 24,000 – ₹ 8,000) = ₹ 16,000 is to be paid by way of profit.

Adjustment of Partnership Net Profit of Prior Years

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

Illustration 18

A and B started a partnership on 1.1.2013 with resepective capital contributions of ₹ 1,20,000 and ₹ 40,000. Their Capital Account balances as on 31.12.2014 were : A—₹ 2,09,500 and B—₹ 90,500.

The transactions recorded in the Capital Accounts during these two years were interest on capital @ 10% p.a. on initial investments and allocations of incomes. On 31.12.2014, it was further discovered that drawings of ₹ 42,000 by A and ₹ 30,000 by B had been wrongly treated as business expenses. You are required to a pass a single Journal Entry to adjust the Partners' Capital Accounts correctly on 31.12.2014.

Solution

Working Notes

(1) Ascertainment of Total Profit for 2 years

Particulars	A (₹)	B (₹)
Balance of capital as on 1.1.2013	1,20,000	40,000
Add: Interest on capital for 2 years @ 10% p.a.	24,000	8,000
Add: Profit credited for 2 years (Balancing fig.)	65,500	42,500
Balance of capital on 31.12.2014	2,09,500	90,500

(2) Ascertainment of Correct Profit

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

(3) Adjustment of Sharing of Profits

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

(4) Ascertainment of Correct Capital Balances

Particulars	A (₹)	B (₹)
Balance of capital as on 31.12.2014	2,09,500	90,500
Less: Drawings previously not charged	42,000	30,000
	1,67,500	60,500
Add: Profits to be credited (Note 3)	24,500	47,500
Corrected capital balances as on 31.12.2014	1,92,000	1,08,000

(5) Adjustment of Partners' Capital Accounts

Particulars	A (₹)	B (₹)
Capital balances as on 31.12.2014 (given)	2,09,500	90,500
Corrected balances as on 31.12.2014 (Note 4)	1,92,000	1,08,000
Required adjustment : excess (+) / short (–)	(+) 17,500	(–) 17,500

Required Journal Entry	Dr. (₹)	Cr. (₹)
A Capital A/c Dr.	17,500	
To B Capital A/c		17,500
(Being the Partners' Capital Account adjusted)		

Adjustment of Profits When a Manager is Treated as a Partner

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

Illustration 19

A and B commenced business on 1.7.2012 as partners with capitals of ₹ 1,80,000 and ₹ 1,20,000 respectively. The capitals remain fixed and carry interest @ 10% p.a. Profits and losses are to be shared in proportion to their capitals.

They appointed C as their manager on 1.7.2012 at a salary of ₹ 9,600 p.a. plus a bonus of 5% of the profits after charging such bonus and interest on capital. C had to deposit on 1.7.2012 ₹ 80,000 as security carrying interest @ 12% p.a.

In June 2015, it was settled that C should be treated as a partner from the commencement of the business. It was agreed that he should be entitled to 1/5th of the profits and his security deposit would be treated as his capital carrying interest @ 10% p.a. instead of the 12% he had received.

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

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

For the year ended : 2012-13 : ₹ 60,000; 2013-14 : ₹ 1,20,000; 2014-15 : ₹ 1,60,000.

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

Solution

Working Notes

(1) Statement Showing Amount Due to C as Manager

Particulars	2012-13	2013-14	2014-15
Salary	9,600	9,600	9,600
Interest on security deposit (@ 12% on ₹ 80,000)	9,600	9,600	9,600
Bonus (5% of net profit after charging bonus and interest on capital) :			
2012-13 : 5/105 of ₹ [60,000 – 10% of (1,80,000 + 1,20,000)]	1,429		
2013-14 : 5/105 of ₹ [1,20,000 – 10% of (1,80,000 + 1,20,000)]		4,286	
2014-15 : 5/105 of ₹ [1,60,000 – 10% of (1,80,000 + 1,20,000)]			6,190
	20,629	23,486	25,390

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

Particulars	2012-13	2013-14	2014-15
Net profit before C's bonus and interest on capital but after charging C's salary and interest on security deposit (as given)	60,000	1,20,000	1,60,000
Add: C's salary and interest on security deposit (added back since not payable) — ₹ (9,600 + 9,600)	19,200	19,200	19,200
Profit before interest on capital to the partners	79,200	1,39,200	1,79,200
Less: Interest on capital : 10% of ₹ (1,80,000 + 1,20,000 + 80,000)	38,000	38,000	38,000
Divisible profits	41,200	1,01,200	1,41,200
C's share of profits — 1/5th of divisible profits	8,240	20,240	28,240

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

Particulars	2012-13	2013-14	2014-15
(A) C's share as the partner :	₹	₹	₹
Interest on capital (@ 10% on ₹ 80,000)	8,000	8,000	8,000
Share of profit (Working Note 2)	8,240	20,240	28,240
Total C's share as the partner	16,240	28,240	36,240
(B) C's share as the manager (Working Note 1)	20,629	23,486	25,390
Difference in payment (being less than what he had received as the manager)	—	4,754	10,850

In 2012-13 C got as the manager more than what he was to receive as a partner. Therefore, no adjustment is required. But, in 2013-14 and 2014-15, as the manager he received less.

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

Required Journal Entry for Adjustment

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

Illustration 20

Following is the Profit and Loss Appropriation Account of A & Co for the year ended 31.12.2014 :

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

The entries were duly passed in the books but the following discrepancies were subsequently discovered:

(1) Interest on capital should be charged at 5% and that on drawings at 6% p.a.;

(2) X was not entitled to any partnership salary but Y was entitled to a salary of ₹ 200 p.m. not yet drawn by him;

(3) Profits to be shared in capital ratio; and,

(4) A loan on ₹10,000 stood in books in the name of A carrying 6% interest p.a.

Pass Journal entries to set these right.

Solution **Statement Showing the required Adjustments**

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

Required Journal Entry for Adjustment

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

Illustration 21

A, B and C are partners in a firm of solicitors since 1.1.2012. They maintain accounts on cash basis and share profits and losses in the ratio of 5:3:2 after allowing salaries of ₹ 8,000 p.a. to A, ₹ 5,000 p.a. to B and ₹ 2,000 p.a. to C. Besides, C's share is guaranteed to a fixed minimum of ₹ 5,000 (including his salary).

In 2015, they decide to change the method of accounting to mercantile basis with retrospective effect. The relevant information is furnished below :

Year	Profit before Partners' Salaries	O/S Exp. on 31st Dec.	Accrued fees on 31st Dec.
2012	₹ 24,000	₹ 6,000	₹ 5,000
2013	₹ 28,000	₹ 5,000	₹ 8,000
2014	₹ 40,000	₹ 3,000	₹ 5,000

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

Solution

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

Particulars	Total (₹)	A	B	C
2012 — Profit for the year	24,000			
Less: Salaries to partners	15,000	8,000	5,000	2,000
	9,000			
Less: C's guaranteed share (₹ 5,000 – ₹ 2,000)	3,000			3,000
Balance to A and B in the ratio 5:3	6,000	3,750	2,250	
2013 — Profit for the year	28,000			
Less: Salaries to partners	15,000	8,000	5,000	2,000
	13,000			
Less: C's guaranteed share (₹ 5,000 – ₹ 2,000)	3,000			3,000
Balance to A and B in the ratio 5:3	10,000	6,250	3,750	
2014 — Profit for the year	40,000			
Less: Salaries to partners	15,000	8,000	5,000	2,000
Balance to A, B and C in the ratio 5:3:2	25,000	12,500	7,500	5,000
Total profit as has been distributed		46,500	28,500	17,000

(2) Profits to be distributed on Mercantile Basis

(a) Calculation of profits under mercantile basis

Particulars	2012	2013	2014
Profit as per cash basis	24,000	28,000	40,000
Less: Outstanding expenses as on 31st December	6,000	5,000	3,000
	18,000	23,000	37,000
Add: Outstanding expenses as on 1st January	—	6,000	5,000

	18,000	29,000	42,000
Add: Accrued fees as on 31st December	5,000	8,000	5,000
	23,000	37,000	47,000
Less: Accrued fees as on 1st January	—	5,000	8,000
Profits under mercantile basis	23,000	32,000	39,000

(b) Share of the above profits

Particulars	Total (₹)	A	B	C
2012 — Profit as above	23,000			
Less: Salary to partners	15,000	8,000	5,000	2,000
	8,000			
Less: C's guaranteed share (₹ 5,000 – ₹ 2,000)	3,000			3,000
Balance to A and B in the ratio 5:3	5,000	3,125	1,875	
2013 — Profit as above	32,000			
Less: Salaries to partners	15,000	8,000	5,000	2,000
Balance to the partners in the ratio of 5 : 3 : 2	17,000	8,500	5,100	3,400
2014 — Profit as above	39,000			
Less: Salary to partners	15,000	8,000	5,000	2,000
Balance to the partners in the ratio of 5 : 3 : 2	24,000	12,000	7,200	4,800
Total Profit as to be distributed		47,625	29,175	17,200

Statement Showing the Adjustments to be Made

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

Required Journal Entry for Adjustment

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

Illustration 22

After the accounts of a partnership have been prepared, it is discovered that for the year 2012, 2013 and 2014, interest has been credited upon Partners' Capital Accounts at 5% p.a., although no provision is made for interest in the partnership agreement. The amounts involved are :

	2012	2013	2014
X	₹ 3,250	₹ 3,500	₹ 3,600
Y	₹ 2,100	₹ 2,000	₹ 2,150
Z	₹ 900	₹ 1,100	₹ 1,100

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

Year	X	Y	Z
2012	1/2	3/10	1/5
2013	2/5	2/5	1/5
2014	3/10	2/5	3/10

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

Solution **Statement Showing the required Adjustments**

Particulars	P&L Adj. A/c		X Capital		Y Capital		Z Capital	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
2012 — For interest on capital credited previously, now written back		6,250	3,250		2,100		900	
Above profit shared in the ratio of 5:3:2	6,250			3,125		1,875		1,250
2013 — For interest on capital credited previously, now written back		6,600	3,500		2,000		1,100	
Above profit shared in the ratio of 2:2:1	6,600			2,640		2,640		1,320

2014 — For interest on capital credited previously, now written back		6,850	3,600		2,150		1,100	
Above profit shared in the ratio of 3:4:3	6,850			2,055		2,740		2,055
TOTAL (₹)	19,700	19,700	10,350	7,820	6,250	7,255	3,100	4,625
Net effect				(Dr.) 2,530		(Cr.) 1,005		(Cr.) 1,525

Required Journal Entry for Adjustment

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

Illustration 23

S, T and Q were partners sharing profits in the proportion of 3:2:1. Their capitals on 31st December, 2014, stood at ₹ 45,000, ₹ 15,000 and ₹ 15,500 respectively after adjustments of net profit of ₹ 18,000 for the year ending that date and drawings of ₹ 6,000, ₹ 4,000 and ₹ 2,000 respectively. It was discovered that while ascertaining the profits, the accountant did not take into consideration the following matters :

1. Interest @ 6% p.a. on capital as on January 1, 2014.
2. Q was entitled to a salary of ₹ 2,000 p.a. of which ₹ 490 was unpaid.
3. Till 31st December, 2013, partners were sharing profits equally. Land costing ₹ 12,000 was purchased on the date of reallocation of profit, but no entry has been passed in that respect for which each partner contributed equal capital.
4. A loan of ₹ 5,000 from T as brought-forward from 2013 carrying interest at 8% p.a. was merged into his capital on July 1, 2014. No interest on loan was, however, charged to Profit and Loss Account.

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

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

Particulars	S	T	Q
Capital at the end (31.12.2014)	45,000	15,000	15,500
Less: Profit of ₹ 18,000 distributed in the ratio 3:2:1	9,000	6,000	3,000
	36,000	9,000	12,500
Add: Drawings during the period	6,000	4,000	2,000
	42,000	13,000	14,500
Add: Capital brought-in to acquire land	4,000	4,000	4,000
	46,000	17,000	18,500
Less: Loan of ₹ 5,000 from T merged on 1.7.2014	—	5,000	—
Opening Capital of the Partners (1.1.2014)	46,000	12,000	18,500

Dr. Profit and Loss Adjustment Account Cr.

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

Statement showing the required Adjustments

Particulars	P&L Adj. A/c		S Capital		T Capital		Q Capital	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
For interest on capital to be paid	4,590			2,760		720		1,110
For unpaid salary to Q	490							490
For interest on loan to T	200					200		

For sharing of profit	12,720			6,360		4,240		2,120
For sharing of the above losses in the ratio 3:2:1		18,000	9,000		6,000		3,000	
TOTAL (₹)	18,000	18,000	9,000	9,120	6,000	5,160	3,000	3,720
Net effect				(Cr.) 120		(Dr.) 840		(Cr.) 720

Required Journal Entry for Adjustment

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

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

Date	Particulars	S	T	Q	Date	Particulars	S	T	Q
31.12.2014	To S Capital A/c	—	120	—	31.12.2014	By Balance b/d	45,000	15,000	15,500
"	To Q Capital A/c	—	720	—	"	By Land A/c	4,000	4,000	4,000
"	To Balance c/d	49,120	18,160	20,220	"	By T Capital A/c	120	—	720
		49,120	19,000	20,220			49,120	19,000	20,220

Illustration 24

A and B were partners sharing profits and losses in the ratio of 5 : 3. On 1.7.2014, C, who was the manager of the firm on a monthly salary of ₹ 500 is admitted as a partner with 1/4th share. After admission to the firm, C's salary was met by B personally. C is guaranteed an annual profit of ₹ 6,000 by A. No stock was taken on 1.7.2014, but it was agreed that stock of 1.1.2014 would be adopted at ₹ 4,000 above the book value. C paid ₹ 4,000 as premium for goodwill and ₹ 13,000 as capital.

Trial Balance as at 31st December, 2014

Heads of Account	Dr. (₹)	Cr. (₹)	Heads of Account	Dr. (₹)	Cr. (₹)
Current and Capital Accounts :			Salaries (inclusive of manager's — ₹ 6,000)	14,000	
A	6,000	32,000	Postage and Telephone charges	2,000	
B	4,800	20,000	Printing and Stationery	1,500	
C's Suspense Account		17,000	Travelling and Conveyance	3,200	
Stock on 31.12.2014	24,000		Debtors and Creditors	20,000	16,500
Furniture	6,000		Bank	18,000	
Machinery (₹ 10,000 purchased on 1.10.2014)	30,000		Gross Profit		54,000
Rent, Rates and Taxes	10,000		Total	1,39,500	1,39,500

Depreciation @ 10% p.a. on written down value basis is to be provided on furniture and machinery.

Prepare Profit and Loss Account, Profit and Loss Appropriation Account, Partners' Capital Accounts and also prepare the Balance Sheet as at 31.12.2014.

Solution

Dr. **Profit and Loss Account for the year ended 31st December, 2014** **Cr.**

Particulars		₹	Particulars		₹
To Salaries: ₹ (14,000 – 6,000)		8,000	By Gross Profit (Note 1)		50,000
To Rent, Rates and Taxes		10,000			
To Postage and Telephone Charges		2,000			
To Printing and Stationery		1,500			
To Travelling and Conveyance		3,200			
To Balance c/d		25,300			
		50,000			50,000
	1.1.2014 to 30.6.2014	1.7.2014 to 31.12.2014		1.1.2014 to 30.6.2014	1.7.2014 to 31.12.2014
To Manager's Salary (Note 2)	3,000	—	By Balance b/d (divided equally)	12,650	12,650
To Depreciation on :					
Furniture	300	300			
Old Machinery	1,000	1,000			
New Machinery	—	250			
To Net Profit c/d	8,350	11,100			
	12,650	12,650		12,650	12,.650

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2014 Cr.

Particulars	1.1.2014 to 30.6.2014	1.7.2014 to 31.12.2014	Particulars	1.1.2014 to 30.6.2014	1.7.2014 to 31.12.2014
To A Capital A/c (5/8)	5,219	—	By Net Profit b/d	8,350	11,100
To B Capital A/c (3/8)	3,131	—			
To Balance c/d	—	11,100			
	8,350	11,100		8,350	11,100
To A Capital A/c (Note 3)	—	4,978	By Balance b/d	—	11,100
To B Capital A/c	—	3,122			
To C Capital A/c	—	3,000			
	—	11,100			11,100

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
To Balance b/d	6,000	4,800	—	By Balance b/d	32,000	20,000	—
To C Salary A/c (Note 2)	—	3,000	—	By C Suspense A/c (Note 5)	2,500	1,500	13,000
To Balance c/d	41,197	21,453	16,000	By Gross Profit A/c (Note 1)	2,500	1,500	—
				By Profit & Loss Appropriation A/c	5,219	3,131	—
				By Profit & Loss Appropriation A/c	4,978	3,122	3,000
	47,197	29,253	16,000		47,197	29,253	16,000

Balance Sheet as on 31st December, 2014

Liabilities		₹	Assets		₹
Capital Accounts :			Machinery	30,000	
A	41,197		Less : Depreciation : ₹ (2,000 + 250)	2,250	27,750
B	21,453		Furniture	6,000	
C	16,000	78,650	Less : Depreciation	600	5,400
Creditors		16,500	Closing Stock		24,000
			Debtors		20,000
			Cash		18,000
		95,150			95,150

Working Notes :

(1) At the time of calculating profits on 31.12.2013, the value of stock was taken ₹ 4,000 less. Therefore, in 2013 partners got ₹ 4,000 less profit. At the time of calculating gross profit for 2014 the value of opening stock was taken ₹ 4,000 less. So, the gross profit of 2014 was increased by ₹ 4,000. Therefore, the following adjustment entry is to be passed : (figures in ₹)

Gross Profit Account	Dr.	4,000	
To A Capital Account			2,500
To B Capital Account			1,500
(Being adjustment for under valuation of opening stock).			

(2) C's salary of ₹ 6,000 is to be charged as follows :
(i) Profit and Loss Account for the period 1.1.2014 to 30.6.2014 ₹ 3,000
(ii) B's Capital Account ₹ 3,000.

(3) Profit for the period 1.7.2014 to 31.12.2014 is ₹ 11,100 which will be shared by A, B and C in the new ratio of 15 : 9 : 8 (See Note 4). However, C's share of profit for this period must not be less than ₹ 3,000 (1/2 of ₹ 6,000 p.a.). Any shortfall to be charged to A.

Particulars	A	B	C
Share of Profit (15 : 9 : 8)	5,203	3,122	2,775
Adjustment for Guarantee	– 225	—	+ 225
	4,978	3,122	3,000

(4) Calculation of new profit sharing ratio : 1 – 1/4 = 3/4. A will get 5/8 of 3/4, i.e., 15/32; B will get 3/8 of 3/4 = 9/32 and C will get 1/4 or 8/32. Therefore, new ratio = 15 : 9 : 8.

(5) C's Suspense Account of ₹ 17,000 represents ₹ 13,000 capital and ₹ 4,000 premium for goodwill.
Premium for goodwill brought in by C will be shared by A and B in the sacrificing ratio of 5 : 3.

Illustration 25

A, B and C are partners in X & Co., boot dealers. The firm controls three shops, and each partner undertakes the management of one of these. C, in addition, manages a repair department.

The profits of each department are subject to a charge for interest at 7.5% p.a. on loan and partners' capital employed. The profits of the repair department are, in addition, chargeable with a salary of ₹ 4,000 p.a. in favour of C.

The profits, subject to interest and salary as stated, are apportionable thus —

Repair department : allocable to shops in proportion of their respective shares in the turnover of this department.

Shop : including transfer from repair department, 90% to individual partners taking control of each respectively. 10% to a general pool.

General pool : A — 1/2, B — 1/3 and C — 1/6.

For the year 2014, repairs department shows profits, prior to charge for interest and salary of ₹ 8,250. Turnover of this department with shops has been A — ₹ 55,000, B — ₹ 30,000, C — ₹ 15,000. For the same period, profits of shops prior to charge for interest are : A — ₹ 64,000, B — ₹ 56,050 and C — ₹ 42,000.

Interest has been paid on loans of ₹ 1,00,000 and partners are entitled to interest on their capital : A—₹ 1,00,000; B—₹ 70,000; C—₹ 50,000. Loan and Partners' Capital employed by A—shop—₹ 1,40,000; B—shop—₹ 90,000; C—shop—₹ 60,000; and repair department—₹ 30,000.

Prepare, for the year 2014, accounts showing allocation of interests and appropriation of profits.

Solution

Dr. Appropriation Account Cr.

Particulars	Shop A	Shop B	Shop C	Particulars	Shop A	Shop B	Shop C
To Interest on Capital and Loan A/c	10,500	6,750	4,500	By Profit & Loss A/c (Net profit)	64,000	56,050	42,000
To Balance c/d	54,600	49,900	37,800	By Repairs Department A/c	1,100	600	300
	65,100	56,650	42,300		65,100	56,650	42,300
To Partners' Capital A/c				By Balance b/d	54,600	49,900	37,800
A — 90% of ₹ 54,600	49,140						
B — 90% of ₹ 49,900		44,910					
C — 90% of ₹ 37,800			34,020				
To General Pool A/c (10% of the shop profit)	5,460	4,990	3,780				
	54,600	49,900	37,800		54,600	49,900	37,800

Dr. Repairs Department Account Cr.

Particulars	₹	Particulars	₹
To Interest on Capital and Loan A/c (7.5% on ₹ 30,000)	2,250	By Profit & Loss A/c	8,250
To Partners' Capital A/cs — Salary to C	4,000		
To Appropriation A/c			
Shop A — 55% of ₹ 2,000	1,100		
Shop B — 30% of ₹ 2,000	600		
Shop C — 15% of ₹ 2,000	300		
	8,250		8,250

Dr. General Pool Account Cr.

Particulars	₹	Particulars	₹
To Partners' Capital A/cs		By Appropriation A/c	
A (1/2)	7,115	Shop A	5,460
B (1/3)	4,743	Shop B	4,990
C (1/6)	2,372	Shop C	3,780
	14,230		14,230

Dr. Interest on Capital and Loan Account Cr.

Particulars	₹	Particulars	₹
To Partners' Capital A/cs — 7.5% on ₹ 1,00,000	7,500	By Appropriation A/c	
To Partners' Capital A/cs		Shop A — 7.5% on ₹ 1,40,000	10,500
A — 7.5% on ₹ 1,00,000	7,500	Shop B — 7.5% on ₹ 90,000	6,750
B — 7.5% on ₹ 70,000	5,250	Shop C — 7.5% on ₹ 60,000	4,500
C — 7.5% on ₹ 50,000	3,750	By Repairs Department A/c — 7.5% on ₹ 30,000	2,250
	24,000		24,000

Illustration 26

X, Y and Z are partners, managing the business at Chennai, Bangalore and Ooty branches respectively. The terms of agreement are :

1. A sum of ₹ 600 p.m. to be charged against the branch profits as salary to the managing partner.
2. The profits and losses, after charge of salary, are to be shared in the following manner :
   (a) The managing partner of each branch has to be paid 50% of the additional profits in excess of 20% return on average capital employed at the branch; and
   (b) The balance of the profits to be pooled for division in the ratio 4:3:3.
3. Interest on capital to be charged @ 8% p.a. and on Current Account (including overdrawals) @ 6% p.a.—both on the opening balances.

The following information made available for the year 2014, to enable you to prepare the statement of distribution of profits among the partners:

(a) Drawings in addition to salary from the respective branches : X—₹ 15,000; Y—Nil; Z—₹ 22,000.

(b) Balance on Capital and Current Accounts at the beginning of the year were :
Capital Accounts : X—₹ 90,000; Y—₹ 84,000; Z—₹ 48,000
Current Accounts : X—₹ 12,000 (Dr.); Y—₹ 7,500 (Cr.); Z—₹ 5,000 (Dr.)

4. Assets and Liabilities at the close of the year at the branches were :

	Chennai (₹)	Bangalore (₹))	Ooty (₹)
Fixed Assets	30,000	48,000	36,000
Stock	25,000	18,000	15,000
Sundry Debtors	48,000	36,000	32,000
Cash and Bank	2,000	1,800	2,200
Sundry Creditors	18,000	12,000	10,000
Outstanding Expenses	1,800	1,200	1,000

5. During the year, fixed assets remain constant; current assets increased by 20% and Current Liabilities by 10%.

Solution **Statement of Profit for the year 2014**

Particulars		Chennai	Bangalore	Ooty
Total Closing Assets :		₹	₹	₹
Fixed Assets		30,000	48,000	36,000
Current Assets (Stock + Debtors + Cash & Bank)		75,000	55,800	49,200
		1,05,000	1,03,800	85,200
Less: Current Liabilities (Creditors and outstanding expenses)		19,800	13,200	11,000
Closing capital employed	(a)	85,200	90,600	74,200
Total Opening Assets :				
Fixed assets		30,000	48,000	36,000
Current assets (Closing value x 100/120)		62,500	46,500	41,000
		92,500	94,500	77,000
Less: Current Liabilities (Closing value x 100/110)		18,000	12,000	10,000
Opening capital employed	(b)	74,500	82,500	67,000
Increase in capital (a – b)		10,700	8,100	7,200
Add: Drawings and salary		22,200	7,200	29,200
Profit for the year 2014	(c)	32,900	15,300	36,400
Average capital employed [(a + b) / 2]		79,850	86,550	70,600
Normal profit : 20% on capital employed	(d)	15,970	17,310	14,120
Additional profit (c – d)	(e)	16,930	Nil	22,280
Share of the managing partner (50% of e)		8,465	Nil	11,140

Dr. **Profit & Loss Appropriation Account for the year ended 31st December, 2014** **Cr.**

Particulars	Chennai	Bangalore	Ooty	Particulars	Chennai	Bangalore	Ooty
To Salary to Partners' A/c				By Profit & Loss A/c (Net profit)	32,900	15,300	36,400
X	7,200	—	—				
Y	—	7,200	—				
Z	—	—	7,200				
To Share of Additional Profit to Partners' A/c							
X	8,465	—	—				
Z	—	—	11,140				
To Balance c/d	17,235	8,100	18,060				
	32,900	15,300	36,400		32,900	15,300	36,400

To Interest on Capital A/c			By Balance b/d		
X — 8% p.a. on ₹ 90,000	7,200		Chennai	17,235	
Y — 8% p.a. on ₹ 84,000	6,720		Bangalore	8,100	
Z — 8% p.a. on ₹ 48,000	3,840	17,760	Ooty	18,060	43,395
To Interest on Current A/c			By Interest on Current A/c		
Y — 6% p.a. on ₹ 7,500		450	X — 6% p.a. on ₹ 12,000	720	
To Share of Profit A/c			Z — 6% p.a. on ₹ 5,000	300	1,020
X (4/10)	10,482				
Y (3/10)	7,862				
Z (3/10)	7,861	26,205			
		44,415			44,415

Key Points

- In India partnership is governed by The Indian Partnership Act, 1932. Section 4 of this Act defines partnership as ***'the relationship between persons who have agreed to share the profit of a business carried on by all or any of them acting for all'.***
- A partner, who has not attained the age of maturity is called a minor partner. A minor partner can be admitted only into the benefits of the partnership but is not personally liable, like other partners, for any debts of the firm.
- A partner who is entitled to the profits of the business without making himself responsible for losses, is called a ***partner in profits*** only.
- As per the provision of Section 69 of the Indian Partnership Act, non-registration of a partnership gives rise to a number of disabilities, such as:
  (i) No partner can bring a suit in any court against the firm or his co-partners.
  (ii) The firm cannot file a suit against third party for breach of contract, and like matters.
- Any amount payable to a partner (except rent), such as interest on capital, interest on loan, salaries, commission, etc., should be treated as appropriation and it should not be charged against profit.
- Interest on capital is chargeable to a firm to the extent of available profit only, since interest on capital is an appropriation of profits.

THEORETICAL QUESTIONS

1. In the absence of any agreement, how are the following dealt with in the books of account of a partnership firm: (a) Salaries to the partners; (b) Interest on capital to the partners; (c) Commission to the partners; (d) Interest on loan to the partners; and (e) Interest on drawings of the partners.
2. Distinguish between 'Fixed Capitals' and 'Fluctuating Capitals'.
3. Why are Partners' Current Accounts opened, when there are Capital Accounts of the partners?
4. How is interest on capital calculated when there are several introductions and withdrawals of capital at equal and unequal intervals?
5. How is interest on drawings calculated when there are several drawings of money at equal or unequal intervals?
6. How would you adjust the capital accounts of the partners, when the share of profit of a partner is guaranteed (a) by the firm and (b) by another partner?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below.

1. A partner's private petrol bills have been treated as part of the partnership vehicle expenses. Which of the following entries is necessary to correct the error :

	Debit	Credit
A	drawings account	motor vehicle expenses account
B	motor vehicle expenses account	drawings account
C	motor vehicle expenses account	capital account
D	capital account	motor vehicle expenses account

2. What double entry is necessary to reflect interest earned on fixed partners' capital account balances ?

A	partners' current accounts	profit and loss appropriation account
B	profit and loss appropriation account	partners' current accounts
C	profit and loss appropriation account	cash account
D	profit and loss appropriation account	partners' capital accounts

3. What double entry is necessary to reflect interest payable on partners' drawings ?

A	partners' drawings accounts	partners' current accounts
B	profit and loss appropriation account	partners' drawings accounts
C	partners' drawings accounts	interest payable account
D	partners' current accounts	profit and loss appropriation account

4. Which of the following is not incorporated in the Partnership Act ?
   A profit and loss are to be shared equally
   B no interest is to be charged on capital
   C all loans are to be charged interest @ 6% p.a.
   D all drawings are to be charged interest
5. When is the Partnership Act enforced ?
   A when there is no partnership deed
   B where there is a partnership deed but there are differences of opinion between the partners
   C when capital contribution by the partners varies
   D when the partner's salary and interest on capital are not incorporated in the partnership deed
6. Which one of the following items cannot be recorded in the appropriation account ?
   A interest on capital
   B interest on drawings
   C rent paid to partners
   D partner's salary
7. How should interest charged on partners' drawings be dealt with in partnership final accounts ?
   A credited as income in profit and loss account
   B deducted from profit in allocating the profit among the partners
   C added to profit in allocating the profit among the partners
   D debited as an expense in the profit and loss account
8. Which of the following statement is true ?
   A a minor cannot be admitted as a partner
   B a minor can be admitted as a partner, only into the benefits of the partnership
   C a minor can be admitted as a partner but his rights and liabilities are same of adult partner
   D none of the above
9. Non-registration of a partnership gives rise to a number of disabilities such as :
   (i) no partner can bring a suit in any court against the firm or his co-partners.
   (ii) the firm cannot file a suit against third party for breach of contract.
   Which of the above statement(s) is / are true ?
   A (i) only
   B (ii) only
   C both (i) and (ii)
   D neither (i) nor (ii)
10. In the absence of partnership deed, interest on partners' loan is payable by the firm @
   A 12% p.a.
   B 6% p.a.
   C 10% p.a.
   D 16% p.a.
11. Ostensible partners are those who
   A do not contribute any capital but get some share of profit for lending their name to the business
   B contribute very less capital but get equal profit
   C do not contribute any capital and without having any interest in the business, lend their name to the business
   D contribute maximum capital of the business
12. Sleeping partners are those who
   A take active part in the conduct of the business but provide no capital. However, salary is paid to them.
   B do not take any part in the conduct of the business but provide capital and share profits and losses in the agreed ratio
   C take active part in the conduct of the business but provide no capital. However, share profits and losses in the agreed ratio.
   D do not take any part in the conduct of the business and contribute no capital. However, share profits and losses in the agreed ratio.

PRACTICAL QUESTIONS

1. X and Y started a business on 1st January, 2014 by contributing ₹ 50,000 and ₹ 25,000 respectively as capitals. On 1st April, 2014, X made an advance to the firm to the tune of ₹ 20,000. Y alone was looking after the business of the firm. During the year ended on 31st December, 2014, they earned a net profit of ₹ 40,900. There was no partnership agreement — oral or written. At the time of distribution of profit

   X claims:

   (i) Interest to be given on capital and loan @ 12% p.a.; and (ii) The profit should be distributed in the capital ratio.

   Y claims:

   (i) Salary @ ₹ 1,000 p.m. for his service; and (ii) Interest on capital and loan should be given @ 8% p.a. only.

   You are required to prepare a Profit and Loss Appropriation Account as per the provisions of the Indian Partnership Act.

2. On 1st January, 2014, A, B and C enter into partnership contributing ₹ 2,50,000, ₹ 1,30,000 and ₹ 1,20,000 respectively and sharing profits and losses in the ratio of 5 : 3 : 2. B and C are entitled to a salary of ₹ 16,000 and ₹ 14,500 respectively per year. Interest on capital is allowed at 5% p.a. 6% interest is charged on drawings.

   During the year, A withdrew ₹ 40,000, B ₹ 25,000 and C ₹ 15,000.

   Interest being : A — ₹ 2,250; B — ₹ 1,125; and C — ₹ 725. Profit in 2014 before the above mentioned adjustments was ₹ 71,400.

   Show how the profit is distributed and also prepare the Capital Accounts, if they were fluctuating.

3. P and Q share profits and losses equally, but by agreement, Q, out of his share, pays P a salary of ₹ 500 p.m. The accounts at 31.12.2014, show the following results:

   Capital: P—₹ 38,430; Q—₹ 41,790

   Net profit before charging interest on capital amount to ₹ 23,505.

   Drawings: P—₹ 7,500; Q—₹ 10,500

   Paid by Q to P in cash privately on account of salary of ₹ 2,000. After charging 5% interest on capital (ignoring interest on drawings and salary), write up the Capital Account of each partner as at the end of the year.

4. From the following information, prepare:

   1. The Profit and Loss Appropriation Account of P, Q and R for the year ended 31.12.2014.
   2. The Capital and Current Accounts of the partners.

Partners	Capital (1.1.2014)	Current (1.1.2014)	Drawings (31.12.2014)
P	₹ 6,000	₹ 2,000 (Cr.)	₹ 4,000
Q	₹ 10,000	₹ 1,000 (Cr.)	₹ 4,800
R	₹ 16,000	₹ 1,000 (Cr.)	₹ 4,800

   (i) Interest is credited @ 6% p.a. on capital and is charged on drawings at the same rate. Interest is neither credited nor charged on the balances of current accounts.

   (ii) Each partner took at the end of each quarter 25% of his drawings.

   (iii) P and Q were to be credited with salaries of ₹ 2,400 and ₹ 1,600 p.a. respectively.

   (iv) On 1.7.2014, P paid in an additional ₹ 2,000 as capital and R withdrew ₹ 2,000 from capital.

   (v) The net profit before charging interest on capital and partners' salaries and before interest on drawings had been credited was ₹ 19,600.

   (vi) Profits and losses were shared among P, Q and R in the ratio of 5 : 4 : 3 respectively.

5. A, B and C start business in partnership. A puts in ₹ 20,000 for the whole year, B puts in ₹ 30,000 at first and increases it to ₹ 40,000 at the end of four months but withdraws ₹ 20,000 at the end of six months. C puts in ₹ 40,000 at first and then withdraws ₹ 20,000 after the end of 8 months. The profit for the period can be assumed to be ₹ 60,000.

   Show the Profit and Loss Appropriation Account, distributing the same on the basis of effective capital employed (interest on capital basis).

6. Sanatan and Narayan are partners in a firm sharing profits and losses as Sanatan—4/5th and Narayan—1/5th. On 1st April 2014, the capital of the partners were: Sanatan—₹ 50,000 and Narayan—₹ 40,000. The Profit and Loss Account of the firm for the year ended 31st March, 2015 showed a net profit of ₹ 1,75,000.

   You are required to give the Profit and Loss Appropriation Account of the firm after taking into consideration the following adjustments :

   (i) interest on capital at 5% p.a.;

   (ii) interest on Narayan Loan Account of ₹ 50,000 for the whole year;

(iii) interest on drawings of partners at 6% p.a.; the drawings were: Sanatan—₹ 15,000 and Narayan—₹ 10,000; and

(iv) transfer 10% of the net profit, before distribution to the Reserve Fund of the firm.

7. On January 1, 2014, John and Robert commenced business as partners with an initial capital of ₹ 20,000 and ₹ 30,000 in their respective accounts. The partnership deed provided, ***inter-alia,*** that :

(1) Profit and Losses shall be shared in the ratio 2:3 as between John and Robert;

(2) Partners shall be entitled to interest on capital at the commencement of each year at 6% p.a.; and

(3) Interest on drawings shall be charged at 8% p.a.

During the year ended 31.12.2014, the firm made a profit of ₹ 19,280 before adjustment of interest on Capital and Drawings. The partners withdrew during the year ₹ 3,000 each at the end of every quarter commencing from 31.3.2014.

You are required to open a Profit and Loss Appropriation Account and show the entries for interest and distribution of profit. Show also the Capital Accounts of partners for the year.

8. A, B and C are partners in a firm. The terms are:

(a) Profits and Losses to be shared by A, B and C as 6 : 3 : 1; (b) Interest on Capital at 6% p.a.; (c) Interest on opening Current Account balance 5% p.a.; and, (d) 5% interest is to be charged on the excess of drawings (excluding salary) over share of profit as such and the converse. Share of profit for this clause means share in balance profit after deducting partnership salary, interest on Capital and Current Accounts. Interest on Drawings under this clause is to be ignored for the purpose. (e) B and C to get salary @ ₹ 600 and ₹ 800 p.a. respectively.

The following facts are available :

Partners	Fixed Capital (31.12.2013)	Current A/c (31.12.2013)	Drawings 2014 (including salary)
A	₹ 9,000	₹ 2,000 (Cr.)	₹ 4,000
B	₹ 6,000	₹ 1,000 (Dr.)	₹ 3,100
C	₹ 3,000	₹ 1,200 (Cr.)	₹ 2,300

D, the manager, is to be admitted as a partner on 31.12.2014. The draft account for 2014 (before providing for partnership salary, interest, etc.) discloses profits of ₹ 12,590. Bonus of ₹ 1,000 is to be provided for D.

Prepare Profit and Loss Appropriation Account for the year ended 31.12.2014.

9. Ripa, Rini and Rima are three partners in a firm. According to the partnership deed, the partners are entitled to draw ₹ 700 per month. On the first day of every month Ripa, Rini and Rima drew ₹ 700, ₹ 600 and ₹ 500 respectively. Interest on capitals and interest on drawings are fixed at 8% and 10% respectively. Profit during the year 2014 was ₹ 75,500 out of which ₹ 20,000 is to be transferred to General Reserve. Rini and Rima are entitled to receive salary of ₹ 3,000 and ₹ 4,500 p.a. respectively and Ripa is entitled to receive commission at 10% on net distributable profit after charging such commission. On 1st January, 2014, the balances of their Capital Accounts were ₹ 50,000, ₹ 40,000 and ₹ 35,000 respectively.

You are required to show Profit and Loss Appropriation Account for the year ended 31st December, 2014, and Capital Accounts of partners in the books of the firm.

10. A, B and C were in partnership. A and B sharing profits in the proportion of three to one, and C receiving a Salary of ₹ 25,000 plus 5% of the profit after charging his salary and his 5% of the profit, or 1/7th of the profit of the firm whichever is the larger. Any excess of the latter over the former is, under the partnership agreement, to be charged to A.

The profit for the year ended 31st December, 2014 was ₹ 2,87,000, after charging interest on capital and C's salary.

You are required to show the distribution of the profit among the partners.

11. A, B and C are partners sharing profits and losses in proportion to their capitals at the beginning of the year. They are entitled annually to draw ₹ 6,000, ₹ 5,000 and ₹ 4,000 respectively out of their anticipated shares of profits. Any drawings in excess of these amounts are to be regarded as advances taken from the firm and are to be subject to interest at an average rate of 6% p.a. The capitals as at the beginning of the year are to be allowed interest at an average rate of 5% p.a.

The capitals of the partners as at the beginning of the year were : A — ₹ 80,000; B — ₹ 60,000 and C — ₹ 40,000. The credit balances of their Current Accounts were : A — ₹ 2,304; B — ₹ 3,728 and C — ₹ 1,152. Their drawings during the year were : A — ₹ 10,000; B — ₹ 12,000 and C — ₹ 5,000. The profit for the year were ₹ 30,096 before making any adjustment for interest as above.

Draw up the Capital and Current Accounts of the partners.

12. X and Y were partners with ₹ 20,000 as capital, contributed equally. They shared profits as follows:

    Salary to X ₹ 1,000 p.a. and Salary to Y ₹ 1,000 p.a. Remaining profits were shared equally. Due to certain circumstances, it became essential to make changes in the shares of X and Y, which were as follows: Salary to X ₹ 500 p.a. and Salary to Y ₹ 1,000 p.a. Remaining profits equally.

    The above new change was applicable subject to Z being introduced on 1st January, 2014 as a partner (without capital) at a salary of ₹ 1,500 and one-seventh share in the profits and losses of the firm (after charging interest on capital and all salaries) all of which was to be charged to X with the exception of ₹ 1,000, the amount of salary, Z had formerly received as manager of the firm. X and Y are entitled to interest on capital at 5% p.a. The profit for the year ended 31st December,2014, before charging interest on capital or partners' salary was ₹ 2,740.

    Prepare Profit And Loss Appropriation Account.

13. A, B and C are in partnership. Their partnership deed provides that :

    (i) Interest on capital is to be provided @ 5% p.a.

    (ii) Interest on drawings is to be charged @ 10% p.a.

    (iii) Each partner is entitled to salary for their duty in the firm @ ₹ 4,000 p.a.

    (iv) A is to receive commission of 10% on the net profit before charging the above provisions.

    (v) B is to receive commission of 10% on the net profit after charging such commission and above provisions.

    (vi) 25% of the net profit after charging all the above provisions to be transferred to reserve.

    (vii) First net distributable profit of ₹ 40,000 to be apportioned in the ratio of 5 : 4 : 1 and the balance to be shared equally.

    The opening balances as on 1.1.2014 were as follows :

    (a) Capital Accounts — A : ₹ 1,00,000; B : ₹ 60,000 and C : ₹ 40,000

    (b) Current Accounts — A : ₹ 20,000 (Cr.); B : ₹ 5,000 (Cr.) and C : ₹ 6,000 (Dr.)

    (c) Loan Account — ₹ 50,000 (Interest on loan provided in the Profit and Loss Account).

    You are required to prepare : Profit and Loss Appropriation Account and Partners' Current Accounts.

14. A, B and C formed a partnership business, in the year 2013. They did not have any Partnreship Deed. From the year 2014, they agreed upon the following :

    (a) Partners will share profits or losses equally.

    (b) Partners will get interest on capital @ 6% p.a.

    (c) 'A' will get salary @ ₹ 1,000 p.m.

    A, B and C started the business contributing capital ₹ 10,000, ₹ 15,000 and ₹ 20,000 respectively. They did not maintain any proper books of accounts. Only the records of assets and liabilities to outsiders were maintained by them. The assets and outside liabilities were as follows :

	31.12.2013 (₹)	31.12.2014 (₹)
Sundry Creditors	35,000	20,000
Furniture and Fixtures	50,000	50,000
Stock	30,000	45,000
Sundry Debtors	25,000	30,000
Cash-in-hand and at bank	20,000	25,000

    They decided to prepare accounts as per Partnership Deed and charge depreciation on Furniture and fixtures @ 10% p.a. on straight line basis withb effect from 2013.

    Show Profit and Loss Appropriation Account and Partners' Capital Account for 2013 and 2014.

15. A and B are partners in a firm sharing profits and losses in the ratio of 3 : 2 with capital of ₹ 1,20,000 and ₹ 40,000 respectively. The amount of capital carries interest @ 5% p.a. They admit C into partnership w.e.f. 1.10.2014 on the following conditions :

    (i) That C is to bring in ₹ 15,000 as premium for goodwill, which will be withdrawn by A and B in their old profit sharing ratio.

    (ii) That C is to contribute ₹ 22,400 to the firm as his share of capital.

    (iii) That the partners' capitals will carry interest @ 5% p.a.

    (iv) That the profit earned during 2014 will be apportioned between the pre-admission and post-admission period on the basis of turnover.

    (v) That the profit sharing ratio between B and C will be the same as A and B.

    The profit for the year ending 31.12.2014 before charging interest on partners' capitals amounted to ₹ 66,500. The monthly average of turnover during the first nine months of the calendar year was twice the corresponding figure for the remaining three months. You are required to prepare Profit and Loss Appropriate Account for the pre and post admission periods.

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

Date	Particulars	A	B	C	Date	Particulars	A	B	C
31.12.2014	To Drawings A/c	12,000	12,000	12,000	1.1.2014	By Balance b/d	20,000	30,000	40,000
	To Balance c/d	23,000	33,000	43,000	31.12.2014	By Sh. of Profit A/c	15,000	15,000	15,000
		35,000	45,000	55,000			35,000	45,000	55,000

On 1.1.2015, it is agreed that the following would be effective retrospectively from 1.1.2014:

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

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

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

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

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

17. A, B, C and D are partners in a firm. Their capital accounts stood at ₹ 60,000; ₹ 30,000; ₹ 30,000 and ₹ 20,000 respectively on 1.1.2014. They share profits and losses in the proportion of 5 : 3 : 2 : 2. D's share of profit (excluding interest on capital) is guaranteed by the firm to be not less than ₹ 16,000 p.a. C's share of profit (including interest on capital and salary) is guaranteed by A at a minimum of ₹ 26,000 p.a.

The profit for the year ended 31.12.2014 amounted to ₹ 91,000 before considering interest on capital @ 5% p.a. and salary to C @ ₹ 1,000 p.m. Prepare the Profit and Loss Appropriation Account for the year ended 31.12.2014.

18. A, B and C were partners. On 1.4.2014, they admitted, their manager, D as a partner. Profits and losses in the new partnership were to be shared in the ratio of 4 : 3 : 2 : 1 respectively. In addition, C is to get a salary of ₹ 600 p.m.

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

On considering the draft accounts for the year ended 31.3.2015, the partners agreed to the following adjustments:

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

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

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

The profits for the year ended 31.3.2015, before making the above adjustments and before charging C's salary amounted to ₹ 32,000.

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

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

	2012	2013	2014
Rent outstanding	5,000	4,000	6,000
Salaries paid in advance	3,000	2,000	4,000
Prepaid insurance premium	3,500	2,500	—
Outstanding insurance premium	—	—	2,000

20. A and B had been in partnership for many years as architects, sharing profits equally. It had been their custom to ignore fees, etc., earned on uncompleted matters when preparing annual accounts. On 1.1.2014, they entered into a new partnership agreement under which the profits earned in any year were to be distributed as follows :

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

Although they shared profits in accordance with the new agreement, they continued to prepare their accounts upon the old basis, i.e., ignoring fees earned on uncompleted work. At the end of 2015, it was pointed out to them that they were not following the terms of their agreement, and it was agreed that such correcting entries as might be necessary, should be put through as on 31.12.2014.

The profits already dealt with were : 2012 — ₹ 11,500; 2013 — ₹ 12,210; 2014 — ₹ 13,350.

The outstanding fees not brought into account on 31st December each year were :

2011 — ₹ 960; 2012 — ₹ 1,280; 2013 — ₹ 1,550; 2014 — ₹ 920.

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

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

    From the following information, prepare the Profit and Loss Appropriation Account for the year ended 31.12.2014:

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

    (b) Assets as on 31.12.2014 : Kolkata — ₹ 2,35,900; Mumbai — ₹ 93,800; Chennai — ₹ 72,100.
    Liabilities as on 31.12.2014 : Kolkata — ₹ 21,400; Mumbai — ₹ 12,200; Chennai — ₹ 8,500.

    (c) Profit for the year ended 31.12.2014 without adjustments:
    Kolkata — ₹ 63,350; Mumbai — ₹ 31,900; Chennai — ₹ 27,600.

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

Guide to Answers

Multiple Choice

1. A 2. B 3. D 4. D 5. A 6. C 7. C 8. B 9. C 10. B 11. C 12. B

Practical Questions

1. **Interest on X Loan — ₹ 900. Share of Profit : X — ₹ 20,000; Y — ₹ 20,000.**
2. **Share of Profit : A — ₹ 10,000; B — ₹ 6,000; C — ₹ 4,000;**
   Balance of Capital Accounts : A — ₹ 2,30,250; B — ₹ 1,32,375; C — ₹ 1,28,775.
3. **Share of Profit : A — ₹ 9,747; B — ₹ 9,747;**
   Balance of Capital Accounts : A — ₹ 46,598.50; B — ₹ 39,126.50.
4. **Share of Profit : P — ₹ 5,828; Q — ₹ 4,662; R — ₹ 3,496;**
   Balance of Partners' Capital Accounts : P — ₹ 8,000; Q — ₹ 10,000; R — ₹ 14,000;
   Balance of Partners' Current Accounts : P — ₹ 6,558; Q — ₹ 2,954; R — ₹ 488;
   Interest on Drawings : P — ₹ 90; Q — ₹ 108; R — ₹ 108.
5. **Profit Sharing Ratio : 3 : 4 : 5. Share of profit : A — ₹ 15,000; B — ₹ 20,000; C — ₹ 25,000.**
6. **Share of Profit : Sanatan — ₹ 1,20,600; Narayan — ₹ 30,150.**
7. **Share of Profit : John — ₹ 6,800; Robert — ₹ 10,200;**
   Balance of Partners' Capital Accounts : John — ₹ 15,640; Robert — ₹ 29,640.
8. **Share of Profit : A — ₹ 8,370; B — ₹ — 2,685; C — ₹ 895;**
9. **Share of Profit : Ripa — ₹ 12,170; Rini — ₹ 12,170; Rima — ₹ 12,169;**
   Commission payable to Ripa : ₹ 3,651; Interest on Drawings : Ripa — ₹ 840; Rini — ₹ 720; Rima — ₹ 600;
   Balance of Partners' Capital Accounts : Ripa — ₹ 60,581; Rini — ₹ 50,450; Rima — ₹ 47,869.
10. **Excess chargeable to A — ₹ 5,904; Share of profit : A — ₹ 1,99,096; B — ₹ 68,333; C — ₹ 44,571.**
11. **Divisible profit — ₹ 21,816; Current account balances : A — ₹ 5,760; B — ₹ 1,580; C — ₹ 2,940.**
12. **Excess chargeable to X — ₹ 320; Share of loss : X — ₹ 380; B — ₹ 380.**
13. **Share of profit : A — ₹ 26,667; B — ₹ 22,667 and C — ₹ 10,666. Commission : A — ₹ 12,000; B — ₹ 8,000. Transfer to Reserve ₹ 20,000; Current account balances : A — ₹ 46,667; B — ₹ 32,167; C — ₹ 166 (Cr.).**
14. **Divisible profit for 2014 — ₹ 25,300; Divisible profit for 2014 — ₹ 17,900. Partners' Capital Accounts balance at the end of 2014 : A — ₹ 50,861; B — 31,760; and C — 37,379.**
15. **Ratio of turnover — 6 : 1, Profit sharing ratio among A, B and C — ₹ 9 : 6 : 4. Divisible profit — Pre-admission period — ₹ 51,000; Post admission period ₹ 7,220.**
16. **Required journal entry : Debit — B ₹ 3,000; Credit : A — ₹ 1,000 and C — ₹ 2,000.**
17. **Share of profit : A — ₹ 10,028; B — ₹ 7,319; C — ₹ 6,313; and D — ₹ 2,590.**
18. **Share of profit : A — ₹ 10,028; B — ₹ 7,319; C — ₹ 6,313 and D — ₹ 2,590.**
19. **Debit : A — ₹ 2,400 and B — ₹ 1,600.**
20. **Adjusted Profits : 2011 — ₹ 960; 2012 — ₹ 11,820; 2013 — ₹ 12,480; and 2014 — ₹ 12,720.**
    Debit : Outstanding Fees — ₹ 920.
    Credit : A Capital — ₹ 520 and B Capital — ₹ 400.
21. **Average capital employed : Mumbai ₹ 79,000; Chennai — ₹ 62,000; Commission payable : B — ₹ 5,700; C — ₹ 4,920.**
    Share of profit : A — ₹ 42,581; B — ₹ 25,569; C — ₹ 17,080 (minimum guarantee).

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Change in the Profit-sharing Ratio

Introduction

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

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

Adjustments For Change in the Profit-Sharing Ratio

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

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

Change In the Share of Profit

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

Illustration 1

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

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

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

Illustration 2

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

Solution **Calculation of New Profit Sharing Ratio**

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

Treatment of Goodwill

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

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

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

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

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

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

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

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

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

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

Illustration 3

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

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

Pass Journal Entries under the following cases when :

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

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

Solution **In the books of the firm**

Journal

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

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

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

Illustration 4

The following is the Balance Sheet of A and B, who are equal partners as on 31.12.2014 :

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

From 1.1.2015, the partners decided to share profits and losses in the ratio of 2 : 1. For this purpose, the goodwill of the firm is valued at ₹ 6,000 which will not be shown in the Balance Sheet.

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

Solution **In the books of the firm**

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2015 Jan. 1	A Capital A/c (Note 1)	Dr.	1,000	
	To B Capital A/c			1,000
	(Being the adjustment for goodwill made through the Partners' Capital Accounts)			

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

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

Balance Sheet of A and B as at 1st January, 2015

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

Revaluation of Assets and Liabilities

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

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

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

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

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

(a) If the value of the assets increase

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

(b) If the value of the assets decrease

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

(c) If the value of the liabilities increase

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

(d) If the value of the liabilities decrease

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

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

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

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

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

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

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

Illustration 5

The following is the Balance Sheet of A and B as on 31.12.2014 :

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

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

From 1.1.2015, they agreed to share profits and losses equally.

For this purpose, the following particulars are provided :

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

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

(c) C is valued at ₹ 15,000.

Prepare Revaluation Account, Partners' Capital Accounts and show the revised Balance Sheet as at 1.1.2015.

Solution — **In the books of the firm**

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

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

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

Date	Particulars	A	B	Date	Particulars	A	B
2015	To Balance c/d	66,000	43,000	2015	By Balance b/d	54,000	37,000
				Jan. 1	By Revaluation A/c	12,000	6,000
		66,000	43,000			66,000	43,000

Balance Sheet of A and B as at 1st January, 2015

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

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

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

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

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

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

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

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

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

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

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

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

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

Illustration 6

The following is the Balance Sheet of A, B and C as on 31.12.2014 :

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

On 1.1.2015, the assets of the firm were revalued as under : Land ₹ 8,000; Buildings ₹ 8,500; Plant and machinery ₹ 3,500. The partners agree that from 1.1.2001, they will share profits and losses in the ratio of 3 : 2 : 1 instead of their former ratio of 2 : 2 : 1. They do not, however, want to alter the book value of the assets.

Prepare Memorandum Revaluation Account, Partners' Capital Accounts and the revised Balance Sheet as at 1.1.2015.

Solution

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

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

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

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2015	To Revaluation A/c (loss)	3,000	2,000	1,000	2015	By Balance b/d	10,000	5,000	3,000
Jan.1	To Balance c/d	9,400	5,400	3,200	Jan.1	By Revaluation A/c (profit)	2,400	2,400	1,200
		12,400	7,400	4,200			12,400	7,400	4,200

Balance Sheet of A, B and C as at 1st January, 2015

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

Reserves and Accumulated Losses

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

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

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

All Partners' Capital Accounts Dr. [Old ratio]

To Profit and Loss Account

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

The accounting entries are as under :

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

Reserve account Dr.

To All Partners' Capital Accounts [Old ratio]

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

All Partners' Capital Accounts Dr. [New ratio]

To Reserve Account

Illustration 7

The following is the Balance Sheet of A, B and C as on 1.1.2015 :

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

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

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

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

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

Solution

In the books of the Firm

Partners' Capital Accounts

Dr. **Cr.**

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2015	To Bank A/c (withdrawn)	15,000	10,000	5,000	2015	By Balance b/d	60,000	50,000	40,000
Jan.1	To General Reserve A/c	7,200	7,200	3,600	Jan.1	By General Reserve A/c	24,000	16,000	8,000
	To Balance c/d	61,800	48,800	39,400					
		84,000	66,000	48,000			84,000	66,000	48,000

Balance Sheet of the New Firm as on 1st January, 2015

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

Adjustment for Joint Life Policy

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

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

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

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

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

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

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

Illustration 8

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

(a) When the surrender value does not appear in the books and the partners have decided not to show that in the books also.

(b) When the surrender value appears as an asset but the partners decided not to show that in the Balance Sheet.

Solution **In the books of the firm**

Journal

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

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

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

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

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

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

(i) *When joint life policy reserve is written-off*

Joint Life Policy Reserve Account Dr.
To All Partners' Capital Accounts [Old ratio]

(ii) *When joint life policy is to be shown again in the Balance Sheet*

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

Illustration 9

The following is the Balance Sheet of A, B and C as on 1.1.2015 :

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

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

Solution

In the books of the Firm

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2015	To Joint Life Policy Reserve A/c	8,000	8,000	4,000	2015	By Balance b/d	40,000	30,000	25,000
Jan. 1	To Balance c/d	40,000	28,000	27,000	Jan. 1	By Joint Life Policy Reserve A/c	8,000	6,000	6,000
		48,000	36,000	31,000			48,000	36,000	31,000

Balance Sheet of the New Firm as on 1st January, 2015

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

Adjustment of Capital

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

The total required capital can be ascertained as under :

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

Illustration 10

The following is the Balance Sheet of A and B, who shared profits and losses in the ratio of 2 : 1, as on 1.1.2015 :

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

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

Prepare Partners' Capital Accounts and the revised Balance Sheet.

Solution

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	Date	Particulars	A	B
2015	To Reserve A/c (See Note)	18,000	12,000	2015	By Balance b/d	30,000	20,000
Jan. 1	To Balance c/d (required)	36,000	24,000	Jan. 1	By Reserve A/c (See Note)	10,000	5,000
					By Land and Buildings A/c	14,000	7,000
					By Cash A/c (Balancing figure)	—	4,000
		54,000	36,000			54,000	36,000

Balance Sheet of A and B as on 1st January, 2015

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

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

Illustration 11

Raju, Shastri and Tanka are partners in a firm, sharing profits and losses in the ratio of 5 : 3 : 2. Their Balance Sheet as on 31st March 2014 stood as follows:

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

From 1st April, 2014 the partners decided to change their profit- sharing ratio as 2 : 1 : 2 instead of their former ratio of 5 : 3 : 2 and for that purpose the following adjustments were agreed upon: (i) The Provision for Bad Debts was to be raised to 10%; and, (ii) Furniture was to be appreciated by ₹ 5,200. They did not, however, want to alter the book values of the assets and reserves but record the change by passing one single journal entry.

The Profit and Loss Account of the firm for the year ended 31st March, 2015 showed a net profit of ₹ 22,900.

You are required: (a) to show the single Journal Entry adjusting the partners' capitals as on 1st April, 2014 and (b) to prepare the Profit and Loss Appropriation Account for the year ended 31st March, 2015 after taking into consideration the following adjustments: (i) Interest on Capital at 5% p.a.; (ii) Interest on Shastri's Loan, and (iii) Transfer 25% of the divisible profit to the General Reserve after charging such Reserve.

Solution

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

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

(2) Ascertainment of Adjusted Capitals

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

Capital as per the Balance Sheet on 31.3.2014	25,000	10,000	5,000
Net effect on capital (as above)	(+) 2,500	(+) 2,500	(–) 5,000
Adjusted capitals as on 1.4.2014	27,500	12,500	—

Required Journal Entry

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

Dr. Profit and Loss Appropriation Account for the year ended 31st March, 2015 Cr.

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

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

Illustration 12

A, B and C are partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1 respectively. Their Balance Sheet as at 31.3.2015 was as follows :

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

From 1.4.2015, they agreed to alter their profit sharing ratio as 4 : 6 : 5. It is also decided that :

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

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

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

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

There is a joint life insurance policy for ₹ 2,00,000 for which an annual premium of ₹ 10,000 is paid, the premium being charged to Profit and Loss Account. The surrender value of the policy on 31.3.2015 was ₹ 81,000.

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

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

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

Solution

In the books of the Firm

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2015				
April 1	Fixed Assets A/c	Dr.	61,000	
	To Revaluation A/c			61,000
	(Being the fixed assets revalued at ₹ 3,21,000)			
	Revaluation A/c	Dr.	19,000	
	To Stock A/c			10,000
	To Provision for Doubtful Debts A/c			9,000
	(Being the downward revaluation of stock and creation of provision for doubtful debts)			
	Revaluation A/c	Dr.	42,000	
	To A Capital A/c			21,000
	To B Capital A/c			14,000
	To C Capital A/c			7,000
	(Being the profit on revaluation transferred to Partners' Capital Accounts in the old profit sharing ratio)			

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

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

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

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

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

Working Notes :

(1) Valuation of Goodwill

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

Total profit for 5 years

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

Adjustment for Goodwill

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

(2) Adjustment for Joint Life Policy

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

(3) Adjustment for General Reserve

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

Change in the Profit Sharing Ratio During an Accounting Year

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

Illustration 13

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

The following data for the year ended 31.12.2014 have been extracted from the partnership books :

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

The partners have agreed that from 1.7.2014, A will be entitled to a salary of ₹ 30,000 p.a. and the balance of the profits will be shared equally. Sales have been taken place evenly throughout the year and all sales earned a uniform rate of gross profit. No entries to reflect the change in profit sharing ratio have been made in the books before the year end.

You are required to prepare the Trading and Profit and Loss Account, and the Profit and Loss Appropriation Account for the year ended 31.12.2014.

Solution

A, B and C

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

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

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2014 Cr.

Particulars	1.1.2014 to 30.6.2014	1.7.2014 to 31.12.2014	Particulars	1.1.2014 to 30.6.2014	1.7.2014 to 31.12.2014
To Partner's Salary A/c	—	15,000	By Net Profit b/d	1,20,000	1,20,000
To Share of Profit A/c : A	60,000	35,000			
B	40,000	35,000			
C	20,000	35,000			
	1,20,000	1,20,000		1,20,000	1,20,000

Illustration 14

A, B and C (without capital) are partners sharing profits and losses in the ratio of 3 : 2 : 1 respectively. Their capital account balances as on 1.1.2014 were : A — ₹ 45,000; B — ₹ 25,000.

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

On 1.7.2014 partners decided that the new profit sharing ratio among A, B and C will be 2 : 2 : 1 respectively and C is to bring in ₹ 20,000 as capital. On the same date, they also decided that the total capital of the firm will be ₹ 1,00,000 and it will be adjusted in the profit sharing ratio. For A and B, any excess or deficiency is to be paid off or brought in cash. Interest on capital will be allowed @ 12% p.a. to all the partners. As regards partners' salaries, instead of A, B will be getting @ ₹ 500 p.m. The net profit for the year ended 31.12.2014 is ₹ 22,000 (which is assumed to be earned evenly throughout the period).You are required to prepare Profit and Loss Appropriation Account for the year ended 31.12.2014, Partners' Capital and Current Accounts.

Solution

A, B and C

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2014 Cr.

Particulars		1.1.2014 to 30.6.2014	1.7.2014 to 31.12.2014	Particulars	1.1.2014 to 30.6.2014	1.7.2014 to 31.12.2014
To Interest on Capital A/c :	A	2,250	2,000	By Profit and Loss A/c — Net Profit	11,000	11,000
	B	1,250	2,000			
	C	—	1,000			
To Partners' Salaries A/c :	A	1,500	—			
	B	—	3,000			
To Share of Profit A/c :	A	3,000	1,200			
	B	2,000	1,200			
	C	1,000	600			
		11,000	11,000		11,000	11,000

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

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2014					2014				
July 1	To Cash A/c	5,000	—	—	Jan 1	By Balance b/d	45,000	25,000	—
Dec. 31	To Balance c/d (as required)	40,000	40,000	20,000	July 1	By Cash A/c	—	15,000	20,000
		45,000	40,000	20,000			45,000	40,000	20,000

Dr. **Partners' Current Accounts** **Cr.**

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2014					2014				
Dec. 31	To Balance c/d	9,950	9,450	2,600	Dec. 31	By Interest on Capital A/c	4,250	3,250	1,000
						By Partners' Salaries A/c	1,500	3,000	—
						By Share of Profit A/c	4,200	3,200	1,600
		9,950	9,450	2,600			9,950	9,450	2,600

Illustration 15

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

The agreement was varied as from 1.9.2014 in that B's salary was reduced to ₹ 3,000 p.a., and the profit sharing ratio became 3:2 to A and B respectively. The partners agreed to assume that profits and drawings accrued evenly over the year.

The following information is provided :

Particulars		₹	₹
Net Profit for the year 2014			12,060
Capital Accounts —	A	30,000	
	B	24,000	54,000
Current Accounts —	A	6,516	
	B	3,264	9,780
Drawings	A	9,480	
	B	4,500	13,980

You are required to prepare : (1) Profit and Loss Appropriation Account for the year ended 31.12.2014; and (2) Partners' Current Accounts.

Solution

A and B

Dr. **Profit and Loss Appropriation Account for the year ended 31st December, 2014** **Cr.**

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

Dr. **Partners' Current Accounts** **Cr.**

Date	Particulars	A	B	Date	Particulars	A	B
2014				2014			
Dec. 31	To Drawings A/c	9,480	4,500	Jan. 1	By Balance b/d	6,516	3,264
"	To Interest on Drawings A/c	474	225	Dec. 31	By Interest on Capital A/c	1,500	1,200
"	To Balance c/d	2,759	5,101	"	By Partner's Salary A/c	—	3,600
				"	By Share of Profit A/c	4,697	1,762
		12,713	9,826			12,713	9,826

Working Notes :

(1) Interest on Capital

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

(2) Partner's Salary — B		
Jan to Aug (8 months)	₹ 3,900 / 12 x 8 = ₹ 2,600	
Sept to Dec (4 months)	₹ 3,000 / 12 x 4 = ₹ 1,000	
(3) Interest on Drawings	A (₹)	B (₹)
At 5% on total Drawings	474	225
Jan to Aug (8 months)	316	150
Sept to Dec (4 months)	158	75
	474	225

Illustration 16

X and Y are in partnership sharing profits and losses equally. Their accounts are made up to 31st December each year. They have decided that from 1.10.2014, the profit sharing ratio is to become X 3/5th and Y 2/5th.

Their Balance Sheet at 31.12.2014 prior to sharing profits is as under :

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

It was decided that the impact of the change in profit sharing ratio would be affected at 31.12.2014 when the sundry assets were revalued at ₹ 2,50,000. The goodwill was valued at ₹ 25,000 but no goodwill account is to be maintained in the books. It is to be assumed that profits have been earned evenly throughout the period.

You are required to prepare Profit and Loss Appropriation Account for the year ended 31.12.2014 and the Partners' Capital Accounts.

Solution

X and Y

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2014 Cr.

Particulars	1.1.2014 to 30.9.2014	1.10.2014 to 31.12.2014	Particulars	1.1.2014 to 30.9.2014	1.10.2014 to 31.12.2014
To Share of Profit A/c :			By Net Profit b/d	45,000	15,000
X	22,500	9,000			
Y	22,500	6,000			
	45,000	15,000		45,000	15,000

Dr. Partners' Capital Accounts Cr.

Date	Particulars	X	Y	Date	Particulars	X	Y
2014				2014			
Dec. 31	To Goodwill A/c	15,000	10,000	Jan. 1	By Balance b/d	80,000	70,000
"	To Balance c/d	1,29,000	1,21,000	Dec. 31	By Share of Profit A/c	31,500	28,500
				"	By Sundry Assets A/c	20,000	20,000
				"	By Goodwill A/c	12,500	12,500
		1,44,000	1,31,000			1,44,000	1,31,000

Illustration 17

The following information relates to the partnership of A and B (until 30.9.2014) and A, B and C (from 1.10.2014) :

1. The net profit for 2014 was ₹ 24,000. The profit sharing ratio changed on 1.4.2014 from A 40%, B 60%, to equal shares. No adjustments were required to the partnership goodwill at that date. The profit sharing ratio changed again on 1.10.2014 when C was admitted as a partner. The share of profit became A 40%, B 40%, C 20%.
2. C was unable to introduce cash into the partnership, but brought in furniture with an agreed value of ₹ 20,000.
3. On C's admission to the partnership, goodwill was valued at 1.5 times the average net profit for 2011, 2012 and 2013. The net profit figure for 2011, 2012 and 2013 were ₹ 8,000, ₹ 10,000 and ₹ 12,000 respectively.
4. C had drawings of ₹ 1,500 in the 3 months to 31.12.2014.

(a) Calculate the profit share for each of the three partners for 2014.

(b) Show a journal entry recording the adjustment of goodwill among partners at 1.10.2014.

(c) Show C's capital account for the 3 months ended 31.12.2014 in as much detail as possible.

Solution

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

Partners	1.1.2014 – 31.3.2014 ₹	1.4.2014 – 30.9.2014 ₹	1.10.2014 – 31.12.2014 ₹	Total ₹
A	2,400	6,000	2,400	10,800
B	3,600	6,000	2,400	12,000
C	—	—	1,200	1,200
	6,000	12,000	6,000	24,000

(b) Required Journal Entry

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

Workings :

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

Required Adjustment for Goodwill

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

Dr. (c) C Capital Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Oct 1	To B Capital A/c (Goodwill)	3,000	Oct 1	By Furniture A/c	20,000
Dec. 31	To Drawings A/c	1,500	Dec. 31	By Share of Profit A/c	1,200
"	To Balance c/d	16,700			
		21,200			21,200

Illustration 18

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

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

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

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

The balances on the partenrs' capital and current accounts at 1.1.2014 were as follows (all balances are in credit) :

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

During the year ended 31.12.2014, the partnership net profit carried to the appropriation account was ₹ 1,60,000 arising uniformly throughout the year. The partners' cash drawings during 2014 were as follows :

A — ₹ 5,000; B — ₹ 6,000

After reviewing the draft accounts for 2014, A and B decided to admit their senior clerk, C, as a partner w.e.f. 1.10.2014.

C has been in the business for many years and from the beginning of 2014 has received a salary of ₹ 40,000 p.a. payably monthly.

For some years, the partnership has used a house owned by C for offices and paid him a rent of ₹ 10,000 p.a. It has now been agreed that w.e.f. 1.10.2014, the property is transferred at its market valuation of ₹ 60,000 to the partnership as C's fixed capital.

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

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

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

You are required to prepare the Profit and Loss Appropriation Account for the year ended 31.12.2014. Also prepare the Partners' Capital and Current Accounts.

Solution

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2014 Cr.

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

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2014					2014				
Dec. 31	To Balance c/d	1,20,000	80,000	60,000	Jan. 1	By Balance b/d	1,20,000	80,000	—
					Oct. 1	By Building A/c	—	—	60,000
		1,20,000	80,000	60,000			1,20,000	80,000	60,000

Dr. Partners' Current Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2014					2014				
Dec. 31	To Drawings A/c :				Jan. 1	By Balance b/d	10,000	7,000	—
	Cash	5,000	6,000	—	Dec. 31	By Interest on Capital A/c	12,000	8,000	1,500
	Salary	—	—	10,000	"	By Partner's Salary A/c	—	22,500	—
	Rent	—	—	2,500	"	By Share of Profit A/c	72,500	46,800	9,200
"	To Balance c/d	89,500	78,300	—	"	By Balance c/d	—	—	1,800
		94,500	84,300	12,500			94,500	84,300	12,500

Working Note :

(1) At the time of calculating profit ₹ 1,60,000 for the year, salary and rent of C were taken into consideration. As per agreement amongst the partners, no salary and rent is payable to C from 1.10.2014. Therefore, three months' salary and rent are to be written-back.

Key Points

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

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

THEORETICAL QUESTIONS

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

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below :

1. Change in the profit-sharing ratio between the partners is :
   A the dissolution of partnership firm
   B the change in the constitution of the partnership firm
   C the formation of a new partnership firm.
2. When there is a change in profit-sharing ratio of the partner :
   A partners will only gain
   B partners will only sacrifice
   C some partners will gain and some partners will sacrifice.
3. When there is a change in the profit-sharing ratio of the partners, the consent of :
   A all the partners are needed
   B some of the partners are needed
   C majority of the partners are needed.
4. When there is a change in the profit-sharing ratio of the partners, the accounts of the firm is :
   A maintained in the usual manner
   B maintained in the new set of books
   C maintained under cash basis.
5. A change in the profit-sharing ratio between the partners may occur :
   A only at beginning of the accounting year
   B only at the end of the accounting year;
   C any time during the accounting year.

PRACTICAL QUESTIONS

1. A and B are partners sharing profits and losses in the ratio of 3 : 1. Their capitals were : A — ₹ 60,000; B ₹ 20,000. They decided to change the profit-sharing ratio to 5 : 3 with effect from 1.1.2015. The goodwill of the firms is to be valued at 2 years' purchase of 3 years' average profits. They also decided that their capitals should be proportionate to their profit-sharing ratio. The profits of the firms for 2012, 2013 and 2014 were ₹ 22,000; ₹ 28,000 and ₹ 34,000 respectively. Pass necessary Journal Entries. Also, show the Partners' Capital Accounts.
2. The following is the Balance Sheet of A, B and C who share profits equally as on 1.1.2015.

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

On the above date, the partners changed their profit-sharing ratio to 2 : 2 : 1. Following are agreed upon : (i) The value of land is ₹ 30,000; (ii) Reserve is to be maintained at ₹ 30,000; (iii) The total capital of the partners will be ₹ 1,00,000 which will be shared by them in their new profit-sharing ratio; (iv) Building is to be increased by ₹ 5,000 and furniture is to be decreased by ₹ 10,000.

You are required to prepare the revised Balance Sheet. Preparation of Ledger Accounts is not required.

3. The following is the Balance Sheet of A, B and C who share profits in the ratio of 3 : 2 : 1 as on 1.1.2015 :

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

From the above date, the partners decided to share profits equally. Following are agreed upon :

(i) The value of the land will be ₹ 21,000;

(ii) Joint life policy will not be shown;

(iii) Half of the reserve will be withdrawn by the partners;

(iv) The total capital of the partners will be ₹ 90,000. Any deficiency is to be brought in cash and the surplus is to to be transferred to a Loan Account carrying interest @ 12% p.a.

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

4. A, B and C were partners sharing profits and losses in the ratio of 3 : 2 : 1. The Balance Sheet of the firm as on 1.1.2014 was as under :

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

On the above date, the partners decided to change their profit sharing ratio to 1 : 2 : 3. Goodwill was valued at ₹ 18,000. No entries were, however, passed to give effect to this change.

The Balance Sheet of the firm as on 31.12.2014 was as under :

Liabilities		₹	Assets	₹
A Capital	30,000		Fixed Assets	36,000
Less: Drawings	5,000	25,000	Stock	55,000
B Capital	20,000		Debtors	45,000
Less: Drawings	3,000	17,000	Advances	14,000
C Capital	10,000			
Less: Drawings	4,000	6,000		
General Reserve		36,000		
Capital Reserve		9,000		
Creditors		50,000		
Bank Overdraft		7,000		
		1,50,000		1,50,000

You are required to pass necessary Journal Entries to give effect to the above change in the constitution of the firm on 1.1.2014. Draw also the revised Balance Sheet as on 31.12.2014 [Assume that there will be no reserve in the new Balance Sheet].

5. The following is the Balance Sheet of A, B and C as on 1.1.2015 :

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

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

(a) The value of the land is ₹ 15,000.

(b) The value of machinery and furniture are to be increased by ₹ 15,000 and ₹ 5,000 respectively.

(c) The value of stock and debtors are to be decreased by ₹ 3,000 and ₹ 2,000 respectively.

(d) The capitals of the partners are to be adjusted according to the new profit-sharing ratio. For that, necessary capital to be brought-in or excess capital to be writhdrawn. No reserve will be shown in the new Balance Sheet.

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

6. The firm of A, B and C has existed for some years, profit being shared as 2/5, 2/5 and 1/5 respectively. C, however, feels that this arrangement has not been satisfactory to him and requires to be placed on some basis as regards profits as A and B. He further wants that this arrangement shall apply not only to future profits but also retrospectively to the profits of the past three years which were ₹ 26,000, ₹ 22,100 and ₹ 25,805. A and B have no objection to this. They further agree that in making such adjustment regards should be given to ₹ 6,500 value of goods which had been charged to profits but which actually were taken privately by B and ₹ 3,900 of office equipment for which no Asset Account had been opened in the books but charged to the Profit and Loss Account. Plant and Machinery of the firm

had not been depreciated over the past years and it was estimated that the total of the amounts which should have been written off was ₹ 9,035. It was further agreed that after adjustment the Capital Accounts were to be equalized without, however, increasing or reducing the total capital of the firm.

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

7. A, B and C are partners in a firm sharing profits and losses as 8 : 5 : 3. Their Balance Sheet as at 31st December, 2014, was as follows :

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

From 1st January, 2015 they agreed to alter their profit-sharing ratio as 5 : 6 : 5. It is also decided that :

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

There is a joint life insurance policy for ₹ 2,00,000 for which an annual premium of ₹ 10,000 is paid, the premium being charged to Profit and Loss Account. The surrender value of the policy on 31st December, 2014 was ₹ 78,000. The net profit of the firm for the last five years were : ₹ 14,000; ₹ 17,000; ₹ 20,000; ₹ 22,000 and ₹ 27,000. Goodwill and the surrender value of the joint policy was not to appear in the books.

Draft Journal Entries necessary to adjust the Capital Accounts of the partners.

Guide to Answers

Multiple Choice

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

Practical Questions

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

28

Admission of a Partner

Introduction

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

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

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

Effects of Admission of a Partner

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

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

Adjustments for Admission of a New Partner

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

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

1. Change in the Profit Sharing Ratio

New Profit Sharing Ratio

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

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

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

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

Illustration 1

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

Calculate new profit sharing ratio after E's admission.

Solution

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

The new profit sharing ratio is :

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

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

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

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

Illustration 2

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

Solution

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

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

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

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

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

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

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

Alternatively, **Calculation of New Profit Sharing Ratio**

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

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

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

Illustration 3

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

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

Solution

X's old share of profit = 3/5. X surrendered 1/3rd of his share, i.e., 3/5 × 1/3 = 3/15 (It means X has surrendered 3/15 in favour of P).
X's share of profit in the new firm = 3/5 – 3/15 = (9 – 3) /15 = 6/15.

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

Alternatively, **Calculation of New Profit Sharing Ratio**

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

Illustration 4

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

Solution

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

Alternatively, **Calculation of New Profit Sharing Ratio**

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

Illustration 5

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

Solution

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

Alternatively, **Calculation of New Profit Sharing Ratio**

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

Illustration 6

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

Solution

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

Alternatively, **Calculation of New Profit Sharing Ratio**

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

Illustration 7

Find out the new ratio :

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

Solution

(i) Let the total share be 1. C is admitted for 1/4 share. Therefore, 1 – 1/4 = 3/4 remains for A and B which they will share in the ratio of 2 : 1. The final profit sharing ratio will be :
A — 2/3 of 3/4 = 6/12; B — 1/3 of 3/4 = 3/12; C — 1/4 = 3/12
A : B : C = 6 : 3 : 3 = **2 : 1 : 1**.
(ii) After admission of C the final profit sharing ratio will be:
A — 3/5 – 2/7 = (21 – 10) / 35 = 11/35 B — 2/5 – 1/7 = (14 – 5) / 35 = 9/35 C — 3/7 or 15/35. A : B : C = **11 : 9 : 15**.

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

Sacrificing Ratio

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

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

Calculation of sacrificing ratio under different situations are shown below :

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

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

Sacrificing Ratio = Old Ratio – New Ratio

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

Illustration 8

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

Solution **Calculation of Sacrificing Ratio**

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

Illustration 9

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

Solution **Calculation of Sacrificing Ratio**

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

Illustration 10

Gopal and Gobind are partners sharing profits and losses in the ratio of 3 : 2. From 1st January, 2015 they have decided to admit Guru as a partner. The new profit sharing ratio will be 7 : 5 : 8. Calculate the sacrificing ratio.

Solution **Calculation of Sacrificing Ratio**

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

Illustration 11

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

Solution **Calculation of Sacrificing Ratio**

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

Illustration 12

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

Solution **Calculation of Sacrificing Ratio**

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

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

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

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

Sacrificing Ratio = Old Ratio – New Ratio

The following Illustrations will clear the matter.

Illustration 13

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

Solution

Calculation of New Profit Sharing Ratio

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

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

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

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

Calculation of Sacrificing Ratio

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

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

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

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

Sacrificing Ratio = Old Ratio – New Ratio

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

Illustration 14

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

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

Solution

Calculation of New Profit Sharing Ratio

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

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

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

Calculation of Sacrificing Ratio

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

Illustration 15

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

Solution

Calculation of New Profit Sharing Ratio

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

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

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

Calculation of Sacrificing Ratio

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

Illustration 16

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

Solution

Calculation of New Profit Sharing Ratio

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

Therefore, new profit sharing ratio will be :

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

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

Calculation of Sacrificing Ratio

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

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

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

Sacrificing Ratio = Old Ratio – New Ratio

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

Illustration 17

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

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

Solution **Calculation of New Profit Sharing Ratio**

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

Calculation of Sacrificing Ratio

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

Illustration 18

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

Solution **Calculation of New Profit Sharing Ratio**

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

Calculation of Sacrificing Ratio

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

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

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

Illustration 19

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

Solution **Calculation of Sacrificing Ratio**

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

Illustration 20

P, Q and R were on partnership terms sharing profits and losses in the ratio of 6 : 3 : 1. They decided to take S into partnership with effect from April 1, 2015. The new profit sharing ratio between P, Q, R and S will be 3 : 3 : 3 : 1. Find out the sacrificing ratio.

Solution **Calculation of Sacrificing Ratio**

<table>
<tr><th>Partners</th><th>Old Ratio</th><th>New Ratio</th><th>Sacrifice / Gain</th><th>Sacrificing / Gaining Ratio</th></tr>
<tr><td>P</td><td>6/10</td><td>3/10</td><td>6/10 – 3/10 = 3/10 (Sacrifice)</td><td rowspan="4">Here, sacrificing ratio cannot be calculated because only P is sacrificing 3/10th of his share.
However, on S's admission, R is gaining 2/10. The gaining ratio between R and S will be 2 : 1.</td></tr>
<tr><td>Q</td><td>3/10</td><td>3/10</td><td>3/10 – 3/10 = 0 (Sacrifice)</td></tr>
<tr><td>R</td><td>1/10</td><td>3/10</td><td>1/10 – 3/10 = 2/10 (Gain)</td></tr>
<tr><td>S</td><td>—</td><td>1/10</td><td>0 – 1/10 = 1/10 (Gain)</td></tr>
</table>

2. Goodwill

Meaning of Goodwill

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

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

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

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

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

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

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

Nature of Goodwill

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

Classification of Goodwill

Goodwill can be classified into two categories :

(1) Purchased Goodwill

(2) Non-Purchased or Inherent Goodwill.

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

The following are the important features of purchased goodwill :

(i) It arises on purchase of a business.

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

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

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

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

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

(i) It is internally generated over years.

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

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

Positive and Negative Goodwill

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

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

Treatment of Purchased Goodwill

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

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

Factors to be Taken into Consideration in Valuing Goodwill

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

Need for Valuation of Goodwill

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

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

Methods of Valuation of Non-Purchased Goodwill

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

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

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

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

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

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

Step 2 : Calculate average profit as follows :

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

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

Illustration 21

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

Year	₹
2011	1,00,000
2012	1,20,000
2013	1,30,000
2014	1,50,000

Calculate the value of goodwill.

Solution

Calculation of Average Profit

Year	Profit (₹)
2011	1,00,000
2012	1,20,000
2013	1,30,000
2014	1,50,000
Total Profit	5,00,000

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

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

Illustration 22

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

Year	₹
2010	50,000
2011	60,000
2012	40,000

2013	65,000
2014	80,000

The profit of 2013 was calculated after charging ₹ 5,000 for loss of goods by fire. Calculate goodwill of the firm.

Solution

Calculation of Average Profit

Year	Profit (₹)
2010	50,000
2011	60,000
2012	40,000
2013	70,000 (See Note)
2014	80,000
Total Profit	3,00,000

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

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

Note: In 2013, profit of ₹ 65,000 was arrived at after charging an abnormal item of ₹ 5,000 (loss of goods by fire). Therefore, the normal profit of 2013 = ₹ 65,000 + 5,000 = ₹ 70,000.

Illustration 23

A, B and C were in partnership sharing profits and losses in ratio 6 : 3 : 1. They decided to take D into partnership from 1st January, 2015. For this purpose, goodwill is to be valued at 60% of the average annual profits of the previous three or four years, whichever is higher.

The average profits for the purpose of goodwill for the past four years were :	₹
Year ending on 31st December 2014	48,000
Year ending on 31st December 2013	30,300
Year ending on 31st December 2012	31,200
Year ending on 31st December 2011	42,200

Calculate the value of goodwill.

Solution **Calculation of Average Profit**

Based on 3 years' Profits	₹	Based on 4 years' Profits	₹
2014	48,000	2014	48,000
2013	30,300	2013	30,300
2012	31,200	2012	31,200
	1,09,500	2011	42,200
Average Profit = ₹ 1,09,500 / 3 = ₹ 36,500.			1,51,700
		Average Profit = ₹ 1,51,700 / 4 = ₹ 37,925.	

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

Illustration 24

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

Year	₹
2010	6,000 (Profit)
2011	14,000 (Profit)
2012	20,000 (Profit)
2013	28,000 (Profit)
2014	24,000 (Loss)

On 1st January, 2014 a moped costing ₹ 8,000 was purchased and debited to travelling expenses account, on which depreciation is to be charged @ 25%. Calculate the value of goodwill after adjusting the above.

Solution **Calculation of Average Profit**

Year	₹
2010	6,000 (Profit)
2011	14,000 (Profit)
2012	20,000 (Profit)
2013	28,000 (Profit)
2014	*18,000 (Loss)
Total Profit	50,000

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

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

***Note** = In 2014, a moped costing ₹ 8,000 was purchased but it was wrongly debited to Travelling Expenses Account. After rectification, the loss of 2014 will be reduced by ₹ 8,000. The depreciation on moped ₹ 2,000 (25% of ₹ 8,000) was not charged to Profit and Loss Account of 2014. Therefore, the final loss of 2014 will be : ₹ 24,000 – 8,000 + 2,000 = ₹ 18,000.

Illustration 25

Red and White are partners sharing profits and losses in the ratio of 60 : 40. Due to financial difficulties, they decided to admit Blue as partner from 1.4.2015 on the following terms :

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

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

The profits of the previous three years were as follows :

For the year ended 31.3.2015 — Profit ₹ 30,000 (after debiting loss of stock by fire ₹ 40,000).

For the year ended 31.3.2014 — Loss ₹ 80,000 (includes voluntary retirement compensation paid ₹ 1,10,000).

For the year ended 31.3.2013 — Profit ₹ 1,05,000 (includes a profit of ₹ 25,000 on the sale of assets).

You are required to value the goodwill.

Solution **Calculation of Normal Profits**

Year ended on 31st March, 2015 (₹)	2015 (₹)	2014 (₹)	2013 (₹)
Profit / Loss for the year	30,000	(80,000)	1,05,000
Add : Abnormal loss of stock by fire	40,000	—	—
Add : Voluntary retirement compensation	—	1,10,000	—
Less : Profit on sale of assets	—	—	25,000
Normal Profits	70,000	30,000	80,000

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

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

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

The weighted average is calculated as follows :

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

In this case, goodwill is calculated as follows :

Goodwill = Weighted Average Profit × Number of years' Purchase

Illustration 26

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

Year ended on 31st December 2012 — ₹ 3,50,000; 2013 — ₹ 2,45,000; and 2014 — ₹ 3,20,000.

On 1st January, 2015 David is admitted to the partnership for 2/5 shares (without any salary). The goodwill for this purpose is to be valued at 4 years' purchase of weighted average profit of last three years (after allowing same salaries to partners); profits to be weighted as 1 : 2 : 3, the greatest weight being given to the last year. Calculate the value of goodwill.

Solution **Calculation of Weighted Average Profit**

Year	Profits before Salary	Salary	Profits after Salary	Weights	Products
2012	3,50,000	2,20,000	1,30,000	1	1,30,000
2013	2,45,000	2,20,000	25,000	2	50,000
2014	3,20,000	2,20,000	1,00,000	3	3,00,000
				6	4,80,000

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

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

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

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

Illustration 27

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

Solution

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

Illustation 28

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

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

Solution

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

Illustration 29

On April 1, 2015, an existing firm had assets of ₹ 75,000 including cash of ₹ 5,000. The Partners' Capital Accounts showed a balance of ₹ 60,000 and reserve constituted the rest. If the normal rate of return is 10% and the goodwill of the firm is ₹ 24,000 at 4 years' purchase of super profits, find the average profits of the firm.

Solution

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

Illustration 30

On 1st April, 2015, an existing firm had assets of ₹ 75,000 including cash of ₹ 5,000. Its creditors amounted to ₹ 5,000 on that date. The firm had a reserve fund of ₹ 10,000 while Partners' Capital Accounts showed a balance of ₹ 60,000. If the normal rate of return is 20% and the goodwill of the firm is valued at ₹ 24,000, at 4 years' purchase of super profit, find the average profits per year of the existing firm.

Solution

Goodwill is 4 years' purchase of super profits, which is ₹ 24,000.

Therefore, Goodwill = Super profits × 4

or, ₹ 24,000 = Super profits × 4

or, Super profits = ₹ 24,000 / 4 = ₹ 6,000

Again, Normal profits = Capital employed × Normal rate of return

= (Capital + reserve) × 20%

= (₹ 60,000 + 10,000) × 20%

= ₹ 14,000.

Super profits are the excess of average profits over normal profits.

Therefore, Super profits = Average profits – Normal profits.

or, ₹ 6,000 = Average profits – ₹ 14,000.

or, Average profits = ₹ 14,000 + ₹ 6,000 = ₹ 20,000.

Illustration 31

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

(i) Capital employed ₹ 3,00,000.

(ii) Trading profit : 2011 — ₹ 61,000; 2012 — ₹ 75,000; 2013 — ₹ 10,000 (Loss) and 2014 — ₹ 1,05,000.

(iii) Rate of return on capital invested in this type of business 12%.

(iv) Remuneration from alternative employment of the partners who are engaged full time in this business ₹ 18,000 p.a.

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

Solution

Calculation of Average Profits

Particulars	₹
2011	61,000
2012	75,000
2013	(10,000)
2014	1,05,000
	2,31,000
Average Profit = ₹ 2,31,000 / 4 = 57,750	

Calculation of Super Profit

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

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

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

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

Now, if we take the above example then the total value of the firm will be:

15,000/10 x 100 = ₹ 1,50,000. The net assets of the firm are ₹ 1,00,000.

Therefore, the value of goodwill will be ₹ 1,50,000 – ₹ 1,00,000 = ₹ 50,000.

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

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

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

Illustrative Example 1

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

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

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

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

The following formula can also be applied for valuing goodwill:

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

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

Illustrative Example 2

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

Solution

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

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

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

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

Illustrative Example 3

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

(a) On the basis of two years' purchase of the average profits over the last 5 consecutive years. These were: 2014 — ₹ 36,000; 2013 — ₹ 28,000; 2012 — ₹ 26,000; 2011 — ₹ 38,000; 2010 — ₹ 46,000.

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

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

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

Solution

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

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

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

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

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

The Admission of a New Partner and Treatment of Goodwill

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

Case 1 : When premium for goodwill is paid privately.

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

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

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

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

Case 6 : Hidden goodwill.

Case 7 : Goodwill raised and written-off.

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

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

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

Case 1 : When premium for goodwill is paid privately

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

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

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

Accounting Entries

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

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

2. For capital brought in cash by the new partner

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

3. For sharing of premium for goodwill

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

Illustration 32

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

Make necessary journal entries to record the above transactions.

Solution

In the books of the Firm
Journal

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

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

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

Illustration 33

On 1st January, 2015, A and B sharing profits two-thirds and one-third respectively, agree to admit C into partnership on condition that he pays ₹ 30,000 as capital and ₹ 9,000 for one-sixth share of goodwill which he acquires equally from A and B. Give journal entries necessary to record these transactions.

Solution

In the books of the Firm
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2015				
Jan. 1	Bank A/c Dr.		39,000	
	To Premium for Goodwill A/c			9,000
	To C Capital A/c			30,000
	(Being the amount of premium for goodwill and capital brought in by C)			
"	Premium for Goodwill A/c Dr.		9,000	
	To A Capital A/c			4,500
	To B Capital A/c			4,500
	(Being the premium for goodwill brought in by C, shared by A and B on the basis of their sacrifice)			

Illustration 34

A and B are in partnership with capitals of ₹ 10,000 and ₹ 6,000 and sharing profits two-thirds and one-third respectively. On 1st January, 2015, they agree to admit C into partnership with a one-sixth share on condition that he brings in ₹ 5,500 (₹ 4,000 to represent his capital and ₹ 1,500 to represent goodwill). The whole of ₹ 5,500 is to remain in the business.

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

Solution

In the books of the Firm
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2015	Bank A/c Dr.		5,500	
Jan. 1	To C Capital A/c			4,000
	To Premium for Goodwill A/c			1,500
	(Being the amount of capital and premium for goodwill brought in by C)			
"	Premium for Goodwill A/c Dr.		1,500	
	To A Capital A/c (Note 1)			1,000
	To B Capital A/c (Note 1)			500
	(Being the premium for goodwill shared by the old partners on the basis of their sacrifice)			

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

Calculation of New Profit Sharing Ratio :

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

Illustration 35

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

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

Solution

In the books of the Firm
Journal

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

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

Calculation of Sacrificing Ratio

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

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

Illustration 36

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

Journalise the above arrangement in the books.

Solution

In the books of the Firm
Journal

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

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

Calculation of Sacrificing Ratio

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

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

Alternatively,

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

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

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

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

Illustration 37

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

Solution

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

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

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

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

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

Illustration 38

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

Solution

In the books of the Firm

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

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

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

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

Illustration 39

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

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

Solution **In the books of the Firm**

Journal

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

Working Note :

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

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

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

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

Accounting Entries

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

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

2. For capital brought in by the new partner

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

3. For sharing of premium for goodwill

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

4. For withdrawal of premium money fully / partly

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

Illustration 40

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

Solution **In the books of Strong, Weak and Able**

Journal

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

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

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

Illustration 41

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

Solution **In the books of the Firm**

Journal

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

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

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

Illustration 42

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

Solution **In the books of the Firm**

Journal

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

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

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

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

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

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

> ***In this connection, Para 36 of AS—10 is very important. This para states that 'Goodwill should be recorded in the books only when some consideration in money or money's worth has been paid for it. Whenever a business is acquired for a price (payable in cash or in shares or otherwise) which is in excess of the value of the net assets of the business taken over, the excess should be termed as Goodwill'.***
> ***The effects of the above provision of AS—10 in Partnership Accounts are the following :***
> ***1. Only purchased goodwill to be recorded in the books of accounts.***
> ***2. Non-purchased goodwill (internally generated goodwill) will be adjusted through Partners' Capital Accounts. In effect, this goodwill cannot be shown in the Partnership Balance Sheet.***

Accounting Entries

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

Illustration 43

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

Solution

In the books of the Firm
Journal

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

Working Notes :

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

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

Calculation of Sacrificing Ratio

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

Illustration 44

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

Calculate the value of goodwill and make necessary journal entries.

Solution

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

In the books of Jadeja, Robin and Kapil
Journal

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

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

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

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

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

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

Journal Entries

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

Alternatively,

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

Illustration 45

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

Solution

In the books of the Firm
Journal

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

Working Note :

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

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

*New profit sharing ratio :

1 – 1/4 = 3/4

A's share = 3/5 of 3/4 — 9/20

B's share = 2/5 of 3/4 — 6/20

C's share = 1/4 — 5/20

Illustration 46

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

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

Solution

In the books of the Firm

Journal

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

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

Case 6 : Hidden Goodwill

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

Illustration 47

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

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

Solution

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

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

Illustration 48

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

Solution

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

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

In the books of the Firm

Journal

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

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

Case 7 : Goodwill raised and written-off

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

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

Journal Entries

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

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

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

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

Illustration 49

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

Pass necessary journal entries to record the above.

Solution

In the books of the Firm
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Goodwill A/c Dr.		1,20,000	
	To A Capital A/c			48,000
	To B Capital A/c			48,000
	To C Capital A/c			24,000
	(Being the raising of goodwill at its full value)			
	A Capital A/c Dr.		40,000	
	B Capital A/c Dr.		40,000	
	C Capital A/c Dr.		20,000	
	D Capital A/c Dr.		20,000	
	To Goodwill A/c			1,20,000
	(Being the writing-off of the full value of goodwill in the new profit sharing ratio)			

Illustration 50

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

Make journal entries.

Solution

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

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

In the books of the Firm
Journal

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

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

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

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

Illustration 51

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

Z brought into partnership —

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

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

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

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

Solution

In the books of the Firm

Journal

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

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

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

In this situation the following steps are followed :

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

Old Partners' Capital Account Dr. [Old ratio]

To Goodwill Account

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

Cash / Bank Account Dr.

To Premium for Goodwill Account

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

Premium for Goodwill Account Dr.

To Old Partners' Capital Account [Sacrificing ratio]

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

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

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

Illustration 52

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

Give the necessary journal entries.

Solution

In the books of the Firm
Journal

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

Working Notes :

(1) New Profit-Sharing Ratio :

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

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

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

(2) Calculation of Sacrificing Ratio

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

Illustration 53

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

Solution

In the books of P, S and R
Journal

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

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

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

Illustration 54

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

(a) Calculate the sacrificing ratio; and

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

Solution

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

In the books of B, C and D

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

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

Illustration 55

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

Solution

In the books of the Firm

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

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

Working Note :

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

Illustration 56

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

Solution

In the books of A, B and C
Journal

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

Working Note :

(1) Calculation of Sacrificing Ratio

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

Illustration 57

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

Solution

In the books of the Firm
Journal

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

Illustration 58

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

Solution

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

The appropriation of premium money is as under :

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

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

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

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

Illustration 59

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

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

Solution

Statement Showing the Premium to be Brought in and its Distribution

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

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

In the books of the Firm

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

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

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

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

Accounting Entries

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

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

    To Premium for Goodwill Account

2. For capital brought in cash by the new partner

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

3. For sharing of premium for goodwill

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

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

Illustration 60

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

Net profit for last 5 years are as under :

2010 — ₹ 40,000; 2011 — ₹ 35,000; 2012 — ₹ 25,000; 2013 — ₹ 38,000 and 2014 — ₹ 45,000.

Calculate the value of goodwill and show how transaction of goodwill be recorded in the books of the firm without opening Goodwill Account.

Solution

Calculation of Average Profit

Year	Profit (₹)
2010	40,000
2011	35,000
2012	25,000
2013	38,000
2014	45,000
Total Profit	1,83,000

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

Goodwill = Average Profit × Number of year's Purchase

= ₹ 36,600 × 3 = ₹ 1,09,800.

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

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

Solution

In the books of the Firm

Journal

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

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

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

Illustration 61

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

Solution

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

Calculation of Sacrificing Ratio

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

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

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

Illustration 62

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

Solution

In the books of the Firm

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

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

Working Notes :

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

(2) Calculation of Sacrificing Ratio

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

Illustation 63

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

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

Solution **In the books of the Firm**

(i) Journal **Dr.** **Cr.**

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

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

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

(iii) Ascertainment of New Profit-Sharing Ratio

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

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

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

Illustration 64

(a) A and B are partners in a firm sharing profits and losses in the ratio of 3 : 2. X who joins the firm for 1/3 share is to pay ₹ 25,000 as premium for goodwill but he cannot pay anything. As between A and B, they decided to share profits and losses equally. Pass the required journal entries in respect of the goodwill.

(b) A and B are equal partners. C comes in as a new partner who pays ₹ 6,000 as premium for goodwill. The new profit sharing ratio among A, B and C is 1 : 2 : 3. Pass necessary journal entries showing the appropriation of premium money assuming that the premium for goodwill is immediately withdrawn by the old partners.

(c) A partnership firm is about to admit a partner and decides theat goodwill is to be raised in the books. The basis is two years' purchase of the average profits over the last five consecutive years.
Profit : ₹ 36,000; ₹ 28,000; ₹ 25,000; ₹ 37,000; ₹ 45,000.
Calculate value of goodwill.

Solution (a)

In the books of the Firm
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	X Capital A/c	Dr.		25,000	
	To A Capital A/c (Note 1)				20,000
	To B Capital A/c (Note 1)				5,000
	(Being the adjustment for goodwill on X's admission)				
	Alternatively,				
	Goodwill A/c (Note 2)	Dr.		75,000	
	To A Capital A/c				45,000
	To B Capital A/c				30,000
	(Being the goodwill raised in the books at its full value)				
	A Capital A/c	Dr.		25,000	
	B Capital A/c	Dr.		25,000	
	X Capital A/c	Dr.		25,000	
	To Goodwill A/c (Note 3)				75,000
	(Being the goodwill written-off in the new ratio)				

Solution (b)

In the books of the Firm
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	Cash A/c	Dr.		6,000	
	To Premium for Goodwill A/c				6,000
	(Being the premium for goodwill brought in by cash)				
	Premium for Goodwill A/c	Dr.		6,000	
	To A Capital A/c (Note 4)				4,000
	To B Capital A/c (Note 4)				2,000
	(Being the premium for goodwill credited to A and B on the basis of their sacrifice)				
	A Capital A/c	Dr.		4,000	
	B Capital A/c	Dr.		2,000	
	To Cash A/c				6,000
	(Being the premium money withdrawn by the old partners)				

Solution (c)

$$\text{Average Profit} = \frac{36{,}000 + 28{,}000 + 25{,}000 + 37{,}000 + 45{,}000}{5}$$

$$= \frac{1{,}71{,}000}{5} = ₹\ 34{,}200$$

Value of Goodwill = 2 × Average Profit = 2 × ₹ 34,200 = ₹ **68,400**.

Working Notes :

(1) X is admitted for 1/3 share in future profit. Therefore, 1 – 1/3 = 2/3 is available to A and B which they will share equally.
A's share will be = 1/2 of 2/3 = 2/6
B's share will be = 1/2 of 2/3 = 2/6
X's share will be = 1/3 or 2/6.
The new profit sharing ratio = 2 : 2 : 2 or 1 : 1 : 1.

Calculation of Sacrificing Ratio

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

(2) X is joining the firm for 1/3 share and he is required to pay ₹ 25,000 as premium for goodwill but cannot pay anything. So goodwill is to be raised at its full value = ₹ 25,000 × 3/1 = ₹ **75,000**.

(3) As per AS—10, only purchased goodwill is recorded in the books of account. Therefore, the entire goodwill ₹ 75,000 is to be written-off immediately in the new ratio. In the Balance Sheet no goodwill is to be shown.

(4) C is joining the firm for 3/6 share. He is paying ₹ 6,000 as premium for goodwill. The total value of goodwill = ₹ 6,000 × 6/3 = ₹ 12,000.

The sharing of premium money is calculated as follows :

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

Special Problems

Illustration 65

A and B are partners in a firm sharing profits and losses in the ratio of 3 : 2 respectively. Their summarised Balance Sheet as on 31.3.2015 is as under :

Liabilities		₹	Assets	₹
Capital :	A	90,000	Fixed Assets	1,60,000
	B	60,000	Current Assets	75,000
Current Liabilities		85,000		
		2,35,000		2,35,000

On 1.4.2015, C is admitted to the partnership.

Prepare the appropriate journal entries for each of the following :

(i) C ***purchases*** $33^1/_3$% of A's interest for ₹ 35,000.

(ii) C ***contributes*** ₹ 70,000 to obtain a 25% interest in the firm.

Solution

In the books of the Firm
Journal

Date	Particulars		Dr. ₹	Cr. ₹
(i)	Cash A/c (Note 1)	Dr.	35,000	
	To C Capital A/c			30,000
	To Premium for Goodwill A/c			5,000
	(Being the amount of capital and premium for goodwill brought in by C)			
	Premium for Goodwill A/c	Dr.	5,000	
	To A Capital A/c			5,000
	(Being the premium for goodwill brought in by C credited to A for his sacrifice)			
	A Capital A/c (₹ 5,000 + 30,000)	Dr.	35,000	
	To Cash A/c			35,000
	(Being the premium for goodwill and 1/3rd of capital withdrawn by A)			
(ii)	Cash A/c (Note 2)	Dr.	70,000	
	To C Capital A/c			50,000
	To Premium for Goodwill A/c			20,000
	(Being the required amount of money as capital and premium for goodwill brought in by C to obtain a 25% interest in the firm)			
	Premium for Goodwill A/c	Dr.	20,000	
	To A Capital A/c			12,000
	To B Capital A/c			8,000
	(Being the premium for goodwill shared by the old partners on the basis of their sacrifice)			

Working Notes :

(1) 1/3rd of A's Capital = ₹ 30,000. C is paying ₹ 35,000 for acquiring 1/3 share of A. Therefore, ₹ 5,000 (₹ 35,000 – ₹ 30,000) will be treated as premium for goodwill.

(2) 3/4 value of the firm = ₹ 1,50,000. Therefore, total value of the firm = ₹ 2,00,000 (₹ 1,50,000 / 3 × 4). C's contribution for 1/4 interest in the firm should be ₹ 2,00,000 × 1/4 = ₹ 50,000. However, C is contributing ₹ 70,000. Therefore, the difference ₹ 20,000 (₹ 70,000 – ₹ 50,000) will be treated as premium for goodwill and it will remain in the business.

Illustration 66

P and Q are partners in a firm sharing profits and losses in the ratio of 3 : 2 respectively. They admit R as a partner on 1.1.2012 on the basis of his buying 1/5th of P's share and 1/6th of Q's share. On 1.1.2014, they permit R to purchase a further 1/10th of their remaining shares. How much did R pay each of the others on each occasion for goodwill, assuming that the goodwill of the firm was ₹ 30,000 on the first occasion and ₹ 40,000 on the second ?

What is the ultimate share of each partner in the business ?

Solution

First occasion	Second occasion
R gets from P — 1/5 × 3/5 = 3/25	R gets from P — 1/10 × 36/75 = 36/750
R gets from Q — 1/6 × 2/5 = 2/30 = 1/15	R gets from Q — 1/10 × 25/75 = 25/750
Therefore, Share of R = 3/25 + 1/15 = 14/75	Therefore, Share of R = 14/75 + 36/750 + 25/750 = 201/750
Sacrificing ratio of P and Q = 3/25 : 1/15 = 9 : 5.	Sacrificing ratio of P and Q = 36/750 : 25/750 = 36 : 25.
R is to bring in premium for goodwill = ₹ 30,000 × 14/75 = ₹ 5,600.	R is to bring in premium for goodwill = ₹ 40,000 × 61/750 = ₹ 3,253.
The premium for goodwill of ₹ 5,600 will be shared by P and Q as under :	The premium for goodwill of ₹ 3,253 will be shared by P and Q as under :
P — ₹ 5,600 × 9/14 = ₹ 3,600; Q — ₹ 5,600 × 5/14 = ₹ 2,000.	P — ₹ 3,253 × 36/61 = ₹ 1,920; Q — ₹ 3,253 × 25/61 = ₹ 1,333.
New profit sharing ratio :	New profit sharing ratio :
P — 3/5 – 3/25 = 36/75	P — 36/75 – 36/750 = 324/750
Q — 2/5 – 1/15 = 25/75	Q — 25/75 – 25/750 = 225/750
R — 3/25 + 1/15 = 14/75	R — 14/75 + 36/750 + 25/750 = 201/750
P : Q : R = 36 : 25 : 14.	**P : Q : R = 108 : 75 : 67**.

Illustration 67

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

Liabilities		₹	Assets	₹
Capital :	A	80,000	Assets	2,00,000
	B	50,000		
Creditors		70,000		
		2,00,000		2,00,000

The business has been valued and the net worth is ₹ 1,80,000. It is decided to introduce a new partner, C who has ₹ 60,000 to contribute. The profits are to be shared in the ratio of 4 : 3 : 3.

Show the Balance Sheet when :

(a) goodwill has been entered in the accounts but eliminated after the admission of C;

(b) the payment made to the partners if C pays a premium for admission to the partnership.

Solution

The net worth as per the Balance Sheet is ₹ 1,30,000 (₹ 2,00,000 – 70,000). But, the actual net worth is ₹ 1,80,000. Therefore, the difference of ₹ 50,000 (₹ 1,80,000 – 1,30,000) represents goodwill.

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

Date	Particulars	A (₹)	B (₹)	C (₹)	Date	Particulars	A (₹)	B (₹)	C (₹)
	To Goodwill A/c	20,000	15,000	15,000		By Balance b/d	80,000	50,000	—
	To Balance c/d	90,000	55,000	45,000		By Bank A/c	—	—	60,000
						By Goodwill A/c	30,000	20,000	—
		1,10,000	70,000	60,000			1,10,000	70,000	60,000

Balance Sheet of A, B and C as at . . .

Liabilities		₹	Assets	₹
Capital : A		90,000	Assets	2,00,000
	B	55,000	Bank	60,000
	C	45,000		
Creditors		70,000		
		2,60,000		2,60,000

(b) Workings :
Adjustment of Premium for Goodwill

Particulars	A (₹)	B (₹)	C (₹)
Right of goodwill before admission (3 : 2)	30,000	20,000	—
Right of goodwill after admission (4 : 3 : 3)	20,000	15,000	15,000
Sacrifice (–) / Gain (+)	(–) 10,000	(–) 5,000	(+) 15,000

Therefore, C is to bring in ₹ 15,000 as premium for goodwill and it will be shared by A ₹ 10,000 and B ₹ 5,000.

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

Date	Particulars	A (₹)	B (₹)	C (₹)	Date	Particulars	A (₹)	B (₹)	C (₹)
	To Balance c/d	90,000	55,000	60,000		By Balance b/d	80,000	50,000	—
						By Bank A/c	—	—	60,000
						By Premium for Goodwill	10,000	5,000	—
		90,000	55,000	60,000			90,000	55,000	60,000

Balance Sheet of A, B and C as at . . .

Liabilities		₹	Assets	₹
Capital :	A	90,000	Assets	2,00,000
	B	55,000	Bank (₹ 60,000 + 15,000)	75,000
	C	60,000		
Creditors		70,000		
		2,75,000		2,75,000

3. Revaluation of Assets and Liabilities

Revaluation is the recording of an asset or a liability at its current value. It is a process of placing a different valuation on an asset or a liability from its book value. At the time of admission of a new partner, it is found necessary to revalue the assets and liabilities of the firm. Buildings could have appreciated substantially due to being in a particularly favourable position; some of the debtors need to be written-off as bad, stock may not reflect the current market values; or the creditors might require some amendment.

The new partner should not be given any benefit of appreciation in the value of assets. Similarly, he should not be burdened for any undisclosed liabilities or losses. For proper adjustment in respect of appreciation or depreciation, a Revaluation Account (Profit and Loss Adjustment Account) should be opened, to which all the items of increase or decrease in the value of assets and liabilities are shown. Therefore, the purpose of preparing a Revaluation Account is to recognise the above events on a current value rather than on a historical cost basis. The balance of Revaluation Account represents profit or loss on revaluation and it is finally closed by transfer to old Partners' Capital Accounts in the old profit-sharing ratio.

Sometimes, either intentionally or by mistake, one or more assets and/or liabilities are not recorded in the books of account. But while preparing Revaluation Account, if all the partners agree, these assets and liabilities are to be recorded. Effectively, the creation of a new asset is a profit on revaluation and recognition of an unrecorded liability in the books is a loss on revaluation.

From the above, it can be comprehended that the practice of asset or liability revaluation is to state fully the true economic condition of the partnership firm at the time of admission of a partner and to assign the changes in asset and liability values to the old partners who have been managing the business during the time the changes in values occured. It should be remembered that revaluation is a comparatively rare event in accounting and is used only where balance sheet values have become conspicuously misleading. Revaluation should be done by independent valuers and it should be ensured that sufficient evidence exists for any revaluation in order to prevent valuation abuses.

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

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

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

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

The relevant Journal entries are as follows:

(a) If the values of the assets increase

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

(b) If the values of the assets decrease

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

(c) If the amount of liabilities increase

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

(d) If the amount of the liabilities decrease

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

(e) The Revaluation Account should be closed by transfer to the old Partners' Capital Accounts in the old profit-sharing ratio

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

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

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

Old Partners' Capital Accounts	Dr.	(Old ratio)
To Revaluation Account		

In this connection, Para 30 of AS—10 is also important. This para states that '***An increase in net book value arising on revaluation of fixed assets should be credited directly to owners' interests under the head of revaluation reserve, except that, to the extent that such increase is related to and not greater than a decrease arising on revaluation previously recorded as a charge to the profit and loss statement, it may be credited to the profit and loss statement. A decrease in net book value arising on revalutaion of fixed asset should be charged directly to the profit and loss statement except that to the extent that such a decrease is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or utilised, it may be charged directly to that account***'.

In case of Partnership, revaluation profit or loss is transferred directly to Partners' Capital Accounts. Therefore, an increase in net book value arising on revaluation of fixed assets may be credited to Revaluation Account (in place of Revaluation Reserve Account because it will be utilimately closed by transferring to Partners' Capital Accounts) and loss on revaluation of fixed assets may be debited to Revaluation Account (in place of Profit and Loss Account because it will be ultimately closed by transferreing to Partners' Capital Accounts).

In this chapter or elsewhere the effects of revaluation of fixed assets have been shown through the Revaluation Account (in place of Revaluation Reserve Account / Profit and Loss Account because the effect will be same on Partners' Capital Accounts).

Illustration 68

A, B and C were in partnership, sharing profits and losses as to A — 1/2, B — 1/3rd and C — 1/6th. As from 1st January, 2015 they admitted D into partnership on the following terms :

D to have a 1/6th share which he purchased entirely from A paying A ₹ 8,000 for that share of goodwill. Of this amount, A had withdrawn ₹ 6,000 and put the balance in the firm as additional capital. As a condition to admission of D as a partner D also brought in ₹ 5,000 capital into the firm. It was further agreed that the investments should be valued at its market value of ₹ 3,600 and plant be valued at ₹ 5,800.

The Balance Sheet of the old firm on 31.12.2014 was as :

Cash at bank ₹ 8,000; Debtors ₹ 12,000; Stock ₹ 10,000; Investments at cost ₹ 6,000; Furniture ₹ 2,000; Plant ₹ 7,000; Creditors ₹ 21,000; Capital : A ₹ 12,000; B ₹ 8,000 and C ₹ 4,000. The profits for the year 2015 were ₹ 12,000 and the drawings were : A ₹ 6,000, B ₹ 6,000, C ₹ 3,000 and D ₹ 3,000.

You are required to journalise the opening adjustments, prepare the opening Balance Sheet of the new firm as on 1st January, 2015 and give the capital account of each partner as on 31st December, 2015. ***[C.A. (Foundation) — Adapted]***

Solution

In the books of the firm

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2015 Jan. 1	Bank A/c	Dr.	13,000	
	To Premium for Goodwill A/c			8,000
	To D Capital A/c			5,000
	(Being the premium for goodwill and capital brought in by D)			
	Premium for Goodwill A/c	Dr.	8,000	
	To A Capital A/c			8,000
	(Being the premium credited to A's Capital)			
	A Capital A/c	Dr.	6,000	
	To Bank A/c			6,000
	(Being the premium withdrawn by A to the extent of ₹ 6,000)			
	Revaluation A/c	Dr.	3,600	
	To Investment A/c			2,400
	To Plant A/c			1,200
	(Being the revaluation of investment and plant on D's admission)			
	A Capital A/c	Dr.	1,800	
	B Capital A/c	Dr.	1,200	
	C Capital A/c	Dr.	600	
	To Revaluation A/c			3,600
	(Being loss on revaluation transferred to Old Partners' Capital Account in the old ratio of 3 : 2 : 1)			

Balance Sheet (after D's admission) as at 1st January, 2015

Liabilities	₹	Assets	₹
Capital A/c : A ₹ (12,000 + 8,000 – 6,000 – 1,800)	12,200	Plant and Machinery	5,800
Capital A/c : B ₹ (8,000 – 1,200)	6,800	Furniture	2,000
Capital A/c : C ₹ (4,000 – 600)	3,400	Investment	3,600
Capital A/c : D	5,000	Stock	10,000
Creditors	21,000	Debtors	12,000
		Cash at Bank ₹ (8,000 + 13,000 – 6,000)	15,000
	48,400		48,400

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	D	Date	Particulars	A	B	C	D
1.1.2015	To Bank A/c	6,000	—	—	—	1.1.2015	By Balance b/d	12,000	8,000	4,000	—
	To Revaluation A/c*	1,800	1,200	600	—	"	By Bank A/c	—	—	—	5,000
31.12.2015	To Drawings A/c	6,000	6,000	3,000	3,000	"	By Premium for Goodwill	8,000	—	—	—
"	To Balance c/d	10,200	4,800	2,400	4,000	31.12.2015	By Net Profit**	4,000	4,000	2,000	2,000
		24,000	12,000	6,000	7,000			24,000	12,000	6,000	7,000

* Revaluation Loss = ₹ 3,600 (₹ 1,200 for plant and ₹ 2,400 for investments).

**New Profit Sharing Ratio will be 4 : 4 : 2 : 2 or 2 : 2 : 1 : 1.

Tutorial Note : D purchased 1/6th share entirely from A. In this situation, generally total capital of the firm should remain the same. However, this question has been solved as per the direction in the question.

Illustration 69

The following is the Balance Sheet of A and B, a partnership business, as at 31st December, 2014:

Liabilities			₹	Assets	₹
Creditors			40,000	Cash at Bank	12,000
Capitals:	A	48,000		Plant and Machinery	50,000
	B	54,000	1,02,000	Furniture	10,000
				Stock	40,000
				Debtors	30,000
			1,42,000		1,42,000

The partners decided to revalue the assets and liabilities as under on the admission of partner C on 1.1.2015, who brings in ₹ 30,000 as capital: Plant and Machinery ₹ 60,000; Debtors ₹ 27,000; Furniture ₹ 9,500; and Stock ₹ 36,000.

An amount of ₹ 3,000 included in creditors is no longer a liability and hence requires to be properly adjusted and ₹ 2,000 is to be paid to the creditors which is not recorded in the books.

A contingent liability of ₹ 500 not included in the above Balance Sheet had to be cleared.

Show the Revaluation Account, Partners' Capital Accounts and the Balance Sheet after C's admission.

Solution **In the books of the firm**

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

Particulars	₹	Particulars	₹
To Debtors A/c	3,000	By Plant and Machinery A/c	10,000
To Furniture A/c	500	By Creditors A/c (no longer a liability)	3,000
To Stock A/c	4,000		
To Creditors A/c (unrecorded)	2,000		
To Bank A/c (contingent liability paid)	500		
To Partners' Capital A/cs: A : ₹ 1,500; B : ₹ 1,500	3,000		
	13,000		13,000

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

Particulars	A	B	C	Particulars	A	B	C
To Balance c/d	49,500	55,500	30,000	By Balance b/d	48,000	54,000	—
				By Revaluation A/c	1,500	1,500	—
				By Bank A/c	—	—	30,000
	49,500	55,500	30,000		49,500	55,500	30,000

Balance Sheet (after C's admission) as at 1st January, 2015

Liabilities	₹	Assets	₹
Capital A/c : A	49,500	Plant and Machinery	60,000
Capital A/c : B	55,500	Furniture	9,500
Capital A/c : C	30,000	Stock	36,000
Creditors ₹ (40,000 – 3,000 + 2,000)	39,000	Debtors	27,000
		Cash at Bank ₹ (12,000 + 30,000 – 500)	41,500
	1,74,000		1,74,000

Tutorial Note : Revaluation profit is shared by A and B equally as the profit sharing ratio has not been mentioned.

Illustration 70

Following is the Balance Sheet of A and B, who share profits and losses as 3 : 2 respectively, as at 31st December, 2014:

Liabilities		₹	Assets		₹
Capitals :	A	35,000	Land and Building		30,000
	B	30,000	Plant and Machinery		20,000
Reserve		10,000	Stock		10,000
Creditors		25,000	Debtors	20,000	
			Less: Provision for Doubtful Debts	1,000	19,000
			Bank		11,000
			Cash		10,000
		1,00,000			1,00,000

On 1st January, 2015 C joins the firm and brings in the following assets :

Stock — ₹ 21,000; Investments — ₹ 12,000; Cash — ₹ 15,000; and Debtors — ₹ 10,000.

Following were agreed upon :

(i) The new profit sharing ratio among A, B and C will be equal.

(ii) The capitals of the partners should also be equal taking C's capital as base.

(iii) The reserve of the new firm will be ₹ 15,000.

(iv) Provision for doubtful debts is to be created @ 10% on total debtors.

(v) An investment provision of ₹ 2,000 is to be created.

You are required to prepare the Balance Sheet of the new firm.

Solution **Balance Sheet of A, B and C as at 1st January, 2015**

Liabilities			₹	Assets		₹
Capitals :	A	50,000		Land and Building		30,000
	B	50,000		Plant and Machinery		20,000
	C	50,000	1,50,000	Stock ₹ (10,000 + 21,000)		31,000
Reserve			15,000	Debtors ₹ (20,000 + 10,000)	30,000	
Creditors			25,000	Less: Provision for Doubtful Debts @ 10%	3,000	27,000
				Investments	12,000	
				Less: Investment Provision	2,000	10,000
				Bank ₹ (11,000 + 14,600 + 21,400)		47,000
				Cash ₹ (10,000 + 15,000)		25,000
			1,90,000			1,90,000

Working Notes :

Dr. **(1) Partners' Capital Accounts** **Cr.**

Particulars	A	B	C	Particulars	A	B	C
To Reserve A/c	5,000	5,000	5,000	By Balance b/d	35,000	30,000	—
To Provision for Doubtful Debts A/c (Note 2)	600	400	1,000	By Stock A/c	—	—	21,000
				By Investments A/c	—	—	12,000
To Investment Provision A/c (Note 3)	—	—	2,000	By Cash A/c	—	—	15,000
To Balance c/d	*50,000	*50,000	50,000	By Debtors A/c	—	—	10,000
(*taking C's capital as base)				By Reserve A/c	6,000	4,000	—
				By Bank A/c (Balancing figure)	14,600	21,400	—
	55,600	55,400	58,000		55,600	55,400	58,000

(2) Debtors of A and B were ₹ 20,000. Provision for doubtful debts is to be maintained at 10%. Therefore, new provision for doubtful debts for these Debtors will be ₹ 2,000. To create further provision of ₹ 1,000, capital of A and B will be debited in the ratio of 3 : 2 respectively.
For the debtors ₹ 10,000 brought-in by C, entire provision is to be created by debiting C's Capital Account.

(3) Investment provision is to be created by debiting C's Capital Account only.

Illustration 71

The Balance Sheet of A and B, who share profits and losses as 3 : 1 respectively as on 1.1.2015 is as under :

Liabilities		₹	Assets	₹
Capital Accounts :	A	50,000	Plant and Machinery	50,000
	B	30,000	Furniture and Fixture	20,000
Reserve		10,000	Stock	10,000
Creditors		10,000	Debtors	5,000
			Bank	15,000
		1,00,000		1,00,000

The partners are unable to bring in any additional capital in order to increase the plant capacity.

To increase the capital base of the firm to ₹ 1,50,000, they admitted C as an equal partner on the above date. To join the business, C was required to pay a sum of ₹ 70,000.

Show Journal Entries, Partners' Capital Accounts and the Balance Sheet after C's admission.

Solution **In the books of the Firm**

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

Date	Particulars		₹	₹
2015	Reserve A/c	Dr.	10,000	
Jan. 1	To A Capital A/c			7,500
	To B Capital A/c			2,500
	(Being the reserve transferred to the old partners in old profit sharing ratio)			
	Bank A/c	Dr.	70,000	
	To C Capital A/c			60,000
	To Premium for Goodwill A/c (Note 1)			10,000
	(Being the amount of capital and premium for goodwill brought in by C)			
	Premium for Goodwill A/c	Dr.	10,000	
	B Capital A/c (Note 2)	Dr.	2,500	
	To A Capital A/c			12,500
	(Being the entire amount of premium for goodwill credited to A, also B is required to pay A a sum of ₹ 2,500)			
	A Capital A/c	Dr.	10,000	
	To Bank A/c			10,000
	(Being the premium for goodwill received in cash, withdrawn by A)			

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
To A Capital A/c	—	2,500	—	By Balance b/d	50,000	30,000	—
To Bank A/c	10,000	—	—	By Reserve A/c	7,500	2,500	—
To Balance c/d	60,000	30,000	60,000	By Bank A/c	—	—	60,000
				By Premium for Goodwill A/c	10,000	—	—
				By B Capital A/c	2,500	—	—
	70,000	32,500	60,000		70,000	32,500	60,000

Balance Sheet (after C's Admission) as at 1st January, 2015

Liabilities			₹	Assets	₹
Capital Accounts :	A	60,000		Plant and Machinery	50,000
	B	30,000		Furniture and Fixture	20,000
	C	60,000	1,50,000	Stock	10,000
Creditors			10,000	Debtors	5,000
				Bank ₹ (15,000 + 70,000 – 10,000)	75,000
			1,60,000		1,60,000

Working Notes :

(1) The total capital of A and B was ₹ 90,000 (₹ 50,000 + ₹ 30,000 + ₹ 10,000). To increase the capital base to ₹ 1,50,000, C is required to bring in ₹ 60,000 (₹ 1,50,000 – ₹ 90,000). But he brings in ₹ 70,000. Therefore, the excess of ₹ 10,000 represents premium for goodwill.

(2) C brings in ₹ 10,000 for 1/3 share. Therefore, the value of the goodwill is ₹ 10,000 × 3/1 = ₹ 30,000.

Adjustment in Regard to Goodwill

Partners		A	B	C
Right of goodwill before admission (3 : 1)	(₹)	22,500	7,500	—
Right of goodwill after admission (1 : 1 : 1)	(₹)	10,000	10,000	10,000
Gain (+) / Sacrifice (–)	(₹)	(–) 12,500	(+) 2,500	(+) 10,000

Illustration 72

Rain and Storm are partners in a firm sharing profits and losses as 3 : 2 respectively. Their Balance Sheet on 31.12.2014 stands as under :

Liabilities		₹	Assets		₹
Creditors			Cash		4,000
Capital Accounts :	₹	35,000	Debtors	22,000	
Rain	40,000		Less: Provision for doubtful debts	2,000	20,000
Storm	20,000	60,000	Stock		18,000
			Machinery		20,000
			Land and Building		33,000
		95,000			95,000

On 1.1.2015, they agreed to take Dust as a partner on the following conditions :

(i) The goodwill of the firm shall be valued at ₹ 23,750 and Dust shall pay his share of goodwill in cash.

(ii) Dust shall contribute ₹ 15,000 as his share of capital.

(iii) Land and Building shall be valued at ₹ 42,000. Machinery shall be depreciated by ₹ 5,000. Provision for doubtful debts shall be raised to ₹ 3,000 and another provision shall be made for a probable liability for damages amounting to ₹ 1,300.

(iv) The profit and loss sharing ratio shall be so adjusted that, between Rain and Storm the former ratio is maintained, while between Storm and Dust there shall be the same ratio as between Rain and Storm.

(v) The capital shall be adjusted (without disturbing the ultimate total capital) so as to correspond with the new ratio, the excess or deficit being transferred to their respective current accounts.

Show journal entries to give effect to the above arrangement and prepare the opening Balance sheet of the new firm.

Solution

In the books of the Firm

Journal **Dr. Cr.**

Date	Particulars		₹	₹
2015	Land and Building A/c	Dr.	9,000	
Jan. 1	To Revaluation A/c			9,000
	(Being the upward revaluation of land and building)			

Revaluation A/c	Dr.	7,300	
To Machinery A/c			5,000
To Provision for Doubtful Debts A/c			1,000
To Liability for Damages A/c			1,300
(Being the downward revaluation of machinery and provision for doubtful debts and creating liability for damages)			
Revaluation A/c (₹ 9,000 – 7,300)	Dr.	1,700	
To Rain Capital A/c			1,020
To Storm Capital A/c			680
(Being profit on revaluation transferred to old partners' capital accounts in the ratio of 3 : 2)			
Cash A/c	Dr.	20,000	
To Premium for Goodwill A/c (Note 2)			5,000
To Dust Capital A/c			15,000
(Being the premium for goodwill and capital brought in by Dust for his 4/9th share of profit)			
Premium for Goodwill A/c (Note 3)	Dr.	5,000	
To Rain Capital A/c			3,000
To Storm Capital A/c			2,000
(Being premium for goodwill shared by the old partners on the basis of their sacrificing ratio, i.e., 3 : 2)			
Rain Capital A/c (Note 4 and 5)	Dr.	5,320	
To Rain Current A/c			5,320
(Being the excess capital transferred to Current Account)			
Storm Current A/c (Note 4 and 5)	Dr.	3,120	
Dust Current A/c	Dr.	2,200	
To Storm Capital A/c			3,120
To Dust Capital A/c			2,200
(Being the shortage capitals transferred to current accounts)			

Balance Sheet of the New Firm as on 1st January, 2015

Liabilities		₹	Assets		₹
Capital Accounts :			Land and Building		42,000
Rain	38,700		Machinery		15,000
Storm	25,800		Stock		18,000
Dust	17,200	81,700	Debtors	22,000	
Current Accounts :			Less: Provision for doubtful debts	3,000	19,000
Rain		5,320	Cash (₹ 4,000 + 20,000)		24,000
Creditors		35,000	Current Accounts :		
Liability for Damages		1,300	Storm	3,120	
			Dust	2,200	5,320
		1,23,320			1,23,320

Working Notes :

(1) Calculation of New Profit Sharing Ratio

The profit sharing ratio between Rain and Storm is 3 : 2, and profit sharing ratio between Storm and Dust will also be 3 : 2.

Therefore, share of Dust = $\frac{2/5}{3} \times 2 = 4/15$

The new profit sharing ratio = 3/5 : 2/5 : 4/15
= 9 : 6 : 4.

(2) Premium for goodwill brought in by Dust = ₹ 23,750 / 19 × 4 = ₹ 5,000.

(3) The partners' old profit sharing ratio (3 : 2) is their sacrificing ratio.

(4) **Total capital of the new firm**

Opening capital + Capital and premium brought in by Dust + Revaluation profit
= ₹ (60,000 + 15,000 + 5,000 + 1,700) = ₹ 81,700

Rain's share = ₹ 81,700 × 9/19 = ₹ 38,700

Storm's share = ₹ 81,700 × 6/19 = ₹ 25,800

Dust's share = ₹ 81,700 × 4/19 = ₹ 17,200.

Dr. **(5) Partners' Capital Accounts** **Cr.**

Particulars	Rain	Storm	Dust	Particulars	Rain	Storm	Dust
To Partners' Current A/cs (Balancing figure)	5,320	—	—	By Balance b/d	40,000	20,000	—
				By Bank A/c	—	—	15,000

To Balance c/d (Note 4)	38,700	25,800	17,200	By Premium for Goodwill A/c	3,000	2,000	—
				By Revaluation A/c	1,020	680	—
				By Partners' Current A/cs (Balancing figure)	—	3,120	2,200
	44,020	25,800	17,200		44,020	25,800	17,200

Illustration 73

A and B are in partnership, sharing profits and losses in the ratio of 3 : 2 respectively. Interest is charged on partners' drawings @ 8% p.a.

On 1.1.2015, C was admitted into partnership, with future profits or losses to be shared equally and interest on drawings to continue @ 8% p.a. He brought in ₹ 52,000 as his share of capital. Goodwill was calculated as twice the average profits after interest on drawings for 2012, 2013 and 2014.

Details of drawings and profits before interest in those years were :

Drawings : 2012 — ₹ 20,000; 2013 — ₹ 30,000; 2014 — ₹ 37,500.

Profit before interest : 2012 — ₹ 30,800; 2013 — ₹ 30,200; 2014 — ₹ 31,000.

The partners' capital balances on 31.12.2014 were : A ₹ 45,000; B ₹ 35,000.

Net profit for 2015 was ₹ 60,000 before interest. Drawings at the end of 2015 totalled :

A ₹ 24,000; B ₹ 22,000; C ₹ 20,000.

Prepare Profit and Loss Appropriation Account for the year ended 31.12.2015 and the Partners' Capital Accounts. Assume that all drawings were made on the first day of the year.

Solution

Workings :

	₹
Total profit for 3 years : ₹ (30,800 + 30,200 + 31,000)	92,000
Add: Interest on drawings for 3 years : @ 8% on ₹ (20,000 + 30,000 + 37,500)	7,000
Total profit for 3 years after interest on Drawings	99,000

Therefore, Goodwill = ₹ 99,000 / 3 × 2 = ₹ 66,000.

Statement Showing Required Adjustment for Goodwill

Partners		A	B	C
Right of goodwill before admission (3 : 2)	(₹)	39,600	26,400	—
Right of goodwill after admission (1 : 1 : 1)	(₹)	22,000	22,000	22,000
Sacrifice (–) / Gain (+)	(₹)	(–) 17,600	(+) 4,400	(+) 22,000

Required journal entry :

C Capital Account	Dr.	22,000	
To A Capital Account			17,600
To B Capital Account			4,400
(Being the required adjustment for goodwill)			

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2015 Cr.

Particulars		₹	Particulars		₹
To Share of Profit A/c :			By Net Profit b/d		60,000
A	21,760		By Interest on Drawings A/c :		
B	21,760		A	1,920	
C	21,760	65,280	B	1,760	
			C	1,600	5,280
		65,280			65,280

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2015					2015				
Jan. 1	To A Capital A/c	—	—	17,600	Jan. 1	By Balance b/d	45,000	25,000	—
"	To B Capital A/c	—	—	4,400	"	By Bank A/c	—	—	52,000
Dec. 31	To Drawings A/c	24,000	22,000	20,000	"	By C Capital A/c	17,600	4,400	—
"	To Interest on Drawings A/c	1,920	1,760	1,600	Dec. 31	By Share of Profit A/c	21,760	21,760	21,760
"	To Balance c/d	58,440	27,400	30,160					
		84,360	51,160	73,760			84,360	51,160	73,760

Illustration 74

A and B are in partnership and share profits and losses in the ratio of 3 : 2 respectively. Interest is paid on capital at 7% p.a. The partners' capital and current accounts balances at 31.12.2013 were :

Capital Account : A ₹ 35,600 (Cr.); B ₹ 28,400 (Cr.);

Current Account : A ₹ 1,400 (Cr.); B ₹ 1,800 (Dr.)

The only change to the capital balances since 2011 has been A's introduction of ₹ 10,000 on 1.7.2013.

On 1.1.2014, C was admitted paying ₹ 45,000 which represented a payment for goodwill and an additional sum as capital. Goodwill was calculated as 1.5 times average profits before interest on capital for the previous 3 years. Profits after interest for those years were : 2011 ₹ 31,640; 2012 ₹ 42,870; 2013 ₹ 62,400. The new profit and loss sharing ratio for A, B and C was 7 : 5 : 3 respectively.

The net profit before interest for the year ended 31.12.2014 was ₹ 82,660.

Drawings were : A ₹ 24,000; B ₹ 18,000; C ₹ 16,000.

Prepare Profit and Loss Appropriation Account for the year ended 31.12.2014, Partners' Capital and Current Accounts.

Solution

Workings :

		₹
Total profit after interest for 3 years : ₹ (31,640 + 42,870 + 62,400)		1,36,910
Add: Interest on capital for 3 years @ 7% p.a. on ₹ (35,600 + 28,400)	13,440	
Less: Interest @ 7% p.a. on ₹ 10,000 for 6 months	350	13,090
Profit for 3 years before interest on capital		1,50,000

Therefore, Goodwill = ₹ 1,50,000 / 3 × 1.5 = ₹ 75,000

C's share of goodwill = ₹ 75,000 / 15 × 3 = ₹ 15,000.

Out of ₹ 45,000 brought in by C, ₹ 15,000 is to be treated as premium for goodwill and the balance ₹ 30,000 (₹ 45,000 – ₹ 15,000) is to be treated as capital.

Statement Showing Required Adjustment for Goodwill

Partners		A	B	C
Right of goodwill before admission (3 : 2)	(₹)	45,000	30,000	—
Right of goodwill after admission (7 : 5 : 3)	(₹)	35,000	25,000	15,000
Sacrifice (–) / Gain (+)	(₹)	(–) 10,000	(–) 5,000	(+) 15,000

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2014 Cr.

Particulars		₹	Particulars	₹
To Interest on Capital A/c :			By Net Profit b/d	82,660
A — On ₹ 35,600 @ 7% p.a.	2,492			
B — On ₹ 28,400 @ 7% p.a.	1,988			
C — On ₹ 30,000 @ 7% p.a.	2,100	6,580		
To Share of Profit A/c :				
(A — ₹ 35,504; B — ₹ 25,360; C — ₹ 15,216)		76,080		
		82,660		82,660

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2014					2014				
Dec. 31	To Balance c/d	35,600	28,400	30,000	Jan. 1	By Balance b/d	35,600	28,400	—
					"	By Bank A/c	—	—	30,000
		35,600	28,400	30,000			35,600	28,400	30,000

Dr. Partners' Current Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2014					2014				
Jan. 1	To Balance b/d	—	1,800	—	Jan. 1	By Balance b/d	1,400	—	—
Dec. 31	To Drawings A/c	24,000	18,000	16,000	"	By Premium for Goodwill A/c	10,000	5,000	—
"	To Balance c/d	25,396	12,548	1,316	Dec. 31	By Interest on Capital A/c	2,492	1,988	2,100
					"	By Share of Profit A/c	35,504	25,360	15,216
		49,396	32,348	17,316			49,396	32,348	17,316

Tutorial Note : When Capital Account is maintained under fixed capital method, premium for goodwill will be credited to Current Account.

Illustration 75

Gopal and Govind are partners sharing profits and losses in the ratio of 60 : 40. The firm's Balance Sheet as on 31.03.2015 was as follows :

Liabilities	₹	Assets	₹
Capital Accounts :		Fixed Assets	3,00,000
Gopal	1,20,000	Investments	50,000
Govind	80,000	Current Assets	2,00,000
Long Term Loan	2,00,000	Loans and Advances	1,00,000
Current Liabilities	2,50,000		
	6,50,000		6,50,000

Due to financial difficulties, they have decided to admit Guru as a partner from 1.4.2015 on the following terms :

Guru will be paid 40% of the profits. Guru will bring in cash ₹ 1,00,000 as capital. It is agreed that goodwill of the firm will be valued at 2 years' purchase of 3 years' normal average profits of the firm and Guru will bring in cash his share of goodwill. It was also decided that the partners will not withdraw their share of goodwill nor will the goodwill appear in the books of account.

The profits of the previous three years were as follows :

For the year ended 31.03.2013 — Profit ₹ 20,000 (includes insurance claim received of ₹ 40,000).

For the year ended 31.03.2014 — Loss ₹ 80,000 (includes voluntary retirement compensation paid ₹ 1,10,000).

For the year ended 31.03.2015 — Profit ₹ 1,05,000 (includes a profit of ₹ 25,000 on the sale of assets).

It was decided to revalue the assets on 31.03.2015 as follows : Fixed Assets (Net) — ₹ 4,00,000; Investments — Nil; Current Assets — ₹ 1,80,000; Loans and Advances — ₹ 1,00,000.

The new profit sharing ratio after the admission of Guru was 35 : 25 : 40.

Pass Journal Entries on admission. Show goodwill calculation and prepare Revaluation Account, Partners' Capital Accounts and Balance Sheet as on 1.4.2015 after the admission of Guru.

Solution

In the books of the firm

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

Date	Particulars		₹	₹
2015	Bank A/c	Dr.	1,24,000	
April 1	To Premium for Goodwill A/c (Note 1)			24,000
	To Guru Capital A/c			1,00,000
	(Being premium for goodwill and capital brought in by Guru)			
	Premium for Goodwill A/c	Dr.	24,000	
	To Gopal Capital A/c			15,000
	To Govind Capital A/c			9,000
	(Being the premium for goodwill shared by the old partners on the basis of their sacrifice)			
	Revaluation A/c	Dr.	70,000	
	To Investments A/c			50,000
	To Current Assets A/c			20,000
	(Being the downward revaluation of investments and current assets)			
	Fixed Assets A/c	Dr.	1,00,000	
	To Revaluation A/c			1,00,000
	(Being the upward revaluation of fixed assets)			
	Revaluation A/c	Dr.	30,000	
	To Gopal Capital A/c			18,000
	To Govind Capital A/c			12,000
	(Being the profit on revaluation shared by the old partners in their old profit sharing ratio)			

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

Particulars	₹	Particulars	₹
To Investments A/c	50,000	By Fixed Assets A/c	1,00,000
To Current Assets A/c	20,000		
To Partners' Capital A/cs:			
Gopal : ₹ 18,000; Govind : ₹ 12,000	30,000		
	1,00,000		1,00,000

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

Particulars	Gopal	Govind	Guru	Particulars	Gopal	Govind	Guru
To Balance c/d	1,53,000	1,01,000	1,00,000	By Balance b/d	1,20,000	80,000	—
				By Bank A/c	—	—	1,00,000
				By Premium for Goodwill A/c	15,000	9,000	—
				By Revaluation A/c	18,000	12,000	—
	1,53,000	1,01,000	1,00,000		1,53,000	1,01,000	1,00,000

Dr. **Bank Account** **Cr.**

Particulars	₹	Particulars	₹
To Guru Capital A/c	1,00,000	By Balance c/d	1,24,000
To Premium for Goodwill A/c	24,000		
	1,24,000		1,24,000

Balance Sheet as at 1st April, 2015 (after Guru's admission)

Liabilities	₹	Assets	₹
Capitals: Gopal	1,53,000	Fixed Assets	4,00,000
Govind	1,01,000	Current Assets (includes a bank balance of ₹ 1,24,000)	3,04,000
Guru	1,00,000	Loans and Advances	1,00,000
Long Term Loan	2,00,000		
Current Liabilities	2,50,000		
	8,04,000		8,04,000

Working Note : **(1) Calculation of Goodwill and its Adjustment**

Year ended on 31st March		2013	2014	2015
Profit / (Loss) for the year	(₹)	20,000	(80,000)	1,05,000
Adjustment for abnormal items	(₹)	*(40,000)	1,10,000	(25,000)
Normal Profit / (Loss)	(₹)	(20,000)	30,000	80,000

*Insurance claim received ₹ 40,000 included in the Profit for the year ended on 31 March, 2013 has been treated as abnormal item as nothing has been mentioned in the question regarding its nature.

Three years' total profit = – 20,000 + 30,000 + 80,000 = ₹ 90,000. Average profit ₹ 90,000 / 3 = ₹ 30,000. Goodwill is two years' purchase of average profit = ₹ 30,000 x 2 = ₹ 60,000. Therefore, premium for Goodwill to be brought in by Guru is 40% of ₹ 60,000 = ₹ 24,000. This premium for goodwill will be shared by Gopal and Govind as under :

	Gopal (₹)	Govind (₹)	Guru (₹)
Right of goodwill before admission (3 : 2)	36,000	24,000	—
Right of goodwill after admission (7 : 5 : 8)	21,000	15,000	24,000
Sacrifice (–) / Gain (+)	(–) 15,000	(–) 9,000	(+) 24,000

Illustration 76

A, B and C are partners sharing profits and losses in the ratio of 3:2:1. D is admitted as a new partner on 31.12.2014 for an equal share and is to pay ₹ 25,000 as capital. Following is the Balance Sheet on the date of admission:

Liabilities	₹	Assets	₹
Capital : A	30,000	Land and Buildings	25,000
Capital : B	30,000	Plant and Machinery	20,000
Capital : C	20,000	Furniture and Fixture	15,000
Creditors	15,000	Stock	10,000
Bills payable	5,000	Debtors	15,000
		Bills receivable	10,000
		Bank	5,000
	1,00,000		1,00,000

Following are the required adjustments on D's admission:

(i) Out of the creditors, a sum of ₹ 5,000 is owing to D.

(ii) Bills worth ₹ 8,000 were discounted with the bankers, out of which, a bill of ₹ 2,000 was dishonoured on 31.12.2014, but no entry has been passed for that. Due dates of the other discounted bills fall in January, 2015.

(iii) Unexpired insurance premium ₹ 600.

(iv) Expenses debited in the Profit and Loss Account includes a sum of ₹ 1,000 paid for B's personal life insurance policy.

(v) A provision for bad debts @ 5% is to be created against Debtors.

(vi) Expenses on revaluation amounting to ₹ 1,010 is paid by A.

(vii) During 2014, part of the furniture was sold for ₹ 2,500. The book value of the furniture sold was ₹ 4,000 and the written-down value on the date of sale is ₹ 3,500. The proceeds were wrongly credited to the Sales Account.

Required: Necessary Ledger Accounts and the Balance Sheet after D's admission.

Solution — **In the books of the Firm**

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

Particulars	₹	Particulars	₹
To Provision for bad debts A/c (Note 2)	850	By Prepaid Insurance Premium A/c	600
To A Capital A/c	1,010	By B Capital A/c	1,000
To Furniture A/c (Note 4)	4,000	By Partners' Capital A/cs (A – ₹ 2,130; B – ₹ 1,420; C – ₹ 710)	4,260
	5,860		5,860

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

Particulars	A	B	C	D	Particulars	A	B	C	D
To Revaluation A/c	—	1,000	—	—	By Balance b/d	30,000	30,000	20,000	—
To Revaluation A/c	2,130	1,420	710	—	By Creditors A/c	—	—	—	5,000
To Balance c/d	28,880	27,580	19,290	25,000	By Bank A/c	—	—	—	20,000
					By Revaluation A/c	1,010	—	—	—
	31,010	30,000	20,000	25,000		31,010	30,000	20,000	25,000

Balance Sheet as at 31st December, 2014 (after D's admission)

Liabilities		₹	Assets		₹
Capitals :	A	28,880	Land and Buildings		25,000
	B	27,580	Plant and Machinery		20,000
	C	19,290	Furniture & Fixture		11,000
	D	25,000	Stock		10,000
Creditors		10,000	Debtors	17,000	
Bills payable		5,000	Less: Provision for bad debts	850	16,150
			Bills receivable		10,000
			Bank — ₹ (5,000 + 20,000 – 2,000)		23,000
			Prepaid Insurance Premium		600
		1,15,750			1,15,750

Working Notes:

(1) Contingent liability for bills discounted ₹ 6,000;

(2) Debtors after adjustment of bills dishonoured = ₹ 17,000. Provision is to be created @ 5%, i.e. ₹ 850.

(3) Capital brought in cash (₹ 25,000 – ₹ 5,000) = ₹ 20,000.

(4) For sale of furniture, the actual rectifying entry will be :

Sales Account	Dr.	₹ 2,500	
Depreciation Account ₹ (4,000 – 3,500)	Dr.	₹ 500	
Loss on Sale of Furniture Account	Dr.	₹ 1,000	
To Furniture Account			₹ 4,000

As all the nominal accounts have been closed at the time of preparing final account for 2014, the rectifying entry to be passed through Revaluation Account.

Revaluation Account	Dr.	₹ 4,000	
To Furniture Account			₹ 4,000

Alternatively,

Old Partners' Capital Account	Dr.	(old ratio)	
To Furniture Account			

If alternative entry is passed, the loss on revaluation will be ₹ 260 only.

Illustration 77

P, Q and R were on partnership terms sharing profits and losses in the ratio of 6:3:1. They decided to take S into partnership with effect from April 1, 2014 on the following terms and conditions:

(i) S is to bring in his proportionate share of goodwill in cash. Goodwill is not to be brought into the books but necessary adjustments are to be made in the old Partners' Capital Accounts.

(ii) Goodwill to be valued at 60% of the average annual profits of the previous three or four years, whichever is the higher.

(iii) The average profits for the purpose of goodwill for the past years, were:
Year ending March 31, 2014 ₹ 48,000 Year ending March 31, 2013 ₹ 30,300
Year ending March 31, 2012 ₹ 31,200 Year ending March 31, 2011 ₹ 42,200

(iv) The new profit-sharing ratio between P, Q, R and S will be 3 : 3 : 3 : 1.

(v) S should bring in ₹ 20,000 as capital.

(vi) The new partner is to receive an annual salary of ₹ 12,000 in addition to his share of profit. R personally guaranteed that the aggregate of salary and share of profit of the new partner shall not be less than ₹ 25,000 p.a.
The draft accounts for the year ending March 31, 2015 showed a profit of ₹ 1,32,800 before taking into account the salary of S.

Show the Journal entries (including cash entries) passed at the time of admission of the partner and also the distribution of the net profit for the year ending March 31, 2015 between the partners.

Solution **In the books of P, Q and R**

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2014	Bank A/c	Dr.	22,275	
April 1	To Premium for Goodwill A/c (Note 1)			2,275
	To S Capital A/c			20,000
	(Being the capital and premium for goodwill brought in by X)			
	Premium for Goodwill A/c	Dr.	2,275	
	R Capital A/c	Dr.	4,551	
	To P Capital A/c			6,826
	(Being the appropriation of premium money)			

Statement Showing Distribution of Profit for the year ended 31st March, 2015

Particulars	P (₹)	Q (₹)	R (₹)	S (₹)
Salary	—	—	—	12,000
Balance (₹ 1,32,800 – ₹ 12,000) in the ratio 3 : 3 : 3 : 1	36,240	36,240	36,240	12,080
	36,240	36,240	36,240	24,080
Excess payable to S by R	—	—	(–) 920	(+) 920
Share of profit	36,240	36,240	35,320	25,000

Working Note :

(1) Calculation of the Value of the Goodwill and its adjustment : Average profit for the last three years is ₹ 36,500; Average profit for the last four years is ₹ 37,925; Goodwill is 60% of ₹ 37,925 = ₹ 22,755. Proportionate share of S on goodwill is ₹ 2,275.

Particulars	P (₹)	Q (₹)	R (₹)	S (₹)
Right of goodwill before admission (6 : 3 : 1)	13,653	6,827	2,275	—
Right of goodwill after admission (3 : 3 : 3 : 1)	6,827	6,827	6,826	2,275
Sacrifice (–) / Gain (+)	(–) 6,826	—	(+) 4,551	(+) 2,275

Illustration 78

Red, White and Blue are partners sharing profits as 4:3:2. For any change in partnership, goodwill is to be valued at 2.5 times the average profits for 4 years — but no Goodwill Account is to be raised. The profits are: 2011 — ₹ 50,000; 2012 — ₹ 60,000; 2013 — ₹ 56,000; 2014 — ₹ 86,000. On 31.12.2014, White and Blue acquire from Red an additional one-ninth share in the firm. On 1.1.2015, Red's son Pink is admitted. His share is to be 1/7th, of which a proportion calculated to produce ₹ 5,500 p.a. on the basis of the past profits, is ceded to him by his father; balance is to be purchased from White and Blue in proportion to their shares immediately prior to Pink's admission.

Show the present ratio and also pass Journal entries.

Solution **Calculation of Profit Sharing Ratio (Before Pink's Admission)**

Partners	Old ratio	Sacrifice/gain	New ratio
Red	4/9	(1/9 + 1/9) = 2/9 (sacrifice)	4/9 – 2/9 = 2/9
White	3/9	1/9 (gain)	3/9 + 1/9 = 4/9
Blue	2/9	1/9 (gain)	2/9 + 1/9 = 3/9

Average profits (50,000 + 60,000 + 56,000 + 86,000)/4 = ₹ 63,000; Value of goodwill = 63,000 x 2.5 = ₹ 1,57,500.

Adjustment for goodwill due to change in the profit sharing ratio

Particulars	Red (₹)	White (₹)	Blue (₹)
Right of goodwill before change (4 : 3 : 2)	70,000	52,500	35,000
Right of goodwill after change (2 : 4 : 3)	35,000	70,000	52,500
Sacrifice (–) / Gain (+)	(–) 35,000	(+) 17,500	(+) 17,500

Journal Dr. Cr.

Date	Particulars		₹	₹
	White Capital A/c	Dr.	17,500	
	Blue Capital A/c	Dr.	17,500	
	To Red Capital A/c			35,000
	(Being adjustment for change in the profit-sharing ratio)			

Proportion that can produce ₹ 5,500 p.a. = 5,500 /63,000 = 11/126.

Pink's total share = 1/7; his father providing 11/126, so remaining (1/7 – 11/126) = 7/126 are to be purchased from White and Blue in the ratio 4:3. White will sell = 7/126 x 4/7 = 4/126; Blue will sell = 7/126 x 3/7 = 3/126.

Calculation of Profit Sharing Ratio (After Pink's Admission)

Partners	Old ratio	Sacrifice/gain	New ratio
Red	2/9	11/126 (sacrifice)	2/9 – 11/126 = 17/126
White	4/9	4/126 (sacrifice)	4/9 – 4/126 = 52/126
Blue	3/9	3/126 (sacrifice)	3/9 – 3/126 = 39/126
Pink	Nil	1/7 or 18/126 (gain)	= 18/126

Adjustment for goodwill on Pink's Admission

	Red (₹)	White (₹)	Blue (₹)	Pink (₹)
Right of goodwill before admission (2 : 4 : 3)	35,000	70,000	52,500	—
Right of goodwill after admission (17 : 52 : 39 : 18)	21,250	65,000	48,750	22,500
Sacrifice (–) / Gain (+)	(–) 13,750	(–) 5,000	(–) 3,750	(+) 22,500

Journal Dr. Cr.

Date	Particulars		₹	₹
	Pink Capital A/c ₹ (22,500 – 13,750)	Dr.	8,750	
	To White Capital A/c			5,000
	To Blue Capital A/c			3,750
	(Being adjustment for goodwill on Pink's admission)			

No entry is required for the amount ceded by Red ₹ 13,750.

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

All the partners may decide that the revised values of assets and liabilities should not be shown in the Balance Sheet to avoid ***departure from historical cost.*** In this case, a Memorandum Revaluation Account is opened. Any increase in the value of assets (and/or decrease in the liabilities) is credited to Memorandum Revaluation Account. Similarly, any decrease in the value of assets (and/or increase in the liabilities) is debited to Memorandum Revaluation Account. If the credit side of the Memorandum Revaluation Account is more than the debit side, there is a profit. This profit should be transferred to Old Partners' Capital Accounts in the old profit-sharing ratio. The Journal entry will be:

Memorandum Revaluation Account Dr.
　　To Old Partners' Capital Accounts

If the debit side of the Memorandum Revaluation Account is more than the credit side, there is a loss which is transferred to Old Partners' Capital Accounts in the old profit-sharing ratio. The journal entry will be:

Old Partners' Capital Accounts Dr.
　　To Memorandum Revaluation Account

After completing the above procedure, reverse entries are made for increase in the values of assets and/or decrease in the liabilities, and decrease in the values of assets and/or increase in the liabilities) in the lower portion of the Memorandum Revaluation Account. The profit on revaluation is to be transferred to all Partners' Capital Accounts in the ***new profit-sharing ratio***.

The Journal entry will be :

Memorandum Revaluation Account Dr.
 To All Partners' Capital Accounts (New ratio)

The loss on revaluation should be transferred to all partners' Capital Accounts in the new profit-sharing ratio. The Journal entry will be:

All Partners' Capital Accounts Dr. (New ratio)
 To Memorandum Revaluation Account

It should be noted that if there is a profit in the upper portion of the Memorandum Revaluation Account, the lower protion of the Memorandum Revaluation Account must show a loss. Conversely, if the upper portion of the Memorandum Revaluation Account shows a loss, the lower portion of the Memorandum Revaluation Account must show a profit.

It should be noted that when a Memorandum Revaluation Account is prepared, the book values of assets and liabilities do not change — they remain at their historical cost to the partnership. In effect, the resultant profit or loss on revaluation is adjusted through the Partners' Capital Accounts. In this way, the amount invested as a capital by the incoming partner may be set at a level that reflects the current fair value of the partnership, even though the book values of assets and liabilities of the existing partnership remain unchanged in the books of accounts.

Illustration 79

A and B are partners sharing profits and losses in the ratio of 3 : 2. Their Balance Sheet as at 31.3.2015 is given below:

Liabilities	₹	Assets	₹
Creditors	30,000	Freehold premises	2,00,000
Bills Payable	20,000	Plant	40,000
Capital A/c		Furniture	20,000
A	2,00,000	Office equipment	25,000
B	1,00,000	Stock	30,000
		Debtors	25,000
		Bank	10,000
	3,50,000		3,50,000

On 1.4.2015 they admit C on the following terms: (1) C will bring ₹ 50,000 as capital and ₹ 10,000 for goodwill for 1/5 share; (2) Provision for doubtful debts is to be made on debtors @ 2%; (3) Stock to be written down by 10%; (4) Freehold premises is to be revalued at ₹ 2,40,000, plant at ₹ 35,000, furniture ₹ 25,000 and office equipment ₹ 27,500; (5) Partners agreed that the values of the assets and liabilities remain the same and, as such, there should not be any change in their book values as a result of the above-mentioned adjustments. You are required to make necessary adjustment in the Capital Accounts of the partners and show the Balance Sheet of the New Firm.

Solution

Dr. Memorandum Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Provision for Doubtful Debts A/c	500	By Freehold premises A/c	40,000
To Stock A/c	3,000	By Furniture A/c	5,000
To Plant A/c	5,000	By Office equipment A/c	2,500
To Profit on Revaluation A/c			
A Capital — 3/5	23,400		
B Capital — 2/5	15,600		
	47,500		47,500
To Freehold premises A/c	40,000	By Provision for Doubtful Debts A/c	500
To Furniture A/c	5,000	By Stock A/c	3,000
To Office equipment A/c	2,500	By Plant A/c	5,000
		By Loss on Revaluation A/c	
		A Capital — 12/25	18,720
		B Capital — 8/25	12,480
		C Capital — 5/25	7,800
	47,500		47,500

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

Particulars	A	B	C	Particulars	A	B	C
To Loss on revaluation A/c	18,720	12,480	7,800	By Balance b/d	2,00,000	1,00,000	—
To Balance c/d	2,10,680	1,07,120	42,200	By Bank A/c	—	—	50,000
				By Premium for Goodwill A/c	6,000	4,000	—
				By Profit on revaluation A/c	23,400	15,600	—
	2,29,400	1,19,600	50,000		2,29,400	1,19,600	50,000

Balance Sheet as at 1st April, 2015

Liabilities	₹	Assets	₹
Creditors	30,000	Freehold premises	2,00,000
Bills Payable	20,000	Plant	40,000
Capital A/c		Furniture	20,000
A	2,10,680	Office equipment	25,000
B	1,07,120	Stock	30,000
C	42,200	Debtors	25,000
		Bank (₹ 10,000 + ₹ 50,000 + ₹ 10,000)	70,000
	4,10,000		4,10,000

Illustration 80

The Balance Sheet of A, B and C, who share profits and losses as 3 : 2 : 1 respectively, as on 1.4.2015 is as follows :

Liabilities		₹	Assets		₹
Capital Accounts :	A	90,000	Building		80,000
	B	80,000	Machinery		70,000
	C	70,000	Debtors	40,000	
Current Accounts :	A	12,000	Less: Provision for Doubtful Debts	2,000	38,000
	B	8,000	Stock		1,05,000
Creditors		60,000	Cash		22,000
			Current Account : C		5,000
		3,20,000			3,20,000

D is admitted as a partner on the above date for 1/5th share in the profit and loss. Following are agreed upon :

(1) The profit and loss sharing ratio among the old partners will be equal.

(2) D brings in ₹ 75,000 as capital but is unable to bring in the required amount of premium for goodwill.

(3) An appropriate valuation of goodwill is to be made under the said circumstances based on all partners' capitals.

(4) Assets and liabilities are to be revealed as follows —
Building ₹ 1,03,000; Machinery ₹ 64,000; Provision for doubtful debts @ 10% on Debtors.

(5) Necessary adjustments regarding goodwill and profit or loss on revaluation are to be made through the Partners' Current Accounts.

(6) Except cash, the values of assets and liabilities are not to be altered in the Balance Sheet of the new firm.

(7) Capital Accounts of the old partners in the new firm should be proportionate to the new profit and loss sharing ratio — taking D's capital as base. The existing partners will not bring in any further capital. The necessary adjustments are to be made through the Partners' Current Accounts.

Prepare a Memorandum Revaluation Account, Partners' Capital and Current Accounts, and the Balance Sheet of the new firm after admission.

Solution **In the books of the Firm**

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

Particulars	₹	Particulars	₹
To Machinery A/c	6,000	By Building A/c	23,000
To Provision for Doubtful Debts A/c	2,000		
To Partners' Current A/cs :			
(A—₹ 7,500; B—₹ 5,000; C—₹ 2,500)	15,000		
	23,000		23,000
To Building A/c	23,000	By Machinery A/c	6,000
		By Provision for Doubtful Debts A/c	2,000
		By Partners' Current A/cs	
		(A—₹ 4,000; B—₹ 4,000; C—₹ 4,000; D—₹ 3,000))	15,000
	23,000		23,000

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

Particulars	A	B	C	D	Particulars	A	B	C	D
To Balance c/d (Note 1)	1,00,000	1,00,000	1,00,000	75,000	By Balance b/d	90,000	80,000	70,000	—
					By Bank A/c	—	—	—	75,000
					By Partners' Current A/cs (Balancing figure)	10,000	20,000	30,000	—
	1,00,000	1,00,000	1,00,000	75,000		1,00,000	1,00,000	1,00,000	75,000

Dr. **Partners' Current Accounts** **Cr.**

Particulars	A	B	C	D	Particulars	A	B	C	D
To Balance b/d	—	—	5,000	—	By Balance b/d	12,000	8,000	—	—
To Memorandum Revaluation A/c	4,000	4,000	4,000	3,000	By Memorandum Revaluation A/c	7,500	5,000	2,500	—
To Goodwill A/c (Note 2)	8,000	8,000	8,000	6,000	By Goodwill A/c (Note 2)	15,000	10,000	5,000	—
To Partners' Capital A/cs	10,000	20,000	30,000	—	By Balance c/d	—	9,000	39,500	9,000
To Balance c/d	12,500	—	—	—					
	34,500	32,000	47,000	9,000		34,500	32,000	47,000	9,000

Balance Sheet after D's Admission

Liabilities			₹	Assets		₹
Capital Accounts :	A	1,00,000		Building		80,000
	B	1,00,000		Machinery		70,000
	C	1,00,000		Stock		1,05,000
	D	75,000	3,75,000	Debtors	40,000	
Current Accounts :	A		12,500	Less: Provision for Doubtful Debts	2,000	38,000
Creditors			60,000	Cash ₹ (22,000 + 75,000)		97,000
				Current Accounts : B		9,000
				C		39,500
				D		9,000
			4,47,500			4,47,500

Working Notes :

(1) D joins the business for 1/5th share and brings in ₹ 75,000 as capital. Therefore, the total capital of the new firm will be ₹ 3,75,000 (₹ 75,000 × 5/1). The total capital of A, B and C will be ₹ 3,00,000 (₹ 3,75,000 – ₹ 75,000), which will be shared by them equally, i.e., ₹ 1,00,000 each.

(2) The total capital of A, B and C before the admission of D is ₹ 2,55,000 (₹ 90,000 + ₹ 80,000 + ₹ 70,000 + ₹ 12,000 + ₹ 8,000 – ₹ 5,000) plus the revaluation profit of ₹ 15,000, i.e., ₹ 2,70,000. But the capitals of A, B and C, after the admission of D, will be ₹ 3,00,000, without the existing partners bringing in any further capital. Therefore, the difference ₹ 30,000 (₹ 3,00,000 – ₹ 2,70,000) represents goodwill.

4. Reserve and Accumulated Profits / Losses

At the time of admission of a new partner any undrawn profit or retained earning and accumulated loss should be transferred to the Capital Accounts of the old partners in the ***old profit-sharing ratio***.

The Journal entry will be:

(i) Profit and Loss Account Dr.
General Reserve Account Dr.
Other Retained Earnings Account Dr.
To Old Partners' Capital Accounts [Old ratio]

If there is any accumulated loss, it should be transferred to the Old Partners' Capital/Current Accounts by passing the following entry:

Old Partners' Capital Accounts Dr. [Old ratio]
To Profit and Loss Account

All partners may decide that the reserve to be shown in the books of the new firm at its orginal figure.

Under this situation, Reserve is written-off first by debiting Reserve Account and crediting Old Partners' Capital Accounts in the old profit sharing ratio, then Reserve is raised in the books at its original value (or agreed value) by debiting All Partners' Capital Accounts in new profit sharing ratio and crediting the Reserve Account.

(i) General Reserve Account Dr.
To Old Partners' Capital Accounts [Old ratio]
(Being general reserve transferred to Old Partners' Capital Accounts in the old ratio).
(ii) All Partners' Capital Accounts Dr. [New Ratio]
To General Reserve Account [Agreed value]
(Being general reserve brought back in the books of account by debiting all partners in the new ratio)

Students must pass necessary entries for reserve and surplus or accumulated losses even if the question is silent on that point.

Illustration 81

A, B and C were Partners in a firm sharing profits and losses in the ratio 3:2:1 respectively. Following is their Balance Sheet as on 31.12.2014:

Liabilities	₹	Assets	₹
Capital — A	30,000	Land and Building	50,000
Capital — B	20,000	Furniture	15,000
Capital — C	10,000	Stock	20,000
Reserve	29,800	Bills Receivable	5,000
Creditors	6,200	Debtors	7,500
Bills Payable	4,000	Cash at bank	2,500
	1,00,000		1,00,000

D is to be admitted as a partner w.e.f. 1.1.2015 on the following terms :

(a) D will bring in ₹ 15,000 as capital and ₹ 12,000 as premium for goodwill. Half of the premium will be withdrawn by the partners; (b) D will be entitled to 1/6th share in the profits of the firm; (c) The assets, will be revalued as: Land and building ₹ 56,000; Furniture ₹ 12,000; Stock ₹ 16,000; Debtors ₹ 7,000; (d) The claim of a creditor for ₹ 2,300 is paid at ₹ 2,000; and (e) Half of the Reserve to be withdrawn by the partners. Prepare necessary Ledger Accounts and the opening Balance Sheet of the new firm.

Solution

Dr. Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Furniture A/c	3,000	By Land and Building A/c	6,000
To Stock A/c	4,000	By Creditors A/c — Discount	300
To Debtors A/c	500	By Partners' Capital A/cs	
		(A — ₹ 600; B — ₹ 400; C — ₹ 200)	1,200
	7,500		7,500

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	D	Particulars	A	B	C	D
To Revaluation A/c	600	400	200	—	By Balance b/d	30,000	20,000	10,000	—
To Bank A/c – reserve	7,450	4,967	2,483	—	By Reserve A/c	14,900	9,934	4,966	—
To Bank A/c – premium	3,000	2,000	1,000	—	By Premium for Goodwill A/c	6,000	4,000	2,000	—
To Balance c/d	39,850	26,567	13,283	15,000	By Bank A/c	—	—	—	15,000
	50,900	33,934	16,966	15,000		50,900	33,934	16,966	15,000

Dr. Bank Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	2,500	By Partners' Capital A/cs — Premium	6,000
To Premium for Goodwill A/c	12,000	By Partners' Capital A/cs — Reserve	14,900
To D Capital A/c	15,000	By Creditors A/c	2,000
		By Balance c/d	6,600
	29,500		29,500

Balance Sheet as at 1st January, 2015

Liabilities	₹	Assets	₹
Capital — A	39,850	Land and Building	56,000
Capital — B	26,567	Furniture	12,000

Capital — C	13,283	Stock	16,000
Capital — D	15,000	Bills Receivable	5,000
Creditors (₹ 6,200 – ₹ 2,300)	3,900	Debtors	7,000
Bills Payable	4,000	Cash at Bank	6,600
	1,02,600		1,02,600

5. Adjustment of Capital

When a new partner is admitted into the partnership, he is to bring in capital.

The amount of capital to be brought in by the new partner will depend upon the agreement between the partners. In some cases, the capital of the new partner is determined on the basis of the adjusted combined capital of the old partners.

Sometimes after admission of a new partner, all the partners may decide to make their capitals proportionate to the profit sharing ratio or other ratios. In that case, old partners' capitals will be changed. Some partners will bring in new capital to make up deficit of his capital and others will withdraw their excess capital.

Adjustments under different situations are shown below :

Case 1 : When the new partner will bring proportionate capital of the firm

For calculating the capital to be brought in by the new partner, the following steps are to be followed:

Step 1. Calculate the adjusted combined capital of the old partners as follows :

Opening combined capital	****
Add : Goodwill to be adjusted	****
Add : Revaluation profit	****
Add : Reserve and surplus of the old partners	****
	****
Less : Revaluation loss	****
Less : Profit and Loss Account (Debit balance)	****
Adjusted combined capital of old partners	****

Step 2. Calculate the combined share of profit of the old partners after deducting the share of new partner.

Step 3. Calculate the total capital of the firm based on adjusted combined capital as calculated in Step 1 above.

Step 4. Calculate the capital of the new partner based on total capital of the firm as calculated in Step 3.

Case 2 : When the old partners' capital to be fixed on the basis of the capital of the new partner

For calculating the revised capital of the old partners in the new partnership, the following steps are to be followed :

Step 1 : Calculate total capital of the firm with the help of the following formula :

$$\text{Total capital of the firm} = \frac{\text{Capital of the new partner}}{\text{Share of profit of the new partner}}$$

Step 2 : Calculate the proportionate capital of the old partners on the basis of the new profit sharing ratio.

Step 3 : Ascertain the present capital of the old partners (after all adjustments)

Step 4 : Find out the surplus capital / deficit capital by comparing proportionate capital (ascertained in Step 2) and present capital (ascertained in Step 3).

Surplus occurs when Present capital is greater than Proportionate capital

Deficit occurs when Present capital is less than Proportionate capital

Step 5 : Pass necessary journal entry for adjusting the above surplus / deficit.

It should be noted that surplus capital is transferred to Current Account or it may be withdrawn by the old partners as per agreement between the partners. Similarly, the deficit capital is brought in by the old partner or it is transferred to Current Accounts of the old partner.

Illustration 82

The following is the Balance Sheet of A and B as at March 31, 2015. C is admitted as a partner on that date when the position of A and B was as under :

Liabilities	₹	Assets	₹
A's Capital	10,000	Debtors	11,000
B's Capital	8,000	Land and Building	8,000
Creditors	12,000	Plant and Machinery	10,000
General Reserve	16,000	Stock of Goods	12,000
Workmen's Compensation Fund	4,000	Cash and Bank Balance	9,000
	50,000		50,000

A and B shared profits in the proportion of 3 : 2. The following terms of admission are agreed upon :

(a) Revaluaton of Assets : Land and Buildings ₹ 18,000 and Stock of Goods ₹ 16,000.

(b) The liability on Workmen's Compensation Fund is determined at ₹ 2,000.

(c) C brought in as his share of goodswill ₹ 10,000 in cash.

(d) C was to bring further cash as would make his capital equal to 20% of the combined capitals of partners A and B after above revaluation and adjustments are carried out.

(e) the future profit sharing proportions are : A — 2/5th; B — 2/5th; and C — 1/5th.

Prepare the new Balance Sheet of the firm and the Capital Accounts of the Partners.

Solution

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

Particulars	A	B	C	Particulars	A	B	C
To Balance c/d	39,200	20,800	12,000	By Balance b/d	10,000	8,000	—
				By Premium for Goodwill (Note 2)	10,000	—	—
				By General Reserve	9,600	6,400	—
				By Workmen's C. Fund	1,200	800	—
				By Revaluation A/c (Note 2)	8,400	5,600	—
				By Bank (Note 1)	—	—	12,000
	39,200	20,800	12,000		39,200	20,800	12,000

Balance Sheet as at 31st March, 2015

Liabilities	₹	Assets	₹
Partners' Capital A/cs : A	39,200	Land and Building	18,000
B	20,800	Plant and Machinery	10,000
C	12,000	Stock of Goods	16,000
Creditors	12,000	Debtors	11,000
Workmen's Compensation Fund	2,000	Cash and Bank (Note 4)	31,000
	86,000		86,000

Working Notes :

	₹
(1) Opening combined capital ₹ (10,000 + 8,000)	18,000
Add: Goodwill premium	10,000
Revaluation profit ₹ (10,000 + 4,000)	14,000
General reserve	16,000
Workmen's compensation fund ₹ (4,000 – 2,000)	2,000
Adjusted combined capital of A and B	60,000

(2) Revaluation Account

Particulars	₹	Particulars	₹
To Partners' Capital A/cs		By Land and Building A/c	10,000
A (3/5)	8,400	By Stock of Goods A/c	4,000
B (2/5)	5,600		
	14,000		14,000

(3) Adjustment of Premium for Goodwill

Particulars	A (₹)	B (₹)	C (₹)
Right of goodwill before admission (3 : 2)	30,000	20,000	—
Right of goodwill after admission (2 : 2 : 1)	20,000	20,000	10,000
Sacrifice (–) / Gain (+)	(–)10,000	Nil	(+) 10,000

Total value of goodwill = ₹ 10,000 × 5/1 = ₹ **50,000**.

(4) Cash at Bank = ₹ 9,000 + 10,000 + 12,000 = ₹ **31,000**.

Illustration 83

A, B and C are partners sharing profits and losses in the ratio of 2 : 3 : 5. On 31st May, 2015, their Balance Sheet was as follows :

Liabilities			₹	Assets	₹
Capitals :	A	36,000		Cash	18,000
	B	44,000		Bills Receivable	24,000
	C	52,000	1,32,000	Furniture	28,000
Creditors			64,000	Stock	44,000
Bills Payable			32,000	Debtors	42,000
Profit and Loss Account			14,000	Investments	32,000
				Machinery	34,000
				Building	20,000
			2,42,000		2,42,000

They admit D into partnership on the following terms :

(1) Furniture, investments and machinery to be depreciated by 15%

(2) Stock is revalued at ₹ 48,000.

(3) Building to be valued at ₹ 26,000.

(4) Outstanding rent amounted to ₹ 1,800.

(5) Prepaid salaries ₹ 800.

(6) D to bring ₹ 32,000 towards capital for 1/6th share and other partners to re-adjust their Capital Accounts on the basis of their profit sharing ratio.

(7) Adjustments of capitals to be made by cash.

Prepare Revaluation Account, Partners' Capital Accounts, Cash Account and Balance Sheet of the new firm.

Solution

In the books of the Firm

Dr. Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Furniture A/c (15% of ₹ 28,000)	4,200	By Stock A/c (₹ 48,000 – 44,000)	4,000
To Investments A/c (15% of ₹ 32,000)	4,800	By Prepaid Salaries A/c	800
To Machinery A/c (15% of ₹ 34,000)	5,100	By Building A/c	6,000
To Outstanding Rent A/c	1,800	By Partners' Capital A/cs :	
		A	1,020
		B	1,530
		C	2,550
	15,900		15,900

Dr. Partners' Capital Accounts Cr.

Particulars	A (₹)	B (₹)	C (₹)	D (₹)	Particulars	A (₹)	B (₹)	C (₹)	D (₹)
To Revaluation A/c	1,020	1,530	2,550	—	By Balance b/d	36,000	44,000	52,000	—
To Cash A/c (Note 2)	5,780	—	—	—	By Profit & Loss A/c	2,800	4,200	7,000	—
To Balance c/d	32,000	48,000	80,000	32,000	By Cash A/c	—	—	—	32,000
(Note 2)					By Cash A/c (Note 2)	—	1,330	23,550	—
	38,800	49,530	82,550	32,000		38,800	49,530	82,550	32,000

Dr. Cash Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	18,000	By A Capital A/c	5,780
To D Capital A/c	32,000	By Balance c/d	69,100
To B Capital A/c	1,330		
To C Capital A/c	23,550		
	74,880		74,880

Balance Sheet of A, B, C and D as at 1st June, 2015

Liabilities			₹	Assets	₹
Capitals :	A	32,000		Building	26,000
	B	48,000		Machinery	28,900
	C	80,000		Furniture	23,800
	D	32,000	1,92,000	Investments	27,200
Creditors			64,000	Stock	48,000
Outstanding Rent			1,800	Debtors	42,000
Bills Payable			32,000	Bills Receivable	24,000
				Cash	69,100
				Prepaid Salaries	800
			2,89,800		2,89,800

Working Notes :

(1) Calculation of New Profit Sharing Ratio

D joins the firm for 1/6th share of profit. Therefore, 1 – 1/6 = 5/6th will be shared by A, B and C in the ratio of 2 : 3 : 5.

So, A's share of profit = 2/10 of 5/6 = 10/60

B's share of profit = 3/10 of 5/6 = 15/60

C's share of profit = 5/10 of 5/6 = 25/60

D's share of profit = 1/6 or 10/60

The new profit sharing ratio = A : B : C : D = 10 : 15 : 25 : 10 = 2 : 3 : 5 : 2

(2) Calculation of Amount of Capital to be Withdrawn / Introduced

Step 1 : Calculation of total capital of the new firm

$$\text{Total capital of the firm} = \frac{\text{Capital of the new partner}}{\text{Share of profit of the new partner}}$$

= ₹ 32,000 × 6/1 = ₹ 1,92,000

Step 2 : Calculation of proportionate capital of the old partners on the basis of the new profit sharing ratio

A's capital = ₹ 1,92,000 × 2/12 = ₹ 32,000;

B's capital = ₹ 1,92,000 × 3/12 = ₹ 48,000;

C's capital = ₹ 1,92,000 × 5/12 = ₹ 80,000.

Step 3 : Present capital of the old partners

A : ₹ (36,000 + 2,800 + 1,200 – 2,220) = ₹ 37,780; B : ₹ (44,000 + 4,200 + 1,800 – 3,330) = ₹ 46,670; C : ₹ (52,000 + 7,000 + 3,000 – 5,550) = ₹ 56,450.

Step 4 : Ascertainment of Capital to be Withdrawn or Brought in

Particulars	A (₹)	B (₹)	C (₹)
Required new capital (see Step 2)	32,000	48,000	80,000
Present capital (see Step 3)	37,780	46,670	56,450
Withdrawn (–) / Brought in (+)	(–) 5,780	(+)1,330	(+)23,550

Illustration 84

A and B share profits and losses as 3 : 1. Their Balance Sheet as on 30th June 2015 is as under:

Liabilities	₹	Assets		₹
A Capital	60,000	Land and Building		50,000
B Capital	32,000	Furniture		2,000
Creditors	75,000	Debtors	33,000	
General reserve	8,000	Less: Provision for doubtful debts	1,000	32,000
		Bills Receivable		6,000
		Stock in trade		40,000
		Cash at bank		45,000
	1,75,000			1,75,000

C is admitted on 1.7.2015 on the following terms:

(1) C to bring in ₹ 20,000 as his capital and to be entitled to a fifth share in the profits.

(2) Goodwill valued at ₹ 50,000. C was to bring half of his share of goodwill in cash and other half was to be purchased by him from the existing partners by book adjustment. The necessary amount was debited to C's current account. No Goodwill Account was to be raised in the books.

(3) The value of stock and furniture was to be reduced by 10% and the reserve for doubtful debts was to be brought to 10% of debtors.

(4) Value of land and building was to be increased by 15%.

(5) The capitals of partners in the new firm are to be in the profit sharing ratio — the capital of C being taken as the basic capital. The excess amount of capital, if any, to be paid-off in cash.

You are required to prepare Journal entries, Capital Accounts of the partners and the new Balance Sheet.

Solution

Working Notes : C is coming for 1/5th share. Therefore, 4/5th remains for A and B which will be shared in the ratio of 3 : 1. A will get 3/4 of 4/5 = 3/5; B will get 1/4 of 4/5 = 1/5 and C 1/5. Now, the capital brought in by C is ₹ 20,000 for 1/5th share. The total capital of the firm will be 5/1 x 20,000 = ₹ 1,00,000.

A = 3/5 of 1,00,000 = ₹ 60,000; B = 1/5 of 1,00,000 = ₹ 20,000; and C = ₹ 20,000.

In the books of A, B and C
Journal

Date	Particulars		Dr. ₹	Cr. ₹
2015 July 1	Bank A/c	Dr.	25,000	
	To C Capital A/c			20,000
	To Premium for Goodwill A/c			5,000
	(Being the amount of capital and 50% of the premium for goodwill brought in by C)			
	Premium for Goodwill A/c	Dr.	5,000	
	To A Capital A/c			3,750
	To B Capital A/c			1,250
	(Being the premium for goodwill credited to the old partners on the basis of their sacrifice)			
	C Current A/c	Dr.	5,000	
	To A Capital A/c			3,750
	To B Capital A/c			1,250
	(Being the adjustment through the current account of C for non-payment of 50% of the premium for goodwill)			
	General Reserve A/c	Dr.	8,000	
	To A Capital A/c			6,000
	To B Capital A/c			2,000
	(Being the general reserve credited to the old partners in the old profit sharing ratio)			
	Revaluation A/c	Dr.	6,500	
	To Stock A/c			4,000
	To Furniture A/c			200
	To Provision for Doubtful Debts A/c			2,300
	(Being the decrease in the value of the above assets and also creation of provision for doubtful debts)			
	Land and Building A/c	Dr.	7,500	
	To Revaluation A/c			7,500
	(Being the increase in the value of land and building)			
	Revaluation A/c	Dr.	1,000	
	To A Capital A/c			750
	To B Capital A/c			250
	(Being the profit on revaluation credited to old partners)			
	A Capital A/c	Dr.	14,250	
	B Capital A/c	Dr.	16,750	
	To Bank A/c			31,000
	(Being excess money withdrawn by the partners to make their capital in the ratio of the new partner)			

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

Particulars	A	B	C	Particulars	A	B	C
To Bank A/c	14,250	16,750	—	By Balance b/d	60,000	32,000	—
To Balance c/d	60,000	20,000	20,000	By Bank A/c	—	—	20,000
				By Premium for Goodwill A/c	3,750	1,250	—
				By C Current A/c	3,750	1,250	—
				By Revaluation A/c	750	250	—
				By General Reserve A/c	6,000	2,000	—
	74,250	36,750	20,000		74,250	36,750	20,000

Balance Sheet as at 1st July, 2015

Liabilities	₹	Assets		₹
A Capital	60,000	Land and Building		57,500
B Capital	20,000	Furniture		1,800
C Capital	20,000	Stock in trade		36,000
Creditors	75,000	Debtors	33,000	
		Less: Provision for doubtful debts	3,300	29,700
		Bills Receivable		6,000
		Cash at bank		39,000
		C Current A/c		5,000
	1,75,000			1,75,000

Illustration 85

A and B are in partnership sharing profits and losses in the proportion of three-fourth and one-fourth respectively. Their Balance Sheet on 31st March, 2015 was as follows: Cash ₹ 1,000; Sundry Debtors ₹ 25,000; Stock ₹ 22,000; Plant and Machinery ₹ 4,000; Sundry Creditors ₹ 12,000; Bank Overdraft ₹ 15,000; A's Capital ₹ 15,000; B's Capital ₹ 10,000. On 1st April 2015, they admitted C into partnership on the following terms :

(a) C is to purchase one-third of the Goodwill for ₹ 2,000 and provide ₹ 10,000 as Capital. Goodwill not to appear in the books.

(b) Future profits and losses are to be shared by A, B and C equally.

(c) Plant and machinery is to be reduced by 10% and ₹ 500 is to be provided for estimated bad debts. Stock is to be taken at a valuation of ₹ 24,940.

(d) By bringing in or withdrawing cash, the capitals of A and B are to be made proportionate to that of C on their profit sharing basis.

Set out entires to the above arrangements in the firm's journal, give the Partners' Capital Accounts in the tabular form and submit the opening Balance Sheet of the new firm.

Solution

In the books of the firm

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

Date	Particulars		₹	₹
2015 April 1	Cash A/c	Dr.	12,000	
	To Premium for Goodwill A/c			2,000
	To C Capital A/c			10,000
	(Being the premium for goodwill and capital brought in by C)			
	Premium for Goodwill A/c	Dr.	2,000	
	B Capital A/c (Note 1)	Dr.	500	
	To A Capital A/c			2,500
	(Being the adjustment in regard to the premium for goodwill)			
	Revaluation A/c	Dr.	900	
	To Plant and Machinery A/c			400
	To Provision for Bad Debts A/c			500
	(Being the downward revaluation of Plant and Machinery and a creation of provision of bad debts)			
	Stock A/c	Dr.	2,940	
	To Revaluation A/c			2,940
	(Being the upward revaluation of stock)			
	Revaluation A/c (₹ 2,940 – ₹ 900)	Dr.	2,040	
	To A Capital A/c			1,530
	To B Capital A/c			510
	(Being the profit on revaluation transferred to old Partners' Capital Accounts in the old profit sharing ratio)			
	A Capital A/c	Dr.	9,030	
	B Capital A/c	Dr.	10	
	To Cash A/c			9,040
	(Being the excess capital withdrawn)			

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

Particulars	A	B	C	Particulars	A	B	C
To A Capital A/c (Goodwill)	—	500	—	By Balance b/d	15,000	10,000	—
To Cash A/c (Balancing figure)	9,030	10	—	By Premium for Goodwill A/c	2,000	—	—
To Balance c/d	10,000	10,000	10,000	By B Capital A/c (Goodwill)	500	—	—
				By Revaluation A/c	1,530	510	—
				By Cash A/c	—	—	10,000
	19,030	10,510	10,000		19,030	10,510	10,000

Balance Sheet (after C's admission) as at 1st April, 2015

Liabilities		₹	Assets		₹
Capital Accounts :	A	10,000	Plant and Machinery (₹ 4,000 – ₹ 400)		3,600
	B	10,000	Stock		24,940
	C	10,000	Sundry Debtors	25,000	
Sundry Creditors		12,000	Less : Provision for Bad Debts	500	24,500
Bank Overdraft		15,000	Cash (₹ 1,000 + 12,000 – 9,030 – 10)		3,960
		57,000			57,000

Working Note :

(1) Adjustment of Premium for Goodwill

C brings in ₹ 2,000 as premium for goodwill. Therefore, the value of the goodwill is ₹ 2,000 x 3/1 = ₹ 6,000.

Particulars	A (₹)	B (₹)	C (₹)
Right of goodwill before admission (3 : 1)	4,500	1,500	—
Right of goodwill after admission (1 : 1 : 1)	2,000	2,000	2,000
Sacrifice (–) / Gain (+)	(–) 2,500	(+) 500	(+) 2,000

Illustration 86

A and B are partners sharing profits and losses equally. Their Balance Sheet as on 31.12.2013 was as follows :

Liabilities		₹	Assets	₹
Capital Accounts	A	60,000	Premises	30,000
	B	70,000	Furniture	14,000
Creditors		30,000	Stock	74,000
			Debtors	24,000
			Bank	18,000
		1,60,000		1,60,000

On 1.1.2014, they decided to admit C as a partner on the following items :

(1) C should pay ₹ 60,000 as capital for being entitled to one-third share of profits. The remaining profits are to be shared by the old partners equally.

(2) Stock to be valued at ₹ 70,000 and premises to be taken at 95% of book value.

(3) After the conclusion of the first trading year, Goodwill is to valued at three times of the net profit of the year in excess of ₹ 30,100. Such goodwill should be divided between A and B in the ratio of their sacrifices in favour of C.

Transactions during the year ended 31.12.2014 were as follows : Purchases ₹ 5,30,000; Sales ₹ 6,00,000; Payments for purchases at 98% in full settlement at ₹ 4,80,200; Collection from debtors (after allowing 5% against a prompt payment of dues ₹ 40,000) ₹ 3,38,000; Sundry expenses ₹ 18,000; Administration expenses ₹ 60,000; Drawings of partners : A ₹ 5,000; B ₹ 4,000 and C ₹ 3,000.

On 31.12.2014, Stock was ₹ 1,20,000. Depreciation was to be provided on furniture ₹ 900. C contributed sufficient cash to make his capital proportionate to his share of profit after goodwill was calculated and given effect.

You are required to prepare : (a) The amended Balance Sheet of the firm on 1.1.2014; and (b) The Balance Sheet of the firm on 31.12.2014 after giving effect to the required adjustments.

Solution **Balance Sheet as on 1st January, 2014**

Liabilities		₹	Assets	₹
Capital (Note 3) :	A	57,250	Premises (95% of ₹ 30,000)	28,500
	B	67,250	Furniture	14,000
	C	60,000	Stock	70,000
Creditors		30,000	Debtors	24,000
			Bank ₹ (18,000 + 60,000)	78,000
		2,14,500		2,14,500

Balance Sheet as on 31st December, 2014

Liabilities		₹	Assets		₹
Capital (Note 3)	A	77,950	Premises		28,500
	B	88,950	Furniture	14,000	
	C	83,450	Less: Depreciation	900	13,100
Creditors (Note 5)		70,000	Stock		1,20,000
Bank Overdraft (Note 6)		1,25,250	Debtors (Note 4)		2,84,000
		4,45,600			4,45,600

Working Notes :

Dr. **(1) Trading and Profit and Loss Account for the year ended 31st December, 2014** **Cr.**

Particulars	₹	Particulars	₹
To Opening Stock	70,000	By Sales	6,00,000
To Purchases	5,30,000	By Closing Stock	1,20,000
To Gross Profit c/d	1,20,000		
	7,20,000		7,20,000

To Sundry Expenses	18,000	By Gross Profit b/d	1,20,000
To Administrative Expenses	60,000	By Discount Received (₹ 4,80,200/98 x 2)	9,800
To Discount Allowed (5% on ₹ 40,000)	2,000		
To Depreciation on Furniture	900		
To Share of Profit : (A — ₹ 16,300; B — ₹ 16,300; C — ₹ 16,300)	48,900		
	1,29,800		1,29,800

(2) Valuation of Goodwill : 3 times of the net profits of the year 2014 in excess of ₹ 30,100. Therefore, the value of the goodwill is 3 × ₹ (48,900 – 30,100) = ₹ 56,400.

Dr. **(3) Partners' Capital Accounts** **Cr.**

Date	Particulars	A	B	C	Date	Particulars	A	B	C
1.1.2014	To Revaluation A/c**	2,750	2,750	—	1.1.2014	By Balance b/d	60,000	70,000	—
	To Balance c/d	57,250	67,250	60,000		By Bank A/c	—	—	60,000
		60,000	70,000	60,000			60,000	70,000	60,000
31.12.2014	To Drawings A/c	5,000	4,000	3,000	1.1.2014	By Balance b/d	57,250	67,250	60,000
	To Goodwill A/c	18,800	18,800	18,800	31.12.2014	By Share of Profit A/c	16,300	16,300	16,300
	To Balance c/d	77,950	88,950	*83,450		By Goodwill A/c (Note 2)	28,200	28,200	—
						By Bank A/c (Bal. fig.)	—	—	28,950
		1,01,750	1,11,750	1,05,250			1,01,750	1,11,750	1,05,250

* 1/2 of ₹ (77,950 + 88,950) — combined capital of A and B after goodwill adjustment.

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

To Stock A/c	4,000	By Partners' Capital A/cs :	
To Premises A/c	1,500	A	2,750
		B	2,750
	5,500		5,500

Dr. **(4) Debtors Account** **Cr.**

To Balance b/d	24,000	By Bank A/c	3,38,000
To Sales A/c	6,00,000	By Discount Allowed A/c	2,000
		By Balance c/d	2,84,000
	6,24,000		6,24,000

Dr. **(5) Creditors Account** **Cr.**

To Bank A/c	4,80,200	By Balance b/d	30,000
To Discount Recd. A/c	9,800	By Purchases A/c	5,30,000
To Balance c/d	70,000		
	5,60,000		5,60,000

Dr. **(6) Bank Account** **Cr.**

To Balance b/d	78,000	By Creditors A/c	4,80,200
To Debtors A/c	3,38,000	By Sundry Exp. A/c	18,000
To C Capital A/c	28,950	By Adm. Exp. A/c	60,000
To Balance c/d	1,25,250	By Drawings A/c	12,000
	5,70,200		5,70,200

Illustration 87

A and B are partners sharing profits and losses in the ratio of 3 : 2. Their Balance Sheet stood as under on 1.1.2015 :

Liabilities		₹	Assets		₹
Capital Accounts	A	29,000	Buildings		35,000
	B	15,000	Machinery		19,000
Reserve		10,000	Furniture		5,000
Creditors		28,500	Stock		15,000
Outstanding Expenses		4,000	Debtors	9,400	
			Less: Provision for Bad Debts	400	9,000
			Prepaid Insurance		1,500
			Cash		2,000
		86,500			86,500

C is admitted as a new partner introducing a capital of ₹ 21,000. The capitals of the partners are to be adjusted in the new profit-sharing ratio, which is 5 : 3 : 2 — taking C's capital as base. C is to bring premium for goodwill in cash. Goodwill amount being calculated on the basis of C's share in the profits and capital contributed by him. Following revaluations are made : (i) Stock to be depreciated by 5%; (ii) Provision for bad debts is to be raised to ₹ 500; (iii) Furniture to be depreciated by 10%; (iv) Buildings are revalued at ₹ 41,350.

Prepare necessary Ledger Accounts and the Balance Sheet of the new firm.

Solution

In the books of the firm

Revaluation Account

Dr. Particulars	₹	Particulars	Cr. ₹
To Stock A/c	750	By Buildings A/c	6,350
To Provision for Bad Debts A/c	100		
To Furniture A/c	500		
To Partners' Capital A/cs — profit (A — ₹ 3,000; B — ₹ 2,000)	5,000		
	6,350		6,350

Partners' Capital Accounts

Dr. Date	Particulars	A	B	C	Date	Particulars	A	B	Cr. C
2015					2015				
Jan.1	To Balance c/d (Note 1)	52,500	31,500	21,000	Jan.1	By Balance b/d	29,000	15,000	—
						By Reserve A/c	6,000	4,000	—
						By Revaluation A/c	3,000	2,000	—
						By Cash A/c	—	—	21,000
						By Premium for Goodwill A/c (Note 1)	3,000	2,000	—
						By Cash A/c (Bal. Fig.)	11,500	8,500	—
		52,500	31,500	21,000			52,500	31,500	21,000

Balance Sheet of the New Firm as at 1st January, 2015

Liabilities			₹	Assets		₹
Capital Accounts :	A	52,500		Buildings		41,350
	B	31,500		Machinery		19,000
	C	21,000	1,05,000	Furniture		4,500
Creditors			28,500	Stock		14,250
Outstanding Expenses			4,000	Debtors	9,400	
				Less: Provision for Bad Debts	500	8,900
				Prepaid Insurance		1,500
				Cash ₹ (2,000 + 21,000 + 5,000 + 11,500 + 8,500)		48,000
			1,37,500			1,37,500

Working Note (1) : C is bringing in ₹ 21,000 for his 2/10th share in profit. Therefore, total capital of the firm will be ₹ 21,000 / 2 x 10 = ₹ 1,05,000.

A's capital = 5/10 x ₹ 1,05,000 = ₹ 52,500; B's capital = 3/10 x ₹ 1,05,000 = ₹ 31,500. Combined capital of A and B will be ₹ 84,000.

At present, combined capital of A and B after adjustment of Revaluation Profit and Reserve = ₹ (29,000 + 15,000 + 10,000 + 5,000) = ₹ 59,000.

Therefore, value of goodwill = ₹ (84,000 – 59,000) = ₹ 25,000.

C's share of goodwill = ₹ 25,000 / 10 × 2 = ₹ 5,000.

Illustration 88

Ranu and Mili are partners in a firm sharing profits and losses in the ratio of 2/3rd and 1/3rd.

The Balance Sheet of the firm on 31.12.2014 was as follows :

Liabilities			₹	Assets		₹
Creditors			7,000	Investments		25,000
Investment Provision			2,000	Stock		15,000
General Reserve			10,500	Debtors	20,000	
Workmen Compensation Fund			6,000	Less: Provision for bad debts	2,500	17,500
Capital Accounts :	Ranu	30,000		Bills Receivable		12,500
	Mili	24,500	54,500	Bank		10,000
			80,000			80,000

On the above date, Manisha is admitted for 2/5th share in the profits or losses of the firm. Following adjustments were made at the time of admission :

(a) Manisha is required to bring in ₹ 50,000 as capital.

(b) Her goodwill was calculated at ₹ 12,000.

(c) Ranu and Mili purchased a machinery on hire purchase system for ₹ 15,000 of which only ₹ 500 are to be paid. Both machinery and unpaid liability did not appear in the Balance Sheet.

(d) There was a joint life policy on the lives of Ranu and Mili for ₹ 75,000. Surrender value of the policy on the date of admission amounted to ₹ 12,000.
(e) Accrued incomes not appearing in the books were ₹ 500.
(f) Market value of investments is ₹ 22,500.
(g) Claim on account of compensation is estimated at ₹ 750.
(h) S, an old customer, whose account was written-off as bad, has promised to pay ₹ 1,750 in settlement of the full claim.
(i) Provision for bad debts is required at ₹ 3,000.

Prepare Revaluation Account, Partners' Capital Accounts and Opening Balance Sheet after the admission of Manisha.

Solution

In the books of the firm

Dr. Revaluation Account Cr.

Liabilities	₹	Assets	₹
To Investment Provision A/c (Note 1)	500	By Accrued Income A/c	500
To Provision for Bad Debts A/c	500	By Workmen Compensation Fund A/c (Note 2)	5,250
To Creditors A/c (hire purchase)	500	By Joint Life Policy A/c	12,000
To Partners' Capital A/cs — profit		By Machinery A/c	15,000
(Ranu — ₹ 20,833; Mili — ₹ 10,417)	31,250		
	32,750		32,750

Dr. Partners' Capital Accounts Cr.

Date	Particulars	Ranu	Mili	Manisha	Date	Particulars	Ranu	Mili	Manisha
	To Goodwill A/c	12,000	6,000	12,000		By Balance b/d	30,000	24,500	—
	To Balance c/d	65,833	42,417	38,000		By Revaluation A/c	20,833	10,417	—
						By General Reserve A/c	7,000	3,500	—
						By Goodwill A/c (Note 3)	20,000	10,000	—
						By Bank A/c	—	—	50,000
		77,833	48,417	50,000			77,833	48,417	50,000

Balance Sheet of the firm (after Manisha's admission)

Liabilities	₹	Assets		₹
Capital A/c		Machinery		15,000
Ranu	65,833	Investment		25,000
Mili	42,417	Stock		15,000
Manisha	38,000	Debtors	20,000	
Creditors	7,500	Less: Provision for bad debts	3,000	17,000
Investment Provision ₹ (2,000 + 500)	2,500	Bills Receivable		12,500
Workmen Compensation Fund ₹ (6,000 – 5,250)	750	Joint Life Policy		12,000
		Accrued Income		500
		Bank ₹ (10,000 + 50,000)		60,000
	1,57,000			1,57,000

Working Notes :

(1) Since there is a fall in the market value of investments of ₹ 2,500, investment provision is increased from ₹ 2,000 to ₹ 2,500.
(2) Workmen compensation fund is nothing but retained profit. Therefore, it is credited to Revaluation Account. Alternatively, it could have been credited to Partners' Capital Accounts in the old profit sharing ratio.
(3) Since Manisha is not paying the required amount of premium for goodwill. Therefore, ₹ 30,000 goodwill will be adjusted through the Capital Accounts of the partners.
(4) There will be no entry for the promise made by S, since it is an event and not a transaction.

Illustration 89

Taylor and Best were in partnership sharing profits and losses in the ratio 2/3 and 1/3 respectively. The partnership deed provided :

1. Interest @ 8% p.a. is to be allowed on fixed capital accounts. No interest is to be allowed on current accounts but 10% p.a. is to be charged on any debit balance at the commencement of the year.
2. Goodwill is to be valued at 1.5 times the average annual profits of the previous four or five years' whichever is lower.

The partners agreed to take Watson into partnership as on 1.1.2014 and he introduced ₹ 5,000 into the business. It was agreed that fixed capital of the business should be ₹ 20,000 contributed by the partners in their profit sharing ratio, any surplus or deficiency being transferred to their current accounts. Taylor was to be entitled to a prior share of the profits of ₹ 500 and the balance was to be shared — Taylor 2/5; Best 2/5 and Watson 1/5. In addition, it was agreed that Watson's share of the profits should not be less than ₹ 3,500 p.a.

Agreed profits for goodwill purposes of the past five years are as under:

2009 ₹ 10,420; 2010 ₹ 11,760; 2011 ₹ 9,400; 2012 ₹ 13,820; 2013 ₹ 14,600.

No account for goodwill is maintained in the books. Adjusting entries for the transactions between the partners being made in their current accounts.

Partners accounts as on 31.12.2013 were as follows:

Fixed Capital : Taylor 10,000; Best 6,000; **Current Account** : Taylor 3,400 (Cr.); Best 1,200 (Cr.).

The draft accounts for the year ended 31.12.2014 before taking into account interest on partners' accounts, show a profit of ₹ 16,400. Partners' drawings during the year are : Taylor ₹ 5,000; Best ₹ 2,500 and Watson ₹ 1,500.

You are required to prepare :

(a) a statement showing the division of profit for the year ended 31.12.2014; and

(b) the Partners' Current Accounts for the year ended 31.12.2014, recording therein the entries necessary upon Watson's admission as a partner.

Solution Statement showing Division of Profit for the year ended 31st December, 2014

Particulars	₹	₹
Profit before interest on capital and current account		16,400
Add: **Interest on debit balance of Current A/c** (See Partners' Current Accounts)		
Best : @ 10% on ₹ 2,000	200	
Watson : @ 10% on ₹ 2,600	260	460
		16,860
Less: **Interest on Fixed Capital**		
Taylor : @ 8% on ₹ 8,000	640	
Best : @ 8% on ₹ 8,000	640	
Watson : @ 8% on ₹ 4,000	320	1,600
Divisible profit		15,260
Less: Taylor's prior share of profit		500
		14,760
Less: Watson's guaranteed share of profit		3,500
Balance should be shared by Taylor and Best equally		11,260

So, Taylor's share of profit = ₹ 500 + 1/2 of ₹ 11,260 = ₹ 6,130; Best's sh. of profit = 1/2 of ₹ 11,260 = ₹ 5,630; Watson's share of profit = ₹ 3,500.

Dr. Partners' Current Accounts Cr.

Particulars	Taylor	Best	Watson	Particulars	Taylor	Best	Watson
To Goodwill A/c (written off)*	7,200	7,200	3,600	By Balance b/d	3,400	1,200	—
To Taylor's Capital A/c	—	2,000	—	By Goodwill A/c (raised)*	12,000	6,000	—
To Balance c/d	10,200	—	—	By Taylor's Capital A/c	2,000	—	1,000
				By Balance c/d	—	2,000	2,600
	17,400	9,200	3,600		17,400	9,200	3,600
To Balance b/d	—	2,000	2,600	By Balance b/d	10,200	—	—
To Interest on Current A/c	—	200	260	By Interest on Capital A/c	640	640	320
To Drawings A/c	5,000	2,500	1,500	By Share of Profit A/c	6,130	5,630	3,500
To Balance c/d	11,970	1,570	—	By Balance c/d	—	—	540
	16,970	6,270	4,360		16,970	6,270	4,360

* Adjustment for goodwill must be done through the Capital Account of the partners but in this case, it has been done through the Current Account of the partners as per the requirement of the question.

Working Notes :

(1) Valuation of Goodwill : 5 years' Average profit = (₹ 14,600 + 13,820 + 9,400 + 11,760 + 10,420) / 5 = ₹ 12,000; 4 years' Average profit = (₹ 14,600 + 13,820 + 9,400 + 11,760) / 4 = ₹ 12,355; Therefore, value of goodwill = (₹ 12,000 x 1.5) = ₹ 18,000.

(2) Total capital of the firm = ₹ 20,000.

So, Taylor's share of capital = 2/5 of ₹ 20,000 = ₹ 8,000; Best's share of capital = 2/5 of ₹ 20,000 = ₹ 8,000 and; Watson's share of capital = 1/5 of ₹ 20,000 = ₹ 4,000.

Admission of a Partner During An Accounting Year

So far we have seen that a partner is admitted to the partnership at the commencement of a new year. But in practical situation, a partner may be admitted during the course of an accounting year.

When a new partner is admitted during the course of an accounting year, the following steps should be followed:

Step 1 Divide the accounting period into two portions: (a) The pre-admission period; and (b) The post-admission period.

Step 2 Divide the whole profit between these two periods on the basis of either time or turnover. If the basis has been given in the problem, then that should be followed.

Step 3 Divide the whole expenses between these two periods on the basis of either time or turnover as the case may be. Care should be taken for the expenses which are exclusively related to pre-admission period or post-admission period. If the basis for allocation of expenses has been given in the problem, then that should be followed. If no hint has been given, then it is logical to allocate fixed expenses such as rent, rates and taxes, etc, on the basis of time and other expenses on the basis of turnover.

Step 4 Calculate profit of each period separately. Divide pre-admission period's profit in the ***old ratio*** amongst, old partners and divide post admission period's profit amongst all partners in the ***new ratio***.

Step 5 Pass necessary entries in the usual manner for other matters in relation to admission.

Illustration 90

J and K have been trading in partnership for several years, sharing profits and losses equally after allowing for interest on their capitals at 8% per annum.

At 1st September, 2014 their manager, L, was admitted as a partner and was to have a one- fifth share of the profits after interest on capitals, J and K shared the balance equally but guaranteed that L's share should not fall below ₹ 6,000 p.a. L was not required to introduce any capital at the date of admission but agreed to retain ₹ 1,500 of his profit share at the end of each year to be credited to his Capital Account until the balance reached ₹ 7,500. Until that time no interest was to be allowed on his capital.

Goodwill, calculated as a percentage of the profits of the last five years', was agreed at ₹ 15,000 at 1st September, 2014, and L paid into the business sufficient cash for his share. No Goodwill Account was to be left in the books.

Land and Buildings was professionally valued at the same date at ₹ 28,400 and this figure was to be brought into the books, while the book vaue of the equipment and vehicles was, by mutual agreement, to be reduced to ₹ 15,000 at that date.

L had previously been entitled to bonus of 5% of the gross profit, payable half-yearly; the bonus together with his manager's salary were to cease when he became a partner.

The trial balance at the end of the 2014 financial year is given below. No adjustments had yet been made in respect of L's admission, and the amount he introduced for goodwill had been put to his current account. The drawings of all the partners have been charged to their current accounts.

It can be assumed that the gross profit and trading expenses accrued evenly throughout the year. Depreciation on the equipment and Vehicles is to be charged at 20% per annum on the book value.

Dr. **Trial Balance as at 31st December, 2014** **Cr.**

Current Account — J	7,800	Capital Account — J	30,000
Current Account — K	7,100	Capital Account — K	15,000
Land and Building	18,000	Current Account — L	1,800
Equipment and Vehicles	21,000	Gross profit	42,000
Stock	9,200	Creditors	3,100
Trading expenses	15,000		
Manager's salary	4,000		
Manager's bonus	1,050		
Debtors	4,850		
Bank balance	3,900		
	91,900		91,900

Required : Profit and Loss Account and Partners' Capital and Current Accounts for the year ended 31.12.2014.

Solution

Dr. Profit and Loss Account for the Pre-admission Period Cr.

Particulars	₹	Particulars	₹
To Trading expenses (8/12th)	10,000	By Gross Profit (42,000 / 12) x 8	28,000
To Manager's salary	4,000		
To Manager's bonus (Note 1)	1,400		
To Depreciation (Note 2)	2,800		
To Net Profit c/d	9,800		
	28,000		28,000
To Interest on capital A/c — J	1,600	By Net Profit b/d	9,800
To Interest on capital A/c — K	800		
To Share of Profit — J	3,700		
To Share of Profit — K	3,700		
	9,800		9,800

Dr. Profit and Loss Account for the Post-admission Period Cr.

Particulars	₹	Particulars	₹
To Trading expenses A/c (4/12th)	5,000	By Gross Profit (42,000 / 12) x 4	14,000
To Depreciation A/c	1,000		
To Net Profit c/d	8,000		
	14,000		14,000
To Interest on capital A/c — J (Note 6)	936	By Net Profit b/d	8,000
To Interest on capital A/c — K (Note 6)	536		
To Share of Profit — J	2,264		
To Share of Profit — K	2,264		
To Share of Profit — L (Note 7)	2,000		
	8,000		8,000

Dr. Partners' Capital Accounts Cr.

Particulars	J	K	L	Particulars	J	K	L
To Balance c/d	35,100	20,100	1,500	By Balance b/d	30,000	15,000	—
				By L Current A/c (goodwill)	1,500	1,500	—
				By Revaluation A/c	3,600	3,600	—
				By L Current A/c	—	—	1,500
	35,100	20,100	1,500		35,100	20,100	1,500

Dr. Partners' Current Accounts Cr.

Particulars	J	K	L	Particulars	J	K	L
To Balance b/d	7,800	7,100	—	By Balance b/d	—	—	1,800
To J Capital A/c (goodwill)	—	—	1,500	By Int. on capital A/c (total)	2,536	1,336	—
To K Capital A/c (goodwill)	—	—	1,500	By Share of Profit (total)	5,964	5,964	2,000
To L Capital A/c (transfer)	—	—	1,500	By Arrears of Bonus A/c	—	—	350
To Balance c/d	700	200	—	By Balance c/d	—	—	350
	8,500	7,300	4,500		8,500	7,300	4,500

Balance Sheet of J, K & L as at 31st December, 2014

Liabilities	₹	Assets	₹
Capital A/c		Land and Building	28,400
(J — ₹ 35,100; K — ₹ 20,100; L — ₹ 1,500)	56,700	Equipment (Less Depreciation: ₹ 1,000)	14,000
Current A/c		Stock	9,200
(J — ₹ 700; K — ₹ 200; L — (–) ₹ 350)	550	Debtors	4,850
Creditors	3,100	Bank	3,900
	60,350		60,350

Working Notes :

(1) Total gross profit = ₹ 42,000. Gross profit of pre-admission period is ₹ 28,000. Manager's bonus @ 5% is ₹ 1,400. Out of which ₹ 1,050 has been paid and ₹ 350 is due and it is credited to L's current account.

(2) Depreciation of pre-admission period = 21,000 x 20/100 x 8/12 = ₹ 2,800

(3) Depreciation of Post-admission period = 15,000 x 20/100 x 4/12 = ₹ 1,000

(4) Book value of equipment on the date of admission is (₹ 21,000 – ₹ 2,800) = ₹ 18,200.

(5) Profit on revaluation = ₹ (28,400 –18,000) = ₹ 10,400; Loss on revaluation = ₹ (18,200 –15,000) = ₹ 3,200; Net profit on revaluation ₹ 7,200.

(6) Interest on Partners' Capital Accounts from 1st September has been calculated on the adjusted capital balances after taking goodwill and revaluation on profit, i.e., J's capital ₹ 35,100 and K's capital ₹ 20,100.

(7) L's share of profit from 1st September has been paid at the guranteed rate of ₹ 6,000 p.a.

Key Points

- Whenever a new partner is admitted, it has the effect of bringing the old partnership to an end.
- After admission, the new partner acquires two rights :
  - (i) he becomes the part owner of the assets of the firm; and
  - (ii) he is entitled to share part of the profits of the business. At the same time, he becomes partly liable for any liability of the business incurred after admission and any loss incurred by the firm.
- The ratio in which the old partners are surrendering their share of profit in favour of the new partner is called ***sacrificing ratio***.
- Goodwill can be classified into two categories : (1) Purchased Goodwill; and (2) Non-Purchased or Inherent Goodwill.
- Generally the following methods are adopted for the valuation of the goodwill :
  - (a) Average profit method
  - (b) Super profit method
  - (c) Capitalisation of average profit method
  - (d) Capitalisation of super profit method
  - (e) Annuity method.

THEORETICAL QUESTIONS

1. What do you mean by Goodwill ? What are the different types of Goodwill ?
2. State the treatment of Purchased Goodwill.
3. What are the different methods of Valuing Non-Purchase Goodwill ?
4. State the treatment of Goodwill on admission of a new partner.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below.

1. When a new partner is admitted, the combined shares of the old partners are:
   A reduced
   B increased
   C none of these
2. Purchased goodwill arises when:
   A one business buys another
   B a value is placed on goodwill in case of a partnership firm
   C none of these
3. It is necessary to value the goodwill at the time of admission of a new partner and credit should be given to:
   A all partners
   B the old partners
   C none of these
4. The premium for goodwill brought in by the new partner is shared by the old partners on the basis of their:
   A profit-sharing ratio
   B capital ratio
   C none of these
5. Profit or loss on revaluation of assets and liabilities is shared by:
   A all the partners
   B the old partners
   C none of these

PRACTICAL QUESTIONS

1. Karuna and Ramen are partners in a firm. They share profits and losses as Karuna 60% and Ramen 40%. Their Balance Sheet as on 31st December, 2014 was as follows:

Liabilities	₹	Assets	₹
Creditors	60,000	Plant	50,000
Capital — Karuna	1,00,000	Motor car	10,000
Capital — Ramen	60,000	Stock	40,000
		Debtors	1,10,000
		Cash	10,000
	2,20,000		2,20,000

The partners agree to admit Pratip as a partner on the following terms: (a) Plant was to be reduced by 10% and a provision for Doubtful Debts @ 2.5% on Debtors is to be made. (b) The Motor Car is to be taken by Karuna for her personal use at a cost of ₹ 8,000. (c) Pratip is to pay ₹ 20,000 as Goodwill premium to the old partners and the said amount is to remain in the business. (d) Pratip is to get 1/4th share of the future profits of the firm and is also to introduce half the combined adjusted Capital of the old partners. Show the journal entries in the books of the firm and prepare the Balance Sheet of the new firm.

2. X and Y are partners sharing profits and losses in proportion to their capital. Their Balance Sheet as at 31.3.2015 is given below:

Liabilities	₹	Assets	₹
Creditors	9,000	Freehold premises	10,000
Bills payable	6,000	Plant	3,500
Reserve	2,100	Furniture	1,750
Capital — X	20,000	Office equipment	550
Capital — Y	15,000	Stock	14,100
		Bills Receivable	3,060
		Debtors	17,500
		Bank	1,590
		Cash	50
	52,100		52,100

On 1.4.2015 they admit Z on the following terms:
(1) Z is to bring in ₹ 10,000 as his capital and to pay ₹ 3,500 for goodwill and he will get 1/4th share of profit.
(2) Provision for bad debts is to be made on debtors at 2%.
(3) Stock to be written-down by 5%.
(4) Freehold premises is to be revalued at ₹ 11,400, Plant at ₹ 2,800, Furniture ₹ 1,540 and office equipment ₹ 495.
(5) Partners agreed that the values of the assets and liabilities are remaining the same and, as such, there should be no change in their book value as a result of the above-mentioned adjustment.

You are required to make necessary adjustments in the Capital Accounts of the partners and show the Balance Sheet of the new firm.

3. G and S were partners to a manufacturing concern sharing profits and losses equally on 31st December, 2014. The firms books revealed the following position:

Liabilities	₹	Assets	₹
Partners' Capital — G	20,000	Cash in hand	152
Partners' Capital — S	16,000	Cash at bank	4,900
Sundry Creditors	15,000	Bills Receivable	1,888
Bills Payable	4,000	Sundry Debtors	21,000
		Stock	4,800
		Plant and Machinery	7,000
		Furniture & fittings	1,700
		Freehold premises	13,560
	55,000		55,000

On 1st January, 2015, it was agreed to admit T into partnership on the following terms:
That he should bring into business sundry debtors amounting to ₹ 2,400 (Less a provision of 10% for bad debts). Sundry creditors amounting to ₹ 500 and also goodwill of his business at a valuation of ₹ 1,500.
His capital in the new business is to be ₹ 5,000, the balance of which he pays in cash and in consideration thereof he receives one fifth share of the profits of the firm.

It was mutually agreed that the following adjustments should be made as regards the business of G and S. Stock to be reduced by ₹ 800; Plant and Machinery to be increased by ₹ 300; Fixtures and fittings to be completely written off. It was further agreed that after the above adjustments had been effected, S should introduce sufficient cash to make his capital equal to that of G. From the above particulars show the opening balance sheet of the new firm as at 1st January, 2015 and state in what proportions the profits and losses will be shared.

4. M/s A, B and C is a firm sharing profits and losses 2:2:1. Their Balance Sheet as on 31.3.2015 is as under:

Liabilities	₹	Assets	₹
Sundry Creditors	12,850	Land and Building	25,000
Outstanding Liabilities	1,500	Furniture	6,500
General Reserve	6,500	Stock	11,750
Capital — A	12,000	Sundry Debtors	5,500
Capital — B	12,000	Cash in hand	140
Capital — C	5,000	Cash at bank	960
	49,850		49,850

They agreed to take in D from 1.4.2015 on the following terms:

1. D shall bring in ₹ 5,000 towards his capital;
2. Value of stock should be increased by ₹ 2,500;
3. Bad Debts amounting to ₹ 550 to be written off;
4. Furniture to be depreciated by 10%;
5. Value of land and building to be enhanced by 20%;
6. Value of Goodwill is ₹ 15,000;
7. New profit sharing ratio among A, B, C and D is 5:5:3:2;
8. Goodwill Account written-off after his admission. Outstanding liabilities include ₹ 1,000 due to X which has been paid by A. Entries were not made in the books.

Required: Revaluation Account, Partners' Capital Accounts and the new Balance Sheet.

5. A and B are in partnership sharing profits and losses as 2:1. As from 1.10.2013, they take C as a partner who will have 1/6th share. As between A and B, they decide to share equally, C brings in ₹ 50,000 as capital and ₹ 4,000 as premium for Goodwill. Following is the Balance Sheet as on 30.9.2014:

Liabilities	₹	Assets	₹
Capital — A	62,500	Cash	7,000
Capital — B	37,500	Stock	50,000
Creditors	50,000	Debtors	30,000
		Plant	25,000
		Investments	38,000
	1,50,000		1,50,000

The assets are revalued as : Stock ₹ 55,000; Plant ₹ 20,000; Investment ₹ 35,000; A provision for bad debts to be created against debtors @ 5%. It is further agreed that A alone is to be charged for any loss on revaluation. The profits after depreciating plant @ 5% p.a. for the year ended 30.9.2014 is ₹ 1,20,000 and the drawings of the partners are: A — ₹ 40,000; B — ₹ 40,000; C — ₹ 10,000.

You are required to journalise the opening adjustments and draw up the Balance Sheet as on 30.9.2014.

6. A and B are partners in a firm sharing profits and losses in 7:3. The balance sheet as at 31.3.2015 is as follows:

Liabilities	₹	Assets		₹
Sundry Creditors	40,000	Cash in hand		36,000
Bank overdraft	20,000	Sundry Debtors	46,000	
Reserve	10,000	Less: Provision for bad debts	2,000	44,000
Capital — A	50,000	Furniture		30,000
Capital — B	40,000	Stock in trade		50,000
	1,60,000			1,60,000

On 1.4.2015 C joins the firm as a 3rd partner for 1/4th share of the future profits of the firm on the following terms:

(a) Goodwill is valued at ₹ 40,000 and C is to bring necessary amount in cash as premium for goodwill.

(b) 20% of the reserve is to remain as a provision against bad and doubtful debts.

(c) Stock-in-trade is to be reduced by 40% and furniture is to be reduced to 40%.

(d) A is to pay off the Bank overdraft.

(e) C is to introduce ₹ 30,000 as his share of capital to which amount other partners' capital shall have to be adjusted.

You are required to show the necessary journal entries to carry out the above transactions and prepare an amended Balance Sheet of the firm immediately after C has become a partner.

7. The following is the Balance Sheet of a partnership firm as on 31.12.2014:

Liabilities	₹	Assets	₹
Capital — A	1,00,000	Property	70,000
Capital — B	82,000	Motor car	15,000
General Reserve	10,000	Furniture	2,000
Loan from A	10,000	Debtors	50,000
Sundry Creditors	30,000	Stock	90,000
Outstanding expenses	3,000	Cash	8,000
	2,35,000		2,35,000

A and B has been sharing profits in the ratio of 3:2. On 1.1.2015, they decide to take C as a partner on the following terms and conditions:

(i) The new profit sharing ratio will be 2:1:1;

(ii) C is to bring in ₹ 75,000 as capital;

(iii) Property and motor car are to be revalued at ₹ 90,000 and ₹ 13,000 respectively and a provision for doubtful debts to be created at 5%;

(iv) C is to bring in required amount of premium for goodwill which will be valued on the basis of two years' purchase of the last three years' average profits which are as under:
2012 — ₹ 10,000; 2013 — ₹ 12,000; 2014 — ₹ 15,000.
The above profits are subject to the following adjustments:
2012 — Bad debts previously written-off ₹ 800 credited to Debtors Account.
Closing stock undervalued by ₹ 2,500.
2013 — Furniture purchased ₹ 600 debited to Purchase Account — depreciation chargeable at 10% on reducing balance method. Closing Stock understated by ₹ 2,000.
2014 — A purchase invoice of ₹ 2,001 was omitted from the books. Closing Stock undervalued by ₹ 2,000.

(v) The amount of premium to be credited to old partners' loan accounts.

You are required to pass necessary Journal entries and to draw up the Balance Sheet as on 1.1.2015.

8. A and B are in partnership sharing profits and losses in the ratio 4:3 and for the last four years they have been entitled to annual salaries of ₹ 90,000 and ₹ 1,50,000 respectively, but not to interest on capitals.
The annual accounts have shown the following net profits before charging salaries:
Year ended on 31st March, 2013 ₹ 3,52,360 (Profit); 2014 ₹ 2,20,000 (Profit); 2015 ₹ 4,20,000 (Profit).
On 1st April, 2015 C is admitted to partnership on the following terms:

(i) From 1st April 2015 profits and losses are to be shared as follows: A 4/9; B 1/3 and C 2/9.

(ii) C is to bring in ₹ 1,80,000 cash for his 2/9 share of capital.

(iii) C is to bring in an additional amount to purchase his share of partnership goodwill, valued at four year's purchase of the weighted average profits of the last three years (after allowing for salaries), profits to be weighted 1:2:3, the greatest weight being given to the last year.

(iv) C is entitled to a salary of ₹ 1,20,000 p.a.; A and B to get the same salaries as before.

No Goodwill Account is to be opened in the books: any adjustments in respect of Goodwill are to be made through the Partners' current Accounts.
The balances on the Partner's Accounts on 1st April 2015 are as follows:

	Capital	Current
A	₹ 3,60,000 (Cr.)	₹ 84,000 (Cr.)
B	₹ 2,70,000 (Cr.)	₹ 32,000 (Dr.)

Prepare Partners' Capital and Current Accounts at 1st April, 2015, incorporating the entries arising on the admission of C.

9. D, H, F were equal partners of the firm 'Enterprise' and the following Balance Sheet as at 1.7.2015 was produced by them:

Fixed Assets	₹	₹	₹
Land		1,19,000	
Building		1,95,000	
Furniture		24,000	3,38,000
Working Capital			
Stock	1,14,000		
Debtors	1,08,000		
Cash	6,000	2,28,000	

Less: Creditors	33,000		
Bills payable	60,000	93,000	1,35,000
Total assets			4,73,000
Represented by :			
D Capital		2,17,000	
H Capital		1,66,000	
F Capital		90,000	4,73,000

On 1.7.2015 they agreed to take R as an equal partner on the following terms:
(a) R should bring ₹ 1,60,000 as his capital and goodwill, his share of goodwill was evaluated at ₹ 60,000; (b) Provision for loss on stock and provision for bad debts to be made at 10% and 5% respectively; (c) The value of building was to be taken at ₹ 2,70,000; (d) The total capital of the new firm was fixed at ₹ 4,00,000 and the Partners Accounts be in their profit sharing ratio. Any excess is to be transferred to Current Account or deficit to be introduced in cash.
You are required to prepare the Profit and Loss Adjustment Account, Capital Accounts of the partners and the Balance Sheet.

10. A, B and C are partners in a firm of accountants who maintain accounts on a cash basis sharing profits and losses in the ratio of 2:3:1. Their Balance Sheet as on March 31, 2015 on which date D is admitted as a partner, is as follows:

Liabilities	₹	Assets	₹
B Capital	35,000	Furniture	10,000
C Capital	22,000	Motor Car	20,000
		Cash at bank	18,000
		A Capital	9,000
	57,000		57,000

D is given 1/4 share of the profits and losses in the firm and the profit and loss sharing ratio as between the other partners remains as before. The following adjustments are to be made prior to D's admission:
(a) The motor car is taken over by B at a value of ₹ 25,000.
(b) The furniture is revalued at ₹ 18,000.
(c) Goodwill is valued at ₹ 50,000. It is agreed among A, B and C that C is interested in goodwill only up to a value of ₹ 30,000.
(d) Fees billed but not realized ₹ 11,000 are brought into account.
(e) Expenses incurred but not paid, ₹ 3,000 are provided for.

D brings in ₹ 20,000 in cash as his capital contribution. He is also to be credited with ₹ 20,000 for having agreed to amalgamate his separate practice as Chartered Accountant with this firm. The partners have decided not to show any goodwill in their new books of account.
Pass necessary Journal entries and prepare the Balance Sheet of the firm after D's admission.

11. K and L are two partners sharing profits and losses in the ratio of 5:3. Their Balance Sheet as at 30th. June, 2015 is as follows:

Liabilities	₹	Assets		₹
Creditors	30,000	Furniture		40,000
Reserve	14,000	Patent		10,000
Capital		Debtors	44,000	
K	40,000	Less: Provision for Bad Debt	5,000	39,000
L	50,000	Stock		20,000
		Cash in hand		25,000
	1,34,000			1,34,000

On 1st July, they take M into partnership. M brings ₹ 25,000 as his capital. The new profit sharing ratio of K, L and M is 2:4:1. Patent is written-off from the books and a Provision for Bad Debt is created at 5%. Reserve appears in the books of new firm at its original figure.
Show the necessary Journal entries to carry out the above transactions and prepare a Balance Sheet of the new firm as at 1st July, 2015.

12. Quick and Slow are partners in a firm sharing profits and losses in the ratio of 3 : 2. The Balance Sheet of the firm as on 31st March, 2015 was as under:

Liabilities			₹	Assets	₹
Capital Accounts :				Furniture and Fixtures	60,000
	Quick	1,20,000		Office Equipments	30,000
	Slow	77,000	1,97,000	Motor Car	75,000
General Reserve			30,000	Stock	50,000
Sundry Creditors			96,000	Sundry Debtors	90,000
				Cash at Bank	18,000
			3,23,000		3,23,000

Smooth was admitted as a new partner with effect from 1st April, 2015 and it was agreed that he would bring some private furniture worth ₹ 10,000 and private stock costing ₹ 8,000 and in addition contribute ₹ 50,000 cash towards capital.

He would also bring proportionate share of goodwill which is to be valued at two years' purchase of the average profits of the last three years. The profits of the last three years were: 2014-10 ₹ 52,000; 2013-09 ₹ 32,000; 2012-08 ₹ 28,000.

However, on a checking of the past records, it was noticed that on 1.4.2013 a new furniture costing ₹ 8,000 was purchased but wrongly debited to revenue, and in 2014-10 a purchase invoice for ₹ 4,000 dated 25.3.2015 has been omitted in the books. The firm charges depreciation on Furniture @ 10% p.a. on original cost.

Your calculation of goodwill is to be made on the basis of correct profits. On revaluation, value of stock is to be reduced by 5% and motor car is worth ₹ 85,000. Smooth duly paid the required amount for goodwill and cash towards capital.

It was decided that the future profits of the firm would be shared as Quick : 50%, Slow : 30% and Smooth : 20%.

Assuming the above-mentioned arrangements were duly carried out, show the Revaluation Account, Capital Accounts of the partners and the Balance Sheet of the firm after Smooth's admission.

Guide to Answers

Multiple Choice

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

Practical Questions

1. **Loss on revaluation ₹ 9,750; Share of premium ₹ 12,000 (Karuna), ₹ 8,000 (Ramen). Capital brought in by Pratip ₹ 81,125; Balance Sheet ₹ 3,03,375.**
2. **Loss on revaluation ₹ 620; Capital Accounts: - X - ₹ 22,212; Y - ₹ 16,658; Z - ₹ 9,630; Balance Sheet 65,600.**
3. **Loss on revaluation ₹ 2,200; Capital Accounts: G - ₹ 18,900; S - ₹ 18,900; T - ₹ 5,000; New ratio 2:2:1; Balance Sheet ₹ 62,300.**
4. **Profit on revaluation ₹ 6,300; Capital Accounts: A - ₹ 19,120; B - ₹ 18,120; C - ₹ 7,560; D - ₹ 3,000; Balance Sheet - ₹ 61,150.**
5. **Loss on revaluation of ₹ 4,500 to be debited to A's account in full. Entire premium to be taken by A and in addition A's account to be credited with ₹ 2,000 and B's capital to be debited by ₹ 2,000. Balance Sheet Plant - ₹ 19,000; Investments - ₹ 35,000; Working capital - ₹ 1,25,500; Capital Accounts: A - ₹ 74,000; B - ₹ 45,500; C - ₹ 60,000; Total ₹ 1,79,500.**
6. **Future profit sharing ratio 21:9:10; sacrificing ratio 7:3; Capital Accounts: A - ₹ 63,000; B - ₹ 27,000; C - ₹ 30,000; Cash in hand ₹ 76,000; Revaluation loss ₹ 38,000; Balance Sheet ₹ 1,60,000.**
7. **Adjusted profit for 3 years ₹ 38,285; Total value of goodwill ₹ 25,524; C is to bring in ₹ 6,381 as premium for goodwill and which will be shared by A & B as ₹ 2,553 and ₹ 3,828 respectively. Profit on revaluation ₹ 15,460; Balance Sheet ₹ 3,35,127.**
8. **Av. profits (₹ 6,12,360/6) = ₹ 1,02, 060; Goodwill ₹ 4,08,240; C's share of goodwill ₹ 90,720; which has been shared by A and B in the ratio of 4:3.**
   Capital Accounts: — A - ₹ 3,60,000; B - ₹ 2,70,000; C - ₹ 1,80,000.
   Current Accounts.:- A - ₹ 1,35,840; B - ₹ 6,880 (all credit balance).
9. **Profit on revaluation : ₹ 58,200; Balance Sheet total : ₹ 7,84,200.**
10. **Balance Sheet total ₹ 67,000.**
11. **Loss of revaluation : ₹ 7,200; Balance Sheet total ₹ 1,51,800.**
12. **Revaluation profit : ₹ 9,900; Balance Sheet total ₹ 4,20,153.**

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Retirement of a Partner

Introduction

A partner may retire from the firm for different reasons such as differences with the other partners, better business opportunity, old age, etc. The retirement of a partner results in a new partnership, although daily operation of the firm currently are not affected. According to Sec. 32(1) of the Indian Partnership Act, a partner can retire in the following three ways :

(i) with the consent of all the other partners (such consent may be expressed or implied);
(ii) in accordance with an express agreement by the partners; and
(iii) where the partnership is at will, by giving notice in writing to all the other partners of his intention to retire.

Effects of Retirement of A Partner

The effects of retirement of a partner are the following :

1. The retirement of a partner will terminate the old partnership and a new partnership will be created.
2. An adjustment is to be made in regard to undrawn profit or accumulated losses.
3. The assets and liabilities of the firms are to be revalued and proper adjustments are to be made.
4. The goodwill of the firm has to be valued and some adjustments are to be made.
5. The combined shares of the remaining partners will be increased.
6. The claim of the retiring partners is to be determined.
7. The continuing partners may find it difficult to pay off the entire claim of the retiring partner.

Gaining Ratio

After retirement of a partner(s) the combined share of the remaining partners will be increased. The ratio in which the remaining partners are acquiring the share of the retiring partner is called gaining ratio. Calculation of gaining ratio is necessary particularly when only retiring partner's share of goodwill/reserve is to be adjusted.

Difference between Sacrificing Ratio and Gaining Ratio

	Sacrificing Ratio		Gaining Ratio
1.	It is generally calculated at the time of admission of a new partner.	1.	It is generally calculated at the time of retirement/death of a partner.
2.	It is the ratio in which the old partners are surrendering their share of profit in favour of the new partner.	2.	It is the ratio in which the remaining partners are acquiring the share of the retiring/ deceased partner.
3.	It is calculated when premium for goodwill brought in by the new partner is to be distributed amongst the old partner.	3.	It is calculated when only the retiring partner's share of goodwill/ reserve is to be adjusted.
4.	Sacrificing ratio = Old ratio – New ratio	4.	Gaining ratio = New ratio – Old ratio.

Adjustments For Retirement of A Partner

At the time of retirement of a partner, different adjustments are required. These are as follows :

1. Adjustment in regard to goodwill.
2. Adjustment in regard to revaluation of assets and liabilities.
3. Adjustment in regard to undistributed profits and losses.
4. Adjustment in regard to joint life policy.
5. Adjustment in regard to share of profits from the date of the last Balance Sheet to the date ofretirement.

1. Adjustment in Regard to Goodwill

At the time of retirement of a partner, an adjustment is necessary in respect of goodwill. The retiring partner is entitled to his share in the goodwill of the firm. In the absence of any agreement, goodwill is to be distributed in the profit-sharing ratio. The valuation of goodwill is done on the basis of the provisions of the partnership deed. If the partnership deed is silent, the valuation should be done in such a manner as must have been agreed upon by the partners (methods of valuation of goodwill have already been discussed in the Chapter on Admission of a Partner).

In this connection, Para 36 of AS—10 is very important. This para states that 'Goodwill should be recorded in the books only when some consideration in money or money's worth has been paid for it. Whenever a business is acquired for a price (payable in cash or in shares or otherwise) which is in excess of the value of the net assets of the business takenover, the excess should be termed as Goodwill'.

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

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

This goodwill can be treated in the books of account in any of the following manner.

Case 1 : When there is no goodwill in the present Balance Sheet and goodwill is raised in the books of the firm at full value but it is written-off immediately

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

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

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

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

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

Illustration 1

A, B and C are partners sharing profits and losses in the ratio of 4 : 3 : 3. C retires from the business. At present goodwill is not appearing in the Balance Sheet.

The agreed value of goodwill is ₹ 1,00,000. It has been decided by A and B to share future profits and losses equally and goodwill not to be shown in the new Balance Sheet.

Pass necessary Journal Entries in respect of goodwill.

Solution

In the books of the Firm
Journal

Date	Particulars		Dr. ₹	Cr. ₹
	Goodwill A/c	Dr.	1,00,000	
	To A Capital			40,000
	To B Capital			30,000
	To C Capital			30,000
	(Being the goodwill raised in the books at full value by crediting the partners in their old orifit-sharing ratio i.e., 4 : 3 : 3)			
	A Capital A/c	Dr.	50,000	
	B Capital A/c	Dr.	50,000	
	To Goodwill A/c			1,00,000
	(Being the goodwill written-off in the books by debiting the remaining partners in their new profit-sharing ratio, i.e., 1 : 1)			

Case 2 : When there is no goodwill in the present Balance Sheet but only retiring partners'share of goodwill is to be adjusted

In this case, retiring partners' share of goodwill is raised in the books by crediting the ***retiring partner*** only. It is then written-off by debiting the remaining partners in the ***gaining ratio***.

The following entries are passed :

(i) ***For raising retiring partner's share of goodwill***

Goodwill Account Dr. [Retiring partner's share]
To Retiring Partner's Capital Account

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

Continuing Partners' Capital Accounts Dr. [Gaining ratio]
To Goodwill Account

Alternatively, the following entry can be passed :

Continuing Partners' Capital Accounts Dr. [Gaining ratio]
To Retiring Partner's Capital Account [Share of retiring partner]

Illustration 2

Red, White and Blue are equal partners. White retires, his share of goodwill is ₹ 18,000. The remaining partners have decided to continue the business sharing profits and losses in the ratio of 3 : 2. At present there is no goodwill in the Balance Sheet and in future goodwill is not to be shown in the Balance Sheet. Give Journal Entry.

Solution

In the books of the Firm
Journal

Date	Particulars		Dr. ₹	Cr. ₹
	Goodwill A/c	Dr.	18,000	
	To White Capital A/c			18,000
	(Being White's share of goodwill raised in the books)			
	Red Capital A/c (Note 1)	Dr.	14,400	
	Blue Capital A/c (Note 1)	Dr.	3,600	
	To Goodwill A/c			18,000
	(Being the goodwill written-off in the books by debiting the continuing partners in the gaining ratio 4 : 1)			
	Alternatively,			
	Red Capital A/c	Dr.	14,400	
	Blue Capital A/c	Dr.	3,600	
	To White Capital A/c			18,000
	(Being the required adjustment through the Capital Accounts of the partners in regard to goodwill)			

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

Partners	New Ratio	Old Ratio	Sacrifice / Gain	Gaining Ratio
Red	3/5	1/3	3/5 — 1/3 = 4/15 (Gain)	Red : Blue = 4/15 : 1/15 = 4 : 1
White	—	1/3	0 – 1/3 = 5/15 (Sacrifice)	
Blue	2/5	1/3	2/5 – 1/3 = 1/15 (Gain)	

It should be noted that without calculating the gaining ratio, the amount to be adjusted in respect of goodwill can be calculated directly with the help of the following statement :

Statement Showing the Required Adjustment for Goodwill

Partners	Red (₹)	White (₹)	Blue (₹)
Right of goodwill before retirement (1 : 1 : 1)	18,000	18,000	18,000
Right of goodwill after retirement (3 : 2)	32,400	—	21,600
Gain (+) / Sacrifice (–)	(+) 14,400	(–) 18,000	(+) 3,600

Tutorial Note : In the alternative method if the full value of goodwill has not been given, then it is to be calculated on the basis of retiring partner's share of goodwill (as has been done in this case, i.e., ₹ 18,000 × 3/1 = ₹ 54,000).

Illustration 3

Ram, Shyam and Rahim are partners sharing profits in the ratio of 4:3:2. Shyam retires and the goodwill is valued at ₹ 21,600. No goodwill appears as yet in the books of the firm. Assuming that Ram and Rahim will share profits in the future in the ratio of 5:3, pass entries for goodwill separately under the following conditions: (a) When Goodwill Account is raised but written-off; (b) When only Shyam's Goodwill Account is raised and then written-off; and (c) When only Shyam's share of goodwill is adjusted through the Capital Account of Ram and Rahim.

Solution **In the books of Ram, Shyam and Rahim**

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

Date	Particulars		₹	₹
(a) (i)	Goodwill A/c	Dr.	21,600	
	To Ram Capital A/c			9,600
	To Shyam Capital A/c			7,200
	To Rahim Capital A/c			4,800
	(Being the goodwill raised in the books at full value crediting the partners in their old profit sharing ratio, 4:3:2)			
(ii)	Ram Capital A/c	Dr.	13,500	
	Rahim Capital A/c	Dr.	8,100	
	To Goodwill A/c			21,600
	(Being goodwill written-off in the books by debiting the remaining partners in their new ratio, 5:3)			
(b) (i)	Goodwill A/c	Dr.	*7,200	
	To Shyam Capital A/c			7,200
	(Being Shyam's share of goodwill raised)			
(ii)	Ram Capital A/c	Dr.	*3,900	
	Rahim Capital A/c	Dr.	*3,300	
	To Goodwill A/c			7,200
	(Being Shyam's share of goodwill written-off by debiting the remaining partners in the gaining ratio, 13:11)			
(c)	Ram Capital A/c	Dr.	3,900	
	Rahim Capital A/c	Dr.	3,300	
	To Shyam Capital A/c			7,200
	(Being Shyam's share of goodwill adjusted through the Capital Account of Ram and Rahim)			

*Shyam's share of goodwill = ₹ 21,600 x 1/3 = ₹ 7,200; The gaining ratio of Ram and Rahim is 13:11.

Calculation of Gaining Ratio

Partners	Ram	Shyam	Rahim
Old Ratio (4 : 3 : 2)	4/9	3/9	2/9
New Ratio (5 : 3)	5/8	—	3/8
New ratio – Old ratio	(5/8 – 4/9)		(3/8 – 2/9)
Gain	13/72		11/72

Case 3 : When there is no goodwill in the present Balance Sheet and adjustment to be done without opening Goodwill Account

In this case, continuing Partners' Capital Accounts will be debited in the gaining ratio and retiring Partner's Capital Account will be credited with his share of goodwill. The entry will be :

Continuing Partners' Capital Accounts	Dr.	[Gaining ratio]
To Retiring Partner's Capital Account		[Share of goodwill of retiring partner]

Illustration 4

Ravi, Mukesh, Naresh and Yogesh are partners in a firm sharing profits in the ratio of 2 : 2 : 1 : 1. On Mukesh's retirement, the goodwill of the firm is valued at ₹ 90,000. Ravi, Naresh and Yogesh decided to share future profits equally. Pass the necessary Journal Entry for the treatment of goodwill without opening Goodwill Account.

Solution **In the books of the Firm**

Journal

Date	Particulars	Dr. ₹	Cr. ₹
	Naresh Capital A/c (Note 1) Dr.	15,000	
	Yogesh Capital A/c (Note 1) Dr.	15,000	
	To Mukesh Capital A/c		30,000
	(Being the required adjustment for goodwill through the Partners' Capital Accounts)		

Working Note :

(1) Mukesh is entitled to 2/6th share of goodwill, i.e., ₹ 90,000 / 6 × 2 = ₹ 30,000. This amount will be debited to continuing partners in the gaining ratio. The gaining ratio is calculated as follows :

Calculation of Gaining Ratio

Partners	New Ratio	Old Ratio	Sacrifice / Gain	Gaining Ratio
Ravi	1/3	2/6	1/3 – 2/6 = Nil	Naresh : Yogesh = 1 : 1
Mukesh	–	2/6	2/6 (Sacrifice)	
Naresh	1/3	1/6	1/3 – 1/6 = 1/6 (Gain)	
Yogesh	1/3	1/6	1/3 – 1/6 = 1/6 (Gain)	

Naresh and Yogesh are gaining equally. Therefore, ₹ 30,000 will be debited to Naresh and Yogesh equally, i.e., ₹ 15,000 each. ***Alternatively***, without calculating gaining ratio, the amount of goodwill to be adjusted can be calculated directly with the help of the following statement :

Statement Showing the Required Adjustment for Goodwill

Partners	Ravi (₹)	Mukesh (₹)	Naresh (₹)	Yogesh (₹)
Right of goodwill before retirement (2 : 2 : 1 : 1)	30,000	30,000	15,000	15,000
Right of goodwill after retirement (1 : 1 : 1)	30,000	–	30,000	30,000
Gain (+) / Sacrifice (–)	Nil	(–) 30,000	(+) 15,000	(+) 15,000

Mukesh is sacrificing ₹ 30,000. Naresh and Yogesh are gaining ₹ 15,000 each. Ravi is not gaining anything.

Illustration 5

A, B and C are partners sharing profits in the ratio of 4 : 3 : 3. On C's retirement the value of firm's goodwill was agreed at ₹ 30,000. A and B agreed to share profits and losses in future in the ratio of 7 and 3 respectively. Give necessary Journal Entry in relation to goodwill, without opening its accounts.

Solution **In the books of the Firm**

Journal

Date	Particulars	Dr. ₹	Cr. ₹
	A Capital A/c Dr.	9,000	
	To C Capital A/c		9,000
	(Being the required adjustment for goodwill through the Partners' Capital Accounts)		

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

Partners	New Ratio	Old Ratio	Sacrifice / Gain	Gaining Ratio
A	7/10	4/10	7/10 – 4/10 = 3/10 (Gain)	Here, gaining ratio cannotbe calculated because only A is gaining
B	3/10	3/10	3/10 – 3/10 = Nil	
C	–	3/10	0 – 3/10 = 3/10 (Sacrifice)	

Alternative Working Note :

Statement Showing the Required Adjustment for Goodwill

Partners	A (₹)	B (₹)	C (₹)
Right of goodwill before retirement (4 : 3 : 3)	12,000	9,000	9,000
Right of goodwill after retirement (7 : 3)	21,000	9,000	–
Gain (+) / Sacrifice (–)	(+) 9,000	Nil	(–) 9,000

C is sacrificing ₹ 9,000. Only A is gaining ₹ 9,000. B is not gaining anything. Therefore A Account will be debited with ₹ 9,000 and C Account will be credited with ₹ 9,000.

Illustration 6

Surender, Ramesh, Naresh and Mohan are partners in a firm sharing profits in 2 : 1 : 2 : 1 ratio. On the retirement of Naresh, the goodwill was valued at ₹ 72,000. Surender, Ramesh and Mohan decided to share future profits equally. Pass the necessary Journal Entry for the treatment of goodwill, without opening Goodwill Account.

Solution **In the books of the Firm**
Journal **Dr.** **Cr.**

Date	Particulars		₹	₹
	Ramesh Capital A/c	Dr.	12,000	
	Mohan Capital A/c	Dr.	12,000	
	To Naresh Capital A/c			24,000
	(Being the required adjustment for goodwill through the Partners' Capital Accounts)			

Working Note :

(1) Naresh is entitled to 2/6th share of goodwill, i.e., ₹ 72,000 × 2/6 = ₹ 24,000. This amount will be debited to continuing Partners' Capital Accounts in the gaining ratio. The gaining ratio is calculated as under:

Calculation of Gaining Ratio

Partners	New Ratio	Old Ratio	Sacrifice / Gain	Gaining Ratio
Surender	1/3	2/6	1/3 – 2/6 = Nil	Ramesh : Mohan = 1 : 1
Ramesh	1/3	1/6	1/3 – 1/6 = 1/6 (Gain)	
Naresh	–	2/6	0 – 2/6 = 2/6 (Sacrifice)	
Mohan	1/3	1/6	1/3 – 1/6 = 1/6 (Gain)	

Ramesh and Mohan are gaining equally. Therefore, ₹ 24,000 will be debited to Ramesh and Mohan equally, i.e., ₹ 12,000 each. ***Alternatively***, the above amount can be calculated directly with the help of the following statement :

Statement Showing the Required Adjustment for Goodwill

Partners	Surender (₹)	Ramesh (₹)	Naresh (₹)	Mohan (₹)
Right of goodwill before retirement (2 : 1 : 2 : 1)	24,000	12,000	24,000	12,000
Right of goodwill after retirement (1 : 1 : 1)	24,000	24,000	–	24,000
Gain (+) / Sacrifice (–)	Nil	(+) 12,000	(–) 24,000	(+) 12,000

Illustration 7

X, Y and Z were partners in a firm sharing profits in the ratio of 3 : 2 : 1. Z retired and the new profit-sharing ratio between X and Y was 1 : 2. On Z's retirement the goodwill of the firm was valued at ₹ 30,000.

Pass necessary Journal Entry for the treatment of goodwill on Z's retirement without opening Goodwill Account.

Solution **In the books of the Firm**
Journal **Dr.** **Cr.**

Date	Particulars		₹	₹
	Y Capital A/c	Dr	10,000	
	To X Capital A/c			5,000
	To Z Capital A/c			5,000
	(Being the adjustment for goodwill on Z's retirement)			

Working Note : **(1) Statement Showing the Required Adjustment for Goodwill**

Partners	X (₹)	Y (₹)	Z (₹)
Right of goodwill before retirement (3 : 2 : 1)	15,000	10,000	5,000
Right of goodwill after retirement (1 : 2)	10,000	20,000	–
Gain (+) / Sacrifice (–)	(–) 5,000	(+) 10,000	(–) 5,000

In this case, only Y is gaining. Both X and Z are sacrificing. Therefore, Y capital will be debited with ₹ 10,000 and X capital will be credited with ₹ 5,000 and Z capital will be credited with ₹ 5,000.

Case 4 : When there is goodwill in the present Balance Sheet

In this case, the revised value of goodwill is to be compared with the book value of goodwill (i.e., which is appearing in the Balance Sheet). Accounting entries are to be passed accordingly.

(i) ***If the revised value of goodwill > book value of goodwill***

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

(ii) ***If the revised value of goodwill < book value of goodwill***

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

(iii) As per AS—10 para 36 no goodwill is to be shown in the Balance sheet unless it is a purchased goodwill. Therefore, after retirement, goodwill is to be written-off by debiting continuing partners in the new ratio.

(iv) If there is no change in the value of goodwill, then existing goodwill is written-off by debiting continuing parters in the new ratio.

Illustration 8

Pass Journal entries under the following circumstances:

(a) A, B and C are partners sharing profits and losses equally. A retires. B and C decided to share profits and losses in the ratio 4:1. The value of the goodwill is ₹ 45,000.

(b) A, B and C are partners sharing profits and losses in the ratio 4:3:2. B retires. The value of the goodwill is ₹ 45,000. A and C decide to share profits and losses in ratio of 3:2.

Solution

In the books of A, B and C

Journal

Date	Particulars		Dr. ₹	Cr. ₹
(a)	B Capital A/c	Dr.	21,000	
	To A Capital A/c			15,000
	To C Capital A/c			6,000
	(Being the adjustment for goodwill made through the capital accounts of the partners)			
(b)	Goodwill A/c	Dr.	45,000	
	To A Capital A/c			20,000
	To B Capital A/c			15,000
	To C Capital A/c			10,000
	(Being the goodwill raised to its full value before B's retirement)			
	A Capital A/c	Dr.	27,000	
	C Capital A/c	Dr.	18,000	
	To Goodwill A/c			45,000
	(Being the goodwill written-down to its old figure after B's retirement by debiting A and B in the ratio of 3 : 2)			

Illustration 9

A, B and C are equal partners. B retires. His share of goodwill is ₹ 9,000. The remaining partners have decided to continue the business sharing profit in the ratio of 3 : 2. Goodwill is not to be shown in the Balance Sheet. Give Journal entry.

Solution

In the books of A, B and C

Journal

Date	Particulars		Dr. ₹	Cr. ₹
	A Capital A/c	Dr.	7,200	
	C Capital A/c	Dr.	1,800	
	To B Capital A/c			9,000
	(Being the required adjustment through the capital accounts of the partners in regard to goodwill)			

Calculation of Gaining Ratio

Partners	A	B	C
Old Ratio (1 : 1 : 1)	1/3	1/3	1/3
New Ratio (3 : 2)	3/5	—	2/5
New ratio – Old ratio	(3/5 – 1/3)		(2/5 – 1/3)
Gain	4/15		1/15

Therefore, the gaining ratio of A : C = 4 : 1.

Alternatively,

Partners		A	B	C
Right of goodwill before retirement	(₹)	9,000	9,000	9,000
Right of goodwill after retirement	(₹)	16,200	—	10,800
Gain (+) / Sacrifice (–)	(₹)	(+) 7,200	(–) 9,000	(+) 1,800

Illustration 10

X, Y and Z are partners sharing profits and losses of 4 : 3 : 2. Z retires from the business. The value of goodwill is ₹ 90,000. Goodwill appearing in the Balance Sheet at ₹ 54,000. X and Y decided to share profits and losses in the ratio of 3 : 1. Pass necessary Journal Entries.

Solution

In the books of the Firm

Journal

Date	Particulars		Dr. ₹	Cr. ₹
	Goodwill A/c (₹ 90,000 – ₹ 54,000)	Dr.	36,000	
	To X Capital A/c			16,000
	To Y Capital A/c			12,000
	To Z Capital A/c			8,000
	(Being goodwill raised to its full value by crediting all partners in the old ratio, i.e., 4 : 3 : 2)			
	X Capital A/c	Dr.	67,500	
	Y Capital A/c	Dr.	22,500	
	To Goodwill A/c			90,000
	(Being the goodwill written-off in the new ratio, i.e., 3 : 1)			

Illustration 11

A, B and C are partners sharing profits and losses in the ratio of 3 : 2 : 1. C retires from the business. the value of goodwill has been agreed at ₹ 60,000. At present, goodwill appearing in the books at ₹ 90,000. After retirement, no goodwill is to be shown. Pass necessary Journal Entries.

Solution

In the books of the Firm

Journal

Date	Particulars		Dr. ₹	Cr. ₹
	A Capital A/c	Dr.	15,000	
	B Capital A/c	Dr.	10,000	
	C Capital A/c	Dr.	5,000	
	To Goodwill A/c (₹ 90,000 –₹ 60,000)			30,000
	(Being the adjustment for goodwill on C's retirement)			
	A Capital A/c	Dr.	36,000	
	B Capital A/c	Dr.	24,000	
	To Goodwill A/c			60,000
	(Being the goodwill written-off in the new ratio, i.e., 3 : 2)			

Illustration 12

Pass Journal Entries under the following circumstances:

(a) X, Y and Z are partners sharing profits and losses in the ratio 2:2:1. X retires. His share of goodwill is ₹ 6,000. Goodwill appears in the books at its full value and it has been decided not to show goodwill in the books. Y and Z decided to share profit and losses in the ratio 3:2.

(b) A, B and C are partners sharing profits and losses equally. A retires. B and C decided to share profits and losses in the ratio 4:1. The value of the goodwill is ₹ 45,000. Goodwill does not appear in the books. The continuing partners decide not to show goodwill in the books.

Solution

Journal

Date	Particulars		Dr. ₹	Cr. ₹
(a)	Y Capital A/c (Note 1)	Dr.	9,000	
	Z Capital A/c (Note 1)	Dr.	6,000	
	To Goodwill A/c			15,000
	(Being goodwill written-off from the books after X's retirement)			
	Goodwill A/c (Note 2)	Dr.	45,000	
	To A Capital A/c			15,000
	To B Capital A/c			15,000
	To C Capital A/c			15,000
	(Being goodwill raised to its full value by crediting all partners in the old ratio)			
	B Capital A	Dr.	36,000	
	C Capital A	Dr.	9,000	
	To Goodwill A/c (Note 2)			45,000
	(Being goodwill written-off in the new ratio)			
	Alternatively,			
	B Capital A/c	Dr.	21,000	
	To A Capital A/c			15,000
	To C Capital A/c			6,000
	(Being the adjustment for goodwill made through the capital accounts of the partners)			

Working Notes :

(1) X's share of goodwill is ₹ 6,000 for 2/5th share of profit. Therefore, total goodwill = ₹ 6,000 × 5/2 = ₹ 15,000. Goodwill already appearing in the Balance Sheet at full value. Therefore no further goodwill is to be raised. However, for writing off goodwill, Y and Z capital will be debited in the **new ratio**.

(2) In this case, goodwill is to be raised in the old ratio and to be written-off in the new ratio.

2. Adjustment in Regard to Revaluation of Assets and Liabilities

Unless otherwise agreed, on retirement, a partner is entitled to have the assets and liabilities of a firm revalued on a proper basis at the date of retirement, so that he gets his fair share of the firm's net assets. The purpose of revaluation is to convert the book values of the assets and liabilities into net market values.

Just like admission, here also, a Revaluation Account is prepared to ascertain the profit or loss on revaluation. The profit/loss on revaluation is transferred to All Partners' Capital Accounts in the old profit sharing ratio. After retirement, the assets and liabilities appear in the Balance Sheet at ***revised value.***

The continuing partners may decide ***not*** to show the assets and liabilities in their revised values, i.e., assets and liabilities are to appear in the ***Original Values***. In such a situation, a Memorandum Revaluation Account is prepared. The profit or loss on revaluation is transferred to ***All Partners' Capital Accounts in the old ratio.***

Thereafter, the same amount is put below the line on the reverse side of the Memorandum Account and it is closed by transferring to the Capital Accounts of the ***continuing partners in the new ratio***.

In this connection, Para 30 of AS—10 is also important. This para states that '***An increase in net book value arising on revaluation of fixed assets should be credited directly to owners' interests under the head of revaluation reserve, except that, to the extent that such increase is related to and not greater than a decrease arising on revaluation previously recorded as a charge to the profit and loss statement, it may be credited to the profit and loss statement. A decrease in net book value arising on revalutaion of fixed asset should be charged directly to the profit and loss statement except that to the extent that such a decrease is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or utilised, it may be charged directly to that account***'.

In case of Partnership, revaluation profit or loss is transferred directly to Partners' Capital Accounts. Therefore, an increase in net book value arising on revaluation of fixed assets may be credited to Revaluation Account (in place of Revaluation Reserve Account because it will be utilimately closed by transferring to Partners' Capital Accounts) and loss on revaluation of fixed assets may be debited to Revaluation Account (in place of Profit and Loss Account because it will be ultimately closed by transferreing to Partners' Capital Accounts).

In this chapter or elsewhere the effects of revaluation of fixed assets have been shown through the Revaluation Account (in place of Revaluation Reserve Account / Profit and Loss Account because the effect will be same on Partners' Capital Accounts).

Computation of Retiring Partner's Interest in the Firm

For calculating the amount of money payable to the retiring partner, the following items should be considered:

1. Opening balance of Capital and Current Account of retiring partner.
2. Share of undistributed reserve and profit.
3. Share of revaluation profit or loss.
4. Share of profit till the date of his retirement.
5. Share of firm's goodwill.
6. The salary or/and interest due to the retiring partner till the date of his retirement.
7. The drawing and interest thereon, of the retiring partner.

Illustration 13

P, Q and R are partners sharing profits and losses in the ratio of 3 : 2 : 1. Following is their Balance Sheet as at 31st March, 2015:

Liabilities	₹	Assets	₹
Capital Accounts :		Plant and Machinery	2,00,000
P	2,00,000	Stock	1,00,000

Q	1,50,000	Debtors	1,00,000
R	1,00,000	Cash	1,00,000
Creditors	50,000		
	5,00,000		5,00,000

Q retires from the business from 1st April, 2015. The following was agreed upon retirement of Q.

(1) Plant and machinery has been revalued at ₹ 3,00,000.
(2) Stock has been revalued at ₹ 90,000.
(3) A sum of ₹ 15,000 is to be written-off from debtors.
(4) The goodwill of the firm has been valued at ₹ 1,50,000 but no Goodwill Account is to be raised in the books of account.
(5) P and R will continue to carry on the business and shall share profits and losses equally in future.
(6) Amount payable by Q shall remain in the business as loan.

You are required to :

(i) prepare Revaluation Account;
(ii) prepare Partners' Capital Accounts; and
(iii) show the Balance Sheet of P and R as on 1st April, 2015.

Solution

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

Particulars	₹	Particulars	₹
To Stock A/c	10,000	By Plant and Machinery A/c	1,00,000
To Debtors A/c	15,000		
To Partners' Capital A/cs :			
P	37,500		
Q	25,000		
R	12,500		
	1,00,000		1,00,000

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

Particulars	P (₹)	Q (₹)	R (₹)	Particulars	P (₹)	Q (₹)	R (₹)
To Q Capital A/c (Note 1)	—	—	50,000	By Balance b/d	2,00,000	1,50,000	1,00,000
To Q Loan A/c	—	2,25,000	—	By Revaluation A/c	37,500	25,000	12,500
To Balance c/d	2,37,500	—	62,500	By R Capital A/c (Note 1)	—	50,000	—
	2,37,500	2,25,000	1,12,500		2,37,500	2,25,000	1,12,500

Balance Sheet of P and R as on 1st April, 2015

Liabilities	₹	Assets	₹
Capital Accounts :		Plant and Machinery	3,00,000
P	2,37,500	Stock	90,000
R	62,500	Debtors	85,000
Q Loan	2,25,000	Cash	1,00,000
Creditors	50,000		
	5,75,000		5,75,000

Working Notes : **(1) Statement Showing the Required Adjustment for Goodwill**

Partners	P (₹)	Q (₹)	R (₹)
Right of goodwill before retirement (3 : 2 : 1)	75,000	50,000	25,000
Right of goodwill after retirement (1 : 1)	75,000	—	75,000
Gain (+) / Sacrifice (–)	Nil	(–) 50,000	(+) 50,000

Illustration 14

A partnership consists of three partners with capital, sharing profits and drawings as follows :

Partners	Capital (₹)	Profit (%)	Drawings (₹)
A	1,50,000	50	15,000
B	1,00,000	30	10,000
C	50,000	2015,000	

Capital is chargeable with 5% interest per annum.

B and C each receive a salary of ₹ 7,500 per annum, capital to remain fixed.

A had loaned a further of ₹ 1,00,000 to the partnership at 4% per annum interest.

Profit for the year, before charging partners' salaries, interest on loan and capital was ₹ 1,00,000.

A retired at the end of the year, and B and C, in accordance with agreement, take over his share. Total goodwill is valued at ₹ 1,25,000. Fixed assets revalued upwards by ₹ 25,000.

You are required to prepare Profit and Loss Appropriation Account and Partners' Current Accounts. Also determine the amount due to A (No account is required).

Solution

Dr. Profit and Loss Appropriation Account for the year ended ... Cr.

Particulars			₹	Particulars	₹
To Interest on Capital A/c :	A	7,500		By Net Profit (Less Interest on Loan)	
	B	5,000		[₹ 1,00,000 – (4% of ₹ 1,00,000)]	96,000
	C	2,500	15,000		
To Partners' Salaries A/c :	B	7,500			
	C	7,500	15,000		
To Share of Profit A/c :	A	33,000			
	B	19,800			
	C	13,200	66,000		
			96,000		96,000

Dr. Partners' Capital Accounts Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Drawings A/c	15,000	10,000	10,000	By Interest on Capital A/c	7,500	5,000	2,500
To A Loan A/c	25,500	—	—	By Partners' Salaries A/c	—	7,500	7,500
To Balance c/d	—	22,300	13,200	By Share of Profit A/c	33,000	19,800	13,200
	40,500	32,300	23,200		40,500	32,300	23,200

Calculation of Amount Due to A

Liabilities	₹
Capital Account Balance	1,50,000
Current Account Balance	25,500
Loan Account Balance	1,00,000
Accrued Interest on Loan	4,000
Share of Goodwill (50% of ₹ 1,25,000)	62,500
Revaluation Profit (50% of ₹ 25,000)	12,500
	3,54,500

Illustration 15

A and B were in partnership sharing profits equally. At 1.1.2015, their Balance Sheet was as follows :

Liabilities		₹	Assets	₹
Capital Accounts :	A	60,000	Freehold Premises	30,000
	B	20,000	Plant and Machinery	15,000
Current Accounts :	A	12,000	Motor Van	16,000
	B	5,000	Stock	14,000
Creditors		7,500	Debtors	12,000
			Bank Balance	17,500
		1,04,500		1,04,500

B retired on 1.1.2015 when the assets were revalued as follows :

Freehold Premises ₹ 40,000; Plant and Machinery ₹ 10,000; Motor Van ₹ 10,000.

It was also agreed that stock which had cost ₹ 7,000 was now worth ₹ 3,000, and further stock which had cost ₹ 2,000 now had nil value.

Debtors at 1.1.2015 included bad debts of ₹ 2,000; no provision for doubtful debts had been made in the past but a provision equal to 4% of debtors as at 1.1.2015 should be created.

The adjustments for the foregoing matters was made in the books as at 1.1.2015. B was paid by cheque ₹ 10,000 and the balance transferred to his Loan Account.

You are required to prepare necessary Ledger Accounts and the Balance Sheet of A, after B's retirement.

Solution — **In the books of the Firm**

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

Particulars	₹	Particulars		₹
To Plant and Machinery A/c	5,000	By Freehold Premises A/c		10,000
To Motor Van A/c	6,000	By Partners' Capital A/cs : A	4,700	
To Stock A/c (₹ 4,000 + ₹ 2,000)	6,000	B	4,700	9,400
To Debtors A/c	2,000			
To Provision for Doubtful Debts A/c (Note 1)	400			
	19,400			19,400

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

Particulars	A (₹)	B (₹)	Particulars	A (₹)	B (₹)
To Revaluation A/c (Loss)	4,700	4,700	By Balance b/d	60,000	20,000
To Bank A/c	—	10,000	By B Current A/c	—	5,000
To B Loan A/c	—	10,300			
To Balance c/d	55,300				
	60,000	25,000		60,000	25,000

B Loan Account

Particulars	₹	Particulars	₹
To Balance c/d	10,300	By Partners' Capital A/cs	10,300

Balance Sheet after B's Retirement

Liabilities	₹	Assets		₹
Capital Account	55,300	Freehold Premises		40,000
Current Account	12,000	Plant and Machinery		10,000
B Loan	10,300	Motor Van		10,000
Creditors	7,500	Stock		8,000
		Debtors (₹ 12,000 – 2,000)	10,000	
		Less: Provision for Doubtful Debts	400	9,600
		Bank (₹ 17,500 – 10,000)		7,500
	85,100			85,100

Working Notes :

Partners	R (₹)
(1) Debtors as per Balance Sheet	12,000
Less: Bad Debts	2,000
	10,000
Provision for Bad Debts 4% of ₹ 10,000 = ₹ 400.	

Illustration 16

X, Y and Z are partners sharing profits in the ratio of their capitals. Y retired from the firm on 31.12.2014, the date on which the Balance Sheet of the firm was as follows :

Liabilities	₹	Assets		₹
Sundry Creditors	4,000	Cash		5,400
Bills Payable	2,500	Debtors	6,000	
Outstanding Salary	500	Less: Provision for bad debts	400	5,600
Capitals :		Stock		10,000
X	30,000	Machinery		28,000
Y	24,000	Land and Buildings		30,000
Z	18,000			
	79,000			79,000

The following adjustments were made :

(i) Buildings appreciated by 20%; stock depreciated by 10%; provision for doubtful debts was to be 5%; and a reserve for legal charges payable was to be made at ₹ 900.

(ii) Goodwill of the firm be valued at ₹ 12,000 and Y's share in it be adjusted into the Capital Accounts of X and Z without opening Goodwill Account.

(iii) ₹ 24,000 from Y's Capital Account be transferred to his Loan Account and balance be paid in cash.

(iv) New profit-sharing ratio of X and Z is decided to be 3 : 2.

Give the necessary Ledger Accounts and the Balance Sheet of the firm after Y's retirement.

Solution **In the books of the Firm**

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

Particulars		₹	Particulars	₹
To Stock A/c (10% on ₹ 10,000)		1,000	By Land and Buildings A/c (20% on ₹ 30,000)	6,000
To Provision for Legal Charges A/c		900	By Provision for Bad Debts A/c (₹ 500 – 400)	100
To Partners' Capital A/cs :	₹			
X	1,750			
Y	1,400			
Z	1,050	4,200		
		6,100		6,100

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

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Y Capital A/c (Note 1)	2,200	—	1,800	By Balance b/d	30,000	24,000	18,000
To Cash A/c (Balancing figure)	—	5,400	—	By Revaluation A/c	1,750	1,400	1,050
To Y's Loan A/c	—	24,000	—	By X Capital A/c (Note 1)	—	2,200	—
To Balance c/d	29,550	—	17,250	By Z Capital A/c (Note 1)	—	1,800	—
	31,750	29,400	19,050		31,750	29,400	19,050

Balance Sheet of X and Z as on 31st December, 2014

Liabilities	₹	Assets		₹
Capitals :		Land and Buildings (₹ 30,000 + 6,000)		36,000
X	29,550	Machinery		28,000
Z	17,250	Stock (₹ 10,000 – 1,000)		9,000
Y's Loan Account	24,000	Debtors	6,000	
Sundry Creditors	4,000	Less: Provision for Bad Debts (₹ 400 – 100)	300	5,700
Outstanding Salary	500	Bills Payable		2,500
		Provision for Legal Charges		900
	78,700			78,700

Working Notes : **(1) Statement Showing the Required Adjustment for Goodwill**

Partners	X (₹)	Y (₹)	Z (₹)
Right of goodwill before retirement (5 : 4 : 3)	5,000	4,000	3,000
Right of goodwill after retirement (3 : 2)	7,200	—	4,800
Gain (+) / Sacrifice (–)	(+) 2,200	(–) 4,000	(+) 1,800

Required Journal Entry :

X Capital Account	Dr.	2,200	
Z Capital Account	Dr.	1,800	
To Y Capital Account			4,000

Illustration 17

D, R and L were in partnership sharing profits and losses in the ratio of 3 : 2 : 1 respectively. The draft Balance Sheet as on 31.3.2015 was as follows :

Liabilities			₹	Assets		₹
Capital Accounts :	D	24,000		Buildings		12,000
	R	12,000		Plant and Equipment		18,800
	L	6,000	42,000	Stock		9,200
Current Accounts :	D	1,920		Debtors	12,400	
	R	1,680		Less: Provision for Doubtful Debts	1,200	11,200
	L	1,120	4,720	Balance at Bank		16,120
Loan — D			5,000			
Creditors			15,600			
			67,320			67,320

D retired on 31.3.2015 and, R and L continued in partnership sharing profits and losses in the ratio of 2 : 1. D's loan was repaid on 1.4.2015 and it was agreed that the remaining balance due to him, other than that of the Current Account, should remain as loan to the partnership.

For the purpose of D's retirement, it was agreed that —

(i) Buildings be revalued at ₹ 24,000 and the plant and equipment at ₹ 15,800.

(ii) The provision for doubtful debts was to be increased by ₹ 400.

(iii) A provision of ₹ 500 included in creditors was no longer required.
(iv) ₹ 1,200 was to be written-off the stock in respect of damaged items included therein.
(v) A provision of ₹ 4,240 be made in respect of outstanding legal charges.
(vi) The goodwill of the firm to be valued at ₹ 14,400. Both the partners decided that goodwill should not appear in the books of account of the firm.

You are required to prepare :
(a) Revaluation Account;
(b) Capital and Current Accounts of the partners;
(c) Balance Sheet of R and L as on 1.4.2015.

Solution

In the books of the Firm

Dr. Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Plant and Equipment A/c	3,000	By Buildings A/c	12,000
To Provision for Doubtful Debts A/c	400	By Creditors A/c	500
To Stock A/c	1,200		
To Provision for Legal Charges A/c	4,240		
To Partners' Capital A/cs (D — ₹ 1,830; R — ₹ 1,220; L — ₹ 610):	3,660		
	12,500		12,500

Dr. Partners' Capital Accounts Cr.

Particulars	D (₹)	R (₹)	L (₹)	Particulars	D (₹)	R (₹)	L (₹)
To D Loan A/c	33,030	—	—	By Balance b/d	24,000	12,000	6,000
To Goodwill A/c	—	9,600	4,800	By Revaluation A/c (Note 1)	1,830	1,220	610
To Balance c/d	—	8,420	4,210	By Goodwill A/c	7,200	4,800	2,400
	33,030	18,020	9,010		33,030	18,020	9,010

Dr. Partners' Current Accounts Cr.

Particulars	D (₹)	R (₹)	L (₹)	Particulars	D (₹)	R (₹)	L (₹)
To Bank A/c	1,920	—	—	By Balance b/d	1,920	1,680	1,120
To Balance c/d		1,680	1,120				
	1,920	1,680	1,120		1,920	1,680	1,120

Balance Sheet of R and L as on 1st April, 2015

Liabilities			₹	Assets		₹
Capital Accounts :	R	8,420		Building		24,000
	L	4,210	12,630	Plant and Equipment		15,800
Current Accounts :	R	1,680		Stock		6,000
	L	1,120	2,800	Debtors	12,400	
D's Loan			33,030	Less: Provision for Doubtful Debts	1,600	10,800
Creditors (₹ 15,600 – 500)			15,100	Bank (₹ 16,120 – 5,000 – 1,920)		9,200
Provision for Legal Charges			4,240			
			67,800			67,800

Tutorial Note : Profits and losses arising out of revaluation of assets and liabilities directly affect the Partners' Capital Account. Therefore, it is to be transferred to Partners' Capital Accounts but not Partners' Current Accounts.

Illustration 18

A, B and C are in partnership sharing profits and losses in the ratio of 3 : 2 : 1 respectively. At 1.1.2015, their Balance Sheet was as follows :

Liabilities			₹	Assets	₹
Capital Accounts :	A	1,00,000		Fixed Assets	1,06,644
	B	50,000		Stock	71,116
	C	25,000	1,75,000	Debtors	42,655
Current Accounts :	A	24,000		Bank	24,863
	B	10,000			
	C	1,000	35,000		
Creditors			35,278		
			2,45,278		2,45,278

A retired on the above date and B and C decided to share profits and losses in the ratio of 2 : 1. Accordingly, it was agreed that —

(a) The balances on their Current Accounts would be transferred to their respective Capital Accounts.
(b) Goodwill would be valued at ₹ 24,000.
(c) Fixed assets would be revalued at ₹ 1,00,000, stock ₹ 70,000 and a debtor for ₹ 1,240 would be written-off as bad.
(d) A reserve of ₹ 30,000 is to be created.
(e) The entire amount due to A would be transferred to his Loan Account.

A took over an unrecorded asset at ₹ 3,000 against the amount due to him.

Prepare necessary Ledger Accounts and the Balance Sheet after A's retirement.

Solution **In the books of the Firm**

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

Particulars	₹	Particulars			₹
To Fixed Assets A/c	6,644	By A A/c (Note 1)			3,000
To Stock A/c	1,116	By Partners' Capital A/cs :	A	3,000	
To Debtors A/c	1,240		B	2,000	
			C	1,000	6,000
	9,000				9,000

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

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Revaluation A/c (Note 1)	3,000	—	—	By Balance b/d	1,00,000	50,000	25,000
To Revaluation A/c	3,000	2,000	1,000	By Partners' Current A/cs	24,000	10,000	1,000
To Goodwill A/c	—	16,000	8,000	By Goodwill A/c	12,000	8,000	4,000
To A Loan A/c	1,30,000	—	—				
To Reserve A/c (2 : 1)	—	20,000	10,000				
To Balance c/d	—	30,000	11,000				
	1,36,000	68,000	30,000		1,36,000	68,000	30,000

Balance Sheet after A's retirement

Liabilities			₹	Assets	₹
Capital :	A	30,000		Fixed Assets	1,00,000
	B	11,000	41,000	Stock	70,000
Reserve			30,000	Debtors	41,415
A Loan			1,30,000	Bank	24,863
Creditors			35,278		
			2,36,278		2,36,278

Working Notes :

(1) Unrecorded assets taken over by A at an agreed value of ₹ 3,000. A's Capital will be debited and Revaluation Account will be credited.

(2) Reserve to be created by debiting B and C Capital in the new profit-sharing ratio, i.e., 2 : 1. A has nothing to do with the Reserve.

3. Adjustment in Regard to Undistributed Profits and Losses

When a partner is retiring from the partnership, an adjustment entry is required for any reserve/accumulated losses appearing in the Balance Sheet at the time of retirement. The Journal Entry will be as follows :

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

If there is any accumulated loss in the Balance Sheet at the time of retirement, the Journal Entry will be as follows :

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

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

The accounting entries will be as follows :

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

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

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

Remaining Partners' Capital Accounts	Dr.	[New ratio]
To Reserve Account		[Agreed amount]

Students must pass necessary entries for reserve and surplus or accumulated losses even if the question is silent on that point.

Illustration 19

X, Y and Z were partners in a firm sharing profits and losses in the ratio of 2 : 2 : 1 respectively. The Balance Sheet of the firm as on 31st December, 2014 was as follows :

Liabilities	₹	Assets		₹
Capital Accounts :		Buildings		3,00,000
X	2,00,000	Plant and Machinery		2,00,000
Y	2,00,000	Furniture		50,000
Z	1,50,000	Stock-in-Trade		1,50,000
General Reserve	75,000	Sundry Debtors	1,00,000	
Creditors	1,25,000	Less: Provision for bad debts	5,000	95,000
Bills Payable	60,000	Cash		15,000
	8,10,000			8,10,000

On 1st January, 2015, Y retired. The terms of his retirement provided the following :

(1) Plant and machinery and furniture were to be depreciated by 5% and 10% respectively.

(2) Stock and building were to be appreciated by 20% and 10% respectively.

(3) Provision for doubtful debts was to be increased to ₹ 7,500.

(4) The goodwill of the firm was to be valued at ₹ 1,00,000.

(5) The amount due to Y was to be transferred to a separate Loan Account.

You are required to show the Revaluation Account, Partners' Capital Accounts and the Balance Sheet of the new firm as on 1st January, 2015.

Solution

In the books of the Firm

Dr. Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Plant and Machinery A/c	10,000	By Stock A/c	30,000
To Furniture A/c	5,000	By Building A/c	30,000
To Provision for Bad Debts A/c	2,500		
To Partners' Capital A/cs :			
X	17,000		
Y	17,000		
Z	8,500		
	60,000		60,000

Dr. Partners' Capital Accounts Cr.

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Y Loan A/c	—	2,87,000	—	By Balance b/d	2,00,000	2,00,000	1,50,000
To Goodwill A/c (2 : 1)	66,667	—	33,333	By Revaluation A/c	17,000	17,000	8,500
To Balance c/d	2,20,333	—	1,60,167	By Goodwill A/c (Note 1)	40,000	40,000	20,000
				By General Reserve A/c (Note 2)	30,000	30,000	15,000
	2,87,000	2,87,000	1,93,500		2,87,000	2,87,000	1,93,500

Balance Sheet of X and Z as on 31st January, 2015

Liabilities	₹	Assets	₹
Capital Accounts :		Buildings (₹ 3,00,000 + 30,000)	3,30,000
X	2,20,233	Plant and Machinery (₹ 2,00,000 – 10,000)	1,90,000
Z	1,60,167	Furniture (₹ 50,000 – 5,000)	45,000

Y Loan	2,87,000	Stock-in-Trade ₹ (1,50,000 + 30,000)		1,80,000
Creditors	1,25,000	Sundry Debtors	1,00,000	
Bills Payable	60,000	Less: Provision for bad debts	7,500	92,500
		Cash		15,000
	8,52,500			8,52,500

Working Notes :

(1) Goodwill is to be raised in the books at its full value by crediting all Partners' Capital Accounts in the old ratio, i.e., 2 : 2 : 1 and immediately it is to be written-off by debiting continuing partners in the new profit-sharing ratio, i.e. 2 : 1.

(2) General Reserve is to be distributed amongst the old partners even when the question is silent on this point. General Reserve Account is debited and Old Partners' Capital Accounts are credited in the old ratio, i.e., 2 : 2 : 1.

Illustration 20

A, B and C are partners sharing profits and losses equally. The Balance Sheet of the firm as on 31st December, 2015 stood as follows :

Liabilities	₹	Assets		₹
Capital Accounts :		Goodwill		19,500
A	30,000	Land and Buildings		40,000
B	20,000	Investments (at cost)		5,000
C	20,000	Stock		10,000
Contingency Reserve	6,000	Debtors	10,000	
Investment Fluctuation Fund	1,2000	Less: Provision for bad debts	800	9,200
Creditors	12,800	Cash at bank		3,300
		Cash in hand		3,000
	90,000			90,000

C retires on 1st January, 2015. In order to arrive at the balance due to C, it was mutually agreed that:

(1) Land and Buildings be valued at ₹ 50,000.
(2) Investment fluctuation fund be brought down to ₹ 500.
(3) Contingency reserve is no longer required.
(4) Debtors are all good.
(5) Stock to be taken at ₹ 9,000.
(6) Amount due to C will be transferred to his Loan Account carrying interest @ 12% p.a.
(7) Goodwill be valued at one year's purchase of the average profits of the past five years. The profits of the preceding five years were :
2015 — ₹ 11,500; 2011 — ₹ 14,000; 2012 — ₹ 9,000; 2013 — ₹ 8,000; and 2014 — ₹ 10,000.

You are required to show :

(i) Revaluation Account;
(ii) Partners' Capital Accounts; and
(iii) Balance Sheet of the new firm as on 1st January, 2015.

Solution

In the books of the Firm

Dr. Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Stock A/c ₹ (10,000 – 9,000)	1,000	By Land and Buildings A/c	10,000
To Partners' Capital A/cs :		By Investment Fluctuation Fund A/c (Note 2)	700
A	3,500	By Provision of Bad Debts A/c	800
B	3,500		
C	3,500		
	11,500		11,500

Dr. Partners' Capital Accounts Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Goodwill A/c (Note 1)	6,500	6,500	6,500	By Balance b/d	30,000	20,000	20,000
To C Loan A/c	—	—	22,500	By Contingency Reserve A/c	2,000	2,000	2,000
To C Capital A/c	1,750	1,750	—	By A Capital A/c	—	—	1,750
To Balance c/d	27,250	17,250	—	By B Capital A/c	—	—	1,750
				By Revaluation A/c	3,500	3,500	3,500
	35,500	25,500	29,000		35,500	25,500	29,000

Balance Sheet of A and B as on 1st January, 2015

Liabilities	₹	Assets	₹
Capital Accounts :		Land and Buildings	50,000
A	27,250	Investments (at cost)	5,000
B	17,250	Stock	9,000
12% C Loan	22,500	Debtors	10,000
Investment Fluctuation Fund	500	Cash at bank	3,300
Creditors	12,800	Cash in hand	3,000
	80,300		80,300

Working Notes :

(1) Ascertainment of Goodwill :

(a) Total profits of last 5 years = (₹ 11,500 + 14,000 + 9,000 + 8,000 + 10,000) = ₹ 52,500.

(b) Average profit = ₹ 52,500 / 5 = ₹ 10,500.

(c) New value of goodwill = ₹ 10,500 × 1 = ₹ 10,500.

Goodwill already appearing in the books at ₹ 19,500. It is to be written-off first by debiting all partners equally. After this, goodwill is to be adjusted as follows :

Working Notes : (1) Statement Showing the Required Adjustment for Goodwill

Partners	A (₹)	B (₹)	C (₹)
Right of goodwill before retirement (equally)	3,500	3,500	3,500
Right of goodwill after retirement (equally)	5,250	5,250	—
Gain (+) / Sacrifice (–)	(+) 1,750	(–) 1,750	3,500

Required Journal Entry :

A Capital Account Dr. 1,750

B Capital Account Dr. 1,750

To C Capital Account 3,500

(2) Investment fluctuation fund is created to guard against the fall in the price of the investment. At the time of retirement, investment fluctuation fund is required to the extent of ₹ 500 only. Therefore, the balance of ₹ 700 will be transferred to Revaluation Account.

4. Adjustment in Regard to Joint Life Policy

When a partner is retiring from the partnership, an adjustment is required in respect of Joint Life Policy. Joint Life Policy should be adjusted according to situations.

Case 1 : When there is no Joint Life Policy in the present Balance Sheet and Joint Life Policy will be shown in the Balance Sheet after retirement

In this case, Joint Life Policy Account will be debited at surrender value and All Partners' Capital Accounts will be credited in the old ratio. Joint Life Policy will be shown in the Balance Sheet at surrender value.

Joint Life Policy Account Dr.

To All Partners' Capital Accounts

Illustration 21

A, B and C are partners sharing profits in the ratio of 4 : 3 : 2. Their Balance Sheet on 31st March, 2015 was as follows :

Liabilities			₹	Assets	₹
Creditors			33,000	Cash	10,000
General Reserve			27,000	Debtors	15,000
Capitals :	A	70,000		Stock	30,000
	B	45,000		Machinery	50,000
	C	30,000	1,45,000	Land and Building	1,00,000
			2,05,000		2,05,000

The firm had a joint life policy for ₹ 40,000. The surrender value of the policy was ₹ 13,500 as on 31st March, 2015. B retires on the above date on the following conditions :

(a) Land and building be appreciated by 20%.

(b) Goodwill to be valued at ₹ 18,000.

(c) A provision for doubtful debts of 5% is to be created and machinery and stock be written down by 10% and 5% respectively.

(d) A provision of ₹ 1,500 be made in respect of legal charges.

B to be paid ₹ 5,000 and balance be transferred to his Loan Account. Prepare Revaluation Account, Partners' Capital Accounts and Balance Sheet of A and C.

Solution

In the books of the Firm

Dr. Revaluation Account Cr.

Particulars		₹	Particulars	₹
To Provision for Doubtful Debts A/c (5% on ₹ 15,000)		750	By Land and Building A/c (20% of ₹ 1,00,000)	20,000
To Machinery A/c (10% of ₹ 50,000)				
To Stock A/c (5% of ₹ 30,000)	1,500			
To Provision for Legal Charges A/c	1,500	3,000		
To Partners' Capital A/cs :				
A	5,000			
B	3,750			
C	2,500	11,250		
		20,000		20,000

Dr. Partners' Capital Accounts Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Goodwill A/c	12,000	—	6,000	By Balance b/d	70,000	45,000	30,000
To Cash A/c	—	5,000	—	By General Reserve A/c	12,000	9,000	6,000
To B's Loan A/c	—	63,250	—	By Goodwill A/c	8,000	6,000	4,000
To Balance c/d	89,000	—	39,500	By Joint Life Policy A/c	6,000	4,500	3,000
				By Revaluation A/c	5,000	3,750	2,500
	1,01,000	68,250	45,500		1,01,000	68,250	45,500

Balance Sheet of A and C as on 31st March, 2015

Liabilities	₹	Assets		₹
Capitals :		Land and Building ₹ (1,00,000 + 20,000)		1,20,000
A	89,000	Machinery ₹ (50,000 – 5,000)		45,000
C	39,500	Stock ₹ (30,000 – 1,500)		28,500
B's Loan	63,250	Debtors	15,000	
Creditors	33,000	Less: Provision for doubtful debts	750	14,250
Provision for Legal Charges	1,500	Joint Life Policy		13,500
		Cash ₹ (10,000 – 5,000)		5,000
	2,26,250			2,26,250

Case 2 : When there is no Joint Life Policy in the present Balance Sheet and Joint Life Policy will not be shown in the Balance Sheet after retirement

In this case, adjustment is done through the Partners' Capital Accounts by passing the following entry :

Continuing Partners' Capital Accounts Dr. [Gaining Ratio]
To Retiring Partners' Capital Accounts [Share of surrender value]

Illustration 22

A, B and C were partners sharing profits and losses in the ratio of 5 : 3 : 2 respectively. They had taken out a Joint Life Policy of the face value of ₹ 2,00,000. On 31st December, 2014 its surrender value was ₹ 40,000. On this date the Balance sheet of the firm stood as follows :

Liabilities		₹	Assets	₹
Sundry Creditors		53,000	Fixed Assets	2,50,000
Outstanding Expenses		7,000	Stock	1,10,000
Reserve		30,000	Book Debts	90,000
Capital A/cs :	A	2,00,000	Cash at Bank	20,000
	B	1,00,000		
	C	80,000		
		4,70,000		4,70,000

On that date, B decided to retire and for that purpose —

(a) Goodwill was valued at ₹ 1,50,000.

(b) Fixed Assets were valued at ₹ 3,00,000.

(c) Stock was considered as worth ₹ 10,000.

Amount due to B will be transferred to his Loan Account earning interest @ 10% p.a. Goodwill was to be passed through books without raising a Goodwill Account.

The Joint Life Policy was also not to appear in the Balance Sheet.

Prepare :

(1) Revaluation Account;

(2) Partners' Capital Accounts; and

(3) Balance Sheet after B's retirement.

Solution

In the books of the Firm

Dr. Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Stock A/c	1,00,000	By Fixed Assets A/c	50,000
		By Partners' Capital A/cs :	
		A	25,000
		B	15,000
		C	10,000
	1,00,000		1,00,000

Dr. Partners' Capital Accounts Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Revaluation A/c (Loss)	25,000	15,000	10,000	By Balance b/d	2,00,000	1,00,000	80,000
To B Capital A/c (Note 1)	15,000	—	30,000	By Reserve A/c	15,000	9,000	6,000
To B Capital A/c (Note 2)	4,000	—	8,000	By A Capital A/c (Note 1)	—	15,000	—
To B Loan A/c	—	1,51,000	—	By C Capital A/c (Note 1)	—	30,000	—
To Balance c/d	1,71,000	—	38,000	By A Capital A/c (Note 2)	—	4,000	—
				By B Capital A/c (Note 2)	—	8,000	—
	2,15,000	1,66,000	86,000		2,15,000	1,66,000	86,000

Balance Sheet (after B's retirement) as on 31st December, 2014

Liabilities		₹	Assets	₹
Capital A/cs :	A	1,71,000	Fixed Assets	3,00,000
	C	38,000	Stock	10,000
B Loan		1,51,000	Book Debts	90,000
Sundry Creditors		53,000	Cash at Bank	20,000
Outstanding Expenses		7,000		
		4,20,000		4,20,000

Working Notes :

(1) Adjustment for Goodwill (₹ 1,50,000)

Partners	A (₹)	B (₹)	C (₹)
Right of goodwill before retirement (5 : 3 : 2)	75,000	45,000	30,000
Right of goodwill after retirement (3 : 2)	90,000		60,000
Gain (+) / Sacrifice (–)	(+) 15,000	(–) 45,000	(+) 30,000

(2) Adjustment for Joint Life Policy (₹ 40,000)

Partners	A (₹)	B (₹)	C (₹)
Right of goodwill before retirement (5 : 3 : 2)	20,000	12,000	8,000
Right of goodwill after retirement (3 : 2)	24,000	—	16,000
Gain (+) / Sacrifice (–)	(+) 4,000	(–) 12,000	(+) 8,000

Journal Entry

A Capital Account	Dr.	4,000	
C Capital Account	Dr.	8,000	
To B Capital Account			12,000

Alternatively:

Joint Life Policy can be adjusted by calculating Gaining Ratio which is as follows :

Partners	A (₹)	B (₹)	C (₹)
Old Profit Sharing Ratio	5/10	3/10	2/10
New Profit Sharing Ratio	3/5	–	2/5
Gaining Ratio	(6 – 5) / 10		(4 – 2) / 10
	= 1/10	= 3/10	= 2/10

Gaining Ratio — A : C = 1 : 2.

B's share of the surrender value = 3/10 of ₹ 40,000 = ₹ 12,000 and it is to be borne by A and C in the Gaining Ratio, i.e., 1 : 2.

A will bear = 1/3 of ₹ 12,000 = ₹ 4,000.C will bear = 2/3 of ₹ 12,000 = ₹ 8,000.

Illustration 23

On 31st March, 2015, the Balance Sheet of M/s. A, B and C sharing profits and losses in proportion to their capitals, stood as follows :

Liabilities	₹	Assets	₹
Sundry Creditors	1,00,000	Land and Buildings	2,00,000
Capital A/cs :		Machinery	3,00,000
A	2,00,000	Closing Stock	1,00,000
B	3,00,000	Sundry Debtors	1,00,000
C	2,00,000	Cash and Bank Balances	1,00,000
	8,00,000		8,00,000

On 31st March, 2015, A desired to retire from the firm and the remaining partners decided to carry on. It was agreed to revalue the Assets and Liabilities on that date on the following basis :

(1) Land and Buildings be appreciated by 30%.

(2) Machinery is to be depreciated by 20%.

(3) Closing Stock is to be valued at ₹ 75,000.

(4) Provision for bad debts is to be made at 5%.

(5) Old credit balances of Sundry Creditors ₹ 20,000 is to be written-back.

(6) Joint Life Policy of the partners surrendered and cash obtained ₹ 80,000.

(7) Goodwill of the entire firm be valued at ₹ 1,40,000 and A's share of the Goodwill be adjusted in the accounts of B and C who share the future profits equally. No Goodwill Account being raised.

(8) The capital of the firm is to be the same as before retirement. Individual capital be in their profit-sharing ratio.

(9) Amount due to A is to be settled on the following basis : 50% on retirement and the balance 50% within one year.

Prepare Revaluation Account, Capital Accounts of Partners, Cash and Bank Account and Balance Sheet as on 1.4.2015 of M/s. B and C.

Solution **In the books of M/s A, B and C**

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

Particulars	₹	Particulars	₹
To Machinery A/c	60,000	By Land and Buildings A/c	60,000
To Closing Stock A/c	25,000	By Sundry Creditors A/c	20,000
To Provision for Bad Debts A/c	5,000	By Partners' Capital A/cs	10,000
(A : ₹ 2,857; B : ₹ 4,286; C : ₹ 2,857)			
	90,000		90,000

Dr. **Cash and Bank Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	1,00,000	By A Capital A/c	1,30,000
To Joint Life Policy A/c	80,000	By Balance c/d	2,40,000
To B Capital A/c	30,000		
To C Capital A/c	1,60,000		
	3,70,000		3,70,000

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

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Revaluation A/c	2,857	4,286	2,857	By Balance b/d	2,00,000	3,00,000	2,00,000
To A Capital A/c (Goodwill)	—	10,000	30,000	By J.L.P. A/c	22,857	34,286	22,857
To Bank A/c (50% paid-off)	1,30,000	—	—	By B Capital A/c (Goodwill)	10,000	—	—
To A Loan A/c	1,30,000	—	—	By C Capital A/c (Goodwill)	30,000	—	—
To Balance c/d (required)	—	3,50,000	3,50,000	By Bank A/c (Bal. figure)	—	30,000	1,60,000
	2,62,857	3,64,286	3,82,857		2,62,857	3,64,286	3,82,857

Balance Sheet of M/s B and C as on 1st April, 2015

Liabilities		₹	Assets		₹
Partners' Capital A/cs :	₹		Land and Buildings		2,60,000
B	3,50,000		Machinery		2,40,000
C	3,50,000	7,00,000	Closing Stock		75,000
A's Loan Account		1,30,000	Sundry Debtors	1,00,000	
Sundry Creditors		80,000	Less: Provision for Bad Debts	5,000	95,000
			Cash and Bank Balances		2,40,000
		9,10,000			9,10,000

Working Notes : **Calculation of Share of Goodwill**

Partners	A (₹)	B (₹)	C (₹)
Right of goodwill before retirement (2 : 3 : 2)	40,000	60,000	40,000
Right of goodwill after retirement (1 : 1)	—	70,000	70,000
Gain (+) / Sacrifice (–)	(–) 40,000	(+) 10,000	(+) 30,000

In this case, Joint Life Policy will be treated as an asset. Any revaluation of Joint Life Policy will be done through Revaluation Account.

Case 3 : When there is Joint Life Policy in the Balance Sheet

Illustration 24

A, B and C were partners sharing profits and losses in the ratio of 3 : 2 : 1. Their Balance Sheet as on 31.03.2015 stood as follows :

Liabilities	₹	Assets		₹
Sundry Creditors	12,500	Cash at Bank		1,500
General Reserve	18,000	Sundry Debtors	15,000	
Capital A/cs :		Less: Provision for bad debts	1,500	13,500
(A — ₹ 40,000; B — ₹ 21,000; C — ₹ 20,000)	81,000	Stock		12,500
Joint Life Policy	8,000	Office Equipments		14,000
		Furniture		12,000
		Building		50,000
	1,11,500			1,11,500

B retired on 1.4.2015 subject to the following conditions :

(i) Office equipment revalued at ₹ 15,900.

(ii) Building revalued at ₹ 75,000. Furniture is to written-down by ₹ 2,000 and stock is reduced to ₹ 10,000.

(iii) Provision for bad debts is to be calculated @ 5% on debtors.

(iv) Goodwill of the firm is to be valued at ₹ 18,000. But no Goodwill Account is to be raised.

(v) Joint Life Policy is to be shown at surrendered value. The surrender value is ₹ 7,500.

(vi) Amount due to B is to be transferred to his Loan Account.

You are required to prepare : Revaluation Account, Partners' Capital Accounts and Balance Sheet immediately after B's retirement.

Solution **In the books of the Firm**

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

Particulars	₹	Particulars	₹
To Stock A/c	2,500	By Office Equipments A/c	1,900
To Furniture A/c	2,000	By Buildings A/c	25,000
To Joint Life Policy A/c	500	By Provision for Bad Debts A/c	
To Partners' Capital A/c :	22,650	(₹ 1,500 — 5% of ₹ 15,000)	750
(A — ₹ 11,325; B — ₹ 7,550; C — ₹ 3,775)			
	27,650		27,650

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

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To B Capital A/c (Note 1)	3,000	—	3,000	By Balance b/d	40,000	21,000	20,000
To B Loan A/c	—	40,550	—	By General Reserve A/c	9,000	6,000	3,000
To Balance c/d	57,325	—	23,775	By A Capital A/c (Note 1)	—	3,000	—
				By C Capital A/c (Note 1)	—	3,000	—
				By Revaluation A/c	11,325	7,550	3,775
	60,325	40,550	26,775		60,325	40,550	26,775

Balance Sheet (after B's retirement) as on 1st April, 2015

Liabilities		₹	Assets		₹
Sundry Creditors		12,500	Cash at Bank		1,500
Loan — B		40,550	Debtors	15,000	
Capital :	A	57,325	Less: Provision for bad debts	750	14,250
	C	23,775	Stock		10,000
Joint Life Policy		7,500	Office Equipments		15,900
			Furniture		10,000
			Buildings		75,000
		1,34,150			1,34,150

Working Notes : **(1) Calculation of Share for Goodwill**

Partners	A (₹)	B (₹)	C (₹)
Right of goodwill before retirement (3 : 2 : 1)	9,000	6,000	3,000
Right of goodwill after retirement (1 : 1)	12,000	—	6,000
Gain (+) / Sacrifice (–)	(+) 3,000	(–) 6,000	(+) 3,000

5. Adjustment in Regard to Share of Profits from the Date of the last Balance Sheet to the Date of Retirement

So far we have seen that a partner is retiring from the partnership either at the beginning or at the end of the accounting year. But in practical situation, a partner may retire during the course of an accounting year. In this case, the retiring partner is entitled to a share of profit of the current year up to the date of retirement, in addition to his share of goodwill, revaluation on profit and reserve. His share of interim profit is calculated on the basis of the provision in the partnership deed. If the partnership deed is silent, the amount of profit should be calculated in such a manner as must have been agreed by the partners. The interim profit can be calculated by adopting any of the following two methods.

Method 1 : Calculation of Interim Profit based on Past Profits

In this case the following steps are followed :

Step 1 : Calculate average profit based on the last few years' profit.

Step 2 : Calculate the profit of that particular period (from the beginning of the year to the date of retirement).

Step 3 : Calculate the share of profit of the retiring partner based on old profit-sharing ratio.

Step 4 : Pass necessary Journal Entries as follows :

Profit and Loss Suspense Account Dr.
   To Retiring Partner's Capital Account [Retiring partner's share of profit]
      OR
Continuing Partners' Capital Account Dr. [Old ratio]
   To Retiring Partner's Capital Account

It should be noted that when actual Profit and Loss Account will be prepared at the end of the accounting period, the balance of this Profit and Loss Suspense Account will be transferred to Profit and Loss Appropriation Account. ***Alternatively***, the Continuing Partners' Capital Account is debited in the old ratio and Profit and Loss Suspense Account is credited. Till adjustment, Profit and Loss Suspense Account is shown in the interim Balance Sheet.

Illustration 25

A, B and C are partners sharing profits and losses in the ratio of 2 : 2 : 1. C retires on 31st March, 2015. The Balance Sheet of the firm on 31st December, 2014 stood as follows :

Liabilities	₹	Assets	₹
Capital A/cs :		Land and Buildings	1,00,000
A	60,000	Investments	12,500
B	60,000	Stock	25,000
C	40,000	Debtors	40,000
General Reserve	40,000	Cash at Bank	22,500
Creditors	10,000	Cash in Hand	10,000
	2,10,000		2,10,000

In order to arrive at the balance due to C, it was mutually agreed that :

(1) Land and buildings be valued at ₹ 1,20,000.

(2) Investment be valued at ₹ 10,000.

(3) Stock be taken at ₹ 30,000.

(4) Goodwill be valued at two year's purchase of the average profit of the past five years. Goodwill will not appear in the books of the reconstituted firm.

(5) C's share of profit up to the date of retirement be calculated on the basis of average profit of the preceding three years. The profits of the preceding five years were as under : 2015—₹ 20,000; 2011—₹ 23,500; 2012—₹ 30,000; 2013—₹ 27,500; and 2014—₹ 32,500.

(6) Amount payable to C to be transferred to his Loan Account carrying interest @ 15% p.a.

You are required to prepare : (i) Revaluation Account; (ii) Partners' Capital Accounts; and (iii) a Balance Sheet as at 31st March, 2015.

Solution

Dr. **(i) Revaluation Account** **Cr.**

Particulars	₹	Particulars	₹
To Investment A/c	2,500	By Land and Building	20,000
To Partners' Capital A/cs :		By Stock	5,000
A	9,000		
B	9,000		
C	4,500		
	25,000		25,000

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

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Goodwill A/c	26,700	26,700	—	By Balance b/d	60,000	60,000	40,000
To 15% C Loan A/c	—	—	64,680	By Goodwill A/c	21,360	21,360	10,680
To Balance c/d	79,660	79,660	—	By General Reserve A/c	16,000	16,000	8,000
				By Revaluation A/c	9,000	9,000	4,500
				By Profit & Loss Suspense A/c	—	—	1,500
	1,06,360	1,06,360	64,680		1,06,360	1,06,360	64,680

(iii) Balance Sheet of A and B as on 31st March, 2015

Liabilities	₹	Assets	₹
Capital A/cs :		Land and Buildings	1,20,000
A	79,660	Investment	10,000
B	79,660	Stock	30,000
15% C Loan	64,680	Debtors	40,000
Creditors	10,000	Cash at Bank	22,500
		Cash in Hand	10,000
		Profit & Loss Suspense A/c	1,500
	2,34,000		2,34,000

Working Notes :

(1) Calculation of Goodwill

(a) Average profit = (₹ 20,000 + 23,500 + 30,000 + 27,500 + 32,500) / 5 = ₹ 26,700.

(b) Goodwill = 2 year's purchase of average profit = 2 × ₹ 26,700 = ₹ 53,400.

(2) Calculation of C's Share of Profit

(a) Average profit (based on last three years) = (₹ 30,000 + 27,500 + 32,500) / 3 = ₹ 30,000.

(b) Profit for the month of January, February and March, 2015 = ₹ 30,000/12 × 3 = ₹ 7,500.

(c) C's share of profit = 1/5th of ₹ 7,500 = ₹ 1,500.

Illustration 26

A, B and C are equal partners. C retires on 31.3.2015. The Balance Sheet of the firm as on 31.12.2014 stood as follows:

Liabilities		₹	Assets		₹
Creditors		12,900	Cash in hand		1,000
Contingency Reserve		4,000	Cash at bank		4,000
Investment Fluctuation Fund		1,200	Debtors	10,000	
Partners' Capitals:	₹		Less: Provision for bad debts	800	9,200
A	30,000		Stock		10,000
B	20,000		Investments (cost)		5,000
C	20,000	70,000	Land and Buildings		40,000
			Goodwill		18,900
		88,100			88,100

In order to arrive at the balance due to C, it was mutually agreed that:

1. Land and Buildings be valued at ₹ 50,000;
2. Investment Fluctuation Fund be brought to ₹ 500;
3. Debtors are all good;
4. Stock be taken at ₹ 9,400;
5. Goodwill be valued at one year's purchase of the average profits of the past five years;
6. C's share of profit to the date of retirement be calculated on the basis of average profit of the preceding three years.

The p rofits for the preceding five years were as under: 2015—₹ 11,500; 2011—₹ 14,000; 2012—₹ 9,000; 2013—₹ 8,000; 2014—₹ 10,000.

Required: Journal entries, C's Capital Account and the revised Balance Sheet (show your workings).

Solution **In the books of the Firm**

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

Date	Particulars		₹	₹
2015 March 31	Land and Buildings A/c	Dr.	10,000	
	Investment Fluctuation Fund A/c	Dr.	700	
	Provision for Bad Debts A/c	Dr.	800	
	To Revaluation A/c			11,500
	(Being the increase in the value of assets)			
	Revaluation A/c	Dr.	600	
	To Stock A/c			600
	(Being the decrease in the value of stock)			
	Revaluation A/c	Dr.	10,900	
	To A Capital A/c			3,634
	To B Capital A/c			3,633
	To C Capital A/c			3,633
	(Being the profit on revaluation transferred to Partners' Capital Accounts)			
	A Capital A/c (Note 1)	Dr.	667	
	B Capital A/c	Dr.	667	
	To C Capital A/c			1,334
	(Being the required adjustment made for contingency reserve)			
	A Capital A/c	Dr.	2,800	
	B Capital A/c	Dr.	2,800	
	C Capital A/c	Dr.	2,800	
	To Goodwill A/c (Note 2)			8,400
	(Being the goodwill written-down to its agreed value)			
	A Capital A/c	Dr.	375	
	B Capital A/c	Dr.	375	
	To C Capital A/c (Note 3)			750
	(Being the required adjustment made for profit)			
	C Capital A/c	Dr.	22,917	
	To C Loan A/c			22,917
	(Being the balance of C's capital transferred to his Loan Account)			

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

Particulars	₹	Particulars	₹
To Goodwill A/c	2,800	By Balance b/d	20,000
To C Loan A/c	22,917	By Revaluation A/c	3,633

		By A Capital A/c – contingency reserve	667
		By B Capital A/c – contingency reserve	667
		By A Capital A/c – profit	375
		By B Capital A/c – profit	375
	25,717		25,717

Balance Sheet as on 31st March, 2015 (Revised)

Liabilities	₹	Assets	₹
Creditors	12,900	Cash in hand	1,000
Contingency Reserve	4,000	Cash at bank	4,000
Investment Fluctuation Fund	500	Debtors	10,000
C Loan Account	22,917	Stock	9,400
Partners' Capitals:		Investments	5,000
A ₹ (30,000 + 3,634 – 667 – 2,800 –375)	29,792	Land and Buildings	50,000
B ₹ (20,000 + 3,633 – 667 – 2,800 – 375)	19,791	Goodwill	10,500
	89,900		89,900

Working Notes : (1) Statement Showing the Required Adjustment for Contingency Reserve

Partners	A (₹)	B (₹)	C (₹)
Right of contingency reserve before retirement (1 : 1 : 1)	1,333	1,334	1,333
Right of contingency reserve after retirement (1 : 1)	2,000	—	2,000
Partners to be Debited (+) / Credited (–)	(+) 667	(–) 1,334	(+) 667

(2) Ascertainment of Goodwill
Total profit for the last 5 years — ₹ (11,500 + 14,000 + 9,000 + 8,000 + 10,000) = ₹ 52,500.
Average profit — ₹ 52,500 / 5 = ₹ 10,500.
Goodwill is one year's purchase of average profits of the past five years, i.e., ₹ 10,500 × 1 = ₹ 10,500.
Therefore, reduction in the value of goodwill = ₹ 18,900 – ₹ 10,500 = ₹ 8,400.
(3) Ascertainment of C's Share of Profit from 1.1.2015 to 31.3.2015
Total profit for the last 3 years — ₹ (9,000 + 8,000 + 10,000) = ₹ 27,000.
Average profit — ₹ 27,000 / 3 = ₹ 9,000.
Average profit for the 3 months, i.e., (1.1.2015 to 31.3.2015) — ₹ 9,000 × 3/12 = ₹ 2,250.
Therefore, C's share of profit — ₹ 2,250 / 3 = ₹ 750.

Method 2 : Calculation of Interim Profit after Preparing Interim Final Accounts

In this case, an interim Final Account is prepared up to the date of retirement. The profit of this interim Final Account is transferred to Partners' Capital Accounts by passing the following entry :

Profit and Loss Appropriation Account Dr. [Total profit of the interim period]
To All Partners' Capital Account [Old ratio]

Mode of Payment of Retiring Partners' Interest

The provision of the partnership deed is to be taken into consideration while deciding the mode of payment to retiring partner. If there is no partnership deed, the partners should decide it mutually. The amount payable to the retiring partner can be paid off in one of the following manner :

In One Lump Sum

When the amount payable to the retiring partner is small and there is enough cash in hand, the entire amount can be paid off in full just after retirement. The entry is :

Retiring Partner's Capital Account Dr. [Full amount]
To Cash/Bank Account

In Instalments

When the amount payable to the retiring partner is substantial and enough cash/bank balance is not there, the amount is paid in instalments. The number of instalments, rate of interest, the time and amount of each instalment is decided by the partners mutually if there is no provision in the partnership deed in this respect.

Generally, the amount payable to the retiring partner is transferred to his Loan Account. The Loan Account is credited with the periodic interest and debited with the instalment paid.

The Journal Entries are :

(i) When amount due to retiring partner is transferred to his Loan Account	
Retiring Partner's Capital Account	Dr.
To Retiring Partner's Loan Account	
(ii) For interest on the balance due	
Interest Account	Dr.
To Retiring Partner's Loan Account	
(iii) For payment of instalment	
Retiring Partner's Loan Account	Dr.
To Bank/Cash Account	

By Way of Annuity

The remaining partners may agree to settle the claim of the retiring partner by paying him a fixed annual amount called an annuity either for a certain number of years or for the whole life of the retiring partner. In this case, the total amount payable to the retiring partner is transferred to an Annuity Suspense Account, which must be credited with interest at a fixed rate per annum on the diminishing balance and debited with the amount of annuity paid.

In the event of death of the retiring partner before the amount is exhausted, the balance of the Annuity Suspense Account is transferred to remaining Partners' Capital Account in the profit-sharing ratio. When the credit balance of the Annuity Suspense Account is exhausted before the death of the retiring partner, subsequent instalment of annuity is charged to Profit and Loss Appropriation Account of the continuing partners.

Illustration 27

On 31st December, 2012 P retired from active partnership and his share of the following was ascertained on the date of retirement :

Goodwill ₹ 20,000; Interest on Capital ₹ 500; Salary ₹ 1,500; Drawings ₹ 20,000; Interest on Drawings ₹ 2,000; Share of Profit ₹ 25,000; Capital ₹ 75,000.

The amount due to P was to be kept with the firm as a loan bearing interest @ 10% p.a. was to be paid to P by annual instalments of ₹ 50,000 each, interest being calculated @ 10% p.a., on the unpaid balances. The first instalment was paid on 31st December, 2013. You are required to prepare P's Capital Account and also P's Loan Account until the payment of the whole amount due to him was made.

Solution

In the books of the Firm

Dr. P Capital Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Drawings A/c	20,000	31.12.2012	By Balance b/d	75,000
	To Interest on Drawings A/c	2,000		By Goodwill A/c	20,000
	To P Loan A/c	1,00,000		By Interest on Capital A/c	500
				By Partners' Salary A/c	1,500
				By Profit and Loss A/c (Share of Profit)	25,000
		1,22,000			1,22,000

Dr. P Loan Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Balance c/d	1,00,000	31.12.2012	By P Capital A/c	1,00,000
31.12.2013	To Bank A/c (₹ 50,000 + 10,000)	60,000	1.1.2013	By Balance b/d	1,00,000
	To Balance c/d	50,000	31.12.2013	By Interest A/c	10,000
		1,10,000			1,10,000
31.12.2014	To Bank A/c	55,000	1.1.2014	By Balance b/d	50,000
			31.12.2014	By Interest A/c	5,000
		55,000			55,000

Illustration 28

The Balance Sheet of M, N and O who are sharing profits and losses in the ratio of 1/2, 1/3 and 1/6 respectively was as follows on 30.6.2012 :

Liabilities		₹	Assets	₹
Bills payable		6,000	Cash in hand	150
Sundry creditors		12,900	Cash at bank	25,500
Capitals :	₹		Bills receivable	5,400
M	40,000		Book debts	17,800
N	25,000		Stock	22,300
O	20,000	85,000	Furniture	3,500
Profit and Loss A/c		4,500	Plant and Machinery	9,750
			Building	24,000
		1,08,400		1,08,400

M retires from business from 1st July, 2012. Assets were revalued as under :

Stock ₹ 20,000; Furniture ₹ 3,000; Plant and Machinery ₹ 9,000; Building ₹ 20,000; and ₹ 850 are to be provided for doubtful debts. The goodwill of the firm is agreed to be valued at ₹ 6,000. M is to be paid ₹ 11,050 in cash on retirement and balance in three equal yearly instalments with interest at 5% per annum.

Prepare Revaluation Account, M's Capital Account and M's Loan Account till it is finally closed.

Solution

In the books of the Firm

Dr. Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Stock A/c	2,300	By Partners' Capital A/cs :	
To Furniture A/c	500	M	4,200
To Plant and Machinery A/c	750	N	2,800
To Building A/c	4,000	O	1,400
To Provision for Doubtful Debts A/c	850		
	8,400		8,400

Dr. M Capital Account Cr.

Particulars	₹	Particulars	₹
To Revaluation A/c	4,200	By Balance b/d	40,000
To Cash A/c	11,050	By Goodwill A/c (1/2 of ₹ 6,000)	3,000
To M Loan A/c	30,000	By Profit and Loss A/c	2,250
	45,250		45,250

Dr. M Loan Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.6.2013	To Cash A/c (₹ 10,000 + 1,500)	11,500	1.7.2012	By M Capital A/c	30,000
	To Balance c/d	20,000	30.6.2013	By Interest A/c	1,500
		31,500			31,500
30.6.2014	To Cash A/c (₹ 10,000 + 1,000)	11,000	1.7.2013	By Balance b/d	20,000
	To Balance c/d	10,000	30.6.2014	By Interest A/c	1,000
		21,000			21,000
30.6.2015	To Cash A/c	10,500	1.7.2014	By Balance b/d	10,000
			30.6.2015	By Interest A/c	500
		10,500			10,500

Illustration 29

A, B and C are partners sharing profits and losses in the ratio of 4 : 3 : 2. Their Balance Sheet as on 31st December, 2010 was as follows :

Liabilities	₹	Assets		₹
Capital A/cs :		Land and Buildings		1,20,000
A	87,800	Plant and Machinery		37,000
B	60,800	Stock		36,000
C	43,800	Debtors	25,000	
Creditors	41,400	Less: Provision for Bad Debts	500	24,500
		Cash at bank		15,800
		Cash in hand		500
	2,33,800			2,33,800

B retired on 1st January, 2011 and these adjustments were agreed upon before ascertaining the amount payable to B:

(1) Land and building to be appreciated by 15%.

(2) Provision for bad debts raised to 5% on debtors.

(3) A provision of ₹ 650 is to be made for outstanding expenses.

(4) Stock to be reduced to ₹ 32,000.

(5) Goodwill to be valued at ₹ 45,000 and B's share to be adjusted into the accounts of A and C who decided to continue the business sharing profits and losses in the ratio of 5 : 3.

Amount payable to B will be paid in four equal annual instalment plus interest @ 10% on balance due. First instalment was paid on 31st December, 2011.

You are required to show: (i) Revaluation Account; (ii) Partners' Capital Accounts just after retirement of B; and (iii) B's Loan Account till it is finally closed.

Solution **In the books of the Firm**

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

Particulars		₹	Particulars	₹
To Provision for Bad Debts A/c		750	By Land and Building A/c	18,000
To Outstanding Expenses A/c		650		
To Stock A/c		4,000		
To Partners' Capital A/cs :	A	5,600		
	B	4,200		
	C	2,800		
		18,000		18,000

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

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To B Capital A/c (Note 1)	8,125	—	6,875	By Balance b/d	87,800	60,800	43,800
To B Loan A/c	—	80,000	—	By A Capital A/c	—	8,125	—
To Balance c/d	85,275	—	39,725	By C Capital A/c	—	6,875	—
				By Revaluation A/c	5,600	4,200	2,800
	93,400	80,000	46,600		93,400	80,000	46,600

Dr. **B Loan Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2011	To Bank A/c (₹ 20,000 + 8,000)	28,000	1.1.2011	By B Capital A/c	80,000
	To Balance c/d	60,000	31.12.2011	By Interest A/c	8,000
		88,000			88,000
31.12.2012	To Bank A/c (₹ 20,000 + 6,000)	26,000	1.1.2012	By Balance b/d	60,000
	To Balance c/d	40,000	31.12.2012	By Interest A/c	6,000
		66,000			66,000
31.12.2013	To Bank A/c (₹ 20,000 + 4,000)	24,000	1.1.2013	By Balance b/d	40,000
	To Balance c/d	20,000	31.12.2013	By Interest A/c	4,000
		44,000			44,000
31.12.2014	To Bank A/c	22,000	1.1.2014	By Balance b/d	20,000
			31.12.2014	By Interest A/c	2,000
		22,000			22,000

Working Notes : **(1) Statement Showing the Required Adjustment for Goodwill**

Partners	A (₹)	B (₹)	C (₹)
Right of goodwill before retirement (4 : 3 : 2)	20,000	15,000	10,000
Right of goodwill after retirement (5 : 3)	28,125	—	16,875
Gain (+) / Sacrifice (–)	(+) 8,125	(–) 15,000	(+) 6,875

Illustration 30

A, B and C are partners sharing profits and losses in the ratio of 3:2:1. Following is their Balance Sheet as at 31st March 2015:

Liabilities	₹	Assets	₹
Capital — A	4,00,000	Plant and Machinery	4,00,000
Capital —B	3,00,000	Stock	2,00,000
Capital — C	2,00,000	Debtors	2,00,000
Creditors	1,00,000	Cash & Bank balances	2,00,000
	10,00,000		10,00,000

B retires from the business owing to illness from 1st April 2015. The following was agreed upon retirement of B:

(i) The goodwill of the firm has been valued at ₹ 3,00,000 but no Goodwill Account is to be raised in the books.
(ii) Plant and Machinery has been revalued at ₹ 6,00,000 and stock revalued at ₹ 1,80,000.
(iii) A sum of ₹ 30,000 out of debtors was agreed to be bad and was to be written-off.
(iv) A and C will continue to carry on the business and shall share profits and losses equally in future.
(v) Amount payable to B shall remain in the business as loan carrying interest at 18% p.a.

You are required: (a) To give Journal entries to give effect to the above, (b) To Prepare Revaluation Account, and (c) To prepare the opening Balance Sheet of A and C as at 1st April, 2015 : (i) When changes in assets and liabilities are to be brought into books. (ii) When changes in assets and liabilities are not to be brought into books.

Solution (Case i) **In the books of A, B and C**

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

Date	Particulars		Dr. ₹	Cr. ₹
2015 April 1	C Capital A/c	Dr.	1,00,000	
	To B Capital A/c			1,00,000
	(Being the adjustment for goodwill on B's retirement)			
	Plant & Machinery A/c	Dr.	2,00,000	
	To Revaluation A/c			2,00,000
	(Being the value of the plant increased to ₹ 6,00,000)			
	Revaluation A/c	Dr.	50,000	
	To Stock A/c			20,000
	To Sundry Debtors A/c			30,000
	(Being the value of stock and sundry debtors reduced to ₹ 1,80,000 and ₹ 1,70,000 respectively)			
	Revaluation A/c	Dr.	1,50,000	
	To A Capital A/c			75,000
	To B Capital A/c			50,000
	To C Capital A/c			25,000
	(Being the profit on revaluation on B's retirement shared by the partners in their profit sharing ratio, 3:2:1)			
	B Capital A/c	Dr.	4,50,000	
	To B Loan A/c			4,50,000
	(Being the balance of B's Capital Account transferred to B's Loan Account)			

Calculation of Share of Goodwill

Partners		A	B	C
Share of goodwill before retirement (old ratio)	(₹)	1,50,000	1,00,000	50,000
Share of goodwill after retirement (new ratio)	(₹)	1,50,000	—	1,50,000
Gain (+) / Sacrifice (–)	(₹)		(–) 1,00,000	(+) 1,00,000

Therefore, on account of goodwill, B sacrifies ₹ 1,00,000 and he gives the entire amount to C. The share of goodwill of A remains unaffected. Therefore, B is to get ₹ 1,00,000 from C.

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

Date	Particulars	₹	Date	Particulars	₹
2015 April 1	To Stock A/c	20,000	2015 April 1	By Plant & Machinery A/c	2,00,000
	To Sundry Debtors A/c	30,000			
	To Partners' Capital A/cs (A — ₹ 75,000; B — ₹ 50,000; C — ₹ 25,000)	1,50,000			
		2,00,000			2,00,000

Balance Sheet of A and C as at 1st April, 2015

Liabilities	₹	Assets	₹
Capital — A	4,75,000	Plant and Machinery	6,00,000
Capital — C	1,25,000	Stock	1,80,000
Loan — B	4,50,000	Debtors	1,70,000
Creditors	1,00,000	Cash and Bank balances	2,00,000
	11,50,000		11,50,000

Solution (Case ii) **In the books of A, B and C**

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

Date	Particulars		Dr. ₹	Cr. ₹
2015 April 1	C Capital A/c	Dr.	1,00,000	
	To B Capital A/c			1,00,000
	(Being the adjustment for goodwill)			
	Plant and Machinery A/c	Dr.	2,00,000	
	To Memorandum Revaluation A/c			2,00,000
	(Being the value of plant and machinery increased to ₹ 6,00,000)			

Memorandum Revaluation A/c To Stock A/c To Sundry Debtors A/c (Being the value of stock and sundry debtors reduced to ₹ 1,80,000 and ₹ 1,70,000 respectively)	Dr.	50,000	 20,000 30,000
Memorandum Revaluation A/c To A Capital A/c To B Capital A/c To C Capital A/c (Being the profit on revaluation transferred to A, B & C Capital in the old ratio 3:2:1)	Dr.	1,50,000	 75,000 50,000 25,000
Memorandum Revaluation A/c To Plant and Machinery A/c (Being the value of plant and machinery reduced to ₹ 4,00,000)	Dr.	2,00,000	 2,00,000
Stock A/c Sundry Debtors A/c To Memorandum Revaluation A/c (Being the value of stock and sundry debtors increased to ₹ 2,00,000 each)	Dr. Dr.	20,000 30,000	 50,000
A Capital A/c C Capital A/c To Memorandum Revaluation A/c (Being the loss on revaluation written back in the new ratio)	Dr. Dr.	75,000 75,000	 1,50,000
B Capital A/c To B Loan A/c (Being the balance of B's Capital Account transferred to B's Loan Account)	Dr.	4,50,000	 4,50,000

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

Date	Particulars	₹	Date	Particulars	₹
2015 April 1	To Stock To Sundry Debtors To Partners' Capital A/cs (A — ₹ 75,000; B — ₹ 50,000; C — ₹ 25,000)	20,000 30,000 1,50,000	2015 April 1	By Plant & Machinery	2,00,000
		2,00,000			2,00,000
	To Plant and Machinery	2,00,000		By Stock By Sundry Debtors By Partners' Capital (A — ₹ 75,000; C — ₹ 75,000)	20,000 30,000 1,50,000
		2,00,000			2,00,000

Balance Sheet of A and C as at 1st April, 2015

Liabilities	₹	Assets	₹
Capital — A	4,00,000	Plant and Machinery	4,00,000
Capital —C	50,000	Stock	2,00,000
Loan — B	4,50,000	Debtors	2,00,000
Creditors	1,00,000	Cash and Bank balances	2,00,000
	10,00,000		10,00,000

Illustration 31

The Balance Sheet of X, Y and Z who share profits in proportion to their capital, stood as follows on March 31, 2015 :

Liabilities	₹	Assets		₹
Capital Accounts :		Land and Buildings		25,000
X	20,000	Plant and Machinery		8,500
Y	15,000	Stock		8,000
Z	10,000	Debtors	5,000	
Creditors	6,900	Less: Provision	100	4,900
		Cash at Bank		5,500
	51,900			51,900

Y retired on the above date and the following was agreed upon :

(a) That stock to be depreciated by 6%.

(b) That the provision for doubtful be brought up to 5% on Debtors.

(c) That the land and buildings be appreciated by 20%.

(d) That a provision of ₹ 770 be made in respect of outstanding legal charges.

(e) That the goodwill of the entire firm be fixed at ₹ 10,800 and Y's share of it be adjusted into the accounts of X and Z who are going to share future profits in the ratio of 5 : 3.

(f) That the assets and liabilities (except Cash at Bank) were to appear in the Balance Sheet at their ***old figures***.

(g) That the entire capital of the firm as newly constituted be fixed at ₹ 28,000 between X and Z in the proportion of 5 : 3 (actual cash to be brought in or paid off, as the case may be).

Show the Balance Sheet after Y's retirement.

Solution **Balance Sheet of X and Z as at 31st March, 2015**

Liabilities	₹	Assets		₹
Partners' Capital A/cs :		Land and Building		25,000
X (Note 2)	17,500	Plant and Machinery		8,500
Z (Note 2)	10,500	Stock		8,000
Y Loan A/c (Note 2)	19,800	Debtors	5,000	
Creditors	6,900	Less: Provision for Doubtful Debts	100	4,900
		Cash at Bank (Note 4)		8,300
	54,700			54,700

Working Notes :

Dr. **(1) Memorandum Revaluation Account** **Cr.**

Particulars	₹	Particulars	₹
To Stock	480	By Land and Building	5,000
To Provision for Doubtful Debts	150		
To Provision for Legal charges	770		
To Partners' Capital A/cs :			
X (4/9)	1,600		
Y (3/9)	1,200		
Z (2/9)	800		
	5,000		5,000
To Land and Building	5,000	By Stock	480
		By Provision for Doubtful Debts	150
		By Provision for Legal Charges	770
		By Partners' Capital A/cs :	
		X (5/8)	2,250
		Y (3/8)	1,350
	5,000		5,000

Dr. **(2) Partners' Capital Accounts** **Cr.**

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Memorandum Revaluation A/c	2,250	—	1,350	By Balance b/d	20,000	15,000	10,000
To Y Capital A/c (Note 3)	1,950	—	1,650	By Memorandum Revaluation A/c	1,600	1,200	800
To Y Loan A/c	—	19,800	—	By X Capital A/c (Note 3)	—	1,950	—
To Balance c/d*	17,500	—	10,500	By Z Capital A/c (Note 3)	—	1,650	—
				By Bank (Cash brought in)	100	—	2,700
	21,700	19,800	13,500		21,700	19,800	13,500

* Total Capital = ₹ 28,000. X's Capital = ₹ 28,000 / 8 × 5 = ₹ 17,500; Z's Capital = ₹ 28,000 / 8 × 3 = ₹ 10,500.

(3) Adjustment for Goodwill

Partners	X (₹)	Y (₹)	Z (₹)
Right of goodwill before retirement (4 : 3 : 2)	4,800	3,600	2,400
Right of goodwill after retirement (5 : 3)	6,750	—	4,050
Gain (+) / Sacrifice (–)	(+) 1,950	(–) 3,600	(+) 1,650

(4) Bank Balance after Retirement

	₹
Opening Balance	5,500
Add: Cash brought in by :	
X	100
Z	2,700
	8,300

Illustration 32

Prakash, Akash and Bikash were partners of a firm sharing profits or losses in the ratio of 4 : 3 : 3. Their Balance Sheet on 31st March, 2014 is as follows :

Liabilities		₹	Assets	₹
Capital Accounts :			Land	2,80,000
Prakash	2,30,000		Building	1,00,000
Akash	1,20,000		Plant and Machinery	1,80,000
Bikash	1,50,000	5,00,000	Furniture	70,000
Reserve		2,05,000	Stock	40,000
Sundry Creditors		50,000	Debtors	30,000
			Advertisement	10,000
			Cash at bank	40,000
			Cash in hand	5,000
		7,55,000		7,55,000

On 31 December, 2014 Akash retired on the basis of following terms :

(i) The goodwill of the firm is to be valued at ₹ 1,25,000.

(ii) Land is to be appreciated by 20%.

(iii) Building, plant and machinery and furniture are to be depreciated by 10%.

(iv) Stock is to be revalued at ₹ 50,000.

(v) 5% provision for doubtful debts is to made on debtors.

(vi) Advertisement is to be written off fully.

(vii) The amount payable to Akash is to be paid in 5 equal instalments with interest at 10% p.a.; the first instalment is being payable on 31 December, 2014.

After Akash's retirement Prakash and Bikash will share profit or loss equally and also make their capital equal. The goodwill cannot be shown in books of accounts of the firm. It's average annual profit for the last five years was ₹ 1,50,000.

You are required to prepare — (a) Revaluation Account; (b) Partners' Capital Accounts; (c) Akash's Loan Account upto 31 December, 2018; and, (d) Balance Sheet of Prakash and Bikash immediately after Akash's retirement.

Solution

In the books of the Firm

Dr. (a) Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Building A/c	10,000	By Land A/c (appreciated)	56,000
To Plant and Machinery A/c	18,000	By Stock A/c (appreciated)	10,000
To Furniture A/c	7,000		
To Provision for Bad Debts A/c	1,500		
To Advertisement A/c (written off)	10,000		
To Partner's Capital A/cs :			
Prakash (4/10)	7,800		
Akash (3/10)	5,850		
Bikash (3/10)	5,850		
	66,000		66,000

Dr. (b) Partners' Capital Accounts Cr.

Particulars	Prakash (₹)	Akash (₹)	Bikash (₹)	Particulars	Prakash (₹)	Akash (₹)	Bikash (₹)
To Akash Capital A/c (goodwill)	12,500	—	25,000	By Balance b/d	2,30,000	1,20,000	1,50,000
To 10% Akash Loan A/c	—	2,58,600	—	By Reserve A/c	82,000	61,500	61,500
To Bank A/c (Note 3)	57,475	—	—	By Revaluation A/c	7,800	5,850	5,850
To Balance c/d	2,49,825	—	2,49,825	By Prakash Capital A/c (Note 1)	—	12,500	—
				By Bikash Capital A/c (Note 1)	—	25,000	—
				By Profit & Loss Suspense A/c	—	33,750	—
				By Bank A/c (Note 3)	—	—	57,475
	3,19,800	2,58,600	2,74,825		3,19,800	2,58,600	2,74,825

(d) Balance Sheet of Prakash and Bikash as at 31st December, 2014

Liabilities	₹	Assets	₹
Capital Accounts :		Land	3,36,000
Prakash	2,49,825	Building	90,000
Bikash	2,49,825	Plant and Machinery	1,62,000
Sundry Creditors	50,000	Furniture	63,000
10% Akash Loan	2,06,880	Stock	50,000

Bank Overdraft (Note 4)	11,720	Debtors	30,000	
		Less: Provision for Doubtful Debts	1,500	28,500
		Cash in hand		5,000
		Profit and Loss Suspense		33,750
	7,68,250			7,68,250

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

Partners	Prakash (₹)	Akash (₹)	Bikash (₹)
Right of goodwill before retirement (4 : 3 : 3)	50,000	37,500	37,500
Right of goodwill after retirement (1 : 1)	62,500	—	62,500
Gain (+) / Sacrifice (–)	(+) 12,500	(–) 37,500	(+) 25,000'

(2) Akash's Share of Current Year's Profit upto 31st December, 2014 :

Total profits for 9 months (1.4.2014 to 31.12.2014) = ₹ 1,50,000 / 12 × 9 = ₹ **1,12,500**.

Akash's Share = ₹ 1,12,500 / 10 × 3 = ₹ **33,750**.

Journal Entry :

Profit and Loss Suspense Account Dr. 33,750

To Akash Capital Account 33,750

(3) The adjusted capital accounts of Prakash and Bikash after Akash's retirement are :

Prakash : ₹ 2,30,000 + ₹ 82,000 + ₹ 7,800 – ₹ 12,500 = ₹ 3,07,300.

Bikash : ₹ 1,50,000 + ₹ 61,500 + ₹ 5,850 – ₹ 25,000 = ₹ 1,92,350.

Therefore, total capital of Prakash and Bikash = ₹ 3,07,300 + ₹ 1,92,350 = ₹ 4,99,650.

Prakash capital : 1/2 of ₹ 4,99,650 = ₹ 2,49,825

Bikash capital : 1/2 of ₹ 4,99,650 = ₹ 2,49,825

Cash to be withdrawn by Prakash = ₹ 3,07,300 – ₹ 2,49,825 = ₹ 57,475.

Cash to be brought in by Bikash = ₹ 2,49,825 – ₹ 1,92,350 = ₹ 57,475.

(5) Amount payable to Akash on 31.12.2003 = 1/5 of ₹ 2,58,600 = ₹ 51,720. At that time, the bank balance was ₹ 40,000 only. It is assumed that the payment was made by availing overdraft facility of the bank. Therefore, bank overdraft = ₹ 51,720 – ₹ 40,000 = ₹ 11,720.

Dr. **(c) 10% Akash Loan Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Bank A/c (1st instalment paid)	51,720	31.12.2014	By Akash Capital A/c	2,58,600
31.12.2014	To Balance c/d	2,06,880			
		2,58,600			2,58,600
31.12.2015	To Bank A/c (₹ 51,720 + ₹ 20,688)	72,408	1.4.2015	By Balance b/d	2,06,880
31.12.2015	To Balance c/d	1,55,160	31.12.2015	By Interest @ 10%	20,688
		2,27,568			2,27,568
31.12.2016	To Bank A/c (₹ 51,720 + ₹ 15,516)	67,236	1.4.2016	By Balance b/d	1,55,160
31.12.2016	To Balance c/d	1,03,440	31.12.2016	By Interest @ 10%	15,516
		1,70,676			1,70,676
31.12.2017	To Bank A/c (₹ 51,720 + ₹ 10,344)	62,064	1.4.2017	By Balance b/d	1,03,440
31.12.2017	To Balance c/d	51,720	31.12.2017	By Interest @ 10%	10,344
		1,13,784			1,13,784
31.12.2018	To Bank A/c	56,892	1.4.2018	By Balance b/d	51,720
			31.12.2018	By Interest @ 10%	5,172
		56,892			56,892

Illustration 33

A, B and C were partners sharing profits and losses in the ratio of 3 : 2 : 1. Their Balance Sheet as on 31.03.2015 stood as follows :

Liabilities	₹	Assets		₹
Sundry Creditors	12,500	Cash at Bank		1,500
General Reserve	18,000	Sundry Debtors	15,000	
Capital A/cs :		Less: Provision for bad debts	1,500	13,500
(A — ₹ 40,000; B — ₹ 21,000; C — ₹ 20,000)	81,000	Stock		12,500
		Joint Life Policy		8,000
		Office Equipments		14,000
		Furniture		12,000
		Building		50,000
	1,11,500			1,11,500

B retired on 1.4.2015 subject to the following conditions :

(i) A typewriter purchased on 1.10.2014 for ₹ 2,000 debited to office expenses account is to be brought into account charging depreciation @ 10% p.a.

(ii) Building revalued at ₹ 75,000. Furniture is to written-down by ₹ 2,000 and stock is reduced to ₹ 10,000.

(iii) Provision for bad debts is to be calculated @ 5% on debtors.

(iv) Goodwill of the firm is to be valued at ₹ 18,000. But no Goodwill Account is to be raised.

(v) Joint Life Policy is to be shown at surrendered value. The surrender value is ₹ 7,500.

(vi) Amount due to B is to be transferred to his Loan Account.

(vii) A and C will share profits and losses in the ratio of 2 : 1 and their capitals are to be adjusted in the profit sharing ratio.

You are required to prepare : Revaluation Account, Partners' Capital Accounts and Balance Sheet immediately after B's retirement.

Solution

In the books of the Firm

Dr. Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Stock A/c	2,500	By Office Equipments A/c (Note 1)	1,900
To Furniture A/c	2,000	By Buildings A/c	25,000
To Joint Life Policy A/c	500	By Provision for Bad Debts A/c	
To Partners' Capital A/c :		(₹ 1,500 — 5% of ₹ 15,000)	750
(A — ₹ 11,325; B — ₹ 7,550; C — ₹ 3,775)	22,650		
	27,650		27,650

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
To B Capital A/c (Note 3)	3,000	—	3,000	By Balance b/d	40,000	21,000	20,000
To B Loan A/c		40,550		By General Reserve A/c	9,000	6,000	3,000
To Bank A/c (Note 2)	3,258	—	—	By A Capital A/c (Note 3)	—	3,000	—
To Balance c/d (Note 2)	54,067	—	27,033	By C Capital A/c (Note 3)	—	3,000	—
				By Revaluation A/c	11,325	7,550	3,775
				By Bank A/c (Note 2)	—	—	3,258
	60,325	40,550	30,033		60,325	40,550	30,033

Balance Sheet (after B's retirement) as at 1st April, 2015

Liabilities		₹	Assets		₹
Sundry Creditors		12,500	Cash at Bank		1,500
Loan — B		40,550	Debtors	15,000	
Capital :	A	54,067	Less: Provision for bad debts	750	14,250
	C	27,033	Stock		10,000
			Joint Life Policy		7,500
			Office Equipments ₹ (14,000 + 1,900)		15,900
			Furniture		10,000
			Buildings		75,000
		1,34,150			1,34,150

Working Notes :

(1) The typewriter purchased was wrongly debited to office expenses account, but it should have been debited to office equipments account. In effect, depreciation for 6 months (from 1.10.2014 to 31.3.2015) has not been provided. Therefore, ₹ 2,000 – ₹ 100 (depreciation for 6 months) = ₹ 1,900 should be added to Office Equipments Account.

(2) Ascertainment of Required Closing Capital

The adjusted capital accounts of A and C after B's retirement are : A — ₹ (40,000 + 9,000 + 11,325 – 3,000) = ₹ 57,325; C — ₹ (20,000 + 3,000 + 3,775 – 3,000) = ₹ 23,775. Therefore, total capital of A and C is ₹ (57,325 + 23,775) = ₹ 81,100, which will be shared by A and C in the new profit-sharing ratio, i.e., 2 : 1. Therefore, capital of A will be ₹ 81,100 x 2/3 = ₹ 54,067; and, capital of C will be ₹ 81,000 x 1/3 = ₹ 27,033. In effect, A will take away ₹ 3,258 (₹ 57,325 – 54,067) and C will introduce additional capital of the same amount of ₹ 3,258 (₹ 27,033 – 23,775).

(3) Calculation of Share of Goodwill

Partners		A	B	C
Right of goodwill prior to retirement (3 : 2 : 1)	(₹)	9,000	6,000	3,000
Right of goodwill after retirement (2 : 1)	(₹)	12,000	—	6,000
Gain (+) / Sacrifice (–)	(₹)	(+) 3,000	(–) 6,000	(+) 3,000

Illustration 34

A, B and J are partners in a firm sharing profits and losses in the ratio of 2 : 2 : 1 respectively. The Balance Sheet as at 31.12.2014 is as follows :

Liabilities		₹	Assets		₹
Capitals :	A	65,600	Land and Building		72,000
	B	43,700	Machinery		35,500
	J	32,200	Furniture		10,400
Reserve		22,000	Motor Car		18,000
Creditors		18,000	Stock		19,800
			Debtors	23,700	
			Less: Provision for Doubtful Debts	1,500	22,200
			Bank		3,600
		1,81,500			1,81,500

B retires on 31.12.2014 but A and J continue in partnership sharing profits in the ratio of 3 : 2 respectively. The terms of retirement provide the following :

(a) Goodwill is to be valued at 2 years' purchase of the average annual profits of the last 3 years, but it should not be shown in the books. The profits of the last 3 years are :2011 — ₹ 12,100; 2012 — ₹ 8,480; 2013 — ₹ 10,920.

(b) The value of land and building is to be appreciated by 20%. Machinery is to valued at ₹ 32,000 and provision for doubtful debts to be maintained at ₹ 1,800.

(c) A furniture costing ₹ 3,000 purchased on 1.7.2013 but was debited to Purchases Account. This asset is to be taken into account charging depreciation @ 10% p.a. under Straight Line Method.

(d) Annual insurance premium of ₹ 2,400 paid on 1.4.2014 had been entirely charged to Profit and Loss Account.

(e) B will take over the motor car at ₹ 16,000 and a bank loan of ₹ 50,000 is to be arranged for the balance amount payable to him on his retirement.

(f) The capital of the new firm will be readjusted by bringing in or paying off cash so that the capital of A and J be in the new profit sharing ratio.

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

Solution

In the books of the Firm

Dr. Revaluation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Machinery A/c	3,500	31.12.2014	By Land and Building A/c	14,400
	To Provision for Doubtful Debts A/c	300		By Furniture A/c (Note 1)	2,550
	To Motor Car A/c (₹ 18,000 – 16,000)	2,000		By Prepaid Insurance A/c	600
	To Partners' Capital A/cs : (A — ₹ 4,700; B — ₹ 4,700; C — ₹ 2,350)	11,750		(₹ 2,400 x 3/12)	
		17,550			17,550

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	J	Date	Particulars	A	B	J
31.12.2014	To Motor Car A/c	—	16,000	—	31.12.2014	By Balance b/d	65,600	43,700	32,200
	To B Capital A/c (Goodwill)	4,580	—	4,580		By Reserve A/c	8,800	8,800	4,400
	To Bank A/c (Note 3)	9,186	50,360	—		By Revaluation A/c	4,700	4,700	2,350
	To Balance c/d	65,334	—	43,556		By A Capital A/c (Goodwill)	—	4,580	—
						By J Capital A/c (Goodwill)	—	4,580	—
						By Bank A/c (Note 3)	—	—	9,186
		79,100	66,360	48,136			79,100	66,360	48,136

Balance Sheet of the new firm as at 31st December, 2014

Liabilities		₹	Assets		₹
Capitals :	A	65,334	Land and Building		86,400
	J	43,556	Machinery		32,000
Bank Loan		50,000	Furniture (₹ 10,400 + 2,550)		12,950
Creditors		18,000	Stock		19,800
			Debtors	23,700	
			Less: Provision for Doubtful Debts	1,800	21,900
			Bank (₹ 3,600 + 50,000 – 50,360)		3,240
			Prepaid Insurance		600
		1,76,890			1,76,890

Working Notes :

(1) Furniture is to be recorded in the books at its written-down value, which is cost less depreciation for 1.5 years (1.7.2013 to 31.12.2014), where cost is ₹ 3,000, accumulated depreciation is @ 10% p.a. on ₹ 3,000 for 1.5 years is ₹ 450. Therefore, W.D.V. of furniture is ₹ 3000 – ₹ 450 = ₹ 2,550.

(2) Calculation of Goodwill

Correct profit for 2013 = Profit (as given) + Purchase of furniture, being treated as purchases – depreciation not charged thereon for 6 months = ₹ (10,920 + 3,000 – 150) = ₹ 13,770.

Average profit for 3 years = ₹ (12,100 + 8,480 + 13,770) / 3 = ₹ 11,450.

Goodwill is 2 years' purchase of average profits = ₹ 11,450 × 2 = ₹ **22,900**.

Calculation of Share of Goodwill

Partners		A	B	J
Right of goodwill prior to retirement (2 : 2 : 1)	(₹)	9,160	9,160	4,580
Right of goodwill after retirement (3 : 2)	(₹)	13,740	—	9,160
Gain (+) / Sacrifice (–)	(₹)	(+) 4,580	(–) 9,160	(+) 4,580

(3) Ascertainment of Required Closing Capital of A and J

The adjusted capital account balances of A and J after B's retirement are :

A — ₹ (65,600 + 8,800 + 4,700 – 4,580) = ₹ 74,520.

J — ₹ (32,200 + 4,400 + 2,350 – 4,580) = ₹ 34,370.

Total capital of A and J is ₹ (74,520 + 34,370) = ₹ 1,08,890, which will be shared in their new profit sharing ratio, i.e., 3 : 2.

Therefore, Capital of A will be = ₹ 1,08,890 × 3 / 5 = ₹ 65,334

Capital of J will be = ₹ 1,08,890 × 2 / 5 = ₹ 43,556

In effect, A will take away ₹ (74,520 – 65,334) = ₹ 9,186.

J will bring in ₹ (43,556 – 34,370) = ₹ 9,186.

Illustration 35

On 31st March, 2015, the Balance Sheet of M/s. A, B and C sharing profits and losses in proportion to their capitals, stood as follows :

Liabilities		₹	Assets	₹
Sundry Creditors		1,00,000	Land and Buildings	2,00,000
Capital A/cs :			Machinery	3,00,000
A	2,00,000		Closing Stock	1,00,000
B	3,00,000		Sundry Debtors	1,00,000
C	2,00,000	7,00,000	Cash and Bank Balances	1,00,000
		8,00,000		8,00,000

On 31st March, 2015, A desired to retire from the firm and the remaining partners decided to carry on. It was agreed to revalue the Assets and Liabilities on that date on the following basis :

(1) Land and Buildings be appreciated by 30%.

(2) Machinery is to be depreciated by 20%.

(3) Closing Stock is to be valued at ₹ 75,000.

(4) Provision for bad debts is to be made at 5%.

(5) Old credit balances of Sundry Creditors ₹ 20,000 is to be written-back.

(6) Joint Life Policy of the partners surrendered and cash obtained ₹ 80,000.

(7) Goodwill of the entire firm be valued at ₹ 1,40,000 and A's share of the Goodwill be adjusted in the accounts of B and C who share the future profits equally. No Goodwill Account being raised.

(8) The capital of the firm is to be the same as before retirement. Individual capital be in their profit sharing ratio.

(9) Amount due to A is to be settled on the following basis : 50% on retirement and the balance 50% within one year.

Prepare Revaluation Account, Capital Accounts of Partners, Cash and Bank Account and Balance Sheet as on 1.4.2015 of M/s. B and C.

[C.A. (Foundation) — Adapted]

Solution — **In the books of M/s. A, B and C**

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

Particulars	₹	Particulars	₹
To Machinery A/c	60,000	By Land and Buildings A/c	60,000
To Closing Stock A/c	25,000	By Sundry Creditors A/c	20,000
To Provision for Bad Debts A/c	5,000	By Partners' Capital A/cs	10,000
		(A : ₹ 2,857; B : ₹ 4,286; C : ₹ 2,857)	
	90,000		90,000

Dr. **Cash and Bank Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	1,00,000	By A Capital A/c	1,30,000
To Joint Life Policy A/c	80,000	By Balance c/d	2,40,000
To B Capital A/c	30,000		
To C Capital A/c	1,60,000		
	3,70,000		3,70,000

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

Particulars	A	B	C	Particulars	A	B	C
To Revaluation A/c	2,857	4,286	2,857	By Balance b/d	2,00,000	3,00,000	2,00,000
To A Capital A/c (Goodwill)	—	10,000	30,000	By J.L.P. A/c	22,857	34,286	22,857
To Bank A/c (50% paid-off)	1,30,000	—		By B Capital A/c (Goodwill)	10,000	—	—
To A Loan A/c	1,30,000	—		By C Capital A/c (Goodwill)	30,000	—	—
To Balance c/d (required)	—	3,50,000	3,50,000	By Bank A/c (Bal. figure)	—	30,000	1,60,000
	2,62,857	3,64,286	3,82,857		2,62,857	3,64,286	3,82,857

Balance Sheet of M/s. B and C as on 1st April, 2015

Liabilities		₹	Assets		₹
Partners' Capital A/cs :	₹		Land and Buildings		2,60,000
B	3,50,000		Machinery		2,40,000
C	3,50,000	7,00,000	Closing Stock		75,000
A's Loan Account		1,30,000	Sundry Debtors	1,00,000	
Sundry Creditors		80,000	Less: Provision for Bad Debts	5,000	95,000
			Cash and Bank Balances		2,40,000
		9,10,000			9,10,000

Working Note : **Calculation of Share of Goodwill**

Particulars	A (₹)	B (₹)	C (₹)
Right of Goodwill before retirement (2 : 3 : 2)	40,000	60,000	40,000
Right of Goodwill after retirement (1 : 1)	—	70,000	70,000
Sacrifice (–) / Gain (+)	(–) 40,000	(+) 10,000	(+) 30,000

Illustration 36

Gold, Silver and Diamond are partners in a firm sharing profits and losses in the ratio of 5 : 3 : 2. Gold retires on 1.4.2015 on which date the Balance Sheet of the firm stood as under :

Liabilities		₹	Assets	₹
Capital Accounts :			Goodwill	10,000
Gold	80,000		Furniture	30,000
Silver	50,000		Office Equipments	25,000
Diamond	40,000	1,70,000	Building	60,000
General Reserve		20,000	Stock	77,000
Sundry Creditors		90,000	Sundry Debtors	75,000
Bills Payable		15,000	Cash	18,000
		2,95,000		2,95,000

It is provided in the Deed of Partnership that in the event of death or retirement of a partner, goodwill is to be valued at 2 years' purchase of the average profits of the last 4 years. The profits for the last 4 years were : 2014-15 : ₹ 30,000; 2013-14 : ₹ 24,000; 2012-13 : ₹ 20,000; 2011-2012 : ₹ 18,000.

Furniture and Building are revalued at ₹ 25,000 and ₹ 75,000 respectively, stock is overvalued by 10%.

It was decided that Gold should be paid ₹ 50,000 immediately on retirement and the balance on his Capital Account is to be treated as a loan to the firm. Silver and Diamond contribute necessary sums in equal proportions for payments to Gold and to leave ₹ 20,000 cash as working capital. Assuming, that above mentioned arrangements are given effect to, you are required to show the Revaluation Account, Cash Account and the Capital Accounts of the partners. Also show the Balance Sheet of the firm after Gold's retirement.

Solution **In the books of the Firm**

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

Particulars	₹	Particulars	₹
To Furniture A/c	5,000	By Building A/c	15,000
To Stock A/c (Note 2)	7,000		
To Partners' Capital A/cs :	3,000		
Gold — ₹ 1,500; Silver — ₹ 900; Diamond — ₹ 600			
	15,000		15,000

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

Particulars	Gold	Silver	Diamond	Particulars	Gold	Silver	Diamond
To Bank A/c	50,000	—	—	By Balance b/d	80,000	50,000	40,000
To Gold Loan A/c	59,500	—	—	By General Reserve A/c	10,000	6,000	4,000
To Goodwill A/c	—	27,600	18,400	By Goodwill A/c (Note 1)	18,000	10,800	7,200
To Balance c/d	—	66,100	59,400	By Revaluation A/c	1,500	900	600
				By Cash A/c	—	26,000	26,000
	1,09,500	93,700	77,800		1,09,500	93,700	77,800

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

Particulars	₹	Particulars	₹
To Balance b/d	18,000	By Gold Capital A/c	50,000
To Partners' Capital A/cs (Balancing figure)		By Balance c/d	20,000
Silver — ₹ 26,000; Diamond — ₹ 26,000	52,000		
	70,000		70,000

Balance Sheet (after Gold's retirement) as on 1st April, 2015

Liabilities		₹	Assets	₹
Capital A/cs :			Building	75,000
Silver	66,100		Office Equipments	25,000
Diamond	59,400	1,25,500	Furniture	25,000
Gold Loan A/c		59,500	Stock	70,000
Sundry Creditors		90,000	Sundry Debtors	75,000
Bills Payable		15,000	Cash	20,000
		2,90,000		2,90,000

Working Notes :

(1) Calculation of the Value of the Goodwill and its Treatment

Total profit for the last 4 years ₹ (30,000 + 24,000 + 20,000 + 18,000) = ₹ 92,000. Average profit (₹ 92,000 ÷ 4) = ₹ 23,000. Goodwill is 2 years' purchase of the average profits of the last 4 years, i.e., ₹ 23,000 x 2 = ₹ 46,000. Goodwill Account has already been raised at ₹ 10,000. Therefore, before Gold's retirement, Goodwill Account is to be raised further by ₹ 36,000, i.e., ₹ (46,000 – 10,000). Thereafter, goodwill is to be written off in the new profit-sharing ratio, i.e., 3 : 2.

(2) Actual Value of Stock = $\frac{77{,}000}{110} \times 100$ = ₹ 70,000. Therefore, it is overvalued by ₹ 77,000 – 70,000 = ₹ 7,000.

Illustration 37

A, B, C and D were partners in a firm sharing profits and losses in the ratio of 4 : 3 : 2 : 1. The Balance Sheet of the firm as on 31st December, 2014 is given below :

Liabilities	₹	Assets	₹
A's Capital	4,00,000	Land and Building	3,40,000
B's Capital	3,00,000	Plant and Machinery	4,50,000
C's Capital	2,00,000	Furniture and Fittings	1,20,000
D's Capital	1,00,000	Fixed Deposit with Bank	80,000
Reserves	50,000	Stock-in-trade	35,000
Bills Payable	12,000	Sundry Debtors	26,000
Sundry Creditors	8,000	Bills Receivable	10,000
Bank Overdraft	5,000	Cash in Hand	14,000
	10,75,000		10,75,000

On 30th September, 2015, D retired from the firm. The partnership deed of the firm had the following provisions regarding the procedure to be followed in the event of retirement of a partner :

(a) The retiring partner will be entitled to his share of profit in proportion to the number of months he served as a partner in the year of his retirement. The profit of the year immediately preceding the year of his retirement will be taken as the basis for calculating his share of profit.

(b) The retiring partner will be entitled to a share of goodwill on the basis of two years' purchase of the average profit of the three years preceding the year of his retirement. The profits of 2012, 2013 and 2014 were ₹ 66,000, ₹ 87,000 and ₹ 72,000 respectively.

(c) No Goodwill Account will be raised in the books, but the retiring partner's share of goodwill is to be adjusted through the Capital Accounts of the continuing partners.

(d) Reserve, undistributed profit or loss, if any, must be transferred to the Capital Accounts of the partners.

A, B and C decided to share the future profits and losses equally and to maintain a fixed capital of ₹ 2,00,000 each, making necessary addition or withdrawal of cash immediately without affecting the bank overdraft balance. The total amount due to D will remain in the business of the firm as loan, earning 10% interest per annum.

Show the Journal Entries and the Capital Accounts of the partners on the basis of the above mentioned conditions which were duly complied with.

Solution

In the books of the Firm

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

Date	Particulars		₹	₹
2015	Reserves A/c	Dr.	50,000	
Sept. 30	To A Capital A/c			20,000
	To B Capital A/c			15,000
	To C Capital A/c			10,000
	To D Capital A/c			5,000
	(Being the reserves transferred to Partners' Capital Accounts before D's retirement)			
	Profit and Loss Suspense A/c (Note 1)	Dr.	5,400	
	To D Capital A/c			5,400
	(Being D's share of profit transferred to his Capital Account)			
	B Capital A/c (Note 2)	Dr.	5,000	
	C Capital A/c	Dr.	20,000	
	To A Capital A/c			10,000
	To D Capital A/c			15,000
	(Being the adjustment in regard to Goodwill made through the Partners' Capital Accounts)			
	D Capital A/c	Dr.	1,25,400	
	To 10% D Loan A/c			1,25,400
	(Being D's capital transferred to D's Loan Account)			
	Cash A/c	Dr.	10,000	
	To C Capital A/c			10,000
	(Being the amount of capital brought in by C to make his capital equal to ₹ 2,00,000)			
	A Capital A/c	Dr.	2,30,000	
	B Capital A/c	Dr.	1,10,000	
	To Cash A/c			3,40,000
	(Being excess money withdrawn by the partners to make their capitals equal to ₹ 2,00,000)			

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

Particulars	A	B	C	D	Particulars	A	B	C	D
To A & D Capital A/c	—	5,000	20,000	—	By Balance b/d	4,00,000	3,00,000	2,00,000	1,00,000
To 10% D Loan A/c	—	—	—	1,25,400	By Reserves A/c	20,000	15,000	10,000	5,000
To Cash A/c (Note 3)	2,30,000	1,10,000	—	—	By P & L Suspense A/c	—	—	—	5,400
To Balance c/d	2,00,000	2,00,000	2,00,000	—	By B & C Capital A/c	10,000	—	—	15,000
					By Cash A/c	—	—	10,000	
	4,30,000	3,15,000	2,20,000	1,25,400		4,30,000	3,15,000	2,20,000	1,25,400

Working Notes :

(1) Profit for the year 2014 is ₹ 72,000. Profit for 9 months will be ₹ 72,000 ÷ 12 x 9 = ₹ 54,000. D will get 1/10 of ₹ 54,000, i.e., ₹ 5,400.

(2) Valuation of Goodwill

Average profit of last three years = $\frac{(66,000 + 87,000 + 72,000)}{3}$ = ₹ 75,000.

Goodwill = ₹ 75,000 x 2 = ₹ 1,50,000.

Adjustment for Goodwill

Particulars	A (₹)	B (₹)	C (₹)	D (₹)
Right of Goodwill before D's retirement (4 : 3 : 2 : 1)	60,000	45,000	30,000	15,000
Right of Goodwill after D's retirement (1 : 1 : 1)	50,000	50,000	50,000	—
Sacrifice (–) / Gain (+)	(–) 10,000	(+) 5,000	(+) 20,000	(–) 15,000

(3) It is assumed that on the date of retirement, i.e., 30th September, 2015 the firm has sufficient cash balance to pay off the excess capital of A and B, though the last Balance Sheet as on 31st December, 2014 does not show sufficient cash.

Illustration 38

X and Y are partners sharing profits equally. It has been agreed that if a partner retires, the other partner, if he desires to carry on the business, shall pay to the retiring partner his share by four equal half yearly instalments, plus interest @ 5% p.a. with half-yearly rests. Goodwill is to be valued on the basis of five years capitalization of the average annual super profits of 3 preceding financial years, fixed assets being revalued for the purpose. The Balance Sheet of the firm as 31.12.2014 is as follows:

Liabilities	₹	Assets	₹
Creditors	9,160	Cash in hand	13,000
Capital — X	22,420	Book debts	10,200
Capital — Y	16,650	Closing stock	5,730
		Building	19,300
	48,230		48,230

Y retires on 1.1.2015 and X decides to carry on the business. The profits for the three years ended on 31.12.2015 were ₹ 13,500 ; ₹ 14,500; and ₹ 14,000.

For the purpose of dissolution, building has been revalued at ₹ 24,800. No interest on capital was charged and partners did not draw any salary.

Show the computation of goodwill; prepare Y's Loan Account. Assume that normal managerial remuneration is ₹ 6,000 p.a. and normal return on capital is 12%.

Solution

In the books of X

Dr. Y Loan Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.6.2014	To Bank A/c (₹ 6,507.50 + ₹ 650.75)	7,158.25	1.1.2014	By Y Capital A/c (See Note)	26,030.00
31.12.2014	To Bank A/c (₹ 6,507.50 + ₹ 488.06)	6,995.56	30.6.2014	By Interest A/c (For 6 months)	650.75
31.12.2014	To Balance c/d	13,015.00	31.12.2014	By Interest A/c (for 6 months on ₹ 19,522.50)	488.06
		27,168.81			27,168.81
30.6.2015	To Bank A/c (₹ 6,507.50 + ₹ 325.38)	6,832.88	1.1.2015	By Balance b/d	19,522.50
31.12.2015	To Bank A/c (₹ 6,507.50 + ₹ 162.69)	6,670.19	30.6.2015	By Interest A/c (for 6 months on ₹ 13,0775)	325.38
			31.12.2015	By Interest A/c (for 6 months on ₹ 6,507.50)	162.69
		13,503.07			13,503.07

Working Note :

Capital Employed		₹	Average Annual Super Profit	₹	Amount due to Y	₹
Assets :			**Average Profit :**		**Capital :**	16,650
Cash	13,000		(13,500 + 14,500 + 14,000)/3	14,000	Share of Revaluation profit	
Book Debt	10,200		Less: Managerial Remuneration	6,000	(1/2 of ₹ 5,500)	2,750
Closing Stock	5,730			8,000	Share of goodwill	
Building	24,800	53,730	Less: Normal rate of return @ 12%	5,348	(1/2 of ₹ 13,260)	6,630
Liabilities : Creditors		9,160	**Super profit**	2,652		26,030
		44,570	Value of goodwill ₹ 2,652 x 5 =	13,260		

Illustration 39

A, B and C are partners in a firm sharing profits and losses in the ratio of 5:3:2 respectively. The partnership deed provides that in the event of retirement of any of the partners, the total amount due to him would be settled by an annuity payable to him. On 31st March, 2010, B retires and the total amount payable on account of his share of goodwill, profits and interest was calculated as ₹ 7,000. On the date of retirement, the capital of A, B and C stood at ₹ 20,000; ₹ 13,000 and ₹ 10,000 respectively. As per deed, the amount was commuted into an annuity of ₹ 2,000, which was to be paid on 1st January each year. The 1st instalment was, however paid, on 1st April 2010. On 2nd January 2015 Mr B died. Prepare Annuity Suspense Account assuming that the unpaid portion thereof carried interest @ 10% p.a. (After B's retirement, A & C shared profit and losses in the ratio of 5:3.)

Solution

In the books of A&C

Dr. Annuity Suspense Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2010	To Bank A/c	2,000	1.4.2010	By Capital A/c (₹ 13,000 + ₹ 7,000)	20,000
31.12.2010	To Balance c/d	19,350	31.12.2010	By Interest A/c @ 10% on ₹ 18,000	1,350
		21,350			21,350
1.1.2011	To Bank A/c	2,000	1.1.2011	By Balance b/d	19,350
31.12.2011	To Balance c/d	19,085	31.12.2011	By Interest A/c @ 10% on ₹ 17,350	1,735
		21,085			21,085
1.1.2012	To Bank A/c	2,000	1.1.2012	By Balance b/d	19,085
31.12.2012	To Balance c/d	18,794	31.12.2012	By Interest A/c @ 10% on ₹ 17,085	1,709
		20,794			20,794

1.1.2013	To Bank A/c	2,000	1.1.2013	By Balance b/d	18,794
31.12.2013	To Balance c/d	18,473	31.12.2013	By Interest A/c @ 10% on ₹ 16,794	1,679
		20,473			20,473
1.1.2014	To Bank A/c	2,000	1.1.2014	By Balance b/d	18,473
31.12.2014	To Balance c/d	18,120	31.12.2014	By Interest A/c @ 10% on ₹ 16,473	1,647
		20,120			20,120
1.1.2015	To Bank A/c	2,000	1.1.2015	By Balance b/d	18,120
2.1.2015	To A Capital A/c (5/8)	10,075			
2.1.2015	To C Capital A/c (3/8)	6,045			
		18,120			18,120

Illustration 40

A, B and C are in partnership sharing profits and losses in the ratio of 3:2:1. The Balance Sheet as on 31.12.2014 is:

Liabilities	₹	Assets		₹
Capital — A	40,000	Machinery at cost	50,000	
Capital — B	60,000	Less: Provision for depreciation	8,000	42,000
Capital — C	20,000	Furniture		1,000
Reserve	30,000	Sundry Debtors	80,000	
Sundry Creditors	60,000	Less: Provision for bad debts	3,000	77,000
		Stock		50,000
		Bank		40,000
	2,10,000			2,10,000

On March 31, 2015, B retired and A and C continued in partnership sharing profits and losses in the ratio of 3:2. It was agreed that the following adjustments were to be made in the Balance Sheet as on March 31, 2015:

(a) The machinery was to be revalued at ₹ 45,000.
(b) The stock was to be reduced by 2%.
(c) The provision for doubtful debts would be ₹ 4,000.
(d) The furniture was to be reduced to ₹ 600.
(e) A provision of ₹ 300 was to be made for outstanding expenses.

The Partnership Agreement provided that on the retirement of a partner, goodwill was to be valued at ₹ 24,000 and B's share of the same was to be adjusted into the accounts of A and C. The profits up to the date of retirement were estimated at ₹ 18,000. B was to be paid off in full. A and C were to bring such an amount in cash so as to make their capitals in proportion to the new profit-sharing ratio, subject to the condition that a cash balance of ₹ 20,000 was to be maintained as working capital. Prepare necessary Journal entries to give effect to the above arrangements and prepare the Partners' Capital Accounts as on 31.3.2015. Also prepare the Balance Sheet as on that date.

Solution

In the books of the Firm

Journal — **Dr.** **Cr.**

Date	Particulars		₹	₹
2015	A Capital A/c (Note 1)	Dr.	2,400	
March 31	C Capital A/c	Dr.	5,600	
	To B Capital A/c			8,000
	(Being the adjustment for goodwill made through the Capital Account of the partners)			
	Revaluation A/c	Dr.	2,700	
	To Stock A/c			1,000
	To Provision for Doubtful Debts A/c			1,000
	To Furniture A/c			400
	To Provision for Outstanding Expenses A/c			300
	(Being the decrease in assets and increase in liabilities transferred to Revaluation Account)			
	Provision for Depreciation on Machinery A/c	Dr.	3,000	
	To Revaluation A/c			3,000
	(Being the increase in the value of machinery transferred to Revaluation Account)			
	Revaluation A/c	Dr.	300	
	To A Capital A/c			150
	To B Capital A/c			100
	To C Capital A/c			50
	(Being the profit on revaluation transferred to Partners' Capital Accounts in the ratio of 3 : 2 : 1)			
	Reserve A/c	Dr.	30,000	
	To A Capital A/c			15,000
	To B Capital A/c			10,000
	To C Capital A/c			5,000
	(Being the reserve transferred to Partners' Capital Accounts in the ratio of 3 : 2 : 1)			

A Capital A/c	Dr.	1,800	
C Capital A/c	Dr.	4,200	
To B Capital A/c			6,000
(Being B's share of profit upto the date of retirement adjusted through the Capital Accounts of the partners)			
Bank A/c	Dr.	64,100	
To A Capital A/c			27,230
To C Capital A/c			36,870
(Being the required amount of cash brought in by A and C)			
B Capital A/c	Dr.	84,100	
To Bank A/c			84,100
(Being the amount of B paid up in full)			

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

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To B Capital A/c —goodwill	2,400	—	5,600	By Balance b/d	40,000	60,000	20,000
To B Capital A/c — profit	1,800	—	4,200	By A Capital A/c — goodwill	—	2,400	—
To Bank A/c	—	84,100	—	By C Capital A/c — goodwill	—	5,600	—
To Balance c/d	78,180	—	52,120	By Revaluation A/c	150	100	50
				By Reserve A/c	15,000	10,000	5,000
				By A Capital A/c — profit	—	1,800	—
				By C Capital A/c — profit	—	4,200	—
				By Bank A/c	27,230	—	36,870
	82,380	84,100	61,920		82,380	84,100	61,920

Balance Sheet as on 31st March, 2015

Liabilities	₹	Assets		₹
Capital — A	78,180	Machinery at cost	50,000	
Capital — C	52,120	Less: Provision for depreciation	5,000	45,000
Sundry Creditors	60,000	Furniture		600
Outstanding expenses	300	Sundry Debtors	80,000	
		Less: Provision for bad debts	4,000	76,000
		Stock		49,000
		Bank		20,000
	1,90,600			1,90,600

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

Partners		A	B	C
Right of goodwill prior to retirement	(₹)	12,000	8,000	4,000
Right of goodwill after retirement	(₹)	14,400	—	9,600
Gain (+) / Sacrifice (–)	(₹)	(+) 2,400	(–) 8,000	(+) 5,600
(2) Adjustment for Profit				
Right of profit prior to retirement	(₹)	9,000	6,000	3,000
Right of profit after retirement	(₹)	10,800	—	7,200
Gain (+) / Sacrifice (–)	(₹)	(+) 1,800	(–) 6,000	(+) 4,200

(3) Cash to be brought in by A and C	₹
Amount payable to B	84,100
Add: Required cash balance	20,000
	1,04,100
Less: Existing cash balance	40,000
Cash to be brought in by A and C	64,100
Adjusted capital of A ₹ (40,000 + 150 + 15,000 — 2,400 — 1,800)	50,950
Adjusted capital of C ₹ (20,000 + 50 + 5,000 — 5,600 — 4,200)	15,250
Cash to be brought in by A and C (as ascertained)	64,100
Total combined capital of A and C	1,30,300
The combined capital of A and C will be shared in the ratio 3 : 2; Therefore,	
Closing capital of A will be (3/5 of ₹ 1,30,300)	78,180
Closing capital of C will be (2/5 of ₹ 1,30,300)	52,120
Cash to be brought in by A ₹ (78,180 — 50,950)	27,230
Cash to be brought in by C ₹ (52,120 — 15,250)	36,870
Total cash to be brought in by A and C (checked)	64,100

Dr. **Bank Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	40,000	By B Capital A/c	84,100
To A Capital A/c	27,230	By Balance c/d	20,000
To C Capital A/c	36,870		
	1,04,100		1,04,100

Illustration 41

A, B and C are equal partners. C retires on 31.3.2015. The Balance Sheet of the firm as on 31.12.2014 stood as follows:

Liabilities		₹	Assets		₹
Creditors		12,900	Cash in hand		1,000
Contingency Reserve		4,000	Cash at bank		4,000
Investment Fluctuation Fund		1,200	Debtors	10,000	
Partners' Capitals:	₹		Less: Provision for bad debts	800	9,200
A	30,000		Stock		10,000
B	20,000		Investments (cost)		5,000
C	20,000	70,000	Land and Buildings		40,000
			Goodwill		18,900
		88,100			88,100

In order to arrive at the balance due to C, it was mutually agreed that:

1. Land and Buildings be valued at ₹ 50,000; 2. Investment Fluctuation Fund be brought to ₹ 500; 3. Debtors are all good; 4. Stock be taken at ₹ 9,400; 5. Goodwill be valued at one year's purchase of the average profits of the past five years; 6. C's share of profit to the date of retirement be calculated on the basis of average profit of the preceding three years.

The profits for the preceding five years were as under: 2010 ₹ 11,500; 2011 ₹ 14,000; 2012 ₹ 9,000; 2013 ₹ 8,000; 2014 ₹ 10,000.

Required: Journal entries, C's Capital Account and the revised Balance Sheet (show your workings).

Solution

In the books of the firm

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

Date	Particulars		₹	₹
2015	Land and Buildings A/c	Dr.	10,000	
March 31	Investment Fluctuation Fund A/c	Dr.	700	
	Provision for Bad Debts A/c	Dr.	800	
	To Revaluation A/c			11,500
	(Being the increase in the value of assets)			
	Revaluation A/c	Dr.	600	
	To Stock A/c			600
	(Being the decrease in the value of stock)			
	Revaluation A/c	Dr.	10,900	
	To A Capital A/c			3,634
	To B Capital A/c			3,633
	To C Capital A/c			3,633
	(Being the profit on revaluation transferred to Partners' Capital Accounts)			
	A Capital A/c (Note 1)	Dr.	667	
	B Capital A/c	Dr.	667	
	To C Capital A/c			1,334
	(Being the required adjustment made for contingency reserve)			
	A Capital A/c	Dr.	2,800	
	B Capital A/c	Dr.	2,800	
	C Capital A/c	Dr.	2,800	
	To Goodwill A/c (Note 2)			8,400
	(Being the goodwill written-down to its agreed value)			
	A Capital A/c	Dr.	375	
	B Capital A/c	Dr.	375	
	To C Capital A/c (Note 3)			750
	(Being the required adjustment made for profit)			
	C Capital A/c	Dr.	22,917	
	To C Loan A/c			22,917
	(Being the balance of C's capital transferred to his Loan Account)			

Dr. C Capital Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goodwill A/c	2,800		By Balance b/d	20,000
	To C Loan A/c	22,917		By Revaluation A/c	3,633
				By A Capital A/c – contingency reserve	667
				By B Capital A/c – contingency reserve	667
				By A Capital A/c – profit	375
				By B Capital A/c – profit	375
		25,717			25,717

Balance Sheet as on 31st March, 2015 (revised)

Liabilities	₹	Assets	₹
Creditors	12,900	Cash in hand	1,000
Contingency Reserve	4,000	Cash at bank	4,000
Investment Fluctuation Fund	500	Debtors	10,000
C Loan Account	22,917	Stock	9,400
Partners' Capitals:		Investments	5,000
A ₹ (30,000 + 3,634 – 667 – 2,800 – 375)	29,792	Land and Buildings	50,000
B ₹ (20,000 + 3,633 – 667 – 2,800 – 375)	19,791	Goodwill	10,500
	89,900		89,900

Working Notes: (1) Statement Showing the Required Adjustment for Contingency Reserve:

Partners		A	C	B
Right of contingency reserve prior to retirement (1 : 1 : 1)	(₹)	1,333	1,334	1,333
Right of contingency reserve after retirement (1 : 1)	(₹)	2,000	—	2,000
Partners to be debited (+) / credited (–)	(₹)	(+) 667	(–) 1,334	(+) 667

(2) Ascertainment of Goodwill

Total profit for the last 5 years — ₹ (11,500 + 14,000 + 9,000 + 8,000 + 10,000) = ₹ 52,500.

Average profit — ₹ 52,500 / 5 = ₹ 10,500.

Goodwill is one years' purchase of average profits of the past five years, i.e., ₹ 10,500 x 1 = ₹ 10,500.

Therefore, reduction in the value of goodwill = ₹ 18,900 – ₹ 10,500 = ₹ 8,400.

(3) Ascertainment of C's Share of Profit from 1.1.2015 to 31.3.2015

Total profit for the last 3 years — ₹ (9,000 + 8,000 + 10,000) = ₹ 27,000.

Average profit — ₹ 27,000 / 3 = ₹ 9,000.

Average profit for the 3 months, i.e., (1.1.2015 to 31.3.2015) — ₹ 9,000 × 3/12 = ₹ 2,250.

Therefore, C's share of profit — ₹ 2,250 / 3 = ₹ 750.

Illustration 42

X, Y and Z were in partnership sharing profits and losses as one- half, one-fourth and one-fourth respectively. It was agreed that interest should be allowed @10% p.a. on Partners' Capital Accounts and charged @ 8% p.a. on their drawings.

No interest was to be allowed or charged on current accouts. The following are the particulars of their Capital Accounts, Current Accounts and drawings (as shown by the draft accounts):

		Capital Accounts balance on 1.1.2014	Current Account balance on 1.1.2014	Drawings for the year to 31.12.2014	Interest on Drawings
X	(₹)	1,50,000 (Cr.)	20,000 (Cr.)	30,000	2,000
Y	(₹)	80,000 (Cr.)	10,000 (Cr.)	20,000	760
Z	(₹)	60,000 (Cr.)	10,000 (Dr.)	20,000	1,400

The draft accounts for the year to 31st December 2014 showed a net profit of ₹ 1,20,000 before taking into account interest on Partners' Capital Accounts balances and drawings. The audit of the draft accounts revealed the following errors:

1. The rent of X's private house, amounting to ₹ 1,500 and paid on 31st December, 2014, had been included in rents charged in Profit and Loss Account.
2. Repairs amounting to ₹ 20,000 had been treated as additions to machinery, depreciation on which had been charged @ 20%.
3. The premium, amounting to ₹ 6,000, on Y's life insurance policy, and paid on 30th June, 2014 had been included on insurance charges in the Profit and Loss Account.

Z retired from the partnership on 31st December 2014, and agreed to leave the amount due to him from the firm as a loan repayable by agreed instalments. X and Y agreed to continue in partnership sharing profits and losses as two-third and one-third. In ascertaining the amount due to Z from the firm and for the purposes of the new partnership, it was agreed to make the following adjustments :

1. Goodwill to be valued at ₹ 1,44,000, but no account for goodwill to be raised in the books.
2. The value of freehold premises to be increased by ₹ 40,000.
3. The provision for bad debts to be increased by ₹ 12,000.

You are required to prepare:

(a) the Profit and Loss Appropriation Account for the year ended 31st December, 2014, making all the necessary adjustments for the errors revealed, and

(b) Partners' Capital and Current Accounts (in columnar form) for the year ended 31st December 2014, incorporating the adjustments on Z's retirement.

Solution

Working Notes :

(1) Ascertainment of Net Profit

Particulars	₹
Net profit as per Draft Accounts	1,20,000
Add: Rent of X wrongly charged to Profit & Loss A/c	1,500
Add: Depreciation wrongly debited in Profit & Loss A/c	4,000
Add: Premium on Y's Life insurance policy wrongly charged in Profit & Loss A/c	6,000
	1,31,500
Less: Repairs wrongly capitalised	20,000
Net profit	1,11,500

(2) Adjustment in Regard to Goodwill

Partners		X	Y	Z
Right of goodwill prior to Z's retirement (2 : 1 : 1)	(₹)	72,000	36,000	36,000
Right of goodwill after Z's retirement (2 : 1)	(₹)	96,000	48,000	—
Gain (+) / Sacrifice (–)	(₹)	(+) 24,000	(+) 12,000	(–) 36,000

Dr. (3) Revaluation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Provision for Bad Debts A/c	12,000		By Freehold premises A/c	40,000
	To Partners' Capital A/cs: A — 14,000; B—7,000 ; C—7,000	28,000			
		40,000			40,000

(4) Adjustment for Y's Interest on Drawings

	₹
Interest on drawings (as given)	760
Add: Interest for life insurance premium paid by the firm (@ 8% on ₹ 6,000 for 6 months)	240
Y's interest on drawings	1,000

(5) Adjustment in Regard to Drawings

	X	Y
Drawings (as given)	30,000	20,000
Add: Rent of X's house paid by the firm	1,500	—
Add: Life insurance premium of Y paid by the firm	—	6,000
Drawings of X and Y	31,500	26,000

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2014 Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Interest on Capital A/c X — 15,000; Y — 8,000; Z — 6,000	29,000		By Net profit (Note 1)	1,11,500
	To Share of Profit A/c X — 43,450; Y — 21,725; Z — 21,725	86,900		By Interest on Drawings A/c X — 2,000; Y — 1,000; Z — 1,400	4,400
		1,15,900			1,15,900

Dr. Partners' Capital Accounts Cr.

Date	Particulars	X	Y	Z	Date	Particulars	X	Y	Z
31.12.2014	To Z Capital A/c — *	24,000	12,000	—	1.1.2014	By Balance b/d	1,50,000	80,000	60,000
"	To Z Current A/c —	—	—	3,675	31.12.2014	By X Capital A/c —*	—	—	24,000
"	To Z Loan A/c —	—	—	99,325	"	By Y Capital A/c —*	—	—	12,000
"	To Balance c/d	1,40,000	75,000		"	By Revaluation A/c (Note 3)	14,000	7,000	7,000
		1,64,000	87,000	1,03,000			1,64,000	87,000	1,03,000

* Goodwill

Dr. **Partners' Current Accounts** **Cr.**

Date	Particulars	X	Y	Z	Date	Particulars	X	Y	Z
1.1.2014	To Balance b/d	—	—	10,000	1.1.2014	By Balance b/d	20,000	10,000	—
31.12.2014	To Drawings A/c (Note 5)	31,500	26,000	20,000	31.12.2014	By Interest on Capital A/c	15,000	8,000	6,000
"	To Int. on Drawings A/c	2,000	1,000	1,400	"	By Share of profit A/c	43,450	21,725	21,725
"	To Balance c/d	44,950	12,725	—	"	By Z Capital A/c —	—	—	3,675
		78,450	39,725	31,400			78,450	39,725	31,400

Unsettled Accounts of A Retiring Partner

As per the provision of Section 37 of the Indian Partnership Act —

"Where any member of a firm has died or otherwise ceased to be a partner, and the surviving or continuing partners carry on the business of the firm with the property of the firm without any final settlement of accounts as between them and the outgoing partner or his estate, then, in the absence of a contract to the contrary, the outgoing partner or his estate is entitled at the option of himself or his representatives to such share of the profits made since he ceased to be a partner as may be attributable to the use of his share of the property of the firm or to interest at the rate of six per cent per annum on the amount of his share in the property of the firm."

Illustration 43

A, B and C were carrying on business in partnership sharing profit and losses equally. On June 30, 2015, C retired from the firm and A and B agreed to share profits and losses in the ratio of 3:2. C continued his association with the firm as an adviser. The parties agreed that from July 1, 2015:

1. C was to be credited with a retainership fee of ₹ 2,000 p.m. while he remained the adviser.
2. The partners decided to bring into the accounts of the firm the various assets which up to now were unrecorded. The various assets on June 30, 2015 were: goodwill ₹ 60,000; office equipment ₹ 18,000; library books ₹ 3,000.
3. The values of the office equipment and library books were to be retained in the books but goodwill was not to be recorded as a permanent asset.
4. C's Capital Account was to bear the whole cost of ₹ 10,000, a payment on March 30, 2015, for providing an annuity for a long-service employee who retired on that date.

The firm's profit for the year ended September 30,2015, which is deemed to have accrued evenly, amounted to ₹ 90,000, after deduction of the cost of the pension but before adjusting for any of the events listed above. Other relevant figures are: Credit balances on Capital Accounts (1.10.2014) : A — ₹ 45,000; B — ₹ 35,000; and, C — ₹ 55,000

Drawings during the year ended 30.9.2015 : A — ₹ 7,000; B — ₹ 9,000; and, C — ₹ 6,000

All entries relevant to partners' entitlements are effected in their Capital Accounts. You are required to write up, in columnar from, the Capital Accounts of A, B and C for the year ended September 30, 2015, transferring the balance in C's Capital Account to C's Loan Account.

Solution

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

Particulars	A	B	C	Particulars	A	B	C
To Goodwill A/c	36,000	24,000	—	By Balance b/d	45,000	35,000	55,000
To Profit & Loss A/c (annuity)	—	—	10,000	By Goodwill A/c	20,000	20,000	20,000
To Drawings A/c	7,000	9,000	6,000	By Revaluation A/c	7,000	7,000	7,000
To C Loan A/c	—	—	1,03,670	By Profit & Loss A/c (upto 30th June)	25,000	25,000	25,000
To Balance c/d	61,398	58,932	—	By Retainership Fees A/c	—	—	6,000
				By Profit & Loss A/c (Note 3) (after 30th June)	7,398	4,932	6,670
	1,04,398	91,932	1,19,670		1,04,398	91,932	1,19,670

Working Notes :

Dr. **(1) Profit and Loss Appropriation Account (upto 30th June, 2015)** **Cr.**

Particulars	₹	Particulars	₹
To Partners' Capital A/cs: (A — 25,000; B — 25,000; C — 25,000)	75,000	By Adjusted Net profit (₹ 90,000 + 10,000) x 9/12	75,000
	75,000		75,000

Dr. (2) Profit and Loss Appropriation Account (1st July to 30th September, 2015) Cr.

Particulars	₹	Particulars	₹
To Retainership fees A/c	6,000	By Adjusted Net profit	
To C share of Profit (as per Sec 37) (Note 3)	6,670	(₹ 90,000 + 10,000) x 3/12	25,000
To Partners' Capital A/cs:			
(A — ₹ 7,398; B — ₹ 4,932)	12,330		
	25,000		25,000

(3) Calculation of C's Share of Profit After Retirement

Partners	A	B	C
Opening capital (1.10.2014)	45,000	35,000	55,000
Add: Goodwill	20,000	20,000	20,000
Revaluation Profit (₹ 18,000 + 3,000)	7,000	7,000	7,000
	72,000	62,000	82,000
Less: Proportionate drawing (except C)	5,250	6,750	6,000
	66,750	55,250	76,000
Less: Annuity	—	—	10,000
Capital as on 30.6.2015	66,750	55,250	66,000

C share of profit = 19,000 x (66,000/1,88,000) = ₹ 6,670. Interest @ 6% p.a. = ₹ 990.
C will get higher of the two, i.e., ₹ 6,670

Admission cum Retirement

Illustration 44

A, B and C were partners, sharing profits in the ratio of 3 : 2 : 1. On 1.1.2015, B retired and D is admitted to the partnership, bringing in an amount of capital equal to a third of the new partnership's net assets.

The Balance Sheet of A, B and C as on 1.1.2015 was as under :

Liabilities		₹	Assets		₹
Capitals :	A	11,25,000	*Fixed Assets* :		
	B	7,50,000	Building		8,40,000
	C	3,75,000	*Current Assets* :		
			Stock		15,00,000
Current Liabilities :			Debtors	6,00,000	
Creditors		10,50,000	Less: Provision for Doubtful Debts	60,000	5,40,000
			Bank		4,20,000
		33,00,000			33,00,000

The terms of the changes to the partnership were as follows :

1. Goodwill was valued at ₹ 3,00,000.
2. Stock was written-down by ₹ 60,000.
3. Provision for doubtful debts was to be reduced to 5%.
4. D brought in equipments worth ₹ 3,45,000 and the balance by cheque.
5. The amount due to B was paid by cheque.
6. The new profit sharing ratio was to be equal.

Prepare necessary Ledger Accounts and the Balance Sheet of the new firm.

Solution

In the books of the Firm

Dr. Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Stock A/c	60,000	By Provision for Doubtful Debts A/c	30,000
		By Partners' Capital A/cs :	
		(A ₹ : 15,000; B : ₹ 10,000; C : ₹ 5,000)	30,000
	60,000		60,000

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	D	Particulars	A	B	C	D
To Revaluation A/c	15,000	10,000	5,000	—	By Balance b/d	11,25,000	7,50,000	3,75,000	—
To Goodwill A/c	1,00,000	—	1,00,000	1,00,000	By Goodwill A/c	1,50,000	1,00,000	50,000	—

To Bank A/c	—	8,40,000	—	—	By Equipment A/c	—	—	—	3,45,000
To Balance c/d (Note 1)	11,60,000	—	3,20,000	7,40,000	By Bank A/c (Balancing figure)	—	—	—	4,95,000
	12,75,000	8,50,000	4,25,000	8,40,000		12,75,000	8,50,000	4,25,000	8,40,000

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	4,20,000		By B Capital A/c	8,40,000
	To D Capital A/c	4,95,000		By Balance c/d	75,000
		9,15,000			9,15,000

Balance Sheet of the New Firm

Liabilities		₹	Assets		₹
Capitals :	A	11,60,000	**Fixed Assets** :		
	C	3,20,000	Building		8,40,000
	D	7,40,000	Equipments		3,45,000
Current Liabilities :			**Current Assets** :		
Creditors		10,50,000	Stock		14,40,000
			Debtors	6,00,000	
			Less: Provision for Doubtful Debts	30,000	5,70,000
			Bank		75,000
		32,70,000			32,70,000

Working Note :

(1) D is to bring in an amount of capital equal to a third of the new partnership's net assets. This means his capital balance is to be 1/2 of the combined adjusted capital of A and C, i.e., 1/2 of ₹ (11,60,000 + 3,20,000) = ₹ 7,40,000.

Illustration 45

Dowell & Co. is a partnership firm with partners A, B and C, sharing profits and losses in the ratio of 10 : 6 : 4. The Balance Sheet of the firm as on 31st March, 2015 is as under :

Liabilities			₹	Assets	₹
Capitals :	A	80,000		Land	10,000
	B	20,000		Buildings	2,00,000
	C	30,000	1,30,000	Plant and Machinery	1,30,000
Reserves (Unappropriated profit)			20,000	Furniture	43,000
Long-term Debt			3,00,000	Investments	12,000
Bank overdraft			44,000	Stock	1,30,000
Trade creditors			1,70,000	Debtors	1,39,000
			6,64,000		6,64,000

It was mutually agreed that B will retire from partnership and in his place D will be admitted as a partner with effect from 1st April, 2015. For this purpose, the following adjustments are to be made :

(i) Goodwill is to be valued at ₹ 1,00,000 but the same will not appear as an asset in the books of the reconstituted firm.

(ii) Buildings, Plant and Machinery are to be depreciated by 5% and 20% respectively. Investments are to be taken over by the retiring partner at ₹ 15,000. Provision of 20% is to be made on debtors to cover doubtful debts.

(iii) In the reconstituted firm, the total capital will be ₹ 2,00,000 which will be contributed by A, C and D in their new profit-sharing ratio, which is 2 : 2 : 1.

(iv) The surplus funds, if any, will be used for repaying the bank overdraft.

(v) The amount due to the retiring partner shall be transferred to his Loan Account.

You are to prepare : (a) Revaluation Account; (b) Partners' Capital Accounts; (c) Bank Account; and, (d) Balance Sheet of the reconstituted firm as on 1st April, 2015. ***[C.A. (Foundation) —Adapted]***

Solution **In the books of Dowell & Co.**

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

Particulars	₹	Particulars	₹
To Buildings A/c	10,000	By Investments A/c	3,000
To Plant and Machinery A/c	26,000	By Partners' Capital A/cs :	
To Provision for Bad Debts A/c	27,800	A — ₹ 30,400; B — ₹ 18,240; C — ₹ 12,160	60,800
	63,800		63,800

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

Particulars	A	B	C	D	Particulars	A	B	C	D
To Goodwill A/c	40,000	—	40,000	20,000	By Balance b/d	80,000	20,000	30,000	—
To Revaluation A/c	30,400	18,240	12,160	—	By Goodwill A/c	50,000	30,000	20,000	—
To Investments A/c	—	15,000	—	—	By Reserves A/c	10,000	6,000	4,000	—
To B Loan A/c	—	22,760	—	—	By Bank A/c	10,400	—	78,160	60,000
To Balance c/d	80,000	—	80,000	40,000					
	1,50,400	56,000	1,32,160	60,000		1,50,400	56,000	1,32,160	60,000

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To A Capital A/c	10,400		By Balance b/d	44,000
	To C Capital A/c	78,160		By Balance c/d	1,04,560
	To D Capital A/c	60,000			
		1,48,560			1,48,560

Balance Sheet (of the reconstituted firm) as at 1st April, 2015

Liabilities			₹	Assets		₹
Capitals :	A	80,000		Land		10,000
	C	80,000		Building		1,90,000
	D	40,000	2,00,000	Plant and Machinery		1,04,000
Loan — B			22,760	Furniture		43,000
Long-term Debt			3,00,000	Stock		1,30,000
Trade Creditors			1,70,000	Debtors	1,39,000	
				Less : Provision for bad debts	27,800	1,11,200
				Bank		1,04,560
			6,92,760			6,92,760

Illustration 46

A, B and C are in partnership sharing profits and losses equally. On 31.12.2014, the firm's Balance Sheet was as follows:

Liabilities			₹	Assets	₹
Capital :	A	40,000		Sundry Assets	88,000
	B	30,000		Cash	10,000
	C	20,000	90,000		
Sundry Creditors			8,000		
			98,000		98,000

On that date C decided to retire. The value of goodwill (which does not appear in the above Balance Sheet) was agreed to be ₹ 12,000. Sundry assets were taken to have increased in value by ₹ 24,000 on revaluation.

Draw up the re-adjusted Balance Sheet showing the amount due to C.

On C's retirement, D comes in as a partner. He pays no premium but brings ₹ 18,000 in cash as capital. Profits and Losses are now to be shared by A, B and D in the ratio of 3 : 3 : 2.

Draw up the Balance Sheet on D's admission after restoring the sundry assets to their original value and wiping out goodwill.

Solution **Balance Sheet after C's Retirement**

Liabilities			₹	Assets	₹
Capital : (Note 1)	A	46,000		Sundry Assets ₹ (88,000 + 24,000)	1,12,000
	B	36,000	82,000	Cash	10,000
Loan — C			32,000		
Sundry Creditors			8,000		
			1,22,000		1,22,000

Balance Sheet after D's Admission

Liabilities			₹	Assets	₹
Capital : (Note 2)	A	38,500		Sundry Assets	88,000
	B	28,500		Cash (₹ 10,000 + ₹ 18,000)	28,000
	D	9,000	76,000		
Loan — C			32,000		
Sundry Creditors			8,000		
			1,16,000		1,16,000

Working Notes :

Dr. (1) Partners' Capital Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
To C Loan A/c	—	—	32,000	By Balance b/d	40,000	30,000	20,000
To Goodwill A/c	6,000	6,000	—	By Goodwill A/c (old ratio)	4,000	4,000	4,000
To Balance c/d	46,000	36,000	—	By Sundry Assets A/c (old ratio)	8,000	8,000	8,000
	52,000	42,000	32,000		52,000	42,000	32,000

Dr. (2) Partners' Capital Accounts Cr.

Particulars	A	B	D	Particulars	A	B	D
To Sundry Assets A/c (new ratio)	9,000	9,000	6,000	By Balance b/d (as above)	46,000	36,000	—
To Goodwill A/c (new ratio)	4,500	4,500	3,000	By Cash A/c	—	—	18,000
To Balance c/d	38,500	28,500	9,000	By Goodwill A/c	6,000	6,000	—
	52,000	42,000	18,000		52,000	42,000	18,000

Illustration 47

A, B and C are in partnership, sharing profits in the ratio of 3 : 2 : 1 and preparing their accounts to 30th June each year. At 1.7.2014, their capital accounts showed the following balances :

A — ₹ 3,35,000; B — ₹ 2,80,000; C — ₹ 3,10,000.

On 31.12.2014, A retired and D is admitted into the partnership. He introduced ₹ 2,00,000 as capital and also paid ₹ 1,50,000 as premium for goodwill. The new profit sharing ratio among B, C and D became 2 : 1 : 1 respectively.

The following adjustments are required to arrive at the amount due to A :

(1) The value of goodwill was agreed to be worth ₹ 6,00,000.

(2) Fixed assets are to be revalued upwards by ₹ 3,00,000.

(3) The net profit for the year ended 30.6.2015 was ₹ 4,00,000 (agreed to accrue evenly) before allowing for the following —

(a) Bad debts of ₹ 50,000 relating to the first half to be written-off;

(b) A left the amount due to him as a loan and received interest @ 10% p.a. for the half year ended 30.6.2015. The interest was paid to him on 30.6.2015.

Partners' drawings during the year were :

A ₹ 60,000 (all before 31st December); B ₹ 60,000 (₹ 30,000 in each half year)

C ₹ 40,000 (₹ 20,000 in each half year); D ₹ 25,000 (all after 31st December).

Prepare Profit and Loss Appropriation Account for the year ended 30.6.2015 and the Partners' Capital Accounts.

Solution

Dr. Profit and Loss Appropriation Account for the year ended 30th June, 2015 Cr.

Particulars		1.7.2014 to 31.12.2014	1.1.2015 to 30.6.2015	Particulars	1.7.2014 to 31.12.2014	1.1.2015 to 30.6.2015
To Share of Profit A/c :	A	75,000	—	By Net Profit b/d (Note 2)	1,50,000	1,60,000
	B	50,000	80,000			
	C	25,000	40,000			
	D	—	40,000			
		1,50,000	1,60,000		1,50,000	1,60,000

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	D	Date	Particulars	A	B	C	D
2014						2014					
Dec. 31	To A Capital A/c	—	1,00,000	50,000	—	Jul 1	By Balance c/d	3,35,000	2,80,000	3,10,000	—
"	To Drawings A/c	60,000	30,000	20,000	—	Dec. 31	By Fixed Assets A/c	1,50,000	1,00,000	50,000	—
"	To A's Loan A/c	8,00,000	—	—	—	"	By Premium for Goodwill A/c (Note 1)	1,50,000	—	—	—
"	To Balance c/d	—	3,00,000	3,15,000	2,00,000	"	By B Capital A/c (Note 1)	1,00,000	—	—	—
						"	By C Capital A/c (Note 1)	50,000	—	—	—
						"	By Bank A/c	—	—	—	2,00,000
						"	By Share of Profit A/c	75,000	50,000	25,000	—
		8,60,000	4,30,000	3,85,000	2,00,000			8,60,000	4,30,000	3,85,000	2,00,000

2015						2015						
Jun 30	To Drawings A/c	—	30,000	20,000	25,000	Jan. 1	By Balance b/d	—	3,00,000	3,15,000	2,00,000
"	To Balance c/d	—	3,50,000	3,35,000	2,15,000	Jun 30	By Share of Profit A/c	—	80,000	40,000	40,000
		—	3,80,000	3,55,000	2,40,000			—	3,80,000	3,55,000	2,40,000

Working Notes :

(1) Statement Showing the Required Adjustment for Goodwill

Particulars	A (₹)	B (₹)	C (₹)	D (₹)
Right of goodwill before retirement (3 : 2 : 1)	3,00,000	2,00,000	1,00,000	—
Right of goodwill after admission (2 : 1 : 1)	—	3,00,000	1,50,000	1,50,000
Sacrifice (–) / Gain (+)	(–) 3,00,000	(+) 1,00,000	(+) 50,000	(+) 1,50,000

Therefore, entire premium for goodwill will go in favour of A. Also, B and C are to pay A ₹ 1,00,000 and ₹ 50,000 respectively.

(2) Adjusted Profit for Distribution

Particulars		1.7.2014 to 31.12.2014 ₹	1.1.2015 to 30.6.2015 ₹
Profit divided equally		2,00,000	2,00,000
Less:	Bad Debts	50,000	—
	Interest on Loan of A @ 10% p.a. on ₹ 8,00,000 for 6 months (See Partners' Capital A/cs)	—	40,000
Adjusted Profit for Distribution		1,50,000	1,60,000

Illustration 48

A, B and C are in partnership, compiling their accounts to 30th September each year and sharing profits in the ratio of 3 : 2 : 1. The summarised partnership Balance Sheet at 30th September, 2014 is shown below :

Liabilities		₹	Assets	₹
Capitals :	A	6,00,000	Sundry Net Assets	16,00,000
	B	6,00,000		
	C	4,00,000		
		16,00,000		16,00,000

In the year ended 30th September 2015, the following events took place :

(1) On 31.3.2015, A retired. In settling the amount due to him, goodwill was valued at ₹ 6,00,000, and a plot of land owned by the partnership was revalued upwards by ₹ 1,20,000. The balance due to A remained in the partnership as a loan, carrying no interest.
B and C continued the partnership business from 1.4.2015, sharing profits in the ratio of 2 : 1.

(2) On 1.7.2015, D joined the partnership and from this date the profit sharing ratio became 2 : 1 : 1.
D brought in ₹ 3,00,000 as capital, plus a further ₹ 1,50,000 for a one quarter share of the goodwill valued at this date at ₹ 6,00,000.

The total profit for the year ended 30.9.2015 was ₹ 6,00,000. The following basis of allocating the profit was agreed:

(a) A bad debt of ₹ 30,000 charged in arriving at the profit of ₹ 6,00,000 should be related to the six months ended 31.3.2015.

(b) Apart from the above adjustment, the profit should be divided —
6 months ended 31.3.2015 — 60%,
3 months ended 30.6.2015 — 20%,
3 months ended 30.9.2015 — 20%.

The partners' drawings for the year were (all figures in ₹) :

Partners	A	B	C	D
6 months ended 31.3.2015	50,000	40,000	30,000	—
3 months ended 30.6.2015	—	30,000	30,000	—
3 months ended 30.9.2015	—	40,000	30,000	25,000

You are required to prepare a Profit and Loss Appropriation Account for the year ended 30.9.2015. Also prepare the Partners' Capital Accounts.

Solution

Dr. Profit and Loss Appropriation Account for the year ended 30th September, 2015 Cr.

Particulars		1.10.2014 to 31.3.2015	1.4.2015 to 30.6.2015	1.7.2015 to 30.9.2015	Particulars	1.10.2014 to 31.3.2015	1.4.2015 to 30.6.2015	1.7.2015 to 30.9.2015
To Share of Profit A/c :	A	1,74,000	—	—	By Net Profit b/d (Note 1)	3,48,000	1,26,000	1,26,000
	B	1,16,000	84,000	63,000				
	C	58,000	42,000	31,500				
	D	—	—	31,500				
		3,48,000	1,26,000	1,26,000		3,48,000	1,26,000	1,26,000

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	D	Date	Particulars	A	B	C	D
2015						2014					
Mar. 31	To Goodwill A/c	—	4,00,000	2,00,000	—	Oct 1	By Balance b/d	6,00,000	6,00,000	4,00,000	—
"	To Drawings A/c	50,000	40,000	30,000	—	2015					
"	To A's Loan A/c	10,84,000	—	—	—	Mar 31	By Land A/c	60,000	40,000	20,000	—
"	To Balance c/d	—	5,16,000	3,48,000	—	"	By Goodwill A/c	3,00,000	2,00,000	1,00,000	—
						"	By Share of Profit A/c	1,74,000	1,16,000	58,000	—
		11,34,000	9,56,000	5,78,000	—			11,34,000	9,56,000	5,78,000	—
Jun 30	To Drawings A/c	—	30,000	30,000	—	April 1	By Balance b/d	—	5,16,000	3,48,000	—
"	To Balance c/d	—	5,70,000	3,60,000	—	Jun 30	By Share of Profit A/c	—	84,000	42,000	—
		—	6,00,000	3,90,000	—			—	6,00,000	3,90,000	—
Sept 30	To Drawings A/c	—	40,000	30,000	25,000	July 1	By Balance b/d	—	5,70,000	3,60,000	—
"	To Balance c/d	—	6,93,000	4,11,500	3,06,500	"	By Bank A/c	—	—	—	3,00,000
						"	By Premium for Goodwill A/c	—	1,00,000	50,000	—
						Sept 30	By Share of Profit A/c	—	63,000	31,500	31,500
		—	7,33,000	4,41,500	3,31,500			—	7,33,000	4,41,500	3,31,500

Working Note :

(1) Profit before charging bad debts = ₹ (6,00,000 + 30,000) = ₹ 6,30,000. This profit is to be allocated in different periods in the given ratio and, thereafter, bad debt is to be deducted as under (all figures in rupees) :

Particulars	1.10.2014 to 31.3.2015	1.4.2015 to 30.6.2015	1.7.2015 to 30.9.2015
Profit of ₹ 6,30,000 shared in the ratio — 6 : 2 : 2	3,78,000	1,26,000	1,26,000
Less : Bad Debts	30,000	—	—
Adjusted Profit for Distribution	3,48,000	1,26,000	1,26,000

Illustration 49

Ram, Rahim and Robert are partners, sharing profits and losses in the ratio of 5 : 3 : 2. It was decided that Robert would retire on 31.3.2015 and in his place Richard would be admitted as a partner with new profit sharing ratio between Ram, Rahim and Richard at 3 : 2 : 1.

Balance Sheet of Ram, Rahim and Robert as at 31.3.2015

Liabilities	₹	Assets	₹
Capital Accounts :		Cash in Hand	20,000
Ram	1,00,000	Cash at Bank	1,00,000
Rahim	1,50,000	Sundry Debtors	5,00,000
Robert	2,00,000	Stock in Trade	2,00,000
General Reserve	2,00,000	Plant and Machinery	3,00,000
Sundry Creditors	8,00,000	Land and Building	5,30,000
Loan from Richard	2,00,000		
	16,50,000		16,50,000

Retirement of Robert and admission of Richard is on the following terms :

(a) Plant and Machinery to be depreciated by ₹ 30,000.

(b) Land and Building to be valued at ₹ 6,00,000.
(c) Stock to be valued at 95% of book value.
(d) Provision for doubtful debts @ 10% to be provided on debtors.
(e) General Reserve to be apportioned amongst Ram, Rahim and Robert.
(f) The firm's goodwill to be valued at 2 years purchase of the average profits of the last 3 years.
The relevant figures are :
Year ended 31.3.2012 — Profit ₹ 50,000;
Year ended 31.3.2013 — Profit ₹ 60,000;
Year ended 31.3.2014 — Profit ₹ 55,000.
(g) Out of the amount due to Robert ₹ 2,00,000 would be retained as loan by the firm and the balance will be settled immediately.
(h) Richard's capital should be equal to 50% of the combined capital of Ram and Rahim.

Prepare : (i) Capital Accounts of the Partners; and (ii) Balance Sheet of the reconstituted firm.

Solution

In the books of the Firm

Dr. Partners' Capital Accounts [all figures in ₹ '000] **Cr.**

Particulars	Ram	Rahim	Robert	Richard	Particulars	Ram	Rahim	Robert	Richard
To Revaluation A/c (Note 1)	10	6	4	—	By Balance b/d	100	150	200	—
To Robert's Loan A/c	—	—	200	—	By General Reserve A/c	100	60	40	—
To Bank A/c (bal. fig.)	—	—	58	—	By Goodwill A/c	55	33	22	—
To Balance c/d	245	237	—	—					
	255	243	262	—		255	243	262	—
To Goodwill (written off)	55	36.667		18.333	By Balance b/d	245	237	—	—
To Balance c/d	190	200.333		195.167	By Loan from Richard	—	—	—	200
					By Bank A/c (Note 3)	—	—	—	13.5
	245	237	—	213.50		245	237	—	213.50

Ram, Rahim and Richard
Balance Sheet of A and C as at . . .

Liabilities	₹	Assets		₹
Capital Accounts :		Land and Building		6,00,000
Ram	1,90,000	Plant and Machinery		2,70,000
Rahim	2,00,333	Stock-in-trade		1,90,000
Richard	1,95,167	Sundry Debtors	5,00,000	
Sundry Creditors	8,00,000	Less: Provision for Doubtful Debts	50,000	4,50,000
Robert's Loan	2,00,000	Cash at Bank (Note 4)		55,500
		Cash in Hand		20,000
	15,85,500			15,85,000

Working Notes :

Dr. (1) Revaluation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Plant and Machinery A/c	30,000		By Land and Building A/c	70,000
	To Stock-in-trade	10,000		By Partners' Capital A/cs :	
	To Provision for Doubtful Debts	50,000		Ram (5/10)	10,000
				Rahim (3/10)	6,000
				Robert (2/10)	4,000
		90,000			90,000

(2) Calculation of Value of Goodwill :

Total profits of last 3 years : ₹ (60,000 + 50,000 + 55,000) = ₹ 1,65,000.
Average profit = ₹ 1,65,000 / 3 = ₹ 55,000.
Goodwill = 2 years' purchase of average profit = 2 × ₹ 55,000 = ₹ 1,10,000.

(3) Combined Capital of Ram and Rahim

	₹
Ram : ₹ (2,45,000 – 55,000)	1,90,000
Rahim : ₹ (2,37,000 – 33,667)	2,00,333
	3,90,333
Richard's Capital (50% of ₹ 3,90,333)	1,95,167
Cash to be brought in : ₹ (2,00,000 – 18,333 – 1,95,167)	13,500

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	1,00,000		By Robert's Capital (paid off)	58,000
	To Richard's Capital (Brought in)	13,500		By Balance c/d	55,500
		1,13,500			1,13,500

Illustration 50

A and B are equal partners. A by agreement, retires and C joins the firm on the basis of one third share of profits on 1.1.2015. The balance of the books as on 31.12.2014 were :

Dr. Cr.

Fixed Assets — at cost	1,30,000	Sundry Creditors	20,000
Stock	60,000	Provision for depreciation	12,000
Sundry Debtors	40,000	Capital Accounts	
Bank balance	8,000	A	1,04,000
		B	1,02,000
	2,38,000		2,38,000

Fixed Assets are valued at ₹ 1,40,000 and it was agreed to be written-up accordingly before admission of C as partner. Sufficient money is to be introduced so as to enable A to be paid off and leave ₹ 5,000 cash at bank; B and C are to provide such sum as to make their capitals proportionate to their share of profit. Assuming the agreement was carried out, show the Journal entries required and prepare the Balance Sheet after admission of C. (All workings should form part of your answer).

Solution **In the books of the Firm**

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

Date	Particulars		₹	₹
2015	Fixed Assets A/c (Note 1)	Dr.	22,000	
Jan. 1	To Revaluation A/c			22,000
	(Being the value of fixed assets increased)			
	Revaluation A/c	Dr.	22,000	
	To A Capital A/c			11,000
	To B Capital A/c			11,000
	(Being profit on revaluation transferred to Partners' Capital Accounts in the profit-sharing ratio)			
	Bank A/c	Dr.	1,12,000	
	To B Capital A/c (Note 3)			37,000
	To C Capital A/c (Note 3)			75,000
	(Being the amount brought in cash by B & C to make their capital ₹ 1,70,000 & ₹ 85,000 respectively)			
	A Capital A/c	Dr.	1,15,000	
	To Bank A/c			1,15,000
	(Being the amount due to A paid off)			

Balance Sheet of B & C as at 1st January, 2015

Liabilities	₹	Assets		₹
Capital A/cs :		Fixed Assets	1,52,000	
B	1,50,000	Less: Provision for Depreciation	12,000	1,40,000
C	75,000	Stock		60,000
Sundry Creditors	20,000	Sundry Debtors		40,000
		Cash at bank		5,000
	2,45,000			2,45,000

Working Notes :

(1) AS—10 Para 29 states that 'When a fixed asset is revalued upwards, any accumulated depreciation existing at the date of the revaluation should not be credited to Profit and Loss Statement'. It means that at the time of upward revaluation of fixed asset, accumulated / provision for depreciation will remain the same. Only the cost of the fixed asset will be revised upwards.

In this problem, fixed asset is ₹ 1,30,000 (at cost) and provision for depreciation is ₹ 12,000. Therefore, net book value is ₹ 1,18,000 (₹ 1,30,000 – ₹ 12,000). But it has been revalued at ₹ 1,40,000. Therefore, cost of the fixed asset will be increased by ₹ 22,000 (₹ 1,40,000 – ₹ 1,18,000). In the Balance Sheet the cost of fixed asset will be (₹ 1,30,000 + ₹ 22,000) = ₹ 1,52,000 ***less*** provision for depreciation ₹ 12,000. Net book value = ₹ 1,52,000 – ₹ 12,000 = ₹ 1,40,000.

(2) For calculating capital of B and C in the new firm, a projected Balance Sheet is to be prepared :

Projected Balance Sheet

Liabilities	₹	Assets	₹
Sundry Creditors	20,000	Fixed Assets	1,40,000
Combined capital of B & C (balancing figure)	2,25,000	Stock	60,000
		Sundry Debtors	40,000
		Cash at bank	5,000
	2,45,000		2,45,000

B's share of capital: 2/3 of ₹ 2,25,000 = ₹ 1,50,000; C's share of capital: 1/3 of ₹ 2,25,000 = ₹ 75,000.

Dr. **(3) Partners' Capital Accounts** **Cr.**

Particulars	A	B	C	Particulars	A	B	C
To Bank A/c	1,15,000	—	—	By Balance b/d	1,04,000	1,02,000	—
To Balance c/d	—	1,50,000	75,000	By Revaluation A/c	11,000	11,000	—
				By Bank A/c (balancing figure)	—	37,000	75,000
	1,15,000	1,50,000	75,000		1,15,000	1,50,000	75,000

Dr. **(4) Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	8,000		By A Capital A/c	1,15,000
	To B Capital A/c	37,000		By Balance c/d	5,000
	To C Capital A/c	75,000			
		1,20,000			1,20,000

Illustration 51

Dosi and Desai are in partnership as equal partners. Dosi, by agreement, retires and his son Dinesh joins the firm on the basis that he would get 1/3rd share of the profits. The balances in the books of M/s Dosi and Desai were:

Particulars	Dr. (₹)	Particulars	Cr. (₹)
Bank	8,000	Capital Accounts:	
Debtors	15,000	Dosi	23,000
Stock	26,000	Desai	20,000
		Creditors	6,000
	49,000		49,000

Goodwill is agreed at ₹ 30,000 and it is to be adjusted through Partners' Capital Accounts. Sufficient money is to be introduced so as to enable Dosi to be paid off and leave ₹ 4,000 in the bank; Desai and Dinesh are to provide such sum as to make their capitals proportionate to their shares of profit. Dosi agreed to contribute from his capital half of the amount Dinesh has to provide. Assuming the agreement was carried out, show the Journal entries and prepare the Balance Sheet of the firm of M/s Desai and Dinesh.

Solution **In the books of M/s Desai and Dinesh**

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

Date	Particulars		₹	₹
	Desai Capital A/c	Dr.	5,000	
	Dinesh Capital A/c	Dr.	10,000	
	To Dosi Capital A/c			15,000
	(Being the necessary adjustment for goodwill)			
	Bank A/c	Dr.	11,500	
	Dosi Capital A/c	Dr.	11,500	
	To Dinesh Capital A/c			23,000
	(Being 1/2 of the amount, contributed by Dosi, transferred to Dinesh Capital Account — the balance 1/2 brought in by him in cash)			
	Bank A/c	Dr.	11,000	
	To Desai Capital A/c			11,000
	(Being the required amount brought in by Desai to make his capital proportionate to his share of profit)			
	Dosi Capital A/c	Dr.	26,500	
	To Bank A/c			26,500
	(Being the amount due to Dosi paid off)			

Balance Sheet of M/s Desai and Dinesh as at ...

Liabilities	₹	Assets	₹
Capital Accounts :		Stock	26,000
Desai	26,000	Debtors	15,000
Dinesh	13,000	Bank	4,000
Creditors	6,000		
	45,000		45,000

Working Notes : (1) For calculating the required capital of Desai and Dinesh in the new firm, a projected Balance Sheet is to be prepared:

Projected Balance Sheet

Liabilities	₹	Assets	₹
Creditors	6,000	Stock	26,000
Combined Capital of Desai & Dinesh (balancing figure)	39,000	Debtors	15,000
		Bank	4,000
	45,000		45,000

Desai's share of capital 2/3 of ₹ 39,000 = ₹ 26,000; Dinesh's share of capital 1/3 of ₹ 39,000 = ₹ 13,000;

Total amount to be brought in by Dinesh = ₹ 13,000 Capital + ₹ 10,000 Premium for Goodwill = ₹ 23,000. 1/2 of this amount is to be given to him by Dosi and the balance is to be brought in by him in cash = ₹ 11,500.

Dr. (2) Partners' Capital Accounts Cr.

Particulars	Dosi	Desai	Dinesh	Particulars	Dosi	Desai	Dinesh
To Dinesh Capital A/c	11,500	—	—	By Balance b/d	23,000	20,000	—
To Dosi Capital A/c	—	5,000	10,000	By Desai Capital A/c	5,000	—	—
To Bank A/c	26,500	—	—	By Dinesh Capital A/c	10,000	—	—
To Balance c/d	—	26,000	13,000	By Bank A/c		11,000	11,500
				By Dosi Capital A/c	—	—	11,500
	38,000	31,000	23,000		38,000	31,000	23,000

(3) Adjustment in Regard to Goodwill

Partners		Dosi	Desai	Dinesh
Right of goodwill prior to retirement (1 : 1)	₹	15,000	15,000	—
Right of goodwill after retirement (2 : 1)	₹	—	20,000	10,000
Gain (+) / Sacrifice (–)	₹	(–) 15,000	(+) 5,000	(+) 10,000

Key Points

- According to Sec. 32(1) of the Indian Partnership Act, a partner can retire in the following three ways :
  (i) with the consent of all the other partners (such consent may be expressed or implied)
  (ii) in accordance with an express agreement by the partners; and
  (iii) where the partnership is at will, by giving notice in writing to all the other partners of his intention to retire.
- The effects of the above provision of AS—10 in Partnership Accounts are the following :
  1. Only purchased goodwill to be recorded in the books of accounts.
  2. Non-purchased goodwill (internally generated goodwill) will be adjusted through Partners' Capital Accounts. In, effect this goodwill cannot be shown in the Partnership Balance Sheet.
- The ratio in which the remaining partners are acquiring the share of the retiring partner is called gaining ratio.

THEORETICAL QUESTIONS

1. How is goodwill treated at the time of retirement of a partner?
2. What are the different ways in which a partner can retire from the firm?
3. Why are assets and liabilities revalued at the time of retirement?
4. Explain the mode of payment to a retired partner.
5. Explain the procedure of computation of retired partner's interest in the firm.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below.

1. Which of the following is true ?
   A The retirement of a partner result in a new partnership.
   B Gaining ratio is the ratio in which the old partners surrender their share of profit in favour of the new partner.
   C When a partner retires, goodwill is to be distributed in the capital ratio.
   D When a partner retires, profit or loss on revaluation is to be shared in the gaining ratio.

2. Which of the following is true ?
   A When the retiring partner's share of goodwill is credited to his capital account, then the same is to be debited to the capital accounts of the remaining partners in the sacrificing ratio.
   B The amount due to the retiring partners if not paid in cash is transferred to his loan account.
   C The account of retiring partner's capital is transferred to a loan account, which carries interest @ 10% p.a. until it is paid.
   D If a partner retires on a date other than the date of preparing final accounts, then he is not entitled to any share in the profit from the date of preceding final accounts to the date of retirement.
3. Which of the following is true ?
   A The profit or loss disclosed by the revaluation account at the time of retirement of a partner is transferred to the capital account of the partners in the capital ratio.
   B When a partner retires, all accumulated losses are transferred to the capital accounts in new profit sharing ratio.
   C When a partner retires, a revaluation account is prepared in the interest of the retiring partner.
   D Unrecorded asset taken over by a retiring partner should appear in the revaluation account.
4. Which of the following is true ?
   A When a partner retires, a goodwill account may be raised which will find a place in the Balance Sheet.
   B When a partner retires, a goodwill account may be raised but it should be written off immediately.
   C When a partner retires, the remaining partners are to bring in money to pay off the retiring partner.
   D Profits and losses on revaluation of assets and liabilities directly affect the partners' current accounts.
5. State which of the following is not true ?
   A A partner can retire from the business with the consent of all the other partners.
   B The profit or loss on revaluation of assets and liabilities is transferred to continuing partners in the new ratio.
   C Upon retirement, adjustment for goodwill is made through the partners' capital accounts.
   D A retiring partner is entitled to his share in the goodwill of the firm as per the agreement between the partners.
6. On retirement of a partner, the combined shares of the continuing partners
   A will remain same
   B will reduce
   C will increase
   D will decrease or increase
7. On retirement of a partner, the assets and liabilities of the firm are
   A to be revalued upward only
   B to be revalued downward only
   C to be revalued both upward and downward where necessary
   D not to be revalued
8. At the time of retirement of a partner, if there is undistributed profit in the Balance Sheet of the firm, it
   A will not be distributed amongst the partners
   B will be distributed in the capital ratio
   C will be distributed in the old profit sharing ratio amongst all the partners
   D will be distributed amongst continuing partners
9. Upon retirement, joint life policy surrender value will be distributed
   A amongst all partners in the old ratio
   B amongst continuing partners in the new ratio
   C to retiring partners only
   D amongst continuing partners in the old ratio

PRACTICAL QUESTIONS

1. A, B and C were partners in a firm sharing profits and losses in the ratio of 2 : 2 : 1 respectively. The Balance Sheet of the firm as on 31.12.2014 was as follows :

Liabilities		₹	Assets		₹
Sundry Creditors		25,000	Cash		3,000
Bills Payable		12,000	Sundry Debtors	20,000	
Capital Accounts :			Less: Provision for Bad Debts	1,000	19,000
A	40,000		Closing Stock		30,000
B	40,000		Furniture		10,000
C	30,000	1,10,000	Plant and Machinery		40,000
Reserve		15,000	Buildings		60,000
		1,62,000			1,62,000

On 31.12.2014, B retired. The terms of retirement provided the following :

(a) The goodwill of the firm was to be valued at ₹ 20,000.

(b) Furniture, plant and machinery were to be depreciated by 10% and 5% respectively.

(c) Stock and building were to be appreciated by 20% and 10% respectively.

(d) Provision for doubtful debts was to be increased to ₹ 1,500.

(e) The reserve was to be transferred to the Capital Accounts of the partners.

(f) The amount due to B was to be transferred to a separate Loan Account earning interest @ 10% p.a.

Show the Revaluation Account, Partners' Capital Accounts and the Balance Sheet of the firm after B's retirement.

2. A, B and C are partners sharing profits and losses 4/7ths, 2/7ths, 1/7ths respectively. Their Balance Sheet on 31st December 2014 was as follows :

Liabilities	₹	Assets	₹
Capital A/cs :		Goodwill	15,000
A	45,000	Stock	22,500
B	30,000	Debtors	16,500
C	25,000	Land and Building	30,000
Bills Payable	3,000	Machinery	39,750
General Reserve	10,500	Motor Van	7,750
Creditors	22,500	Cash	4,500
	1,36,000		1,36,000

On the same date A retired from the business and the following adjustments were made :

(i) Firm's goodwill was valued at ₹ 36,000.

(ii) Assets and liabilities are to be revalued as : Stock ₹ 18,000; Land and Building ₹ 33,900; Debtors ₹ 15,750; Machinery ₹ 37,500; Creditors ₹ 21,000.

(iii) B to bring in ₹ 30,000 and C ₹ 7,500 as additional capital.

(iv) A was to be paid ₹ 24,300 in cash and the balance of his Capital Account to be transferred to his Loan Account.

Prepare Revaluation Account, Partners' Capital Accounts, Cash Account and the Balance Sheet of the firm after A's retirement.

3. A, B and C are partners sharing profits and losses in the ratio of 3:2:1. Their Balance Sheet on 31.12.2014 was :

Liabilities	₹	Assets	₹
Capital Accounts:		Cash at bank	3,500
A	45,000	Debtors	30,000
B	35,000	Stock	25,000
C	25,000	Plant	40,000
Reserve	15,000	Building	50,000
Profit & Loss A/c	12,000	Furniture	4,000
Creditors	20,500		
	1,52,500		1,52,500

C retires on that date subject to the following conditions:

(i) Goodwill of the firm is to be valued at ₹ 36,000;

(ii) Building is to be appreciated by 20%;

(iii) Plant & Furniture are to be depreciated by 10% and 15% respectively; and

(iv) Provision is to be made for doubtful debts at 5%;

A and B are to bring in cash, if necessary, in their profit-sharing ratio to pay off C's dues on retirement and leave a sum of ₹ 10,000 as working capital.

Prepare Revaluation Account, Partners' Capital Account and new Balance Sheet as at 1.1.2015.

4. A, B and C carried on partnership sharing profits as 4:3:2. Their balance Sheet on 30.6.2015 was as follows:

Liabilities	₹	Assets		₹
Creditors	41,400	Cash in hand		500
Capital — A	87,800	Cash at bank		21,000
Capital — B	66,000	Debtors	25,000	
Capital — C	43,800	Less: Provision for doubtful debts	500	24,500
		Stock		36,000
		Plant and Machinery		37,000
		Land and Buildings		1,20,000
	2,39,000			2,39,000

B Retired on 1.7.2015 and these adjustments were agreed upon before ascertaining the amount payable to B:

1. Provision for Doubtful Debts raised to 5% on debtors;
2. Land and Buildings to be appreciated by 15%;
3. A provision of ₹ 650 is to be made for outstanding legal charges;
4. Goodwill to be valued at ₹ 45,000 and B's share to be adjusted into the Accounts of A and C who decided to continue the business sharing profit as 5:3;
5. Stock to be reduced to ₹ 32,000;
6. The capital of the new firm to be adjusted in proportion to their new profit-sharing ratio and actual cash to be brought in or paid off by or to the continuing partners, as the case may be.

B agreed to leave the amount due to him by the firm as loan to the firm carrying interest at 6% p.a. Pass Journal entries and make the Balance Sheet following the retirement of B.

5. A, B and C were partners sharing profits and losses in the ratio of 5 : 3 : 2 respectively. They had taken out a joint life policy of the face value of ₹ 2,00,000. On 31st December, 2014, its surrender value was ₹ 40,000. On this date the Balance Sheet of the firm stood as follows :

Liabilities	₹	Assets	₹
Sundry Creditors	53,000	Fixed Assets	2,50,000
Outstanding Expenses	7,000	Stock	1,10,000
Reserve	30,000	Book Debts	90,000
Capital A/cs :		Cash at Bank	20,000
(A — ₹ 2,00,000; B — ₹ 1,00,000; C — ₹ 80,000)	3,80,000		
	4,70,000		4,70,000

On that date B decided to retire and for that purpose : (a) Goodwill was valued at ₹ 1,50,000; (b) Fixed assets were valued at ₹ 3,00,000; and (c) Stock was considered as worth ₹ 10,000. B was to be paid in cash brought in by A and C in such a way so as to make their capital proportionate to their new profit sharing ratio which was to be 3 : 2 respectively. Goodwill was to be passed through books without raising a Goodwill Account; the joint life policy was also not to appear in the Balance Sheet. Prepare Ledger Accounts and the resultant Balance Sheet.

6. The Balance Sheet of A, B and C, who were sharing profits in the ratio of 4:3:2 respectively stood as follows on 31.12.2014 :

Liabilities	₹	Assets		₹
Sundry Creditors	4,140	Cash at Bank		3,300
Capital — A	12,000	Sundry Debtors	3,045	
Capital — B	9,000	Less: Provision	105	2,940
Capital — C	6,000	Stock		4,800
		Plant and Machinery		5,100
		Land and Building		15,000
	31,140			31,140

B having given notice to retire from the firm, the following adjustments in the books of the firm were agreed upon:

1. That the land and building be appreciated by 10%;
2. That the provision for bad and doubtful debts is no longer necessary;
3. That the stock be appreciated by 20%;
4. That the adjustment be made in the accounts to rectify a mistake previously made whereby B was credited in excess by ₹ 810, while A and C were debited in excess of ₹ 420 and ₹ 390 respectively.

5. That goodwill of the firm be fixed at ₹ 5,400 and B's share of the same be adjusted to that of A and C who are going to share in future profits in the ratio of 2:1.
6. That the entire capital of the firm, as newly constituted, will be readjusted by bringing in or paying of cash so that the future capital of A and C be in the ratio of 2:1.

Pass Journal entries and prepare the Balance Sheet of the new firm showing B's balance as loan.

7. P, Q and R are in partnership sharing profits and losses in the ratio of 2 : 2 : 1. P retired on 31.12.2014 and on that date, the Balance Sheet of the firm was as under :

Liabilities	₹	Assets	₹
Capital Accounts :		Land and Building	10,000
P	16,000	Plant and Machinery	6,000
Q	8,000	Furniture	2,000
R	8,000	Stock	7,000
Creditors	12,000	Debtors	15,000
		Cash	4,000
	44,000		44,000

On P's retirement, Goodwill is valued at ₹ 10,000 and the assets are revalued as follows : Land and Building ₹ 12,000; Plant and machinery ₹ 5,000; Furniture ₹ 1,500; Debtors ₹ 12,500. While apportioning profits for the year 2014, an amount of ₹ 3,000 was given to P in excess, Q and R provide cash in their profit sharing ratio in order to pay-off P.

You are required to pass Journal Entries, prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet after P's retirement.

8. A, B and C are partners sharing profits and losses in the ratio of 3 : 2 : 1. The Balance Sheet of their business as on 31.3.2015 is given below :

Liabilities	₹	Assets	₹
Capital Accounts :		Machinery	40,000
A	50,000	Furniture	20,000
B	40,000	Motor Car	30,000
C	30,000	Stock	25,000
Reserve	12,000	Debtors	75,000
Creditors	60,000	Cash	2,000
	1,92,000		1,92,000

A retired w.e.f. 1.4.2015. Goodwill of the firm was valued at ₹ 24,000. On revaluation, machinery and furniture are to be appreciated by 10%. Debtors include ₹ 1,500 as bad and doubtful and are to be written-off. Value of stock is to be reduced to ₹ 23,000. Creditors include ₹ 800 as no more payable. It was decided that due effect is to be given to the retiring partners' capital account as his share of goodwill without raising any goodwill account. B and C are to share the future profits in equal proportions. Amounts payable to A is to be treated as a loan to the firm.

You are required to prepare the Revaluation Account, Capital Accounts of the partners and the Balance Sheet of the firm after A's retirement.

9. A, B and C were partners sharing profits in the ratio of 3 : 2 : 1. On 1st January, 2015, B retired, on that date Balance Sheet was as follows :

Liabilities	₹	Assets	₹
General Reserve	6,000	Plant	30,000
Expenses Owing	2,000	Patents	3,000
Bills Payable	5,000	Debtors	9,500
Creditors	10,000	Stock	11,000
Capital Accounts :		Cash	500
A	12,000		
B	10,000		
C	9,000		
	54,000		54,000

The terms were :

(i) Goodwill was to be valued to ₹ 12,000 but no Goodwill Account was to be raised.

(ii) New ratio between A and C will be 3 : 2.

(iii) Expenses owing are to be brought down to ₹ 1,500; Plant is to be valued at 10% less and patents at ₹ 4,000.

(iv) The total capital of new firm will be fixed at ₹ 25,000 to be contributed by partners in profit sharing ratio.

Prepare Ledger Accounts to record the above and prepare Balance Sheet after B's retirement.

10. A, B and C were carrying on business in partnership, sharing profits and losses in the ratio of 2 : 1 : 1. On December 31, 2014 B decided to retire from the firm and the following terms were agreed upon :
    (a) A typewriter purchased on January 1, 2013 for ₹ 1,200 was charged to the Office Expenses Account in 2014 and has to be brought into account after allowing 15% p.a. depreciation on the reducing balance basis.
    (b) Furniture and fittings are to be written-down by ₹ 603 and stock by ₹ 5,000.
    (c) The provision for bad and doubtful debts standing in the books at ₹ 4,000 are to be reduced by 25%.
    (d) A liability in respect of workmen's compensation for ₹ 2,100 not acknowledged by the partnership as a valid claim, is however, to be provided for.
    (e) Goodwill of the firm is valued at ₹ 24,000.
    (f) The capital accounts of the partners on December 31, 2014 stood at A — ₹ 20,001, B — ₹ 15,001 and C — ₹ 10,001.

    A and C agree that the Goodwill is to be adjusted through Capital Accounts of the partners and the amount payable to B shall be brought in by them in their new profit-sharing ratio.

    You are required to pass Journal Entries to record the above transactions.
11. A, B and C are in partnership sharing profits and losses in the ratio of 2 : 2: 1 respectively. It was agreed that in case of retirement or death of a partner, the value of goodwill shall be determined at 1.5 years' purchase of the average profits of the last four years. C retired from his business w.e.f. 1.7.2015 and the following matters came up for consideration in connection therewith:
    (i) Capital expenditure of ₹ 30,000 incurred on 15.11.2011, wrongly debited to Purchase Account is to be written-back and depreciation at 10% is to be charged annually on the closing balance on reducing balance method.
    (ii) No adjustment was made for goods worth ₹ 10,000 taken over by A on 28.2.2015.
    (iii) The profits for four years ended on 30th June : 2012, 2013, 2014, 2015 were ₹ 1,20,000, ₹ 1,50,000, ₹ 1,40,000, ₹ 1,60,000 respectively.
    (iv) C's Capital Account stood at ₹ 5,50,000 as on 30.6.2015.

    You are required to draw up the Capital Account of C and to find out the amount finally due to him.
12. A, B and C were in partnership sharing profits and losses in the ratio 3 : 2 : 1 respectively. The summarized Balance Sheet of the firm as on 31.3.2015 stood as follows :

Liabilities	₹	Assets		₹
Capital — A	1,20,000	Freehold Land and Building		80,000
Capital — B	60,000	Plant and Machinery		30,000
Capital — C	40,000	Motor Cars		12,000
Loan — A	20,000	Stock		56,000
Creditors	40,000	Debtors	60,000	
		Less: Provision for Doubtful Debts	6,000	54,000
		Cash at bank		48,000
	2,80,000			2,80,000

A retired on March 31, 2015 to commence business individually, and B and C continued in partnership sharing profits and losses equally.

It was agreed that A should take over certain plant and machinery valued at ₹ 7,500 and one of the firm's cars at the book value of ₹ 5,000.

It was further agreed that for the purpose of both of the dissolution and continuation of partnership, the following adjustments should be made in the Balance Sheet as on March 31, 2015 :

1. Freehold Land and Buildings should be revalued at ₹ 1,00,000 and Plant and Machinery (inclusive of that taken by A) at ₹ 25,000.
2. The provision for doubtful debts should be increased by ₹ 1,500.
3. A provision of ₹ 2,500 included in creditors for a possible claim for damages was no longer required.
4. The stock should be reduced by ₹ 4,000 in respect of obsolete and damaged items.

In accordance with the terms of the partnership deed, the total value of goodwill on March 31,2015 was agreed at ₹ 1,80,000. In view of the fact that A intended to retain some of the customers of the firm, it was agreed that the value of the proportion of goodwill to be purchased by him was ₹ 60,000. The continuing partners B and C decided that goodwill should not appear in the books of the new partnership as an asset and the necessary adjustments should be made through the Capital Accounts of the partners. Pending the introduction of further capital in cash by the continuing partners, the amount due to A was agreed to be transferred to Loan Account. You are required to prepare the Revaluation Account, the Partners' Capital Accounts and the Balance Sheet of the new firm.

13. A, B and C are in partnership sharing profits and losses in the ratio of 3 : 2 : 5 respectively. The following are the particulars of the personal accounts of the partners :

		A	B	C
1.	Capital Accounts (1.1.2014)	20,000	12,000	35,000
2.	Current Accounts (1.1.2014)	(Cr.) 4,000	(Dr.) 1,000	(Cr.) 6,000
3.	Drawings during the year 2014	2,400	3,800	4,600
4.	Interest on drawings	300	500	600

The partnership firm earned a profit of ₹ 1,200 in the year 2014. A retired from 31.12.2014 and it was agreed to settle his accounts on the following terms :

(a) Accounts for the year 2014 should be thoroughly scrutinised and rectified. Accordingly, the following discrepancies were found out during the scrutiny:
   (i) An amount of ₹ 100 paid towards life insurance of A was wrongly debited to Taxes and Insurance Account of the firm.
   (ii) Goods worth ₹ 200 taken by B were not recorded in the books of accounts.
   (iii) Wages paid ₹ 420 for extension of office building were treated as wages. The depreciation of building was charged at 2%.
   (iv) Bad debts of ₹ 300 were omitted while preparing the Profit and Loss Account.

(b) The share of A should be distributed in the ratio of 3 : 5 between B and C.

(c) The following assets should be revalued :
   (i) Stock to be depreciated by ₹ 1,000; (ii) Machinery to be depreciated by ₹ 2,500; (iii) Building to be appreciated by ₹ 5,500.

(d) Interest on capital to be charged at 6% and no interest on Current Accounts.

(e) Goodwill to be estimated at ₹ 6,000 and to be adjusted accordingly.

Prepare Profit and Loss Appropriation Account, Revaluation Account, Partners' Capital and Current Accounts.

14. On 1.1.2011, A and B started a firm, sharing profits and losses equally. Each of the partners contributed ₹ 2,000 towards the capital of the firm and was allowed to draw ₹ 400 p.m. in anticipation of profits. On 1.1.2012, they admitted C as a third partner with equal share and he contributed ₹ 3,000 towards his capital and a further sum of ₹ 2,000 towards premium for goodwill. He too was entitled to draw ₹ 400 p.m. From 1.1.2013, A got a part-time job elsewhere and considered that he would be unable to devote his full time towards the business of the firm, agreed to leave half of his share in the profits to be apportioned equally between B and C and his drawings was reduced to ₹ 200 p.m. from 1.1.2013.

On 1.1.2014, B got a full time job and in consequence, A had to leave his part time job and to devote full time in the firm. It was arranged that B will retain only a quarter of his earlier share in the firm and would be drawing nothing from 1.1.2014. A and C would be drawing @ ₹ 600 p.m. instead. The interest surrendered by B would be apportioned equally by A and C.

On 31.12.2014, B decided to retire altogether from the firm.

You are required to ascertain the amount due to B by the firm from the following particulars :

(a) Profits earned by the firm : 2011 — ₹ 17,000; 2012 — ₹ 18,000; 2013 — ₹ 24,000; 2014 — ₹ 28,896.

(b) B's share of goodwill is to be taken at 2 years' purchase of the average of his share of profits of the previous two years.

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

15. On 31.12.2014, the Balance Sheet of M/s. A, B and C, sharing profits and losses in proportion to their capitals, stood as follows :

Liabilities	₹	Assets		₹
Creditors	1,08,000	Cash at Bank		80,000
Capital A/cs:		Debtors	1,00,000	
A	4,50,000	Less: Provision for Doubtful Debts	2,000	98,000
B	3,00,000	Stock		90,000
C	1,50,000	Machinery		2,40,000
		Land and Building		5,00,000
	10,08,000			10,08,000

On that date, B wants to retire from the firm and the remaining partners decide to carry on the firm. The following readjustment of assets and liabilities have been agreed upon before the ascertainment of the amount payable to B :

(i) that out of the amount of insurance premium which was debited annually entirely to Profit and Loss Account, ₹ 10,000 be carried forward for unexpired insurance on 31.12.2014;

(ii) that the land and building be appreciated by 10%.

(iii) that the provision for doubtful debts be brought up to 5% on debtors;

(iv) that machinery be depreciated by 5%;

(v) that a provision for ₹ 15,000 be made in respect of an outstanding bill for repairs;

(vi) that the goodwill of the entire firm be fixed at ₹ 1,80,000 and B's share of the same adjusted in the accounts of A and C who share future profits in the proportion of 3/4th and 1/4th respectively (no goodwill account being raised); and,

(vii) that B be paid ₹ 50,000 in cash and the balance be transferred to his Loan Account.

Prepare Revaluation Account, the Capital Accounts of the Partners and the Balance Sheet of the firm of A and C.

16. A, B and C are partners sharing profits and losses in the ratio of 3 : 2 : 1. On 31.1.2015, B decides to retire and their Capital Accounts on that date are A — ₹ 60,000; B — ₹ 45,000; and C — ₹ 50,000. Their Current Accounts on that date are A — ₹ 5,000 (Cr.); B — ₹ 2,300 (Dr.) and C — 3,000 (Cr.).

The partnership deed provided that in case of retirement, the retiring partner should be entitled to a share of the goodwill of the firm to be calculated on the average of the profits of last three years' ending on 31.3.2015 which comes to ₹ 12,000 and that the payment of the total interest of the retiring partner shall be made by annual instalments of ₹ 10,000 each. The retiring partner will be entitled to interest also at 6% on the unpaid balance. The first instalment was paid on 31.3.2015.

Show B's Loan Account until the whole payment due to him is made.

17. A, B and C were in partnership till 31.12.2013, when C retired from partnership. The amount due to him after necessary adjustments arising in connection with such retirement was ₹ 1,00,000. At the request of the other partners, he agreed to leave the amount with the new firm as loan on the following terms and conditions :

(i) Repayment of loan to be made at the end of each year by annual instalments representing 40% of future annual profits after charging salary of ₹ 7,500 p.a. to each partner.

(ii) Interest @ 5% p.a. calculated on the balance outstanding at the beginning of the year to be credited, but such interest will not be taken into account for calculation of 40% stated above.

Profits before charging partners' salaries, were as follows : 2009 — ₹ 15,000; 2010 — ₹ 1,03,125; 2011 — ₹ 1,11,875; 2012 — ₹ 1,15,000; 2013 — ₹ 1,43,250.

You are required to show C's Loan Account for all these years as it would appear in the books of the firm.

18. A, B and C were in partnership sharing profits and losses in the ratio 3:2:1. Their Balance Sheet as on 31.3.2015 was as under:

Liabilities	₹	Assets	₹
Capital — A	60,000	Machinery	80,000
Capital — B	50,000	Furniture	15,000
Capital — C	40,000	Motor car	30,000
Sundry Creditors	72,000	Stock	50,000
Bank loan	30,000	Sundry Debtors	60,000
Other liabilities	20,000	Cash at bank	37,000
	2,72,000		2,72,000

A retired on 1.4.2015 and the partnership deed provided *inter alia* that in the event of admission, retirement or death of a partner, the assets and liabilities are to be revalued and that goodwill of the firm is to be computed on the basis of 2 years' purchase of the correct profit of the last 4 years.

It is discovered that the accounts required adjustments owing to certain mistakes in earlier years. On 1.10.2012, repairs to machinery for ₹ 6,000 had been wrongly debited to Machinery Account; and on 1.4.2013, a piece of furniture, whose book value was ₹ 2,000 was disposed of for ₹ 800 but the proceeds were wrongly credited to Sales Account. The partners had been charging depreciation on all fixed assets at 10% p.a. on the reducing balance system on a time basis. Profits for the last four years without adjusting the above mentioned mistakes were as follows:

2011-12 – ₹ 20,000; 2012-13 – ₹ 24,000; 2013-14 – ₹ 32,000; 2014-15 – ₹ 36,000.

Revaluation on the date of retirement was: Machinery — ₹ 90,000; Furniture — ₹ 10,000; Motor car — ₹ 22,000.

B and C, decided to share future profits, after A's retirement, in the ratio of 3:2. It was further agreed that the retiring partner shall be credited with his due proportion of goodwill, without raising a Goodwill Account in the books.

A is to be paid 50% of the amount due to him on retirement immediately and the balance is to be transferred to his Loan Account carrying interest at 6% p.a. B and C are to bring necessary cash (in their new ratio) subject to the condition that a cash balance of ₹ 20,000 is to be maintained as working capital.

Show the Capital Accounts of the partners and the Balance Sheet of the firm after all the above mentioned transactions have been carried out. Ignore fractions. (All working should form part of your answer.)

19. A, B and C were partners sharing profits/losses in the ratio of A 40%, B 35% and C 25%. The draft Balance Sheet of the partnership as on December 31, 2014 was as follows :

Liabilities	₹	Assets		₹
Sundry Creditors	30,000	Cash in Hand and at Bank		67,000
Bills Payable	8,000	Stock		42,000
Loan from B	30,000	Sundry Debtors	34,000	
Current Accounts:		Less: Provision for Doubtful Debts	6,000	28,000
(A — ₹ 12,000; B — ₹ 8,000; C — ₹ 6,000)	26,000	Plant and Machinery (at cost)	80,000	
Capital Accounts:		Less : Provision for Depreciation	28,000	52,000
(A — ₹ 90,000; B — ₹ 50,000; C — ₹ 30,000)	1,70,000	Premises (at cost)		75,000
	2,64,000			2,64,000

B retired on December 31, 2014. A and C continued partnership sharing profits/losses in the ratio of A— 60% and C— 40%. It was agreed that the amount then remaining due to him, a sum of ₹ 80,000, should remain as loan to the partnership and the balance be carried forward as ordinary trading liability. The following adjustments were agreed to be made to the above mentioned Balance Sheet.

(a) ₹ 10,000 should be written-off from the premises;

(b) Plant and machinery were revalued at ₹ 58,000;

(c) Provision for doubtful debts to be increased by ₹ 1,200;

(d) ₹ 5,000 due to creditors for expenses had been omitted from the books of account;

(e) ₹ 4,000 to be written-off from stock; and

(f) Provide ₹ 1,200 for professional charges in connection with revaluation.

As per the deed of partnership, in the event of the retirement of a partner, goodwill was to be valued at an amount equal to one year's purchase of the average profits of the preceding three years on the date of retirement. Before determining the said average profits, a notional amount of ₹ 80,000 should be charged for remuneration to partners. The profits before charging such remuneration were : Year ended 31.12.2012 — ₹ 1,44,000; Year ended 31.12.2013 — ₹ 1,68,000; and Year ended 31.12.2014 — ₹ 1,88,200 (as per draft accounts).

It was agreed that for the purpose of valuing goodwill, the amount of profit for year 2014 be recomputed after charging the loss on revaluation in respect of premises and stock that unprovided, expenses (except professional expenses) and increase in provision for doubtful debts. The continuing partners decided to eliminate the Goodwill Account from their books.

You are required to prepare: (i) Revaluation Account; (ii) Capital Accounts (merging Current Accounts therein); (iii) B's Account showing balance due to him; (iv) Balance Sheet of A and C as on January 1,2015.

20. A, B and C sharing profits and losses as 4:3:1 had their capitals on 1.4.2015: ₹ 15,000; ₹15,000; and ₹10,000 respectively. The Deed provided: (i) that interest would be payable on capital at 10% p.a.; (ii) that in case of retirement, the goodwill would be valued at two years' purchase of the average divisible profits of the last five years; (iii) that the profit of the retiring partner to the date of retirement would be estimated on the basis of the average divisible profit of the last three years, and (iv) that the firm would effect a joint life policy of ₹ 30,000, charging the premium as expense.

A retired with effect from 1.10.2015. The surrender-value of the policy as on that date was ascertained at ₹ 8,000 and to that date drawings amounted to A — ₹ 3,000; B — ₹ 2,000 and C — ₹ 1,000. Profits after charging interest and policy premium were:

2014-15 — ₹ 10,000; 2013-14 — ₹ 9,500; 2012-13 — ₹ 7,200; 2011-12 — ₹ 8,800; 2010-11 — ₹ 8,000.

A's final claim was met to the extent of claims on revenue accounts out of the assets of the business and the rest out of cash brought in by B and C in such proportions as to set their capitals at balances equated to their shares in the profits. Prepare the Capital Accounts of A, B and C.

21. A, B and C are partners sharing profits and losses in the ratio of 3 : 3 : 4. The Balance Sheet as on 31.12.2014 is :

Liabilities	₹	Assets	₹
Sundry Creditors	12,000	Cash at Bank	3,000
Bills Payable	18,000	Bills receivable	11,000

6% Mortgage Loan	17,000	Stock	25,000
Capital Accounts		Sundry Debtors	20,000
(A — ₹ 50,000; B — ₹ 45,000; C — ₹ 65,000)	1,60,000	Furniture	5,000
General Reserve	10,000	Plant and Machinery	40,000
		Land and Building	1,13,000
	2,17,000		2,17,000

The firm earned profits as follows for the past five years: 2010 — ₹ 14,000; 2011 — ₹ 16,500; 2012 — ₹ 15,000; 2013 — ₹ 15,000 and 2014 — ₹ 15,800.

On December 31, 2014, C retired from partnership and in order to ascertain the amount due to C, the accounts of 2014 were verified and the following mistakes were detected:

(i) A bill receivable for ₹ 1,000 which was dishonoured and became irrecoverable, was not taken into consideration while preparing the final accounts.

(ii) An amount of ₹ 200 paid for the rent of the house occupied by C was wrongly debited to the Rent Account of the firm.

(iii) Goods worth ₹ 1,500 given by B to the firm were not taken into account.

(iv) An outstanding bill for ₹ 500 towards electricity was not paid and the same was not adjusted while preparing the final accounts.

(v) Purchase of machinery of July 1, 2014 at a cost of ₹ 9,500 was wrongly treated as the Purchase Account and the expenses of ₹ 500 incurred towards erection of the machinery were charged to the Machinery Repairs Account. Depreciation on the Machinery Account was charged at 10% p.a.

The partners agreed to rectify the mistakes noted above and the following adjustments were made to settle the accounts of C:

(i) A provision was made at 5% on Sundry Debtors; (ii) Stock was revalued at ₹ 21,925; (iii) Plant and Machinery were depreciated by 15%; (iv) Land and building were appreciated by 20%; (v) Sundry creditors for ₹ 2,900 will not rank; (vi) Goodwill of the firm should be ascertained at three times the average profit of the last five years. The Goodwill Account should not appear in the books. Goodwill of C should be shared by A and B; (vii) The Capital of C should be purchased by A and B in the ratio of 3:2; (viii) Since C was in urgent need of ₹ 50,000, the partners are required to make payment to him in cash in their new profit-loss sharing ratio and the balance of C's capital will be treated as loan; and (ix) The partners are also required to adjust their capitals in cash in proportion to their new profit-loss sharing ratio.

You are required to prepare the Profit and Loss Adjustment Account, Revaluation Account, Capital Accounts of the partners and also the Balance Sheet after the retirement of C.

Admission cum Retirement

22. The following is the Balance Sheet of A and B as at 30th June, 2015 on which date A retired and his son D joined that firm from 1st July, 2015 with one-fourth share in the profits of the business :

Liabilities	₹	Assets	₹
Capital Accounts :		Land	12,000
A	50,000	Plant	40,000
B	31,000	Investments	14,000
Creditors	10,000	Debtors	15,000
		Cash at Bank	10,000
	91,000		91,000

The following adjustments and arrangements have been agreed upon for the purposes of retirement and admission of partners :

1. Land to be written upto ₹ 30,000 and Plant to ₹ 50,000;
2. Sufficient money to be introduced so as to leave ₹ 11,000 cash after payment of amount due to Raman;
3. B and D to provide such fund as would make their capitals proportionate to their share of profit.

Show the Journal Entries to record the above transactions.

23. A, B and C are partners sharing profit and losses in the proportion of 3 : 2 : 1. Following is the Balance Sheet as at 31.12.2014:

Liabilities	₹	Assets	₹
Capital A/cs:		Building	10,000
(A — ₹ 65,000; B — ₹ 38,000; C — ₹ 28,000)	1,31,000	Debtors	61,400
Reserve	38,400	Sundry Assets	1,48,000
Creditors	50,000		
	2,19,400		2,19,400

C desires to retire from the firm on 1.1.2015. In terms of agreement :

Building is to be revalued at ₹ 50,000. Debtors at ₹ 41,400 and Sundry Assets at ₹ 1,50,000. The amount payable to the retired partner is for the present to be treated as loan with 5% interest.

On the same day, i.e., on 1.1.2015, D is admitted as a partner on payment of ₹ 32,000. Profit and loss are henceforth to be shared as 4:3:2 among A, B and D. No alteration is to be made in the book value of the assets other than cash brought in by D and Reserve.

Draw up the final Balance Sheet as at 1.1.2015 on the above basis after admission of D.

24. A, B and C were in partnership sharing profits and losses in the ratio 3 : 2 : 1. Their Balance Sheet as on 31.3.2015 was as follows :

Liabilities	₹	Assets		₹
Capital A/cs :		Plant and Machinery		1,70,000
(A — ₹ 50,000; B — ₹ 80,000; C — ₹ 90,000)	2,20,000	Furniture and Fixtures		30,000
General Reserve	18,000	Trade Debtors	1,79,000	
Workmen's Accidental Compensation Fund	50,000	Less: Provision	10,000	1,69,000
Trade Creditors	1,07,000	Cash in hand		26,000
	3,95,000			3,95,000

C retired on that date. It was agreed that :

(a) Plant and machinery to be revalued at ₹ 1,94,000. Provision on debtors be kept at ₹ 19,000 and liability for workmen's accident compensation was decided at ₹ 23,000.

(b) C should get, apart from other amounts due to him, his share in goodwill ₹ 40,000.

(c) The total amount payable to C was brought by A and B in their profit sharing ratio.

Immediately after this, they admitted D as a partner on his bringing ₹ 80,000 as share in goodwill and ₹ 1,40,000 as capital. It was agreed that A and B, as between themselves, will share profits and losses equally.

You are required to prepare : (i) Revaluation Account; (ii) Partners' Capital Accounts; (iii) Balance Sheet after all the adjustments are carried out.

25. A, B, C and D were in partnership sharing profits and losses as 4 : 3 : 2 : 1 respectively. The following is their Balance Sheet as on 31.12.2014 :

Liabilities	₹	Assets	₹
Capital Account — A	50,000	Furniture	40,000
Capital Account — B	70,000	Stock	20,000
Capital Account — C	60,000	Debtors	1,50,000
Capital Account — D	20,000	Bills Receivable	30,000
Trade Creditors	50,000	Profit & Loss A/c	10,000
	2,50,000		2,50,000

On the above date, B retired and the amount due to him was paid by the other partners in their profit-sharing ratio. It was agreed as among A, C and D that they should share in future as 3 : 3 : 2. E was then admitted as a partner on his bringing in ₹ 60,000 as capital and ₹ 20,000 as goodwill for 1/5th share in the future profits.

Show the Journal Entries for the above transactions and prepare the Balance Sheet of A, C, D and E after E's admission.

26. A, B and C were partners, sharing profits and losses in the proportion of 3 : 2 : 2 respectively. The Balance Sheet of the firm as on 1.1.2014 was as follows :

Liabilities	₹	Assets	₹
Capital Account — A	50,000	Plant and Machinery	36,000
Capital Account — B	40,000	Furniture	24,000
Capital Account — C	35,000	Stock	56,000
Bank Overdraft	10,000	Debtors	48,000
Sundry Creditors	28,000	Cash at Bank	9,000
	1,63,000		1,63,000

A retired on 1.1.2014, on which date D was admitted as a new partner. For the purpose of adjusting the rights as among the old partners, goodwill was to be valued at ₹ 42,000 and Sundry Debtors and Stock were to be reduced by ₹ 8,000 and ₹ 6,000 respectively. A was to receive ₹ 22,000 in cash on the date of retirement and the balance due to him was to remain on loan at 8% p.a., interest payable on 31st December each year on which date the firm closes its accounts. D was to bring in ₹ 50,000 in cash as his capital on the date of admission. The new partners were to share profits and losses equally after allowing interest on loan from A.

The net profit for the year ended 31.12.2014 was ₹ 33,200 before taking into account interest on loan from A. You are to prepare the following :

1. Capital Accounts of the partners as on 31.12.2014;
2. A's Loan Account as on 31.12.2014;
3. Profit and Loss Appropriation Account for the year ended 31.12.2014.

27. A, B and C are partners sharing profits equally. Their Balance Sheet on 30.6.2015 was :

Liabilities	₹	Assets	₹
Capital Account — A	1,00,000	Land and Property	1,00,000
Capital Account — B	1,00,000	Plant and Machinery	2,00,000
Capital Account — C	2,00,000	Furniture	50,000
Current Account — A	50,000	Stock-in-trade	1,00,000
Current Account — B	75,000	Debtors	1,00,000
Current Account — C	25,000	Cash at bank	1,50,000
Creditors	1,50,000		
	7,00,000		7,00,000

On 1.7.2015 A retires and it is agreed that he should be paid in full on that date all his dues. So, goodwill is calculated on the basis of 3 years' purchase of average profits of the past 3 years, such profits amounted to ₹ 1,00,000; ₹ 1,20,000 and ₹ 1,40,000. In order to meet this obligation, a bank loan is arranged as at 1.7.2015 for ₹ 2,00,000 by pledging fixed assets as security. To compensate a loyal manager D, it is agreed between B and C that D should be admitted as a partner who would bring in over and above a capital of ₹ 1,00,000, his share of goodwill in cash to serve as working capital. B and C agree to forego one-third of their individual share of profit to D. Show Journal and the Balance Sheet.

28. A, B and C are partners sharing profits and losses in the ratio of 6 : 5 : 3. Work-in-progress was not brought into the accounts. The Balance Sheet of the partnership as on 31.3.2015 showed the following position :

Liabilities	₹	Assets	₹
Capital A/cs :		Fixed Assets	35,350
A	25,000	Debtors	73,500
B	18,000	Bank	10,450
C	8,700		
Sundry Creditors	67,600		
	1,19,300		1,19,300

On the above date, A retired from the partnership and it was agreed to admit D as a partner on the following terms :

1. Goodwill was agreed at ₹ 13,720 and it is to be adjusted accordingly.
2. A is to take his car out of the partnership assets at an agreed value of ₹ 1,000. The car had been included in the accounts as on 31.3.2015 at a written-down value of ₹ 594.
3. Although work-in-progress had not been and will not be included in the partnership accounts, the new partners were to credit A with his share based on an estimate that work-in-progress was equivalent to 20% of the debtors.
4. The new partnership of B, C and D were to share profits in the ratio of 5 : 3 : 2. The initial capital of ₹ 25,000 subscribed in the profit-sharing ratio.
5. B, C and D were each to pay A the sum of ₹ 5,000 out of their personal resources in part repayment of his share of the partnership.
6. A to lend to D any amount required to make up his capital in the firm from the money due to him, and any further balance due to A was to be left in the new partnership as a loan bearing, interest at 9% p.a. Any adjustment required to the Capital Accounts of B and C were to be paid into or withdrawn from the partnership Bank Account.

You are required to prepare the Partners' Capital Accounts and the Balance Sheet.

29. Sun, Moon and Jupiter are partners in a business, sharing profits and losses in the ratio of 5 : 3 : 2.

It is provided, in the partnership deed, that the goodwill of the firm shall be equal to 2.5 times the average annual profits of the four years to the date of change, and that the consideration for the changes in the partners' shares, is to be calculated on this basis, but the Goodwill Account is not be brought into the firm's books. Profits, of the firm, have been : 2011 – ₹ 30,000; 2012 – ₹ 32,000; 2013 – ₹ 28,000; and 2014– ₹ 46,000. It was agreed that :

(a) On December 31, 2014 Moon and Jupiter should each acquire from Sun, an additional 1/10th share in the firm.

(b) On January 1, 2015 Venus (son of Sun) should be admitted into the partnership on the following terms : His share to be one-eighth, of which a proportion, calculated to produce ₹ 3,400 p.a. on the basis of the annual average of the past profits set out above, is to be ceded to him by his father, the balance to be purchased by him (Venus) from Moon and Jupiter, in proportion to their respective shares as they were immediately prior to the admission of Venus.

(c) On December 31, 2015 Sun should retire and the continuing partners should acquire his share of goodwill in such proportion as would make them equal owners of the same, the value of goodwill remaining unchanged and the item of goodwill not to be brought into the books as an asset.

You are required : (i) to set out the Journal Entries necessary to record the foregoing matters in the books of the firm; and (ii) to set out the revised proportion in which the partners share the profits following the admission of Venus. (Calculations to be made to the nearest rupee).

30. A, B and C are partners of M/s Evergreen & Co sharing profits and losses in the ratio of 3 : 3 : 2. Their balances as on 30th September, 2015 is as under :

Particulars		(₹)	(₹)
Fixed Assets :			
Cost		3,00,000	
Less : Depreciation		1,80,000	1,20,000
Investment : Cost (market value ₹ 2,00,000)			80,000
Working Capital			3,00,000
Financed by :			5,00,000
Loans from	D	1,50,000	
	E	1,00,000	2,50,000
Reserves			1,00,000
Capitals	B	2,00,000	
	C	1,00,000	
		3,00,000	
Less :	A	1,50,000	1,50,000
			5,00,000

On that day, A retired from business. B and C decided to admit D as a partner and E, who is a minor, to benefits of partnership. B, C, D and E are to share profits in the ratio of 3 : 3 : 2 : 2. Losses, if any, are to be borne by B, C and D in the ratio of 3 : 2 : 2.

For the purpose of the above retirement-cum-admission, it is decided that :

(a) Goodwill of the firm to be valued at ₹ 2,00,000. However, no account is to appear for goodwill. Treatment of goodwill in relation to minor, is to be deferred to the date when he opts to be a partner on attaining majority, when the value of goodwill will be deemed, for this purpose, to remain unchanged at ₹ 2,00,000.

(b) A takes over : (i) Buildings (cost ₹ 1,00,000; written-down value ₹ 35,000) for ₹ 75,000; and (ii) Investments (cost ₹ 10,000) at their market value of ₹ 5,000.

(c) The continuing partners take over the remaining assets at their book values, except investments which are taken over at their market values.

(d) Loans are to be transferred to Capital Accounts.

(e) The amount due to/from A is to be settled by cheque immediately.

You are required to prepare : (a) the Revaluation / Adjustment Account; (b) the Capital Accounts; and, (c) the Balance Sheet of the firm after giving effect to all the above points of agreement.

Guide to Answers

Multiple Choice

1. A 2. B 3. D 4. B 5. B 6. C 7. C 8. C 9. A.

Practical Questions

1. **Revaluation profit — ₹ 8,500; Balance Sheet total — ₹ 1,70,500.**
2. **Revaluation loss — ₹ 2,100; Balance Sheet total — ₹ 1,30,600.**
3. **Revaluation profit — ₹ 3,900; Balance Sheet total — ₹ 1,62,900.**
4. **Revaluation profit — ₹ 12,600; Balance Sheet total — ₹ 2,52,250.**
5. **Revaluation loss — ₹ 50,000; Balance Sheet total — ₹ 4,20,000.**
6. **Transfer to B's Loan Account ₹ 10,845; Balance Sheet ₹ 33,705.**
7. **Revaluation loss ₹ 2,000; Amount paid to P ₹ 16,200; Capital Account balances — Q ₹ 17,333; R : ₹ 12,667; Balance Sheet — ₹ 42,000.**
8. **Revaluation profit ₹ 3,300; A's Loan Account ₹ 69,650; Capital balances : B — ₹ 41,100; C — ₹ 24,500; Balance Sheet ₹ 1,94,500.**
9. **Revaluation loss ₹ 1,500; B's Loan Account ₹ 15,500; Balance Sheet ₹ 57,000.**
10. **Revaluation loss ₹ 5,836; Amounnt paid to B ₹ 19,542.**
11. **C's share of goodwill ₹ 44,980 (app.); C's share of adjusted profit ₹ 5,940 (app.); Amount due to C ₹ 6,00,920.**

12. **Revaluation profit ₹ 12,000; A's Loan Account ₹ 1,63,500; Capital Balance — B ₹ 64,000; C ₹ 12,000; Balance Sheet ₹ 2,77,000.**
13. **Revaluation profit ₹ 2,000; Adjusted profit ₹ 1,000; Capital Account balances — A ₹ 22,400; B ₹ 11,350; C ₹ 35,250; Current Account balances — A ₹ 2,100; B ₹ 4,900 (Dr.); C ₹ 2,400.**
14. **B's share of profit : ₹ 8,500; ₹ 6,000; ₹ 10,000; ₹ 3,010; B's share of goodwill ₹ 16,000; Amount due to B ₹ 32,110.**
15. **Entry for unexpired insurance : Unexpired insurance (Dr.) and Revaluation Account (Cr.); Goodwill to be adjusted through Capital Accounts : Debit A's capital ₹ 45,000 and C's capital ₹ 15,000; Credit B's capital ₹ 60,000; Profit on revaluation ₹ 30,000. B's Loan's Account ₹ 3,20,000; Capital Account balances — A ₹ 4,20,000; C ₹ 1,40,000; Balance Sheet ₹ 10,03,000.**
16. **Amount payable to B — ₹ 46,700; Interest — 1st ₹ 2,202; 2nd ₹ 1,734; 3rd ₹ 1,238; 4th ₹ 712; 5th ₹ 155.**
17. **Interest — 1st ₹ 5,000; 2nd ₹ 5,250; 3rd ₹ 3,750; 4th ₹ 2,000; 5th ₹ 100.**
18. **Revaluation loss ₹ 3,000; Value of goodwill ₹ 52,800; A's Loan Account ₹ 42,470; Bank balance ₹ 20,000; Capital balances — B ₹ 50,181; C ₹ 37,349; Balance Sheet ₹ 2,52,000.**
19. **Revaluation loss ₹ 15,400; Value of goodwill ₹ 80,000; Amount due to B ₹ 1,10,610; Capital balances — A ₹ 79,840; B ₹ 20,150; Balance Sheet ₹ 2,54,800.**
20. **Total Capital of B and C — ₹ 30,775; Cash to be brought-in by B — ₹ 21,275 and by C — ₹ 2,425; Value of goodwill ₹ 17,400; Profit for 6 months upto the date of retirement — ₹ 4,450; Claim of A on Revenue Account — ₹ 3,975; Claim of A on the rest — ₹ 23,700.**
21. **Share of Profit : A ₹ 2,010; B ₹ 2,010; C 2,680; Revaluation profit ₹ 14,000; Adjusted capital of A and B — ₹ 1,45,000; Goodwill — ₹ 49,800.**

Admission-cum-Retirement

22. **Revaluation profit ₹ 28,000; Capital balances — B ₹ 82,500; D ₹ 27,500; Balance Sheet ₹ 1,20,000.**
23. **Revaluation profit ₹ 62,000; Capital balances — A ₹ 85,422; B ₹ 50,800; D — ₹ 27,111; Balance Sheet ₹ 2,51,400.**
24. **Revaluation profit ₹ 42,000; Payment to C ₹ 1,40,000; Capital balances — A ₹ 2,04,000; B ₹ 1,56,000; D ₹ 1,40,000; Balance Sheet ₹ 6,30,000.**
25. **Goodwill ₹ 1,00,000; Profit sharing ratio A, C, D and E is 3 : 3 : 2 : 2. Balance Sheet ₹ 3,20,000.**
26. **Share of profit to B, C and D ₹ 10,000 each; A's Loan Account ₹ 40,000; Capital balances : B — ₹ 44,000; C — ₹ 49,000; D— ₹ 46,000.**
27. **Share of goodwill of A ₹ 1,20,000; D will bring in premium ₹ 1,20,000; Amount paid to A ₹ 2,70,000; Cash balance ₹ 3,00,000; Balance Sheet ₹ 8,50,000.**
28. **A's share of W.I.P. ₹ 6,300; Capitals — A ₹ 12,500; B ₹ 7,500; D ₹ 5,000; Balance Sheet ₹ 1,07,360.**
29. **Sun : Moon : Jupiter : Venus = 168 : 44 : 37 : 175.**
30. **Revaluation profit ₹ 1,160,000; Balance Sheet total ₹ 6,37,500.**

30

Death of a Partner

Introduction

The accounting procedures on the death of a partner are very similar to those that cover a partner's retirement. The retirement of a partner is voluntary in character and can be anticipated but death of a partner may occur any time. When a partner dies, a firm has to face the following problems : (1) Calculation of deceased partner's financial interest in the firm; and (2) Determination of the mode of payment.

Ascertainment of Financial Interest

The executors of the deceased partner have the following claims from the firm:

(i) Balance of Capital Account of the deceased partner as per the last Balance Sheet.
(ii) Share of Goodwill of the firm.
(iii) Share of accumulated Profit/Reserve.
(iv) Share of revaluation Profit/Loss.
(v) Share of Joint Life Policy taken by the firm.
(vi) Share of profit from the date of the last Balance Sheet to the date of death.

The problems relating to first four items have already been discussed chapter 29 (Retirement of a partner).

Here, we will discuss the matters relating to:

(i) Joint Life Insurance Policy; and
(ii) Profits earned by the firm from the date of the last Balance Sheet to the date of death.

(i) Joint Life Insurance Policy

Partners commonly take out a joint life insurance policy on the lives of all the partners to provide cash to pay the amount due to the executors of the deceased partner.

The insurance policy matures on the happening of the *first death*. When a partner dies, the firm receives the policy money and it is distributed amongst the partners (including the deceased partner) in the profit-sharing ratio. The main advantage of this policy is that it removes the hardship which might be caused by the untimely death of a partner.

The joint life insurance policy may be dealt with in the accounts by any of the following methods:

(a) ***Without taking surrender value into account.***
(b) ***Taking surrender value into account.***

Meaning of Surrender Value Surrender value is the amount receivable on a life insurance policy that is cancelled before the end of its term. In other words, it is the amount which an insurance company is prepared to return to the policy-holder if the policy is surrendered. The surrender value is calculated according to a formula adopted by the insurance company which is made known to the policyholder at the time he takes out the policy. It is usually specified in the contract. Surrender values are very low during the early years of a policy. Surrender value of a policy develops after the first few years that the policy is in force and accumulates subsequently by annual increments which is generally equal to a portion of the aggregate amount of premium paid. It should be noted that the policy issued by the Life Insurance Corporation of India acquires surrender value after two annual premiums have been paid. However, in examination problems, we may find exceptions to this rule. At any point of time, the surrender value of policy represents an asset.

Meaning of 'with profits' or 'without profits' Policy In case of a ''without profits'' policy, the holder will get only the amount specified in the policy. In case of a 'with profits' policy, the holder will get the amount specified in the policy *plus bonuses declared on each valuation.*

(a) Without taking Surrender Value into Account

Under this method, premia paid on the policy are charged to Profit and Loss Account as an expense, thus reducing divisible profits and, in effect, charging the partners with the cost of the policy in their profit sharing ratio. No Joint Life Insurance Policy is opened in the books and nothing is shown in the Balance Sheet. At any time, the surrender value of policy represents a secret reserve. On the death of a partner, the cash received is debited to Bank Account and credited to Partners' Capital Accounts (including deceased partner) in the profit-sharing ratio. The cash so made available can be applied for payment to the executors of the deceased partner.

Summary of Accounting Entries

(a) For recording payment of premia

Joint Life Insurance Premium Account	Dr.	
To Bank Account		

(b) For closing Premium Account

Profit and Loss Account	Dr.	
To Joint Life Insurance Premium Account		

(c) For recording the receipts of policy money

Bank Account	Dr.	[Amount received]
To Joint Life Policy Account		

(d) For distributing policy money

Joint Life Policy Account	Dr.	
To All Partners' Capital Accounts		[Old ratio]

Instead of passing (c) & (d) entries above, we can pass a combined entry:

Bank Account	Dr.	[Amount received]
To All Partners' Capital Accounts		[Old ratio]

(b) Taking Surrender Value into Account

This method can be divided into: (a) Joint Life Policy Method; and (b) Joint Life Policy Reserve Method.

(a) Joint Life Policy Method : Under this method, a Joint Life Policy Account is opened in the books. The premia are debited to Joint Life Policy Account as and when paid. At the end of each year, the book value of the policy is adjusted to its surrender value by transferring the difference between the premium paid and the increase in the surrender value to Profit and Loss Account. The policy will appear in the Balance Sheet at its ***Surrender Value*** on the assets side.

Summary of Accounting Entries

(a) For recording payments of premia

Joint Life Policy Account	Dr.	
To Bank Account		

(b) For adjusting the book value of policy with its surrender value

Profit and Loss Account Dr.
To Joint Life Policy Account

(c) For realization of Policy money

Bank Account Dr.
To Joint Life Policy Account

(d) The credit balance of Joint Life Policy Account is transferred to Partners' Capital Accounts in the old Profit-Sharing ratio.

(b) Joint Life Policy Reserve Method : Under this method also a Joint Life Policy Account is opened in the books, to which the premia are debited as and when paid. At the end of each year, an amount equal to annual premium is debited to Profit and Loss Appropriation Account and credited to Joint Life Policy Reserve Account. The book value of the policy is adjusted to its surrender value by a transfer from Joint Life Policy Reserve Account. After adjustment, the Joint Life Policy will appear on the assets side of the Balance Sheet at surrender value and Joint Life Policy Reserve will also appear in the Balance Sheet, but on the liabilities side. On the death of a partner, the money received under the policy will be debited to Bank Account and credited to Joint Life Policy Account. The ultimate balance of the Joint Life Policy Account is transferred to Joint Life Policy Reserve Account. The final balance of the Joint Life Policy Reserve Account is transferred to Partners' Capital Accounts (including the deceased) in the old profit-sharing ratio.

Summary of Accounting Entries

(a) For recording payment of premia

Joint Life Policy Account Dr.
To Bank Account

(b) For appropriation of amount equal to annual premium

Profit and Loss Appropriation Account Dr.
To Joint Life Policy Reserve Account

(c) For adjusting the difference between the premium paid and the increase in the surrender value

Joint Life Policy Reserve Account Dr.
To Joint Life Policy Account

(d) For realization of policy money

Bank Account Dr.
To Joint Life Policy Account

(e) For transferring the credit balance of Joint Life Policy Account

Joint Life Policy Account Dr.
To Joint Life Policy Reserve Account

(f) The final balance of the Joint Life Policy Reserve Account is transferred to Partners' Capital Accounts in the old profit-sharing ratio (including deceased partner)

Individual Policies

Instead of joint life policy, partners may take individual policies for each partner. In the event of the death of a partner, the policy of the deceased partner will mature and the firm is entitled to the full value of the policy. In such a case, the deceased partner's legal representatives will be entitled to the proportional share of: (a) the total value of the policy matured; plus (b) surrender values of the other policies.

(ii) Ascertainment of share of profit from the date of last Balance Sheet to the date of death

The executors of the deceased partner are entitled to a share of profit earned by the firm from the date of last Balance Sheet and to the date of death. The profits of this period will be calculated on the basis of the provision of the partnership deed. Generally, the following two methods are followed for finding out the profit of the said period: (a) on the basis of time; and (b) on the basis of turnover.

(a) On the Basis of Time: Under this method, profits of the year is distributed between the pre-death period and post-death period on time basis assuming that profits have been accrued evenly throughout the year. The pre-death period's profit is distributed among all the partners (including deceased) in the old profit-sharing ratio.

Example: A, B & C were partners sharing profits and losses in the ratio of 3:2:1. On 1st March 2015, C died. The average profits of the firm for the last four years were ₹ 72,000. Assume the date of closing to be 31st December every year.

C's share of profit is calculated as follows:

Total profit for the year	₹ 72,000
Pre-death period's profit (2 months)	₹ 12,000
Post -death period's profit (10 months)	₹ 60,000
C's share of profit 1/6 of ₹ 12,000	₹ 2,000

(b) On the Basis of Turnover: Under this method, profit for the year is distributed on the basis of turnover between pre-death period and post-death period. The pre-death period's profit is divided among all partners (including the deceased) in the old profit-sharing ratio.

Example: X, Y & Z are equal partners. On 30th June 2014, X died. The profit for the year ended on 31st December 2014 is ₹ 60,000. The total turnover for the year 2014 is ₹ 6,00,000. Turnover up to 30th June 2014 is ₹ 4,50,000.

X's share of profit is calculated as follows:

Total Profit for the year	₹ 60,000
Pre-death period's profit = 60,000 x 4,50,000/6,00,000	₹ 45,000
X's share of profit 1/3 of ₹ 45,000	₹ 15,000

Mode of Payment

Similar to that of 'Retirement of a Partner'.

Illustration 1

X, Y & Z are partners sharing profits and losses in the ratio of 2:2:1. On 1st January 2012, they took out a joint life policy of ₹ 1,00,000. Annual premium of ₹ 5,000 was payable on 1st January each year. Last premium was paid on 1st January 2015. Y died on 1st March, 2015, and policy money was received on 31st March, 2015.

The surrender value of policy as on 31st December each year were as follows :

2012 — Nil ; 2013 — ₹ 1,000; 2014 — ₹ 2,500.

Show necessary accounts and Balance Sheet as on 31st December, each year, assuming that:

1. The premium is charged to Profit and Loss Account every year.
2. The premium is debited to Joint Life Policy Account and the balance of the Joint Life Policy Account is adjusted every year to its surrender value.
3. The premium is debited to Joint Life Policy Account and a sum equal to premium is debited to Profit and Loss Appropriation Account and credited to Joint Life Policy Fund.

Solution

Case 1 : In this case, premium paid is charged to Profit and Loss Account every year, so nothing will appear in the Joint Life Policy Account and in the Balance Sheets of 2012; 2013 and 2014.

However, in 2015 the Joint Life Policy Account will appear as follows:

Dr. Joint Life Policy Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Partners' Capital A/cs (X — 40,000; Y — 40,000; Z — 20,000)	1,00,000	31.3.2015	By Bank A/c (policy money received)	1,00,000
		1,00,000			1,00,000

Case 2

Dr. Joint Life Policy Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Bank A/c—Premium	5,000	31.12.2012	By Profit & Loss A/c	5,000
1.1.2013	To Bank A/c—Premium	5,000	31.12.2013	By Profit & Loss A/c	4,000
			31.12.2013	By Balance c/d	1,000
		5,000			5,000

1.1.2014	To Balance b/d	1,000	31.12.2014	By Profit & Loss A/c	3,500
1.1.2014	To Bank A/c—Premium	5,000	31.12.2014	By Balance c/d	2,500
		6,000			6,000
1.1.2015	To Balance b/d	2,500	31.3.2015	By Bank A/c (policy money received)	1,00,000
1.1.2015	To Bank A/c—Premium	5,000			
31.3.2015	To Partners' Capital A/cs (X—37,000; Y—37,000; Z—18,500)	92,500			
		1,00,000			1,00,000

Balance Sheet as at 31st December, 2012

Liabilities	₹	Assets	₹
		Joint Life Policy	Nil

Balance Sheet as at 31st December, 2013

Liabilities	₹	Assets	₹
		Joint Life Policy	1,000

Balance Sheet as at 31st December, 2014

Liabilities	₹	Assets	₹
		Joint Life Policy	2,500

Case 3

Dr. **Joint Life Policy Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Bank A/c—Premium	5,000	31.12.2012	By Joint Life Policy Fund A/c	5,000
1.1.2013	To Bank A/c—Premium	5,000	31.12.2013	By Joint Life Policy Fund A/c	4,000
			31.12.2013	By Balance c/d	1,000
		5,000			5,000
1.1.2014	To Balance b/d	1,000	31.12.2014	By Joint Life Policy Fund A/c	3,500
1.1.2014	To Bank A/c—Premium	5,000	31.12.2014	By Balance c/d	2,500
		6,000			6,000
1.1.2015	To Balance b/d	2,500	31.3.2015	By Bank A/c (policy money received)	1,00,000
1.1.2015	To Bank A/c—Premium	5,000			
31.3.2015	To Joint Life Policy Fund A/c	92,500			
		1,00,000			1,00,000

Dr. **Joint Life Policy Fund Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Joint Life Policy A/c	5,000	31.12.2012	By Profit & Loss Appropriation A/c	5,000
31.12.2013	To Joint Life Policy A/c	4,000	31.12.2013	By Profit & Loss Appropriation A/c	5,000
31.12.2013	To Balance c/d	1,000			
		5,000			5,000
31.12.2014	To Joint Life Policy A/c	3,500	1.1.2014	By Balance b/d	1,000
31.12.2014	To Balance c/d	2,500	31.12.2014	By Profit & Loss Appropriation A/c	5,000
		6,000			6,000
31.3.2015	To Partners' Capital A/cs (X—38,000; Y—38,000; Z—19,000)	95,000	1.1.2015	By Balance b/d	2,500
			31.3.2015	By Joint Life Policy A/c	92,500
		95,000			95,000

Balance Sheet as at 31st December, 2012

Liabilities	₹	Assets	₹
Joint Life Policy Fund	Nil	Joint Life Policy	Nil

Balance Sheet as at 31st December, 2013

Liabilities	₹	Assets	₹
Joint Life Policy Fund	1,000	Joint Life Policy	1,000

Balance Sheet as at 31st December, 2014

Liabilities	₹	Assets	₹
Joint Life Policy Fund	2,500	Joint Life Policy	2,500

Illustration 2

X, Y and Z are partners in a firm, sharing profits in the ratio of 2 : 2 : 1. They took out a Joint Life Policy in 2011 for ₹ 65,000. On 1st February, 2015, Z died. The surrender value of the policy appearing in the books on that date was ₹ 15,000. Pass the necessary Journal Entries to close the Joint Life Policy Account.

Solution

In the books of the firm
Journal

Date	Particulars	Dr. ₹	Cr. ₹
2015 ?	Bank A/c Dr.	65,000	
	To Joint Life Policy A/c		65,000
	(Being the receipt of the policy value)		
	Joint Life Policy A/c : ₹ (65,000 – 15,000) Dr.	50,000	
	To X Capital A/c		20,000
	To Y Capital A/c		20,000
	To Z Capital A/c		10,000
	(Being the balance of the Joint Life Policy Account transferred to all the Partners' Capital Accounts in the ratio of 2 : 2 : 1)		

Illustration 3

M/s A, B and C who share profits and losses in the ratio of 3:2:2, arranged for a joint life policy of the partners of ₹ 50,000 from 5.3.2012 in order to provide for the repayment of the deceased partner's share. The annual premium of ₹ 1,000 is debited to the Joint Life Policy Account. The premia were paid on 5th March of every year and the last of such premium was paid in 2015. The surrender values of the policy in the various years are: 2012 — Nil; 2013 — ₹ 100; 2014 — ₹ 250. A died on 14.4.2015 and the policy amount was secured in full on 30.4.2015. Show the Joint Life Policy Account and the Joint Life Policy Reserve Account assuming that the accounts were closed on 30th April every year.

Solution

Dr. Joint Life Policy Account Cr.

Date	Particulars	₹	Date	Particulars	₹
5.3.2012	To Bank A/c—Premium	1,000	30.4.2012	By Joint Life Policy Reserve A/c	1,000
5.3.2013	To Bank A/c—Premium	1,000	30.4.2013	By Joint Life Policy Reserve A/c	900
			30.4.2013	By Balance c/d	100
		1,000			1,000
1.5.2013	To Balance b/d	100	30.4.2014	By Joint Life Policy Reserve A/c	850
5.3.2014	To Bank A/c—Premium	1,000	30.4.2014	By Balance c/d	250
		1,100			1,100
1.5.2014	To Balance b/d	250	30.4.2015	By Bank A/c (money received)	50,000
5.3.2015	To Bank A/c—Premium	1,000			
30.4.2015	To Joint Life Policy Reserve A/c	48,750			
		50,000			50,000

Dr. Joint Life Policy Reserve Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.4.2012	To Joint Life Policy A/c	1,000	30.4.2012	By Profit & Loss Appropriation A/c	1,000
30.4.2013	To Joint Life Policy A/c	900	30.4.2013	By Profit & Loss Appropriation A/c	1,000
30.4.2013	To Balance c/d	100			
		1,000			1,000
30.4.2014	To Joint Life Policy A/c	850	1.5.2013	By Balance b/d	100
30.4.2014	To Balance c/d	250	30.4.2014	By Profit & Loss Appropriation A/c	1,000
		1,100			1,100
30.4.2015	To Partners' Capital A/cs :		1.5.2014	By Balance b/d	250
	(A—21,000; B—14,000; C—14,000)	49,000	30.4.2015	By Joint Life Policy A/c	48,750
		49,000			49,000

Illustration 4

The following is the Balance Sheet of V. Fishy & Co. as at 31st December, 2014.

Balance Sheet as at 31st December, 2014

Liabilities	₹	Assets	₹
Capital : Mahseer	4,100	Machinery	5,000
Salmon	4,100	Furniture	2,800
Carp	4,500	Fixture	2,100

General Reserve	1,500	Cash		1,500
Creditors	2,350	Stock		950
		Debtors	4,500	
		Less: Provision for Bad Debts	300	4,200
	16,550			16,550

Carp died on 3rd January, 2015 and the following agreement was to be put into effect :

(a) Assets were to be revalued : Machinery to ₹ 5,850; Furniture to ₹ 2,300; Stock to ₹ 750.

(b) Goodwill was valued at ₹ 3,000 and Carp was to be credited with his share, without using a Goodwill Account.

(c) ₹ 1,000 was to be paid away to the executors of the dead partner on 5th January, 2015.

You are required to show :

(i) The Journal Entry for Goodwill adjustment.

(ii) The Revaluation Account and Capital Accounts of the partners.

(iii) Which account would be debited and which account credited if the Provision for Bad Debts in the Balance Sheet was to be found unnecessary to maintain at the death of Carp ?

Solution

Workings **(i) Statement Showing the Required Adjustment for Goodwill**

Particulars		Mahseer	Salmon	Carp
Right of goodwill before death (1 : 1 : 1)*	(₹)	1,000	1,000	1,000
Right of goodwill after death (1 : 1)*	(₹)	1,500	1,500	—
Gain (+) / Sacrifice (–)	(₹)	(+) 500	(+) 500	(–) 1,000

* Profit sharing ratio is equal before or after the death of Carp because nothing has been mentioned in respect of profit-sharing ratio.

In the books of the firm

Journal **Dr. Cr.**

Date	Particulars		₹	₹
2015 Jan. 3	Mahseer Capital A/c	Dr.	500	
	Salmon Capital A/c	Dr.	500	
	To Carp Capital A/c			1,000
	(Being the required adjustment for goodwill through the Partners' Capital Accounts)			

Dr. (ii) Revaluation Account Cr.

Particulars	₹	Particulars	₹
To Furniture A/c (₹ 2,800 – 2,300)	500	By Machinery A/c (₹ 5,850 – 5,000)	850
To Stock A/c (₹ 950 – 750)	200		
To Partners' Capital A/cs : (Mahseer—₹ 50; Salmon—₹ 50; Carp—₹ 50)	150		
	850		850

Dr. Partners' Capital Account Cr.

Particulars	Mahseer	Salmon	Carp	Particulars	Mahseer	Salmon	Carp
To Carp Capital A/c (Goodwill)	500	500	—	By Balance b/d	4,100	4,100	4,500
To Cash A/c	—	—	1,000	By General Reserve A/c	500	500	500
To Carp Executors A/c	—	—	5,050	By Revaluation A/c (Profit)	50	50	50
To Balance c/d	4,150	4,150	—	By Mahseer Capital A/c (Goodwill)	—	—	500
				By Salmon Capital A/c (Goodwill)	—	—	500
	4,650	4,650	6,050		4,650	4,650	6,050

(iii) Provision for Bad Debts Account is a credit balance. To close this, this account is to be debited. It becomes a gain for the partners. Therefore, either Partners' Capital Accounts (including Carp) or Revaluation Account is to be credited.

Illustration 5

Bimla and Nutan were partners. The partnership deed provides inter alia :

(i) That the accounts be balanced on 31st December each year.

(ii) That the profits be divided as follows :
Bimla : one-half; Nutan : one-third; and carried to Reserve Account : one-sixth.

(iii) That in the event of death of a partner, his executor will be entitled to the following :
(a) the capital to her credit at the date of death; (b) her proportion of profit to date of death based on the average profits of the last three completed years; (c) her share of goodwill based on three years' purchases of the average profits for the three preceding completed years.

Trial Balance on 31st December, 2014

Particulars	Dr. (₹)	Cr. (₹)
Bimla Capital		90,000
Nutan Capital		60,000
Reserve		30,000
Bills Receivable	50,000	
Investments	40,000	
Cash	1,10,000	
Creditors		20,000
	2,00,000	2,00,000

The profits for the three years were : 2012 : ₹ 42,000; 2013 : ₹ 39,000; and 2014 : ₹ 45,000. Nutan died on 1st May, 2015. Show the calculation of Nutan's (i) Share of profits; (ii) Share of Goodwill; and (iii) Draw up Nutan's Executors Account as would appear in the firm's ledger transferring the amount to her Loan Account.

Solution

(i) Ascertainment of Nutan's Share of Profit	₹	(ii) Ascertainment of Value of Goodwill	₹
2012	42,000	2012	42,000
2013	39,000	2013	39,000
2014	45,000	2014	45,000
Total profit	1,26,000	Total profit for 3 years	1,26,000
Average profit	42,000	Average profit	42,000
4 Months' Profit	14,000	Goodwill—3 years' purchase of Average Profit	1,26,000
Nutan's Share in Profit (2/5th* of ₹ 14,000)	**5,600**	**Nutan's Share of Goodwill (*2/5 of ₹ 1,26,000)**	**50,400**

* Profit sharing ratio between Bimla and Nutan = 1/2 : 1/3 = 3 : 2. Therefore, Nutan's share of Profit = 2/5.

Dr. Nutan's Executors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015 May 1	To Nutan Loan A/c	1,28,000	2015 Jan. 1	By Nutan Capital A/c	60,000
			May 1	By Reserves A/c (2/5th of ₹ 30,000)	12,000
			May 1	By Goodwill A/c (share of goodwill)	50,400
			May 1	By P/L Suspense A/c (share of profit)	5,600
		1,28,000			1,28,000

Illustration 6

R, S and T were partners sharing profits and losses in the ratio of 5 : 3 : 2 respectively. On 31st December, 2013, their Balance Sheet stood as under :

Liabilities		₹	Assets	₹
Sundry Creditors		55,000	Leasehold	1,00,000
Reserve Fund		30,000	Patents	30,000
Capital Accounts :			Machinery	1,50,000
R	1,50,000		Stock	50,000
S	1,25,000		Debtors	40,000
T	75,000	3,50,000	Cash at Bank	65,000
		4,35,000		4,35,000

T died on 1st May, 2014. It was agreed that :

(a) Goodwill be valued at $2^1/_2$ years purchase of last four years' profits which were : 2010 — ₹ 55,000; 2011 — ₹ 50,000; 2012 — ₹ 60,000 and 2013 — ₹ 75,000.

(b) Machinery be valued at ₹ 1,40,000. Patents be valued at ₹ 40,000; Leasehold be valued at ₹ 1,25,000 on 1st May, 2014.

(c) For the purpose of calculating T's share in the profits of 2014, the profits in 2014 should be taken to have accrued on the same scale as in 2013.

(d) A sum of ₹ 21,000 to be paid immediately to the executors of T and the balance to be paid in four equal half-yearly instalments together with interest @ 10% interest per annum.

Pass the necessary journal entries to record the above transactions. Also show T Capital Account and T's Executors Account for 2014.

Solution

In the books of the firm

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

Date	Particulars	₹	₹
2014	Revaluation A/c Dr.	10,000	
May 1	To Machinery A/c		10,000
	(Being the downward revaluation of machinery)		

Patents A/c	Dr.	10,000	
Leasehold A/c	Dr.	25,000	
To Revaluation A/c			35,000
(Being the upward revaluation of patents and leasehold)			
Revaluation A/c (₹ 35,000 – ₹ 10,000)	Dr.	25,000	
To R Capital A/c			12,500
To S Capital A/c			7,500
To T Capital A/c			5,000
(Being the profit on revaluation transferred to Partners' Capital Accounts in the ratio of 5 : 3 : 2)			
R Capital A/c	Dr.	18,750	
S Capital A/c	Dr.	11,250	
To T Capital A/c			30,000
(Being the adjustment of goodwill)			
Profit and Loss Suspense A/c (Note 2)	Dr.	5,000	
To T Capital A/c			5,000
(Being the proportionate share of profit for 2014 credited to T's Capital Account)			
Reserve Fund A/c	Dr.	30,000	
To R Capital A/c			15,000
To S Capital A/c			9,000
To T Capital A/c			6,000
(Being the reserve fund transferred to Partners' Capital Accounts)			
T Capital A/c	Dr.	1,21,000	
To T's Executors A/c			1,21,000
(Being T's Capital Account balance transferred to his Executor's Account)			
T's Executors A/c	Dr.	21,000	
To Bank A/c			21,000
(Being the payment of ₹ 21,000 to T's executors)			

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

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
May 1	To T's Executors A/c	1,21,000	May 1	By Balance b/d	75,000
				By Revaluation A/c (profit)	5,000
				By R Capital A/c	18,750
				By S Capital A/c	11,250
				By Profit and Loss Suspense A/c	5,000
				By Reserve Fund A/c	6,000
		1,21,000			1,21,000

Dr. **T's Executors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
May 1	To Bank A/c	21,000	May 1	By T Capital A/c	1,21,000
Oct. 31	To Bank A/c (₹ 25,000 + 5,000)	30,000	Oct. 31	By Interest A/c (₹ 1,00,000 x 10/100 x 6/12)	5,000
Dec. 31	To Balance c/d	76,250	Dec. 31	By Interest A/c (₹ 75,000 x 10/100 x 2/12)	1,250
		1,27,250			1,27,250

Working Notes :

(1) Ascertainment of Goodwill	₹	**(2) Ascertainment of T's share of profit for January to April 2014**	₹
2010	55,000	Profit of 2013	75,000
2011	50,000	Profit for 4 months	25,000
2012	60,000	T's share of profit—1/5th of ₹ 25,000	5,000
2013	75,000		
Total profit	2,40,000		
Average profit	60,000		
Goodwill ($2^1/_2$ years purchase of average profit)	1,50,000		

Illustration 7

The following was the Balance Sheet of A, B and C who share profits in the ratio of 1:2:2 as on 31.12.2014. C died on 31st March, 2015. His account has to be settled under the following terms :

Liabilities	₹	Assets	₹
Sundry creditors	10,000	Debtors	25,000
Capital (A—10,000; B—20,000; C—20,000)	50,000	Machinery	20,000

General Reserve	5,000	Building	30,000
Investment Fluctuation Fund	3,000	Stock	10,000
Bad Debts Reserve	2,000	Cash at bank	5,000
Bank Loan	30,000	Investments	10,000
	1,00,000		1,00,000

Goodwill is to be calculated at the rate of 3 years' purchase on the basis of the average of 5 years' profit or loss. Profit for January to March 2015 is to be calculated proportionately on the average profit of 3 years. The profits are: 2010 ₹ 3,000; 2011 ₹ 7,000; 2012 ₹ 10,000; 2013 ₹ 14,000; and 2014 Loss ₹ 12,000. During 2014, a moped costing ₹ 4,000 was purchased and debited to Travelling Account on which depreciation is to be calculated @ 25%. Other values agreed on assets are: Building ₹ 37,000; and Machinery ₹ 25,000. Investment is valued at ₹ 8,000. Debtors are considered good.

Prepare new Balance Sheet of the firm, necessary Journal Entries and Capital Accounts of the partners.

Solution **In the books of the firm**

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

Date	Particulars		Dr. ₹	Cr. ₹
2015	A Capital A/c	Dr.	2,000	
March 31	B Capital A/c	Dr.	4,000	
	To C Capital A/c			6,000
	(Being the adjustment for goodwill)			
	Building A/c	Dr.	7,000	
	Machinery A/c	Dr.	5,000	
	To Revaluation A/c			12,000
	(Being the increase in the value of assets)			
	Revaluation A/c	Dr.	2,000	
	To Investments A/c			2,000
	(Being the decrease in the value of investments)			
	General Reserve A/c	Dr.	5,000	
	Investment Fluctuation Fund A/c	Dr.	3,000	
	Bad Debts Reserve A/c	Dr.	2,000	
	To A Capital A/c			2,000
	To B Capital A/c			4,000
	To C Capital A/c			4,000
	(Being the transfer of the above reserves to the Partners' Capital Accounts in their profit-sharing ratio)			
	Moped A/c	Dr.	3,000	
	To A Capital A/c			600
	To B Capital A/c			1,200
	To C Capital A/c			1,200
	(Being the cost less depreciation value of moped recorded in the books)			
	Profit and Loss Suspense A/c	Dr.	500	
	To C Capital A/c			500
	(Being the estimated profit of 3 months credited to C)			
	Revaluation A/c	Dr.	10,000	
	To A Capital A/c			2,000
	To B Capital A/c			4,000
	To C Capital A/c			4,000
	(Being distribution of profit on revaluation in the profit-sharing ratio)			
	C Capital A/c	Dr.	35,700	
	To C Executors A/c			35,700
	(Being the estimated payable to C is transferred to his Executors Account)			

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

Particulars	A	B	C	Particulars	A	B	C
To C Capital A/c	2,000	4,000	—	By Balance b/d	10,000	20,000	20,000
To C Executors A/c	—	—	35,700	By Revaluation A/c	2,000	4,000	4,000
To Balance c/d	12,600	25,200	—	By A Capital A/c	—	—	2,000
				By B Capital A/c	—	—	4,000
				By General & Other Reserve A/c	2,000	4,000	4,000
				By Moped A/c	600	1,200	1,200
				By Profit & Loss Suspense A/c	—	—	500
	14,600	29,200	35,700		14,600	29,200	35,700

Balance Sheet as on 31st March, 2015

Liabilities	₹	Assets	₹
Capital A/cs (A — 12,600; B — 25,200)	37,800	Building	37,000
Bank Loan	30,000	Machinery	25,000
Sundry creditors	10,000	Investments	8,000
C Executors A/c	35,700	Moped	3,000
		Stock	10,000
		Debtors	25,000
		Bank	5,000
		Profit and Loss Suspense A/c	500
	1,13,500		1,13,500

Working Notes :

(1) Ascertainment of Goodwill	₹	**(2) Ascertainment of C' share of profit for Jan to Mar 2015**	₹
2010	3,000	2012	10,000
2011	7,000	2013	14,000
2012	10,000	2014*	(–) 9,000
2013	14,000	Total profit for 3 years	15,000
2014*	(–) 9,000	Average profit	5,000
Total profit	25,000	3 months' profit	1,250
Average profit	5,000	C' share in profit	500
Goodwill (3 years' purchase of Average profit)	**15,000**		

*Loss 2014—₹ 12,000; Less cost of moped—₹ 4,000; Add: Depreciation 25% = ₹ 1,000; So actual loss of 2014 = ₹ 9,000.

Illustration 8

A, B and C were in partnership sharing profits and losses in the ratio of 5 : 4 : 3 respectively. A died on 31.12.2014, on which date the Balance Sheet of the firm was as under:

Liabilities	₹	Assets		₹
Capital Accounts:		Leasehold Premises	40,000	
(A—₹ 42,500; B—₹ 30,000; C—₹ 22,500)	95,000	Less: Accumulated depreciation	4,000	36,000
Current Accounts:		Plant	46,000	
(A—₹ 4,250; B—₹ 6,500; C—₹ 5,750)	16,500	Less: Accumulated depreciation	13,500	32,500
Loan Account: A	20,000	Stock		27,000
Creditors	21,250	Debtors	21,000	
		Less: Provision for doubtful debts	3,750	17,250
		Bank		40,000
	1,52,750			1,52,750

B and C decided to carry on the business sharing profits and losses in the ratio of 7 : 5 respectively. The following adjustments were made on 31.12.2014:

(a) Plant, stock and debtors were valued at ₹ 34,500, ₹ 24,300 and ₹ 16,850 respectively; (b) Valuer's charge of ₹ 700 was to be provided for; and (c) Goodwill was to be valued as equal to 3 years' purchase of super profits. The required return was to be calculated as 25% on partners' capital, current and loan accounts, and was to be set against weighted average profits of the last three years. The profits were: 2014 ₹ 52,000; 2013 ₹ 46,000; 2012 ₹ 45,250.

₹ 25,000 was repaid to A's executors on 1.1.2015, the balance owing to be a loan to the partnership.

Required: Necessary Ledger Accounts and the Balance Sheet on 1.1.2015.

Solution

Working Notes: **(a) Ascertainment of Goodwill and the Required Adjustment**

Year	Profit (₹)	Weight	₹	
				Capital + Current + Loan Accounts
2012	45,250	1	45,250	= ₹ 95,000 + ₹ 16,500 + ₹ 20,000 = ₹ 1,31,500.
2013	46,000	2	92,000	Required return = 25% x ₹ 1,31,500 = ₹ 32,875.
2014	52,000	3	1,56,000	Weighted average profit ₹ 48,875
		6	2,93,250	Less: Required return ₹ 32,875
Weighted average profit ₹ 2,93,250/6 = ₹ 48,875.				₹ 16,000
				Therefore, goodwill is ₹ 16,000 x 3 = ₹ 48,000.

Partners		A	B	C
Right of goodwill before A's death (5 : 4 : 3)	(₹)	20,000	16,000	12,000
Right of goodwill after A's death (7 : 5)	(₹)	—	28,000	20,000
Gain (Cr.) / Sacrifice (Dr.)	(₹)	(Cr.) 20,000	(Dr.) 12,000	(Dr.) 8,000

In the books of the firm

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

Particulars	₹	Particulars	₹
To Stock A/c	2,700	By Accumulated Depreciation A/c (Plant)	2,000
To Provision for bad debts A/c	400	By Partners' Capital A/cs:	
To Valuer's charges A/c	700	(A – ₹ 750; B – ₹ 600; C – ₹ 450)	1,800
	3,800		3,800

Dr. **Partners' Capital Accounts** **Cr.**

Particulars	A	B	C	Particulars	A	B	C
To Revaluation A/c	750	600	450	By Balance b/d	42,500	30,000	22,500
To A Capital A/c—goodwill	—	12,000	8,000	By B Capital A/c—goodwill	12,000	—	—
To Executors of A	61,750	—	—	By C Capital A/c—goodwill	8,000	—	—
To Balance c/d	—	17,400	14,050				
	62,500	30,000	22,500		62,500	30,000	22,500

Dr. **Executors of A Account** **Cr.**

Particulars	₹	Particulars	₹
To Bank A/c	25,000	By A Capital A/c	61,750
To Balance c/d	61,000	By A Current A/c	4,250
		By A Loan A/c	20,000
	86,000		86,000

Balance Sheet as at 1st January, 2015 (after A's death)

Liabilities	₹	Assets		₹
Capital Accounts:		Leasehold Premises	40,000	
(B—₹ 17,400; C—₹ 14,050)	31,450	Less: Accumulated depreciation	4,000	36,000
Current Accounts:		Plant	46,000	
(B—₹ 6,500; C—₹ 5,750)	12,250	Less: Accumulated depreciation	11,500	34,500
Executors of A	61,000	Stock		24,300
Sundry Creditors (including valuer's charges of ₹ 700)	21,950	Debtors	21,000	
		Less: Provision for doubtful debts	4,150	16,850
		Bank (₹ 40,000 – 25,000)		15,000
	1,26,650			1,26,650

Illustration 9

A, B and C were partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1. C died on 28th February, 2015. The Balance Sheet of the firm as on that date was as follows :

Liabilities	₹	Assets	₹
A's Capital A/c	1,20,000	Plant and Machinery	1,20,000
B's Capital A/c	80,000	Furniture and Fittings	75,000
C's Capital A/c	40,000	Investments	20,000
A's Current A/c	8,000	Stock-in-Trade	32,000
B's Current A/c	2,500	Sundry Debtors	25,000
Reserve	30,000	Bills Receivable	11,000
Bills Payable	17,000	Cash at Bank	18,500
Sundry Creditors	20,000	Cash in Hand	11,000
		C's Current A/c	5,000
	3,17,500		3,17,500

The following decisions were taken by the surviving partners :

(a) Goodwill is valued at ₹ 30,000.

(b) A Provision for Bad Debts is to be raised at 5% on debtors.

(c) While Plant and Machinery to be depreciated by 10%, Furniture is to be appreciated by 5%.

(d) Revised value of stock-in-trade will be ₹ 26,500.

(e) The fixed capital method is to be converted into the fluctuating capital method by transferring the Current Account balances to the respective Partners' Capital Accounts.

Prepare a Revaluation Account, Capital Account of the three partners, showing the necessary adjustment at C's death, and prepare C's Executors Account to show that C's Executor was paid off in two half-yearly equal instalments plus the interest at 10% p.a. on the unpaid balance, the first instalment was paid on 31st August, 2015.

Solution **In the books of the firm**

Dr. **Revaluation Account** **Cr.**

Particulars	₹	Particulars	₹
To Provision for Bad Debts A/c	1,250	By Furniture and Fittings A/c	3,750
To Plant and Machinery A/c	12,000	By Partners' Capital A/cs	
To Stock-in-trade A/c	5,500	(A : ₹ 7,500; B : ₹ 5,000; C : ₹ 2,500)	15,000
	18,750		18,750

Dr. **Partners' Capital Accounts** **Cr.**

Particulars	A	B	C	Particulars	A	B	C
To Revaluation A/c	7,500	5,000	2,500	By Balance b/d	1,20,000	80,000	40,000
To Partners' Current A/c	—	—	5,000	By Reserve A/c	15,000	10,000	5,000
To Goodwill A/c	18,000	12,000	—				
To C's Executors A/c	—	—	42,500	By Goodwill A/c	15,000	10,000	5,000
To Balance c/d	1,32,500	85,500	—	By Partners' Current A/cs	8,000	2,500	—
	1,58,000	1,02,500	50,000		1,58,000	1,02,500	50,000

Dr. **C's Executors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Aug.31	To Bank A/c	23,375	2015 Mar 1	By C Capital A/c	42,500
	To Balance c/d	21,250	Aug 31	By Interest A/c (for 6 months)	2,125
		44,625			44,625
2016 Feb 28	To Bank A/c	22,313	2015 Sept 1	By Balance b/d	21,250
			2016 Feb 28	By Interest A/c (for 6 months)	1,063
		22,313			22,313

Illustration 10

The following is the Balance Sheet of the firm ABC as on 31.12.2014. Their profit sharing ratio is 3 : 2 : 1.

Liabilities		₹	Assets	₹
Capital Accounts :			Fixed Assets	40,000
A : ₹ 16,000; B : ₹ 12,000; C : ₹ 10,000		38,000	Sundry Debtors	32,000
Current Accounts :			Joint Life Policy	6,000
A : ₹ 4,000; B : ₹ 3,000; C : ₹ 1,000		8,000	Stock	24,000
Reserves		18,000	Bank	9,000
Profit and Loss Account :			Cash	3,000
Opening Balance	6,000			
Profit for the period	14,000	20,000		
Creditors		20,000		
Bank Overdraft		10,000		
		1,14,000		1,14,000

B died on 31.3.2015. His account has to be settled and paid. For the year 2015, proportionate profit of 2014 is to be taken into account. For 2014, a bad debt of ₹ 2,000 has to be adjusted. Goodwill has to be calculated 3 times of the four years' average profits. A policy is taken on the joint life of partners for ₹ 35,000 and the premium of ₹ 2,000 has to be paid on February 1, every year. The profits for 2013 is ₹ 16,000, 2012 ₹ 20,000 and 2011 is ₹ 12,000. Goodwill Account need not be kept in the accounts. Calculate the amount payable to B's heirs. Show necessary Ledger Accounts of all partners and other detailed calculations.

Solution **In the books of firm**

Dr. **Partners' Current Accounts** **Cr.**

Particulars	A	B	C	Particulars	A	B	C
To B Capital A/c—transfer	—	25,000	—	By Balance b/d	4,000	3,000	1,000
To Balance c/d	35,500	—	11,500	By Reserve A/c	9,000	6,000	3,000
				By Profit and Loss A/c (4)	9,000	6,000	3,000
				By P&L Suspense A/c	—	1,000	—
				By Joint Life Policy A/c	13,500	9,000	4,500
	35,500	25,000	11,500		35,500	25,000	11,500

Dr. **Partners' Capital Accounts** **Cr.**

Particulars	A	B	C	Particulars	A	B	C
To B Capital A/c—Goodwill	11,250	—	3,750	By Balance b/d	16,000	12,000	10,000
To Bank A/c	—	52,000	—	By A Capital A/c (Goodwill)	—	11,250	—
To Balance c/d	4,750	—	6,250	By C Capital A/c (Goodwill)	—	3,750	—
				By B Current A/c	—	25,000	—
	16,000	52,000	10,000		16,000	52,000	10,000

Dr. **Joint Life Policy Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	6,000	By Bank A/c—policy value	35,000
To Bank A/c—premium paid in February 2015	2,000		
To Partners' Current A/cs (A—₹ 13,500; B—₹ 9,000; C—₹ 4,500)	27,000		
	35,000		35,000

Working Notes :

(1) Calculation of Goodwill

Total profit for the last 4 years	₹	
2014 (₹ 14,000 – ₹ 2,000)	12,000	Average profit = ₹ 60,000 / 4 = ₹ 15,000
2013	16,000	Goodwill is 3 years' purchase of the average profit of last 4 years = ₹ 15,000 x 3 = ₹ 45,000.
2012	20,000	
2011	12,000	
	60,000	

(2) Adjustment for Goodwill

Particulars		A	B	C
Right of goodwill before death (3 : 2 : 1)	(₹)	22,500	15,000	7,500
Right of goodwill after death (3 : 1)	(₹)	33,750	—	11,250
Gain (+) / Sacrifice (–)	(₹)	(+) 11,250	(–) 15,000	(+) 3,750

(3) Calculation of B's share of profits
Profit for 2014 — ₹ 12,000. Profit for 3 months — ₹ 12,000 / 12 x 3 = ₹ 3,000. B's share is 2/6th of ₹ 3,000 = ₹ 1,000.

(4) After adjustment of bad debts, the balance of Profit and Loss Account comes to ₹ 18,000 (₹ 20,000 – ₹ 2,000).

Illustration 11

A, B and C share profits and losses in the ratio of 5:3:2. Partner A died on February 20, 2015. The Profit and Loss Account for the period up to the date of death and the Balance Sheet as on that date were prepared.

Balance Sheet as on 20th February, 2015

Liabilities	₹	Assets	₹
Capital Accounts: (A—12,000; B—16,000; C—12,000)	40,000	Land	6,000
		Machinery	35,000
Loan from A	5,000	Furniture	6,000
General Reserve	7,000	Stock	9,000
Creditors	22,000	Debtors	15,000
		Bank	3,000
	74,000		74,000

In addition to the assets shown above, the firm had three life policies in the name of each partner, at an insured value of ₹ 20,000 each, the premiums of which were charged to the Profit and Loss Account.

According to the partnership deed, on the death of a partner, the assets and liabilities are to be revalued by a valuer. The revalued figures were:

1. Land ₹ 21,000; machinery ₹ 45,000; debtors are subject to a provision for doubtful debts at 10%; and furniture ₹ 7,000.
2. Provision for taxation to be created for ₹ 1,500.
3. Death claim for policy in the name of A realised in full and the surrender value of the other two policies were ₹ 7,500 each.

The business will be continued by B and C, henceforth sharing profits and losses equally. The net balance due to A is transferred to a Loan Account, which will be paid off later.

Show the Capital Account, Revaluation Account and the New Balance Sheet of the firm.

Solution

In the books of the Firm

Dr. **Revaluation Account** **Cr.**

Particulars	₹	Particulars	₹
To Provision for Doubtful Debts A/c	1,500	By Land A/c	15,000
To Provision for Taxation A/c	1,500	By Machinery A/c	10,000
To Partners' Capital A/cs (A—11,500; B—6,900; C—4,600)	23,000	By Furniture A/c	1,000
	26,000		26,000

Dr. **Partners' Capital Accounts** **Cr.**

Particulars	A	B	C	Particulars	A	B	C
To A Executors A/c	44,500	—	—	By Balance b/d	12,000	16,000	12,000
To Balance c/d	—	35,500	25,000	By Bank A/c (J.L.P.)	10,000	6,000	4,000
				By General Reserve A/c	3,500	2,100	1,400
				By Joint Life Policy A/c	7,500	4,500	3,000
				By Revaluation A/c	11,500	6,900	4,600
	44,500	35,500	25,000		44,500	35,500	25,000

Balance Sheet (after A's death)

Liabilities	₹	Assets	₹
Capital Accounts:		Land	21,000
(B—35,500; C—25,000)	60,500	Machinery	45,000
A Executors A/c	49,500	Furniture	7,000
Creditors	22,000	Stock	9,000
Provision for taxation	1,500	Joint Life Policy (surrender value)	15,000
		Debtors (₹ 15,000 Less: Provision—1,500)	13,500
		Bank (₹ 3,000 + 20,000)	23,000
	1,33,500		1,33,500

Working Notes :

Dr. **(1) Joint Life Policy Account** **Cr.**

Particulars	₹	Particulars	₹
To A Capital A/c*	7,500	By Balance c/d	15,000
To B Capital A/c*	4,500		
To C Capital A/c*	3,000		
	15,000		15,000

* Surrender value of remaining two policies ₹ 15,000 : ₹ (7,500 + 7,500) is to be credited to Partners' Capital Account in the profit sharing ratio and the surrender value of the policies are to be shown in the Balance Sheet.

Dr. **(2) A's Executors Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance c/d	49,500	By A Loan A/c	5,000
		By A Capital A/c	44,500
	49,500		49,500

Illustration 12

R, S and T were partners sharing profits and losses in the proportion of 1/2, 1/3 and 1/6 respectively. T expired on 31st May, 2014.

Partnership agreement provided that:

(a) Interest on fixed capital to be allowed at 12% p.a.

(b) T to be Credited with salary of ₹ 18,000 p.a.

(c) On the death of any of the partners, his heir will receive in addition to the balance in the Fixed Capital and Current Account:

(i) Salary and interest on Capital.

(ii) Share of proportionate profit from last Balance Sheet to the date of death based on annual average profits of last 3 years (after interest on capital and salary to the partners).

(iii) Share of goodwill calculated at twice the average profits of last 3 years (before interest on capital and salary to the partners).

(iv) Share of profit on joint assurance policy.

Following further information is available :

	(A) Fixed Capitals on 31.3.2014	(B) Current Accounts (Cr.) 31.3.2014
R	₹ 3,00,000	₹ 50,000
S	₹ 2,00,000	₹ 10,000
T	₹ 1,00,000	₹ 20,000

(C) Joint Life Policy—₹ 1,00,000.

(D) There is no change in capital and current accounts since 31.3.2014.

(E) Joint Life Policy realised ₹ 1,50,000 (on 15.6.2014, amount due to T paid on receipt of policy amount.)

(F) Profits (before interest and salary) were :
2013-14—₹ 1,24,000; 2012-13 — ₹ 1,20,000; 2011-12—₹ 80,000; 2010-11—₹ 1,30,000.

(G) The firm closes its books on 31st March, decided to continue the firm and not to raise goodwill.

Show the following accounts in the books of the firm relating to the above transactions:
(a) Current Accounts of partners;
(b) Profit and Loss Adjustment Account; and
(c) Heir of T's Loan Account.

Solution **In the books of the Firm**

Dr. **Profit & Loss Adjustment Account** **Cr.**

Particulars	₹	Particulars	₹
To Partners' Current A/cs (R—₹ 25,000; S—₹ 16,667; T—₹ 8,333)	50,000	By Joint Life Policy A/c (profit)*	50,000
	50,000		50,000
To Partners' Current A/cs—T (Note 3)		By Balance c/d	15,500
Profit	500		
Salary	3,000		
Interest	2,000		
To Partners' Current A/cs—R (Interest)	6,000		
To Partners' Current A/cs—S (Interest)	4,000		
	15,500		15,500

* Alternatively, it can be directly credited to Partners' Current Accounts.

Dr. **Partners' Current Accounts** **Cr.**

Particulars	R	S	T	Particulars	R	S	T
31.5.2014	₹	₹	₹	1.4.2014	₹	₹	₹
To T Current A/c – goodwill	21,600	14,400	—	By Balance b/d	50,000	10,000	20,000
To Heir of T's Loan A/c	—	—	69,833	31.5.2014			
To Balance c/d	59,400	16,267	—	By R Current A/c – goodwill	—	—	21,600
				By S Current A/c – goodwill	—	—	14,400
				By P & L Adjustment A/c:			
				Profit on J.L. Policy A/c	25,000	16,667	8,333
				Profit	—	—	500
				Salary	—	—	3,000
				Interest	6,000	4,000	2,000
	81,000	30,667	69,833		81,000	30,667	69,833

Dr. **Heir of T's Loan Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
15.6.2014	To Balance c/d	1,69,833	1.4.2014	By T Capital A/c	1,00,000
				By T Current A/c	69,833
		1,69,833			1,69,833

Working Notes:

(1) Ascertainment of Proportionate Profit	₹	(2) Ascertainment of T's Share of Goodwill			₹
2013-14	1,24,000	Average profit (as calculated)			1,08,000
2012-13	1,20,000	Total value of goodwill (₹ 1,08,000 x 2)			2,16,000
2011-12	80,000	T's share of goodwill (1/6 of ₹ 2,16,000)			36,000
Total profit	3,24,000	**Required Journal Entry**			
Average profit (₹ 3,24,000/3)	1,08,000	R Current A/c	Dr.	21,600	
Therefore, proportionate profit for 2 months	**18,000**	S Current A/c	Dr.	14,400	
		To T Current A/c			36,000

(3) Ascertainment of Profit after Interest and Salary	₹
Proportionate profit	18,000
Less: Interest for 2 months (R — ₹ 6,000 + S — ₹ 4,000 + T — ₹ 2,000)	12,000
	6,000
Less: Salary of T for 2 months (₹ 1,500 x 2)	3,000
Profit after interest and salary	3,000
Therefore, T's share of profit is 1/6 of ₹ 3,000	500

(4) Adjustment for Goodwill

Partners		R	S	T
Right of goodwill before death (3 : 2 : 1)	₹	1,08,000	72,000	36,000
Right of goodwill after death (3 : 2)	₹	1,29,600	86,400	—
Gain (+) / Sacrifice (–)	₹	(+) 21,600	(+) 14,400	(–) 36,000

Unsettled Accounts of A Deceased Partner

As per the provision of Section 37 of the Indian Partnership Act:

"Where any member of a firm has died or otherwise ceased to be a partner, and the surviving or continuing partners carry on the business of the firm with the property of the firm without any final settlement of accounts as between them and the outgoing partner or his estate, then, in the absence of a contract to the contrary, the outgoing partner or his estate is entitled at the option of himself or his representatives to such share of the profits made since he ceased to be a partner as may be attributable to the use of his share of the property of the firm or to interest at the rate of six per cent per annum on the amount of his share in the property of the firm".

Illustration 13

The following is the Balance Sheet of A, B and C as on 31.12.2013, sharing profits in the ratio 4:3:1.

Liabilities	₹	Assets	₹
Capital Account — A	1,00,000	Property and Assets	2,28,000
Capital Account — B	70,000	Joint Survivorship Policy	32,000
Capital Account — C	20,000	Bank	50,000
Creditors	1,20,000		
	3,10,000		3,10,000

On 1.1.2014, D was admitted as a partner, entitling him to 1/5th share of the profit. D paid ₹ 30,000 on account of capital and also ₹ 20,000 as his share of Goodwill (the latter sum to remain in the business.)

On 30.6.2014, A died. The joint survivorship policy realised ₹ 50,000. The share of the deceased partner in the goodwill of the firm was determined at ₹ 36,000.

The Profit and Loss Account for the period ending 30.6.2014 disclosed a profit of ₹ 45.000.

The surviving partners carried on the business, profit-sharing ratio remains unchanged. Net profit for the period from 1.7.2014 to 31.12.2014 amounted to ₹ 33,000.

Drawings of the partners were:	A	B	C	D
For 6 months upto 30.6.2014 (₹)	13,000	10,000	4,000	7,500
For 6 months upto 31.12.2014 (₹)	Nil	8,000	5,000	7,000

A sum of ₹ 50,000 was advanced by B as loan to facilitate payment in full on 1.12.2014 of the deceased partner's share.

Show the Partners' Capital Accounts and draft the Balance Sheet as on 31.12.2014. The Balances of 'Creditors' and 'Property and Assets' as on 31.12.2014 were ₹ 1,17,000 and ₹ 2,37,000 respectively.

Solution

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	D	Particulars	A	B	C	D
30.6.2014	₹	₹	₹	₹	1.1.2014	₹	₹	₹	₹
To A Capital A/c (goodwill)	—	18,000	6,000	12,000	By Balance b/d	1,00,000	70,000	20,000	—
					By Bank A/c	—	—	—	30,000
To Drawings A/c	13,000	10,000	4,000	7,500	By Premium (goodwill)	10,000	7,500	2,500	—
To Balance c/d	1,60,000	69,750	19,250	19,500	By B Capital A/c	18,000	—	—	—
					By C Capital A/c	6,000	—	—	—
					By D Capital A/c (goodwill)	12,000	—	—	—
					By J.S. Policy A/c	9,000	6,750	2,250	—
					By Share of Profit	18,000	13,500	4,500	9,000
	1,73,000	97,750	29,250	39,000		1,73,000	97,750	29,250	39,000
31.12.2014					1.7.2014				
To Bank A/c	1,76,387	—	—	—	By Balance b/d	1,60,000	69,750	19,250	19,500
To Drawings A/c	—	8,000	5,000	7,000	By Interest on Loan A/c	—	250	—	—
To Balance c/d	—	70,182	16,977	17,954	By Share of profit A/c (Note 3)	16,387	8,182	2,727	5,454
	1,76,387	78,182	21,977	24,954		1,76,387	78,182	21,977	24,954

Balance Sheet as at 31st December, 2014

Liabilities	₹	Assets	₹
Capital Account — B	70,182	Property and Assets	2,37,000
Capital Account — C	16,977	Bank (balancing figure)	35,113
Capital Account — D	17,954		
Loan from B	50,000		
Creditors	1,17,000		
	2,72,113		2,72,113

Working Notes : **(1) Calculation of new profit-sharing ratio after D's admission**.

D was admitted for 1/5 share. The balance 4/5 share will be enjoyed by A, B & C in the ratio 4:3:1. Therefore, the new ratio will be: A = 4/5 x 4/8 = 16/40; B = 4/5 x 3/8 = 12/40; C = 4/5 x 1/8 = 4/40; D = 1/5 = 8/40; A : B : C : D = 4 : 3 : 1 : 2.

Dr. (2) Profit & Loss Appropriation Account for 6 months upto 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To A Capital (share of profit u/s 37)	16,387	By Net profit	33,000
To Interest on B Loan @ 6% for ₹ 50,000 for 1 month	250		
To Partners' Capital A/cs (A —8,182; C — 2,727; D — 5,454)	16,363		
	33,000		33,000

(3) **Profits for 5 months** = ₹ 33,000/6 x 5 = ₹ 27,500; Ratio of capital = 160 : 69.75 : 19.25 : 19.50; So A's share of profit for unsettled accounts = (27,500 x 160)/268.50 = ₹ 16,387.

(4) **Interest on B's loan** @ 6% p.a. is payable for one month as per Indian Partnership Act, 1932.

Illustration 14

A and B have been in partnership business for some years, sharing profits in the proportions of 3/5th and 2/5th respectively, after salary entitlements of ₹ 8,000 and ₹ 12,000 per annum respectively. Accounts are made upto 30th June in each year.

Their partnership agreement provides, on the death of a partner for : (i) revaluation of the firm's assets — net gain or loss to be dealt with in the capital accounts in the profit-sharing ratio; (ii) the amount due to a deceased partner's personal representatives to be the amount standing to the credit of his Capital Account, including salary and profits to date of death, less drawings on account; (iii) ₹ 10,000 to be paid immediately and the balance one year after death; and (iv) an annuity of ₹ 6,000 payable half-yearly in arrears to a deceased partner's widow.

A died on 31.12.2013, when the lease of the partnership premises was deemed to be worth ₹ 40,000, goodwill ₹ 25,000 and all other assets at their book values. Non-profit life insurance policies had been taken out on each partner's policy, being debited to him. A's life was insured for ₹ 50,000 and B's for ₹ 20,000. The surrender value of the policy on B's life on 31.12.2013 was ₹ 2,200, and the benefit thereof was assigned to him at that value by A's personal representatives.

On 31.3.2014, C was taken into partnership by B on the terms that he should : (i) introduce ₹ 25,000 as partnership capital; and (ii) receive 1/5th share of profits, after charging the annuity to A's widow, with no provision for partners' salaries.

Profits and losses are assumed to accrue evently throughout the year. The partnership Trial Balance as on 30.6.2014 was as follows :

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Lease	15,000		Capital Account — A (30.6.2013)		37,000
Stock on 30th June, 2014	65,000		Capital Account — B (30.6.2013)		12,900
Gross trading Profit for year ended 30.6.2014		1,82,000	Sundry Debtors	33,000	
Office salaries and expenses	82,000		Sundry Creditors		41,000
Life Assurance Policy Premium :			Cash paid in by C		25,000
On A's life, paid in Nov., 2013	650		Cash paid to personal representative of A	10,000	
On B's life, paid in May, 2014	250		Partners' Drawings — A	27,000	
Cash from life assurance policy on A's life		50,000	Partners' Drawings — B	46,000	
Annuity to A's widow, paid on 30.6.2014	3,000		Partners' Drawings — C	5,000	
Balance at bank	61,000		TOTAL	3,47,900	3,47,900

You are required to prepare : (a) the Capital Accounts of partners and the account of the personal representative of A, covering the year ended 30.6.2014; (b) the Partnership Balance Sheet as on 30.6.2014.

Solution

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	D	Particulars	A	B	D
To Bank A/c — Drawings	27,000	46,000	5,000	By Balance b/d	37,000	12,900	—
To Insurance Premium :				By Revaluation A/c	15,000	10,000	—
on A's life (See Note)	—	650	—	By Goodwill A/c	15,000	10,000	—
on B's life	—	250	—	By Salaries A/c (upto 31.12.2013)	4,000	6,000	—
To Executor of A A/c	—	2,200	—	By Sh. of Profit (upto 31.12.2013)	24,000	16,000	—
(assignment of policy)				By Bank A/c — Capital	—	—	25,000
To Executor of A A/c	68,000	—	—	By Bank A/c — Policy of A	—	50,000	—
(final claim of A)				By Sh. of Profit (upto 31.3.2014)	—	23,500	—
To Balance c/d	—	98,100	24,700	By Sh. of Profit (upto 30.6.2014)	—	18,800	4,700
	95,000	1,47,200	29,700		95,000	1,47,200	29,700

Tutorial Note : Here life insurance policy has been taken out on each partner's life for the benefit of other. It means on the death of A, B is to get the policy money. Conversely on B's death, A will get the policy money. Again insurance premium of A's policy to be borne by B and Premium on B's Policy to be borne by A. A died before the payment of premium of B's policy, so it is payable by B.

Dr. **Executor of A Account** **Cr.**

Particulars	₹	Particulars	₹
To Bank A/c	10,000	By A Capital A/c	68,000
To Balance c/d	60,200	By B Capital A/c	2,200
	70,200		70,200

Balance Sheet as at 30th June, 2014

Liabilities	₹	Assets	₹
Capital Account — B	98,100	Goodwill	25,000
Capital Account — C	24,700	Lease	40,000
Executors of A	60,200	Stock	65,000
Creditors	41,000	Debtors	33,000
		Balance at bank	61,000
	2,24,000		2,24,000

Working Notes :

Dr. **(1) Revaluation Account** **Cr.**

Particulars	₹	Particulars	₹
To A Capital A/c (3/5)	15,000	By Lease A/c (₹ 40,000 – 15,000)	25,000
To B Capital A/c (2/5)	10,000		
	25,000		25,000

Dr. **Profit and Loss Appropriation Capital Accounts** **Cr.**

Particulars	First 6 months	Next 3 months	Last 3 months	Particulars	First 6 months	Next 3 months	Last 3 months
To Salaries — A	6,000	—	—	By Net Profit * ₹ 1,00,000			
To Salaries — B	4,000	—	—	(apportioned on time basis)	50,000	25,000	25,000
To Annuity Accrued	—	1,500	1,500				
To Share of Profit A/c — A	24,000	—	—				
To Share of Profit A/c — B	16,000	23,500	18,800				
To Share of Profit A/c — C	—	—	4,700				
	50,000	25,000	25,000		50,000	25,000	25,000

* Net profit – Gross profit ₹ 1,82,000 – Office salaries ₹ 82,000 = ₹ 1,00,000.

Illustration 15

A, B and C are in partnership, sharing profits and losses equally. Interest on capital and partnership salaries is not provided. The Balance Sheet as at 30.6.2014 was as under :

Liabilities		₹	Assets	₹
Capital Account — A	9,000		Buildings	17,000
Capital Account — B	8,000		Equipment	3,300
Capital Account — C	8,000	25,000	Stock	900
Current Account — A	140		Debtors	2,020
Current Account — B	200	340	Bank	2,840
Creditors		820	Current Account — C	100
		26,160		26,160

A died suddenly on 31.10.2014.

The partnership agreed provides that in the event of the death of a partner, the sum to be paid to his estate will be the amount of his capital and current account balances at the last financial year and adjusted by his share of profit or loss since that date together with his share of goodwill. A formula for calculation of goodwill is given, and its application produced figure of ₹ 7,500. No goodwill account is to remain in the books after any change of the partnership constitution.

The stock value at 31st October has been calculated and all other accounts balanced off, including provisions for depreciation, accrued expenses and prepaid expenses. This results in the following position at 31st October:

Buildings ₹ 17,000; Equipment (including additions ₹ 400) ₹ 3,480; Stock ₹ 1,100; Debtors ₹ 2,230; Bank balance ₹ 3,370; Creditors ₹ 980.

There were no additions to, or reductions of, the capital accounts during the four months, but the following drawings have been made : A ₹ 2,000; B ₹ 1,600; C ₹ 1,800.

B has also been agreed that the share should be repaid in three equal instalments, the first payment being made as on the day after the day of death.

The surviving partners agree that D (son of A) should be admitted as a new partner w.e.f 1st November, and it is agreed that he will bring into the business ₹ 4,000 as his capital together with a premium for his share of the goodwill using the existing valuation. The new profit-sharing agreement is B : 2/5th; C : 2/5th and D 1/5th.

Required : (a) Show the partnership Balance Sheet as at 1st November, 2014, on the assumption that the above transactions have been completed by that date.

Solution

Working Notes : (1) Statement showing the Profit for the period from 1.7.2014 to 31.10.2014

Particulars	₹
Combined capital as on 31.10.2014 (assets – liabilities) [₹ 17,000 + 3,480 + 1,100 + 2,230 + 3,370 – 980]	26,200
Add: Combined drawings for the period [₹ 2,000 + 1,600 + 1,800]	5,400
	31,600
Less: Combined capital as on 1.7.2014 (Capital and Current Accounts) [₹ 9,000 + 8,000 + 8,000 + 140 + 200 – 100]	25,240
Profit for the period	6,360

(2) Statement showing the Adjustment in regard to Premium for Goodwill

Particulars	A (₹)	B (₹)	C (₹)	D (₹)
Right of goodwill before A's death (1 : 1 : 1)	2,500	2,500	2,500	—
Right of goodwill after D's admission (2 : 2 : 1)	—	3,000	3,000	1,500
Premium to be received (–) / paid (+)	(–) 2,500	(+) 500	(+) 500	(+) 1,500

Dr. (3) Partners' Capital Accounts Cr.

Particulars	A	B	C	D	Particulars	A	B	C	D
To A Capital — goodwill	—	500	500	1,500	By Balance b/d	9,000	8,000	8,000	—
To Executors of A A/c	11,500	—	—	—	By B Capital — goodwill	500	—	—	—
To Balance c/d	—	7,500	7,500	4,000	By C Capital — goodwill	500	—	—	—
					By D Capital — goodwill	1,500	—	—	—
					By Bank A/c — capital & premium	—	—	—	5,500
	11,500	8,000	8,000	5,500		11,500	8,000	8,000	5,500

Dr. (4) Partners' Current Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
To Balance b/d	—	—	100	By Balance c/d	140	200	—
To Drawings	2,000	1,600	1,800	By Share of Profit A/c	2,120	2,120	2,120
To Executors of A A/c	260	—	—				
To Balance c/d	—	720	220				
	2,260	2,320	2,120		2,260	2,320	2,120

Balance Sheet as at 1st November, 2014

Liabilities		₹	Assets	₹
Capital Account — B	7,500		Buildings	17,000
Capital Account — C	7,500		Equipment	3,480
Capital Account — D	4,000	19,000	Stock	1,100
Current Account — B	720		Debtors	2,230
Current Account — C	220	940	Bank [₹ 3,370 + 5,500 – (1/3 x 11,760)]	4,950
Executors of A [2/3 x (₹ 11,500 + 250)]		7,840		
Creditors		980		
		28,760		28,760

Key Points

- Surrender value is the amount receivable on a life insurance policy that is cancelled before the end of its term.
- In case of a "without profits" policy, the holder will get only the amount specified in the policy. In case of a 'with profits' policy, the holder will get the amount specified in the policy *plus bonuses declared on each valuation.*

THEORETICAL QUESTIONS

1. What problems arise when a partner dies ? As an accountant, how will you deal with them?
2. Why do the partners take a Joint Life Policy ? What are the different methods adopted for accounting Joint Life Policy?
3. What is surrender value? When is it paid ?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below.

1. Joint life policy premium will be treated as
   A a personal expenses of the partners
   B an operating loss of the firm
   C an expense of the firm
   D an appropriation of profit
2. At the time of death of a partner if there is undistributed profit in the Balance Sheet of the firm, it
   A will not be distributed amongst the partners
   B will be distributed in the capital ratio
   C will be distributed amongst the surviving partners only
   D will be distributed in the old profit sharing ratio amongST all the partners
3. Upon death, the amount of joint life policy should be distributed
   A amongst all partners in the old ratio
   B amongst continuing partners in the old ratio
   C to the executors of the deceased
   D amongst continuing partners in the new ratio
4. The executors of deceased partners are entitled to the share of goodwill as per the
   A agreement between the partners
   B profit sharing ratio
   C capital ratio
   D equally
5. Which of the following is true ?
   A Due to death of a partner, the profit sharing ratio between the old partners does not change
   B The death of a partner dissolves the old partnership firm
   C A joint life policy matures on the happening of the first death
   D The premium paid on a joint life policy is charged against capital of the partners
6. Which of the following is not true ?
   A When premium payable on the policy taken on the life of partners is treated as an asset, the amount of premium is debited to the joint life policy account and credited to bank account
   B When the premium paid on the policy taken on the life of partners is treated as an asset and reserve is to be maintained, then at the end of the accounting year, an amount equal to the premium is debited to profit and loss appropriation account
   C When the premium paid on the policy taken on the life of partners is treated as an asset and a joint life policy reserve is to be maintained, then the reserve account appears on the assets side of the balance sheet
   D Joint life policy reserve account is in the nature of an accumulated profit
7. Which of the following is true ?
   A A joint life policy is always shown as an asset
   B A joint life policy is never shown as an expense
   C A joint life policy reserve is an external transaction
   D The creation of a joint life policy reserve reduces the divisible profit
8. Which of the following is true ?
   A Revaluation account is unaffected when an unrecorded asset is taken over by the executors of a deceased partner
   B Revaluation account is debited at the decrease in the value of creditors at the death of a partner
   C Revaluation account is credited when an unrecorded asset is sold on the death of a partner
   D Revaluation account is unaffected when revaluation expenses are paid by a partner

PRACTICAL QUESTIONS

1. A and B sharing profits and losses in the ratio of 3 : 2 took out joint life policy on January 1, 2011 for ₹ 20,000. The annual premium payable on the policy was ₹ 2,000. The surrender value is nil in the first year but thereafter it increases by ₹ 1,600 per annum. On December 31, 2014 A dies. Show the Policy Account and Policy Reserve Account in the books of the firm from 2011 to 2014.
2. A and B, sharing profits in the ratio of 3 : 2, took out a joint life policy on 1st January, 2012 of ₹ 20,000 for 20 years paying annual premium of ₹ 1,000. The surrender values were : 2012 : ₹ nil; 2013 : ₹ 200; 2014 : ₹ 550; 2015: ₹ 970. B dies on 8th March, 2015 and claim was received on 30th April, 2015. Prepare Joint Life Policy Account and Joint Life Policy Reserve Account.
3. A and B are in partnership sharing profits and losses in the ratio 3 : 2. They insure their lives jointly for ₹ 75,000 at an annual premium of ₹ 3,500 to be debited to the business. B died three months after the date of the last Balance Sheet. According to the partnership deed the legal personal representatives of B are entitled to the following payments: (a) his capital as per the last Balance Sheet; (b) interest on above capital @ 3 per cent per annum to the date of death; (c) his share of profits to the date of death calculated on the basis of last year's profits; and (d) his drawings are to bear interest at an average rate of 2% on the amount irrespective of the period. The net profits for the last three years, after charging insurance premium, were ₹ 20,000, ₹ 25,000 and ₹ 30,000 respectively. B's capital as per last Balance Sheet was ₹ 40,000 and his drawings to the date of death were ₹ 5,000. Draw B's Account to be rendered to his representatives.
4. A, B and C carried on business in the partnership sharing profits as 3 : 2 : 1. The Balance Sheet on 31st December, 2014 showed their capitals to be : A ₹ 10,400; B ₹ 5,000; C ₹ 3,000. On 28th February, 2015 A died and you are required to prepare necessary accounts for presentation to his executors having regard to the following facts :
   (i) The firm had insured the partners' lives severally, A for ₹ 9,000; B for ₹ 4,800; and C for ₹ 2,400. The premiums have been charged to Profit and Loss Account and the surrender value on 28th February 2015 amounted in each case to one-fourth of the sum assured;
   (ii) Capital carried interest at 5% p.a.;
   (iii) A's drawings from 1st January, 2015 to the date of his death amounted to ₹ 1,200;
   (iv) A's share of profits for the portion of the current financial year for which he lived was to be taken at the sum calculated on the average of the last three completed years and Goodwill was to be valued on the basis of two years' purchase of the average profits of those three years. The annual profits were ₹ 9,200; ₹ 7,400 and ₹ 8,600 respectively.
5. A, B and C were partners sharing profits in the proportion of one-half, one-fourth and one-fourth respectively. Their Balance Sheet on 31st December, 2014 was as follows :

Liabilities	₹	Assets	₹
Sundry Creditors	4,000	Cash	1,000
A's Capital	10,000	Sundry Debtors	4,500
B's Capital	6,000	Stock-in-Trade	5,500
C's Capital	4,000	Loan to A	3,000
		Freehold Property	10,000
	24,000		24,000

A died on 1st January, 2015. The firm had affected an assurance of ₹ 10,000 on the joint lives of the three partners and the amount on the policy was realised on 1st February, 2015. According to the partnership agreement, the goodwill was to be calculated at two years' purchase of average profits of three completed years preceding the death or retirement of a partner. The deceased partner's share of capital and goodwill, etc., was paid out in cash on 1st March, 2015, the available cash balance being supplemented by a loan from the firm's bankers on the security of the freehold property. The net profits of the years 2012, 2013 and 2014 were ₹ 5,500, ₹ 4,800 and ₹ 6,600 respectively. You are required to show the Ledger Accounts of the partners and the Balance Sheet of B and C as it would stand after A's share is paid out. (Ignore interest)

6. A, B and C are partners sharing profits and losses in the proportion of 3 : 2 : 1 and their Balance Sheet on 31st December, 2014 stood as under :

Liabilities		₹	Assets	₹
Bills Payable		7,560	Cash in hand	250
Creditors		12,300	Bank	960
Reserve		3,000	Debtors	7,450
Capitals :			Bills Receivable	3,300
A	10,000		Stock	12,470
B	6,000		Investment	10,430
C	4,000	20,000	Buildings	8,000
		42,860		42,860

B died on 28th February 2015 and according to the deed of partnership, his executors are entitled to be paid as under:

(i) The capital to his credit at the time of his death and interest upon the time of his death at 6% p.a.

(ii) His proportionate share of Reserve.

(iii) His share of profit for the period based on the figure of the previous year.

(iv) Goodwill according to his share of profits to be calculated by taking twice the amount of the average profits of the last three years. The profits of the previous years were : 2012 : ₹ 7,800; 2013 : ₹ 9,000; and 2014 : ₹ 9,600.

The investments were sold for ₹ 16,200 and his executors were paid out. Pass the necessary Journal Entries and write the account of the executors of B.

7. The partnership agreement of a firm consisting of three partners A, B and C who share profits and losses in the ratio of 2 : 1 : 1 and whose fixed capital are ₹ 10,000; ₹ 6,000 and ₹ 4,000 respectively, provide as follows :

(a) That partners be allowed interest @ 10% p.a. on their fixed capitals, but no interest be allowed on undrawn profits or charged on drawings.

(b) That, upon the death of a partner, the goodwill of the firm be valued at two years' purchase of the average net profits (after charging interest on capital) for the three years to 31st December preceding the death of a partner.

(c) That an insurance policy of ₹ 10,000 each to be taken in individual names of each partner, the premium to be charged to the profit of the firm.

(d) That, upon the death of a partner, he be credited with his share of the profits, interest on capital, etc., calculated upon 31st December, following his death.

(e) That, the share of the partnership policy and goodwill be credited to a deceased partner as on 31st December following his death.

(f) That the partnership books be closed annually on 31st December.

A died on 30th September, 2014, the amount standing to the credit of his Current Account on 31st December, 2013, was ₹ 450 and from that date to the date of death he had withdrawn ₹ 3,000 from the business.

An unrecorded liability of ₹ 2,000 was discovered on 30th September, 2013. It was decided to record it and be immediately paid-off.

The trading results of the firm (before charging interest on capital) had been as follows : 2011 : profit ₹ 9,640; 2012: profit ₹ 6,720; 2013 : loss ₹ 640; and 2014 : profit ₹ 3,670.

Assuming the surrender value of the policy to be 20% of the sum assured, you are required to prepare an account showing the amount due to A's legal representative as on 31st December, 2014.

8. A and B are partners. The Partnership deed provides, ***inter alia***, that:

1. The accounts be balanced on December 31 every year.
2. The profits be divided 1/2 to A 1/3 to B and 1/6 carried to a Reserve Account.
3. In the event of the death of a partner, his executors be entitled to be paid out :

(a) the capital to his credit at the date of death;

(b) his portion of the reserve at the date of last Balance Sheet;

(c) his portion of profits upto the date of death based on the average profits of the last three completed years; and

(d) his portion of the total profit for the three preceding years by way of goodwill.

On December 31,2014, the Ledger Balances were :

	Dr.	Cr.
A Capital A/c		90,000
B Capital A/c		60,000
Reserve		30,000
Creditors		30,000
Bills Receivable	20,000	
Investment	50,000	
Cash	1,40,000	
	2,10,000	2,10,000

The profits of the three preceding years were: 2012—₹ 42,000; 2013—₹ 39,000; and 2014—₹ 45,000.

B dies on May 1, 2015. Show the account between the firm and B's executors as on May 1, 2015.

9. The firm of P, Q and R, who share profits and losses in the ratio of 2:2:1, took out, joint supervisorship policy on 10th January, 2012 for ₹ 25,000 in order to provide a fund for repayment of a deceased partner's share. The last annual premium of ₹ 625 was paid on 10th January, 2015 and Q died on 15th February, 2015.

The surrender values of the policy were as follows :

in 2012—Nil, in 2013—₹ 175, in 2014—₹ 300. The policy amount was realized in full on Q's death.

Show the Joint Life Policy Account in firm's books which are closed on 31st December, each year.

10. A and B entered into partnership on 1.1.2012, the former introducing a capital of ₹ 90,000 and the latter ₹ 30,000. They effect a policy of insurance for ₹ 45,000 upon their joint lives in order to enable the survivor, in case of death of one, to pay out in cash part of the other's interest. The net profits before charging interest on capital as at the beginning of each year at 6% p.a. and on drawings (averaged at 4% p.a.) were as follows:

Year	Net profit (₹)	A's Drawings (₹)	B's Drawings (₹)
2012	34,800	10,000	5,000
2013	37,628	12,000	7,000
2014	38,100	14,000	7,500

Profits and losses were divided between A and B in the ratio of 2:1 respectively. The annual insurance premium which is ₹ 3,600 is charged to profit and loss account as a business expense. On 31.3.2015, A died. According to the terms of the partnership deed, the deceased partner's executors are entitled to receive his share of the capital as it stood on 31.12.2014 plus the three months share of the profit, calculated upon the previous year's rate of profit and share of goodwill which is reckoned at two-thirds of the previous three years' profits after adjusting for interest on capital and drawings but without deducting the premiums paid on the joint life insurance policy.

Make up A's Account showing the amount for which B shall be liable to account to his executors.

Workings of adjusted net profits and computation of A's share of goodwill will be considered as a part of the answer. Calculations are to be made to the nearest rupee ignoring fractions, wherever arising.

11. For some years, X has been carrying on proprietorship business with a capital of ₹ 77,500 and his accounts are closed annually on 31st March.

On 1st April, 2012 Y joined him as a partner with 1/3rd interest in the profit and goodwill. Y introduced a sum of ₹ 40,000 on account of capital and it was agreed that X be credited with goodwill of ₹ 22,500.

The deed of partnership provided inter alia:

(a) Capital and Current Account kept separately; (b) Drawings be—X ₹ 3,600 per month, Y ₹ 2,000 per month including salary as mentioned below; (c) Y be allowed salary of ₹ 6,000 per annum; and (d) Interest be allowed on capitals at 5% per annum.

On the death of a partner, executors be entitled to: (a) Balance of capital and current accounts; (b) Interest on capital and salary upto the date of death; (c) Accruing share of profit to be based on the profits for the completed year immediately preceding thedate of death; and (d) Share of goodwill, the value of which is to be calculated at two years' purchase of the average profits (after charging interest on capital and partner's salary) for 3 completed years immediately precedingthe date of death.

Profits before charging interest on capital and partner's salaries were given as: Year ending 31st March, 2013, ₹ 67,000, year ending on 31st March, 2014—₹ 70,000; and year ending 31st March, 2015—₹ 77,000.

On 30th September, 2014 Y introduced additional capital of ₹, 16,000.

Y died on 30th June, 2015. It was ascertained that upto 31st March 2015, he had drawn the amount as mentioned in (b) above and from 1st April, 2015 to the date of death his drawings had been ₹ 5,500.

Prepare:

(i) Profit and Loss Appropriation Account for each of the three years ending 31st March, 2013, 2014, 2015;

(ii) Y's Capital and Current Accounts to show respective balances on 31st March, 2015; and (iii) A chart showing computation of the amount due to the executor of the deceased as on 30th June, 2015.

Guide to Answers

Multiple Choice

1. C 2. D 3. A 4. A 5. C 6. C 7. D 8. C

Practical Questions

3. **Share of profit ₹ 3,000; Amount due to B's Executors ₹ 68,200.**
4. **Share of profit ₹ 700; Share of Goodwill ₹ 8,400; Amount due to A's Executors ₹ 23,787.**
5. **Amount due to A's Executors ₹ 17,634; Balance Sheet ₹ 25,634.**
6. **Amount due to B's Executors ₹ 13,460.**
7. **Share of profit ₹ 835; Share o f Goodwill ₹ 3,240; Share of Joint Life Policy ₹ 7,000; Amount due to A's Executors ₹ 18,525.**
8. **A's share of goodwill ₹ 38,800; Closing capital ₹ 3,00,000 – Opening capital ₹ 2,40,000 = ₹ 60,000 + Drawings ₹ 1,72,800 = ₹ 2,32,800 (Net profit for 6years). Amount payable ₹ 1,77,200.**
9. **B's share of profit ₹ 5,600; B's share of goodwill ₹ 50,400; Amount payable to B's Executor ₹ 1,28,000.**
10. **A's share of goodwill ₹ 42,957; Amount payable to A's Executors ₹ 2,09,488.**
11. **Profit after charging interest on capital and partners' salaries : 2013 — ₹ 54,000; 2014 — ₹ 57,000; 2015 — ₹ 63,600. Amount payable to Executors of Y ₹ 99,867.**

31

Accounting for Dissolution of the Firm

Introduction

Technically, a partnership is terminated or dissolved whenever a new partner is admitted or an old partner retires or dies. The formation or dissolution of a partnership, however, does not necessarily indicate that the business is to be discontinued. The business may be continued without interruption, if the remaining partners resolve in its favour.

The process of breaking up and discontinuing a Partnership business is called ***Dissolution of the firm***. The dissolution of the firm spells an end to the business.

Dissolution by the Partners

The partnership firm may be dissolved by the partners mutually for the following reasons:

1. A business may be formed for a fixed term or for a specific purpose, and is wound up at the end of that term or when that purpose has been achieved.
2. A sharp fall in sales revenue due to changes in technology and product obsolescence may force the partners to dissolve the firm.
3. A continuous high demand for firm's products may tempt the partners to dissolve the firm and to form a limited company for additional capital and limited liability.
4. Sudden death or retirement of a partner may force other partners to dissolve the firm.
5. The business of the firm may become illegal and it may be required to dissolve the firm.

Dissolution by the Court

Section 44 of the Indian Partnership Act states that:

At the suit of a partner, the court may dissolve a firm on any of the following grounds, namely :

(a) that a partner has become of unsound mind in which case, the suit may be brought as well by the next friend of the partner who has become of unsound mind as by any other partner;

(b) that a partner, other than the partner suing, has become in any way permanently incapable of performing his duties as partner;

(c) that a partner, other than the partner suing, is guilty of misconduct which is likely to affect prejudicially the carrying on the business, regard being had to the nature of the business;

(d) that a partner, other than the partner suing, willfully or persistently commits breach of agreements relating to the management of the affairs of the firm or the conduct of its business; or, otherwise so conduct himself in matters relating to the business that it is not reasonably practicable for the other partners to carry on the business in the partnership with him;

(e) that a partner, other than the partner suing, has in any way transferred the whole of his interest in the firm to a third party or has allowed his share to be charged under the provisions of rule 49 of Order XXI of the First Schedule to the Code of Civil Procedure, 1908; or has allowed it to be sold in the recovery of arrears of land-revenue or of any dues recoverable as arrears of land-revenue due by the partner;

(f) that the business of the firm cannot be carried on without a loss; or

(g) on any other ground which renders it just and emitable that the firm should be dissolved.

Steps in the Dissolution Process

1. The ***first step*** in the dissolution process is to prepare a Balance Sheet of the firm as on the date of dissolution. Where both the date of dissolution and the date of Balance Sheet are same, no fresh Balance Sheet is required to be prepared. At the time of preparing the Balance Sheet on the date of dissolution, the effect of all transactions between the date of last Balance Sheet and the date of dissolution must be taken into consideration. [***See Illustration 15, page 1.22***]
2. In the ***next step*** of the dissolution process, non-cash assets that are not acceptable for distribution in their present form are sold and converted into cash. If the realised sales value is more than the book value of the assets, there is a gain from the sale. If it is less than the book value, it will be a loss. Procedurally, gains and losses on the realisation of assets is collected in one account (known as Realisation Account). The balance of the Realisation Account is transferred to Partners' Capital/ Current Accounts in the agreed profit-sharing ratio before any cash is distributed to them. In the preceding chapters, we have seen that we prepare a Revaluation Account when the assets are retained in the partnership, on the occasion of admission or retirement or death. In case of dissolution, instead of a Revaluation Account, a Realisation Account is prepared because the assets are to be sold or realised.
3. The ***last step*** in the dissolution is to distribute the available cash to creditors and partners.

Settlement of Accounts

Section 48 of the Indian Partnership Act,1932 states that:

"In settling the accounts of a firm after dissolution, the following rules, subject to the agreement by the partners, shall be observed:

(a) Losses, including deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly, if necessary, by the partners individually in the proportions in which they were entitled to share profits.

(b) The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital, shall be applied in the following manner and order:
- (i) in paying the debts of the firm to third parties;
- (ii) in paying each partner rateably what is due to him from the firm for advances as distinguished from capital;
- (iii) in paying to each partner rateably what is due to him on account of capital; and
- (iv) the residue, if any, shall be divided among the partners in the proportions in which they were entitled to share profits."

Accounting Entries for Dissolution

On the dissolution of a partnership firm, the work that has to be done is divided into two sections :

(a) Realisation of assets and settlement of liabilities, and

(b) Settlement of the accounts of the partners.

(a) Realisation of Assets and Settlement of Liabilities

Whatever may be the reason for dissolving the partnership, the accounts have to be closed. A special account — called a ***Realisation Account*** — is used to record the closing transactions, showing the net gain or loss that has resulted from the realisation of assets and settlement of liabilities.

1. To close the various assets accounts

All the tangible assets appearing in the Balance Sheet (awaiting realisation) are all having debit balances. These assets are closed by transferring to the Realisation Account by crediting them at their respective book values. The following entry is passed:

Realisation Account	Dr.
To Land and Buildings Account	
To Plant and Machinery Account	
To Furniture and Fixture Account	
To Stock Account	
To Sundry Debtors Account	

In this connection, we are to remember the following:

(i) Cash or Bank Account will not be transferred to Realisation Account because they are not to be realised — they can be distributed in their present form instead. A separate Cash and Bank Account will be opened with the balance as appearing in the last Balance Sheet. Students should remember that bank overdraft will not be transferred to Realisation Account. However, Bank Loan Account must be transferred to Realisation Account.

(ii) Sometimes, in the Balance Sheet some assets are shown at their net realisable market values or some assets at their unexpired portion. The example for the former is:

Sundry Debtors	₹ 40,500
Less : Provision for doubtful debts	₹ 500
	₹ 40,000

The example for the other is provision for depreciation, which appears as under:

Asset (at Cost)	₹ 1,00,000
Less : Provision for depreciation	₹ 10,000
	₹ 90,000

In fact, the accounts like provision for doubtful debts or provision for depreciation, etc, are called ***Valuation Accounts*** or ***Contra-Asset Accounts***. They are having credit balances and they should appear in the liability side of a Balance Sheet. But they appear on the debit side as a deduction from the main Asset Account . The assets should be transferred to the debit side of the Realisation Account at the ***gross figures*** and provisions should be transferred to the credit side of the Realisation Account.

For example, to close Sundry Debtors and provisions for doubtful debts, following entries are to be passed:

Realisation Account	Dr. ₹ 40,500	
To Sundry Debtors Account		₹ 40,500
Provision for Doubtful Debts Account	Dr. ₹ 500	
To Realisation Account		₹ 500

Similarly, to close an asset and Provisions for Depreciation Account following two entries will be passed:

Realisation Account	Dr. ₹ 1,00,000	
To Plant and Machinery Account		₹ 1,00,000
Provision for Depreciation Account	Dr. ₹ 10,000	
To Realisation Account		₹ 10,000

2. To close the various outside liabilities accounts

The various outside liabilities awaiting final settlement are to be transferred to the Realisation Account at the book values. The following entry is passed:

Sundry Creditors Account	Dr.
Bills Payable Account	Dr.
Outstanding Expenses Account	Dr.
Bank Loan Account	Dr.
To Realisation Account	

3. When the assets are sold

The proceeds or the amounts received on the sale of the assets are credited to Realisation Account and debited to Cash or Bank Account.

The following entry is passed:

Cash/Bank Account	Dr.		
To Realisation Account			

4. When some of the assets are taken over by a partner/partners

One or more of the assets may be taken over by a partner or by the partners at agreed valuation. When a partner (partners) takes over any asset, the claim of Capital Account is reduced by the taken over value of the assets. . The following entry is passed:

Partner's Capital Account	Dr. [Agreed value]		
To Realisation Account			

5. When outside liabilities of the firm are settled

After realisation of assets, the outside liabilities must be paid off first. The following entry is passed:

Realisation Account	Dr. [Actual amount paid]		
To Cash/Bank Account			

6. When some of the assets are taken over by creditors

No entry is required to be passed for assets taken over by the creditors. The actual amount paid to creditors (after adjusting the agreed value of the assets) to be debited to Realisation Account. For example, amount due to the creditors is ₹ 50,000. The creditors agree to take over a machinery of ₹ 40,000 at an agreed value of ₹ 35,000. The balance amount paid to the creditors in cash.

In this case journal entry will be:

Realisation Account (₹ 50,000 – ₹ 35,000)	Dr.	₹ 15,000	
To Cash Account			₹ 15,000

7. When unrecorded liabilities are paid

At the time of dissolution, if a liability exists which has not been recorded in the books, will have a priority over payment to partners along with other creditors .

At the time of payment the following entry is to be passed:

Realisation Account	Dr.		
To Bank Account			

8. When one of the partners agrees to discharge a liability personally

Without paying off one of the creditors directly, one of the partners may take the responsibility to settle the creditors. In such a case, Realisation Account is debited and Partner's Capital Account is credited. The effect is that the claim of the partner against the firm is increased by the amount of liability assumed. The following entry will be passed:

Realisation Account	Dr. [Assumed amount of liability]		
To Partner's Capital Account			

9. When dissolution expenses are incurred

Some expenses are definitely to be incurred during the process of liquidation. This is a loss to the firm and each partner must share this loss. Dissolution expenses must have a priority over payment to creditors. When one of the partners takes the responsibility of meeting the realisation expenses, generally a fixed sum is credited to his Capital Account. In such a case, the partnership firm has nothing to do with the actual expenses incurred by the partner towards realisation expenses (unless otherwise agreed).

The following entry will be passed:

(i) Realisation Account	Dr.		
To Cash/Bank Account			
or			
(ii) Realisation Account	Dr. [Agreed amount]		
To Partners' Capital Accounts			

10. For closing the Realisation Account

After passing all the above entries the Realisation Account is balanced and the balance is transferred to the Partners' Capital Accounts in their profit-sharing ratio. If a credit balance exists in the Realisation Account, it shows a net profit on realisation. It will be a net loss on realisation, when it shows a debit balance. The following entry will be passed according to the situation:

(i) For Profit		*(ii) For Loss*	
Realisation Account	Dr.	Partners' Capital Accounts	Dr.
To Partners' Capital Accounts		To Realisation Account	

(b) Settlement of the Accounts of the Partners

After closing the Realisation Account and transferring the balance to the Partners' Capital Accounts, the next step is to settle the accounts of the partners among themselves. Since all the tangible assets and liabilities accounts are closed, the Balance Sheet leaves only the following accounts:

Liabilities	₹	Assets	₹
Partners' Capital A/cs		Preliminary Expenses A/c	
Partners' Current A/cs		Advertisement Suspense A/c	
Partners' Loan A/cs		Profit & Loss A/c (Dr.)	
General Reserve		Partners' Capital A/cs (overdrawn)	
Investment Fluctuation Fund A/c		Partners' Current A/cs (overdrawn)	
Joint Life Policy Fund A/c		Partners' Loan A/cs	

1. First Partners' Capital Accounts are to be opened with the balances as are appearing in the Balance Sheet on the date of dissolution. When the partners are maintaining ***fixed capital method***, Current Accounts balances are closed by transferring to the respective Capital Accounts of the Partners by passing the following entry:

   Partners' Current Accounts Dr.
   To Partners' Capital Accounts

   For a debit Current Account balance, the entry will be:

   Partners' Capital Accounts Dr.
   To Partners' Current Accounts

2. Secondly, if there is any Reserve/Joint Life Policy/Investment Fluctuation Fund or Profit or Loss Account (Cr.) balance in the Balance Sheet, these should be transferred to the Partner's Capital Accounts in the profit-sharing ratio. The entry will be:

   Reserve Fund/Profit and Loss Account/Investment Fluctuation Fund Account Dr.
   Joint Life Policy Fund Account Dr.
   To Partners' Capital Accounts

Conversely, if there are any fictitious assets in the Balance Sheet like Profit and Loss Account (Dr.) balance, preliminary expenses, advertisement suspense, etc, these should be debited to Partners' Capital Accounts in the profit-sharing ratio. The entry will be:

Partners' Capital Accounts Dr.
To Preliminary Expenses Account
To Advertisement Suspense Account
To Profit and Loss Account (Dr.)

3. If the Partner has advanced any loan to the business, a Partner's Loan Account will be opened with the balance appearing in the Balance Sheet.
4. Finally, the Capital Accounts of the Partners are to be closed. The way this is done depends on the solvency of the partners. Following are the three cases to be considered in this regard. The procedure of closing the Partners' Capital Accounts will be different in each of the following cases:

Case 1 : Where all the partners are solvent.

Case 2 : Where some of the partners are solvent and others are insolvent.

Case 3 : Where all the partners are insolvent.

Case 1 : Where All the Partners are Solvent

(i) Where all the partners are solvent, the loan from any partner is to be paid first. The entry will be:

Partners' Loan Account Dr.
    To Bank/Cash Account

If a partner has taken any loan from the firm, he is required to bring in the amount in cash to the business. The entry will be:

Bank Account Dr.
    To Partner Loan Account

(ii) Thereafter, Partners' Capital Accounts are to be balanced. If one of the Partner's Capital Account shows a debit balance, the respective partner is to bring in the required amount to the business to make up his deficiency. The entry will be:

Cash/Bank Account Dr.
    To Partner's Capital Account

The final payment is to be made to partners having credit balance in their Capital Accounts .The entry will be:

Partners' Capital Accounts Dr.
    To Cash/Bank Account

After the claim of the partners are settled, there will be no balance in the Cash/Bank Account.

Illustration 1

A, B and C are partners in a firm sharing profits and losses in the ratio of 3:2:1. They decided to dissolve the partnership business as on 31st December, 2014. Following is the Balance Sheet on the date of dissolution :

Liabilities	₹	Assets	₹
Capitals :		Machinery	31,000
A	20,000	Furnitures	3,000
B	10,000	Stock	10,000
C	2,000	Debtors	6,000
Bank overdraft	6,000		
Sundry creditors	12,000		
	50,000		50,000

The following assets were realised in cash: Machinery at ₹ 22,000; 50% of the stock at ₹ 3,500; and Debtors were collected at 15% less than their book values. Remaining 50% of the stock was taken over by A at ₹ 3,200. Furniture was taken over by B at ₹ 2,400. Realisation expenses were ₹ 300.

Pass necessary Journal Entries to close the books of the firm and also prepare Realisation Account, Bank Account and Partners' Capital Accounts.

Solution **Journal** **Dr.** **Cr.**

Date	Particulars		₹	₹
2014	Realisation A/c	Dr.	50,000	
Dec. 31	To Machinery A/c			31,000
	To Furniture A/c			3,000
	To Stock A/c			10,000
	To Debtors A/c			6,000
	(Being the transfer of various assets to Realisation Account at book values on dissolution of the firm)			
	Sundry Creditors A/c	Dr.	12,000	
	To Realisation A/c			12,000
	(Being the transfer of Sundry Creditors Account to Realisation Account at book value on dissolution of the firm)			
	Bank A/c	Dr.	30,600	
	To Realisation A/c			30,600
	(Being the realisation of various assets)			
	Realisation A/c	Dr.	12,000	
	To Bank A/c			12,000
	(Being the liability to sundry creditors discharged by payment)			
	Realisation A/c	Dr.	300	
	To Bank A/c			300
	(Being the payment of realisation expenses)			

A Capital A/c	Dr.	3,200	
B Capital A/c	Dr.	2,400	
To Realisation A/c			5,600
(Being the assets taken over by the partners)			
A Capital A/c	Dr.	7,050	
B Capital A/c	Dr.	4,700	
C Capital A/c	Dr.	2,350	
To Realisation A/c			14,100
(Being loss on realisation transferred to Partners' Capital Accounts in the profit-sharing ratio)			
Bank A/c	Dr.	350	
To C Capital A/c			350
(Being the amount brought in by C to make up deficiency of his Capital Account)			
A Capital A/c	Dr.	9,750	
B Capital A/c	Dr.	2,900	
To Bank A/c			12,650
(Being the final payment to partners on dissolution)			

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014	To Machinery A/c	31,000	2014	By Sundry Creditors A/c	12,000
Dec. 31	To Furniture A/c	3,000	Dec. 31	By Bank A/c (assets realised)	30,600
	To Stock A/c	10,000		By A Capital A/c (stock taken over)	3,200
	To Debtors A/c	6,000		By B Capital A/c (furniture taken over)	2,400
	To Bank A/c (sundry creditors paid)	12,000		By Partners' Capital A/cs (loss):	
	To Bank A/c (expenses)	300		(A—₹ 7,050; B—₹ 4,700; C—₹ 2,350)	14,100
		62,300			62,300

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014	To Realisation A/c	30,600	2014	By Balance b/d (Note 1)	6,000
Dec. 31	To C Capital A/c	350	Dec. 31	By Realisation A/c (payment to creditors)	12,000
				By Realisation A/c (expenses)	300
				By Capital A/c (A—₹ 9,750; B—₹ 2,900)	12,650
		30,950			30,950

Dr. **Partners' Capital Accounts** **Cr.**

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2014	To Realisation A/c	3,200	2,400	—	2014	By Balance b/d	20,000	10,000	2,000
Dec 31	To Realisation A/c (loss)	7,050	4,700	2,350	Dec 31	By Bank A/c	—	—	350
	To Bank A/c	9,750	2,900	—					
		20,000	10,000	2,350			20,000	10,000	2,350

Working Note : (1) Bank overdraft represents adverse balance in the Bank Account. Therefore, it should not be transferred to Realisation Account.

Illustration 2

A, B and C are in partnership sharing profits and losses in the ratio of 5:3:2. They decide to dissolve their partnership and the Balance Sheet at the date of the dissolution is as follows :

Liabilities	₹	Assets		₹
Sundry creditors	6,000	Freehold property		52,000
Bills payable	3,000	Plant		30,000
Bank overdraft	1,500	Stock in trade		40,000
Reserve fund	5,000	Furniture		5,000
Capital — A	53,500	Sundry debtors	17,500	
Capital — B	44,100	Less: Provision for bad debts	500	17,000
Capital — C	39,400	Cash in hand		8,500
	1,52,500			1,52,500

A is to take the freehold property at ₹ 35,000, B is to take the stock-in-trade at ₹ 35,000 and C is to take furniture at ₹ 3,000. Sundry debtors realised ₹ 16,000 and Plant realised ₹ 40,000. Cost of dissolution was ₹ 2,000. Close the books of the firm showing the Realisation Account, Capital Accounts and Cash Account.

Solution

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Freehold property A/c	52,000		By Provision for bad debt A/c	500
	To Plant A/c	30,000		By Sundry creditors A/c	6,000
	To Stock-in-trade A/c	40,000		By Bills payable A/c	3,000
	To Furniture A/c	5,000		By Partners' Capital A/cs:	
	To Sundry Debtors A/c	17,500		A (freehold property taken over)	35,000
	To Cash A/c (expenses)	2,000		B (stock taken over)	35,000
	To Cash A/c (sundry creditors paid)	6,000		C (furniture taken over)	3,000
	To Cash A/c (bills payable paid)	3,000		By Cash A/c (assets realised)	56,000
				By Partners' Capital A/cs: (loss)	
				(A : 8,500; B : 5,100; C : 3,400)	17,000
		1,55,500			1,55,500

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
	To Realisation A/c	35,000	35,000	3,000		By Balance b/d	53,500	44,100	39,400
	To Realisation A/c (loss)	8,500	5,100	3,400		By Reserve fund A/c	2,500	1,500	1,000
	To Cash A/c (final payment)	12,500	5,500	34,000					
		56,000	45,600	40,400			56,000	45,600	40,400

Dr. Cash Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/f	8,500		By Bank overdraft A/c	1,500
	To Realisation A/c: (assets realised)			By Realisation A/c (expenses)	2,000
	Sundry debtors	16,000		By Realisation A/c (liabilities paid)	9,000
	Plant	40,000		By A Capital A/c	12,500
				By B Capital A/c	5,500
				By C Capital A/c	34,000
		64,500			64,500

Tutorial Note : Sundry debtors should be transferred to Realisation Account at its gross figure, i.e., ₹ 17,500 and Provision for Bad Debts should be transferred to the credit side of the Realisation Account.

Illustration 3

X, Y and Z are in partnership sharing profits and losses equally. They decided to dissolve the partnership on 1st October, 2014 on which date the Balance Sheet of the firm was as follows :

Liabilities	₹	Assets	₹
Capital : X	20,000	Premises	25,650
Capital : Y	12,000	Machinery	10,800
Reserve	6,000	Stock	8,420
Sundry creditors	20,260	Sundry debtors	15,800
Bank loan	5,120	Bills receivable	850
		Capital : Z	1,280
		Cash at bank	580
	63,380		63,380

The assets realised the following amounts : Premises ₹ 16,000; Machinery ₹ 10,000; Stock ₹ 9,000; Debtors ₹ 15,000; Bills receivable ₹ 850. The goodwill was sold for ₹ 2,500. Discount amounting to ₹ 260 were allowed by creditors while paying their claims. The expenses of realisation amounted to ₹ 540. During the course of dissolution a liability for damages was settled at ₹ 9,000 against ₹ 7,000 provided in the books of the firm.

Prepare the Accounts necessary to show the result of the realisation and also to close the books of the firm (calculations may be made to the nearest rupee).

Solution

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014	To Premises A/c	25,650	2014	By Sundry creditors A/c	20,260
Oct. 1	To Machinery A/c	10,800	Oct. 1	By Bank loan A/c (Note 1)	5,120
	To Stock A/c	8,420		By Bank A/c (assets realised)	53,350
	To Sundry debtors A/c	15,800		By Partners' Capital A/cs: (loss on realisation)	
	To Bills receivable A/c	850		X	3,484
	To Bank A/c (payment to creditors)	20,000		Y	3,483
	To Bank A/c (extra payment for damages)	2,000		Z	3,483
	To Bank A/c (expenses)	540			
	To Bank A/c (loan paid)	5,120			
		89,180			89,180

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014	To Balance b/f	580	2014	By Realisation A/c (sundry creditors paid)	20,000
Oct. 1	To Realisation A/c (assets realised)	53,350	Oct. 1	By Realisation A/c (loan paid)	5,120
	To Z Capital A/c	2,763		By Realisation A/c (damages)	2,000
				By Realisation A/c (expenses)	540
				By X Capital A/c	18,516
				By Y Capital A/c	10,517
		56,693			56,693

Dr. **Partners' Capital Accounts** **Cr.**

Date	Particulars	X	Y	Z	Date	Particulars	X	Y	Z
2014	To Balance b/f	—	—	1,280	2014	By Balance b/f	20,000	12,000	—
Oct. 1	To Realisation A/c (loss)	3,484	3,483	3,483	Oct. 1	By Reserve A/c	2,000	2,000	2,000
	To Bank A/c	18,516	10,517	—		By Bank A/c	—	—	2,763
		22,000	14,000	4,763			22,000	14,000	4,763

Working Note : (1) Bank loan is a separate account. For closing this account, it is transferred to Realisation Account.

Illustration 4

P, Q and R are partners sharing profits and losses in the ratio of 2 : 2 : 1. Their Balance Sheet as on 31st March, 2015 is as follows :

Liabilities		₹	Assets	₹
Capital Accounts :			Plant and Machinery	1,08,000
P	1,20,000		Fixtures	24,000
Q	48,000		Stock	60,000
R	24,000	1,92,000	Sundry Debtors	48,000
Reserve Fund		60,000	Cash	60,000
Creditors		48,000		
		3,00,000		3,00,000

They decided to dissolve the firm. the following are the amounts realised from the assets :

Particulars	₹
Plant and Machinery	1,02,000
Fixtures	18,000
Stock	84,000
Sundry Debtors	44,400

Creditors allowed a discount of 5% and realisation expenses amounted to ₹ 1,500. A bill for ₹ 4,200 due for sales tax was received during the course of realisation and this was also paid.

You are required to prepare :

(a) Realisation Account; (b) Partners' Capital Accounts; and (c) Cash Account.

Solution

Dr. **Realisation Account** **Cr.**

Date	Particulars		₹	Date	Particulars		₹
2015	To Plant and Machinery A/c		1,08,000	2015	By Creditors A/c		48,000
Mar 31	To Fixtures A/c		24,000	Mar 31	By Cash A/c :		
	To Stock A/c		60,000		Plant and Machinery	1,02,000	
	To Sundry Debtors A/c		48,000		Fixtures	18,000	
	To Cash A/c (Creditors)		45,600		Stock	84,000	
	To Cash A/c (Sales tax)		4,200		Sundry Debtors	44,400	2,48,400
	To Cash A/c (Realisation expenses)		1,500				
	To Partners Capital A/cs :						
	P	2,040					
	Q	2,040					
	R	1,020	5,100				
			2,96,400				2,96,400

Dr. **Partners' Capital Accounts** **Cr.**

Date	Particulars	P	Q	R	Date	Particulars	P	Q	R
2015	To Cash A/c	1,46,040	74,040	37,020	2015	By Balance b/d	1,20,000	48,000	24,000
Mar 31	(Final Payment)				Mar 31	By Reserve Fund A/c	24,000	24,000	12,000
						By Realisation A/c	2,040	2,040	1,020
		1,46,040	74,040	37,020			1,46,040	74,040	37,020

Dr. **Cash Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Mar 31	To Balance b/d To Realisation A/c (Assets realised)	60,000 2,48,400	2015 Mar 31	By Realisation A/c : Creditors Expenses Sales Tax By Partners' Capital A/cs : P Q R	 45,600 1,500 4,200 1,46,040 74,040 37,020
		3,08,400			3,08,400

Illustration 5

A, B and C were partners in a firm sharing profits and losses in the ratio of 3:2:1. They decided to dissolve their firm w.e.f. 31.12.2014, the Balance Sheet on which date was as follows:

Liabilities	₹	Assets		₹
Creditors	25,000	Machinery		45,000
Loan on mortgage	20,000	Stock		20,000
Joint life policy reserve	12,000	Debtors	30,000	
Capital Account — A	45,000	Less: Provision	1,500	28,500
Capital Account — B	30,000	Joint life policy		15,000
Capital Account — C	15,000	Patents		20,000
		Cash at bank		18,500
	1,47,000			1,47,000

Additional information in connection with the dissolution was as follows:

(a) Joint Life Policy was surrendered and insurance company paid a sum of ₹ 18,000;

(b) B took some of the patents at ₹ 3,500 whose book value was ₹ 5,000;

(c) The remaining assets were realised as follows —
Machinery ₹ 30,000; Stock ₹ 15,500; Debtors ₹ 25,500; Patents 50% of the book value;

(d) Liabilities were paid and discount of ₹ 1,250 was allowed by the creditors;

(e) Expenses of dissolution amounted to ₹ 1,500.

Prepare the necessary Ledger Accounts to close the books of the firm.

Solution

In the books of the Firm

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Machinery A/c To Stock A/c To Debtors A/c To Joint Life Policy A/c To Patents A/c To Bank A/c (creditors payment) To Bank A/c (expenses paid) To Bank A/c (loan repaid)	45,000 20,000 30,000 15,000 20,000 23,750 1,500 20,000	2014 Dec. 31	By Provision for Doubtful Debts A/c By Creditors A/c By Loan on Mortgage A/c By B Capital A/c (patents taken over) By Bank A/c (policy realised) By Bank A/c (assets realised): Machinery Stock Debtors Patents (50% of ₹ 15,000) By Partners' Capital A/cs: (A - ₹ 14,375; B - ₹ 9,583; C - ₹ 4,792)	1,500 25,000 20,000 3,500 18,000 30,000 15,500 25,500 7,500 28,750
		1,75,250			1,75,250

Dr. **Partners' Capital Accounts** **Cr.**

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2014 Dec. 31	To Realisation A/c To Realisation A/c (loss) To Bank A/c (final payment)	— 14,375 36,625	3,500 9,583 20,917	— 4,792 12,208	2014 Dec. 31	By Balance b/d By Joint Life Policy Reserve A/c	45,000 6,000	30,000 4,000	15,000 2,000
		51,000	34,000	17,000			51,000	34,000	17,000

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Balance b/d To Realisation A/c (policy realised) To Realisation A/c (assets sold)	18,500 18,000 78,500	2014 Dec. 31	By Realisation A/c (loan) By Realisation A/c (creditors) By Realisation A/c (expenses) By Partners' Capital A/cs: (A - ₹ 36,625; B - ₹ 20,917; C - ₹ 12,208)	20,000 23,750 1,500 69,750
		1,15,000			1,15,000

Illustration 6

A, B and C share the profits of a business in the ratio of 2:2:1 respectively. They decide to dissolve the firm on 31st December, 2014 when their Balance Sheet appears as below :

Liabilities	₹	Assets		₹
Capital A/c : A	20,000	Building		37,000
Capital A/c : B	10,000	Machinery		17,000
Capital A/c : C	1,000	Furniture		8,000
Reserve Fund	10,000	Investment		10,000
Joint Life Policy Fund	15,000	Stock		1,500
Investment Fluctuation Fund	5,000	Debtors	8,000	
C's Loan	10,000	Less: Provision for bad debts	400	7,600
Mrs A's Loan	3,000	Joint Life Policy		15,000
Creditors	21,000	Bank		6,900
Acceptances	15,000	Profit & Loss		2,000
		C's Drawings		5,000
	1,10,000			1,10,000

A agrees to pay his wife's loan. Joint Life Policy is surrendered for ₹ 13,500 and the investment taken by B for ₹ 6,000. The remaining assets realised as below : Building ₹ 60,000; Machinery ₹ 7,000; Furniture ₹ 5,000; Stock ₹ 1,200 and Debtors 80%. Acceptances are met in full but creditors are paid ₹ 20,500 (in final settlement) including an investment worth ₹ 4,500 unrecorded in the books. Realization expenses amount to ₹ 4,800.

Journalise the entries to complete the dissolution of the firm, and show the Realization, Bank and Partners' Capital Accounts.

Solution **Journal** **Dr.** **Cr.**

Date	Particulars		Dr. ₹	Cr. ₹
2014	Realisation A/c	Dr.	96,500	
Dec 31	To Building A/c			37,000
	To Machinery A/c			17,000
	To Furniture A/c			8,000
	To Investment A/c			10,000
	To Stock A/c			1,500
	To Debtors A/c			8,000
	To Joint Life Policy A/c			15,000
	(Being transfer of various assets to Realisation Account at book values on dissolution of the firm)			
	Provision for Bad Debts A/c	Dr.	400	
	Creditors A/c	Dr.	21,000	
	Acceptances A/c	Dr.	15,000	
	To Realisation A/c			36,400
	(Being the transfer of various liabilities to Realisation Account)			
	A Capital A/c	Dr.	800	
	B Capital A/c	Dr.	800	
	C Capital A/c	Dr.	400	
	To Profit & Loss A/c			2,000
	(Being debit balance of P/L transferred to Partners' Capital Accounts in the profit-sharing ratio)			
	C Capital A/c	Dr.	5,000	
	To C Drawings A/c			5,000
	(Being the balance of drawings transferred to Capital Account)			
	Reserve Fund A/c	Dr.	10,000	
	Joint Life Policy Fund A/c	Dr.	15,000	
	Investment Fluctuation Fund A/c	Dr.	5,000	
	To A Capital A/c			12,000
	To B Capital A/c			12,000
	To C Capital A/c			6,000
	(Being the transfer of the balances of different funds to Partners' Capital Accounts in the profit-sharing ratio)			
	Bank A/c ₹ (13,500 + 60,000 + 7,000 + 5,000 + 1,200 + 6,400)	Dr.	93,100	
	To Realisation A/c			93,100
	(Being realisation of sundry assets)			
	Mrs A's Loan A/c	Dr.	3,000	
	To A. Capital A/c			3,000
	(Being the transfer of Mrs A's loan to A's Capital A/c)			
	Realisation A/c ₹ (15,000 + 20,500 – 4,500)	Dr.	31,000	
	To Bank A/c			31,000
	(Being discharge of creditors and acceptances)			
	Realisation A/c	Dr.	4,800	
	To Bank A/c			4,800
	(Being realisation expenses paid)			

C Loan A/c To Bank A/c (Being the discharge of C's loan)	Dr.	10,000	 10,000
B Capital A/c To Realisation A/c (Being the investment taken over by B)	Dr.	6,000	 6,000
Realisation A/c To A Capital A/c To B Capital A/c To C Capital A/c (Being profit on realisation transferred to Partners' Capital Accounts in the profit-sharing ratio)	Dr.	3,200	 1,280 1,280 640
A Capital A/c B Capital A/c C Capital A/c To Bank A/c (Being final payment on dissolution)	Dr. Dr. Dr.	35,480 16,480 2,240	 54,200

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec 31	To Building A/c To Machinery A/c To Furniture A/c To Investment A/c To Stock A/c To Debtors A/c To Joint Life Policy A/c To Bank A/c (liabilities paid) To Bank A/c (expenses) To Partners' Capital A/c — A 2/5 To Partners' Capital A/c — B 2/5 To Partners' Capital A/c — C 1/5	37,000 17,000 8,000 10,000 1,500 8,000 15,000 31,000 4,800 1,280 1,280 640	2014 Dec 31	By Provision for Bad Debts A/c By Creditors A/c By Acceptances A/c By Bank A/c (assets realised) By B Capital A/c (investment taken over)	400 21,000 15,000 93,100 6,000
		1,35,500			1,35,500

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec 31	To Balance b/d To Realisation A/c (sale of assets)	6,900 93,100	2014 Dec 31	By Realisation A/c By Realisation A/c (expenses) By C's Loan A/c By Partners' Capital A/cs: (A — ₹ 35,480; B — ₹ 16,480; C — ₹ 2,240)	31,000 4,800 10,000 54,200
		1,00,000			1,00,000

Dr. **Partners' Capital Accounts** **Cr.**

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2014 Dec 31	To Profit & Loss A/c To Realisation A/c (investment taken over) To Drawings A/c To Bank A/c	800 — — 35,480	800 6,000 — 16,480	400 — 5,000 2,240	2014 Dec 31	By Balance b/f By J.L.P. Fund A/c By Reserve Fund A/c By Mrs A's Loan A/c By Investment Fluctuation Fund A/c By Realisation A/c	20,000 6,000 4,000 3,000 2,000 1,280	10,000 6,000 4,000 — 2,000 1,280	1,000 3,000 2,000 — 1,000 640
		36,280	23,280	7,640			36,280	23,280	7,640

Illustration 7

A, B and C were partners sharing profits and losses in the ratio of 5:3:2. The partnership was dissolved on 31.12.2014:

Liabilities	₹	Assets	₹
Sundry Creditors Capital Account : A Capital Account : B Capital Account : C	10,000 25,000 15,000 10,000	Cash in hand Furniture Stock Sundry Debtors Plant and Machinery	5,000 2,500 7,500 15,000 30,000
	60,000		60,000

C joined the firm on 1.1.2013, paying a premium for goodwill of ₹ 10,000 on the understanding that the partnership would continue for 10 years. Due to B's ill-health, the dissolution became necessary. Before C's admission, the partners were sharing profits and losses in the ratio of 3:2. Furniture and stock were realised for ₹ 2,250 and ₹ 6,750 respectively.

The debtors were taken over by A at ₹ 14,250, apprehending bad debts of ₹ 750. Plant and machinery was sold for ₹ 27,500. Sundry creditors were accepted ₹ 9,500 in full satisfaction. Prepare Ledger accounts to close the books of the firm.

Solution

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars		₹
2014	To Furniture A/c	2,500	2014	By Sundry Creditors A/c		10,000
Dec. 31	To Stock A/c	7,500	Dec. 31	By Cash A/c:		
	To Sundry Debtors A/c	15,000		Furniture	2,250	
	To Plant and Machinery A/c	30,000		Stock	6,750	
	To Cash A/c (creditors paid)	9,500		Plant and machinery	27,500	36,500
				By A Capital A/c (Debtors taken over)		14,250
				By Partners' Capital A/cs : Loss		3,750
				(A — ₹ 1,875; B — ₹ 1,125; C — ₹ 750)		
		64,500				64,500

Dr. **Partners' Capital Accounts** **Cr.**

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2014	To Realisation A/c	14,250	—	—	2014	By Balance b/d	25,000	15,000	10,000
Dec. 31	To C Capital A/c (Note 1)	1,000	1,000	—	Dec. 31	By A Capital A/c (goodwill)	—	—	1,000
	To Realisation A/c	1,875	1,125	750		By B Capital A/c (goodwill)	—	—	1,000
	To Cash A/c	7,875	12,875	11,250					
		25,000	15,000	12,000			25,000	15,000	12,000

Dr. **Cash Account** **Cr.**

Date	Particulars	₹	Date	Particulars		₹
2014	To Balance b/d	5,000	2014	By Realisation A/c		9,500
Dec. 31	To Realisation A/c	36,500	Dec. 31	By Partners' Capital A/cs:	A	7,875
					B	12,875
					C	11,250
		41,500				41,500

Working Note: (1) C paid ₹ 10,000 as premium for goodwill for 10 years but the business was dissolved after the completion of the 8th year. Therefore, unexpired portion of goodwill should be returned to C, which is ₹ 2,000 (₹ 10,000 x 2/10) by A and B. A premium of ₹ 10,000 was shared by A and B in the sacrificing ratio of 1 : 1. Therefore, their CapitalAccounts will be debited in the same ratio.

Illustration 8

Krishna and Arjun are partners in a firm. They share profits and losses in the ratio of 4:1. They decide to dissolve the firm on 31.3.2015 on which date the Balance Sheet of the same stood as follows:

Liabilities	₹	Assets		₹
Capital A/c — Krishna	16,000	Trade marks		1,200
Capital A/c — Arjun	6,000	Machinery		12,000
Bank loan	1,500	Furniture		400
Creditors for goods	8,000	Stock-in-trade		6,000
Bills payable	500	Debtors	9,000	
		Less: Provision for bad debts	400	8,600
		Cash in hand		2,800
		Profit and Loss A/c		1,000
	32,000			32,000

The realization shows the following results: (i) Debtors were realized at book value less 10%; (ii) Goodwill was sold for ₹ 1,000; (iii) Trade marks were realized for ₹ 800; (iv) Machinery and Stock-in-trade were taken over by Krishna respectively for ₹ 14,400 and ₹ 3,600; (v) An unrecorded asset estimated at ₹ 600 was sold for ₹ 200; (vi) Creditors for goods were settled at a discount of ₹ 80. The expenses on realization were ₹ 400.

Prepare Realization Account, Cash Book and Capital Accounts of the partners.

Solution

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015	To Trade Marks A/c	1,200	2015	By Provision for bad debts A/c	400
Mar 31	To Machinery A/c	12,000	Mar 31	By Bank loan A/c	1,500
	To Furniture A/c	400		By Creditors for goods A/c	8,000
	To Stock-in-trade A/c	6,000		By Bills payable A/c	500

	To Debtors A/c	9,000		By Cash A/c (assets realised):	
	To Cash A/c (payment of liabilities):			Debtors	8,100
	Bills payable	500		Goodwill	1,000
	Bank loan	1,500		Trade Marks	800
	Creditors	7,920		Unrecorded Asset	200
	To Cash A/c (expenses)	400		By Partners' Capital A/cs (assets) — Krishna	18,000
				By Partners' Capital A/c (loss) — Krishna	336
				By Partners' Capital A/c (loss) — Arjun	84
		38,920			38,920

Dr. **Cash Book** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015	To Balance b/f	2,800	2015	By Realisation A/c (payment of liabilities)	9,920
Mar 31	To Realisation A/c (realisation of assets)	10,100	Mar 31	By Realisation A/c (expenses)	400
Apr 1	To Partners' Capital A/cs — Krishna	3,136	Apr 1	By Partners' Capital A/cs — Arjun	5,716
		16,036			16,036

Dr. **Partners' Capital Accounts** **Cr.**

Date	Particulars	Krishna	Arjun	Date	Particulars	Krishna	Arjun
2015	To Realisation A/c	18,000	—	2015	By Balance b/f	16,000	6,000
Mar 31	To Profit and Loss A/c	800	200	Apr 1	By Cash A/c	3,136	—
	To Realisation A/c	336	84				
Apr 1	To Cash A/c	—	5,716				
		19,136	6,000			19,136	6,000

Illustration 9

A, B and C are partners in a firm, sharing profits and losses equally, whose Balance Sheet as at 30th September, 2014 was as under:

Liabilities			₹	Assets	₹
Capital Accounts :	A	20,000		Plant and Machinery (Less: Depreciation)	23,760
	B	25,000		Furniture and Fittings	4,240
	C	12,500	57,500	Sundry Debtors	14,165
Current Accounts :	A	18,600		Joint Life Policy	12,105
	C	7,200	25,800	Bills Receivable	8,610
Sundry Creditors			17,720	Stock-in-trade	29,940
Bills Payable			8,400	Current Account : B	12,400
				Cash at bank and in hand	4,200
			1,09,420		1,09,420

The value of the joint Life Policy shown in the Balance Sheet represents the surrender value of the policy taken by the firm for ₹ 30,000 to enable the settlement of accounts with a partner's estate in case of death of a partner during the continuance of the firm.

A died on 1st October, 2014. The remaining partners could not arrive at any understanding with the legal representative of A with the result that it was decided that the firm would be dissolved, subject to the following adjustments:

(a) The sum assured was realised from the insurance company;
(b) Plant and machinery realised only 70% of the book value;
(c) Furniture and fittings were taken over by partner C, at a market value of ₹ 2,500.
(d) Bills receivable and Sundry debtors had to be discounted by 4%;
(e) Stock-in-trade comprised—
 (i) Easily marketable items — 70% of the total inventory which realised its full value;
 (ii) Obsolete items — 10% of the total inventory which had to be discarded;
 (iii) The rest of the items which realised 50% of their book value;
(f) A liability for ₹ 1,500 which had not been recorded in the firm's books had to be settled by the firm before its dissolution.

Draw up accounts showing *inter-se* settlement among the partners.

Solution **In the books of the Firm**

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars		₹
2014	To Plant and Machinery A/c	23,760	2014	By Sundry Creditors A/c		17,720
Oct. 1	To Furniture and Fittings A/c	4,240	Oct. 1	By Bills Payable A/c		8,400
	To Sundry Debtors A/c	14,165		By Bank A/c — assets realised		
	To Joint Life Policy A/c	12,105		Plant and Machinery	16,632	

	To Bills Receivable A/c	8,610		Sundry Debtors 13,598	
	To Stock-in-trade A/c	29,940		Joint Life Policy 30,000	
	To Bank A/c — Liabilities paid			Bills Receivable 8,266	
	Sundry Creditors 19,220			Stock-in-trade 23,952	92,448
	Bills Payable 8,400	27,620		By C Capital A/c (furniture taken over)	2,500
	To Partners' Capital A/cs: (A — ₹ 210; B — ₹ 209; C — ₹ 209)	628			
		1,21,068			1,21,068

Dr. **Partners' Capital Accounts** **Cr.**

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2014	To Partners' Current A/cs	—	12,400	—	2014	By Balance b/d	20,000	25,000	12,500
Oct. 1	To Realisation A/c	—	—	2,500	Oct. 1	By Partners' Current A/cs	18,600	—	7,200
	To Cash and Bank A/c	38,810	12,809	17,409		By Realisation A/c	210	209	209
		38,810	25,209	19,909			38,810	25,209	19,909

Dr. **Partners' Current Accounts** **Cr.**

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2014	To Balance b/d	—	12,400	—	2014	By Balance b/d	18,600	—	7,200
Oct. 1	To Partners' Capital A/cs	18,600	—	7,200	Oct. 1	By Partners' Capital A/cs	—	12,400	—
		18,600	12,400	7,200			18,600	12,400	7,200

Dr. **Cash and Bank Account** **Cr.**

Particulars	₹	Particulars		₹
To Balance b/d	4,200	By Realisation A/c		27,620
To Realisation A/c	92,448	By Partners' Capital A/cs :	A	38,810
			B	12,809
			C	17,409
	96,648			96,648

Working Note: (1) Calculation of money realised from sale of stock

	Book value		Amount realised
(i)	70% of ₹ 29,940	= ₹ 20,958	₹ 20,958
(ii)	10% of ₹ 29,940	= ₹ 2,994	Nil (Discarded)
(iii)	the rest	= ₹ 5,988	₹ 2,994 (50%)
		₹ 29,940	₹ 23,952

Illustration 10

Ram, Rahim and Anthony were in partnership sharing profits and losses in the ratio of 1/2, 1/3 and 1/6 respectively. They decided to dissolve the partnership firm on 31.3.2015, when the Balance Sheet of the firm appeared as under :

Liabilities		₹	Assets	₹
Sundry Creditors		5,67,000	Goodwill	4,56,300
Bank Overdraft		6,06,450	Plant and Machinery	6,07,500
Joint Life Policy Reserve		2,65,500	Furniture	64,650
Loan from Mrs. Ram		1,50,000	Stock	2,36,700
Capital Accounts :			Sundry Debtors	5,34,000
Ram	4,20,000		Joint Life Policy	2,65,500
Rahim	2,25,000		Commission Receivable	1,40,550
Anthony	1,20,000	7,65,000	Cash in Hand	48,750
		23,53,950		23,53,950

The folowing details are relevant for dissolution :

(i) The joint life policy was surrendered for ₹ 2,32,500.
(ii) Ram took over goodwill and plant and machinery for ₹ 9,00,000.
(iii) Ram also agreed to discharge bank overdraft and loan from Mrs Ram.
(iv) Furniture and stocks were divided equally between Ram and Rahim at an agreed valuation of ₹ 3,60,000.
(v) Sundry debtors were assigned to firm's creditors in full satisfaction of their claims.
(vi) Commission receivable was received in toto in time.
(vii) A bill discounted was subsequently returned dishonoured and proved valueless ₹ 30,750 (including ₹ 500 noting charges).
(viii) Ram paid the expenses of dissolution amounting to ₹ 18,000.
(ix) Anthony agreed to receive ₹ 1,50,000 in full satisfaction of his rights, title and interest in the firm.

You are required to show accounts relating to closing of books on dissolution of the firm.

Solution

In the books of the Firm

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015	To Goodwill A/c	4,56,300	2015	By Sundry Creditors	5,67,000
Mar. 31	To Plant and Machinery	6,07,500	Mar. 31	By Cash A/c :	
	To Furniture	64,650		Joint Life Policy	2,32,500
	To Stock	2,36,700		Commission Receivable	1,40,550
	To Sundry Debtors	5,34,000		By Ram Capital :	
	To Joint Life Policy	2,65,500		Goodwill + Machinery	9,00,000
	To Commission Receivable	1,40,550		Furniture + Stock	1,80,000
	To Ram Capital :			By Rahim Capital :	
	Realisation Expenses paid	18,000		Furniture + Stock	1,80,000
	To Bank A/c			By Partners' Capital A/cs :	
	Bill Dishonoured	30,750		Ram	76,950
				Rahim	51,300
				Anthony	25,650
		23,53,950			23,53,950

Dr. Cash Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015	To Balance b/d	48,750	2015	By Ram Capital A/c	1,94,160
Mar. 31	To Realisation A/c : Joint Life Policy	2,32,500	Mar. 31	By Rahim Capital A/c	77,640
	Commission Receivable	1,40,550		By Anthony A/c	1,50,000
		4,21,800			4,21,800

Dr. Partners' Capital Account Cr.

Particulars	Ram	Rahim	Anthony	Particulars	Ram	Rahim	Anthony
To Realisation A/c	10,80,000	1,80,000	—	By Balance b/d	4,20,000	2,25,000	1,20,000
To Realisation A/c (Loss)	76,950	51,300	25,650	By J.L.P. Reserve (Note 1)	1,32,750	88,500	44,250
To Cash A/c	—	—	1,50,000	By Loan from Mrs Ram (Note 3)	1,50,000	—	—
To Anthony Capital A/c	6,840	4,560	—	By Realisation A/c	18,000	—	—
To Cash (Balancing fig.)	1,94,160	77,640	—	By Ram Capital A/c (Note 5)	—	—	6,840
				By Rahim Capital A/c (Note 5)	—	—	4,560
				By Bank A/c (Overdraft)	6,37,200	—	—
	13,57,950	3,13,500	1,75,650		13,57,950	3,13,500	1,75,650

Dr. Bank Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015	To Ram Capital A/c	6,37,200	2015	By Balance b/d	6,06,450
Mar. 31			Mar. 31	By Realisation A/c (Note 2)	30,750
		6,37,200			6,37,200

Working Notes :

(1) Joint Life Policy Reserve is transferred to Partners' Capital Accounts in the profit sharing ratio.

(2) For dishonour of discounted bill, the following entry is passed :

Sundry Debtors Account	Dr.	30,750	
To Bank Account			30,750

Here, nothing can be collected from Debtors. Therefore, it is to be treated as realisation loss and it is to be recorded by passing the following entry :

Realisation Account	Dr.	30,750	
To Sundry Debtors Account			30,750

However, a consolidated entry can be passed as follows to give effect the dishonour of the discounted bill:

Realisation Account	Dr.	30,750	
To Bank Account			30,750

(3) Loan from Mrs Ram has not been transferred to Realisation Account. It has been directly adjusted in Ram's Capital Account.

(4) No entry is required for assignment of Sundry Debtors in favour of Sundry Creditors in full satisfaction of their claim.

(5) Actual amount payable to Anthony is ₹ 1,38,600 (₹ 1,64,250 – ₹ 25,650) but agreed amount payable is ₹ 1,50,000. So the difference of ₹ 11,400 is to be borne by Ram and Rahim in their profit sharing ratio, i.e., 3 : 2.

Share of Ram : ₹ 11,400 × 3/5 =₹ **6,840**

Share of Rahim : ₹ 11,400 × 2/3 = ₹ **4,560**

Illustration 11

A, B and C are in partnership as accountants carrying on practices in Calcutta and Delhi and sharing profits in the ratio of 7:6:5 respectively. Interest @ 5% p.a. is allowed on capital accounts. They decided to dissolve the firm. The terms of dissolution were as under:

1. A to retire from business, his share of goodwill being valued at ₹ 3,300 to be paid by B and C in their profit-sharing ratio.
2. B to carry on business in Calcutta, taking over at book values furniture and debtors in Calcutta, and all liabilities, he also has to pay ₹ 600 for the lease of Calcutta office which he kept on.
3. C to take over the furniture and debtors in Delhi.
4. B and C each to be credited with 2% of the amount of the book debts taken over by them respectively by way of an allowance to cover the cost of collection.
5. Each parnter to take over a third of the cash balance and to pay his own costs in connection with the dissolution.

The following Trial Balance was extracted from the firm's books as on 30.6.2015, on which date the partnership was dissolved by agreement.

Dr. Trial Balance Cr.

Particulars	₹	Particulars	₹
Drawings : A	3,973	Capital as on 1.7.2014	
B	1,292	A	4,000
C	816	B	4,000
Cash	318	C	3,000
Sundry Debtors : Calcutta	6,750	Profit & Loss Account before charging interest for the	
Sundry Debtors : Delhi	3,150	year ended 30.6.2015	5,716
Furniture : Calcutta	320	Sundry Creditors	78
Furniture : Delhi	175		
	16,794		16,794

You are required to close the books of the firm, assuming that partners settle their accounts through bank on 30.9.2013. Interest after 30.6.2015 to be ignored.

Solution

In the books of A, B and C

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars		₹
2015	To Sundry Debtors A/c (₹ 6,750 + ₹ 3,150)	9,900	2015	By B Capital A/c — assets taken over		
June 30	To Furniture A/c (₹ 320 + ₹ 175)	495	June 30	Lease	600	
	To B Capital A/c — allowances on debtors			Debtors	6,750	
	(2% on ₹ 6,750)	135		Furniture	320	7,670
	To C Capital A/c — allowances on debtors			By C Capital A/c — assets taken over		
	(2% on ₹ 3,150)	63		Debtors	3,150	
	To Partners' Capital A/cs:			Furniture	175	3,325
	(A — ₹ 156; B — ₹ 134; C — ₹ 112)	402				
		10,995				10,995

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2015	To Drawings A/c	3,973	1,292	816	2014	By Balance b/d	4,000	4,000	3,000
June 30	To Realisation A/c —				July 1				
	assets taken over	—	7,670	3,325	2015	By Interest on Capital A/c	200	200	150
	To Cash A/c	106	106	106	June 30	By Share of Profit A/c			
Sept. 30	To Bank A/c	2,286	—	513		(₹ 5,716 – 550)	2,009	1,722	1,435
						By Realisation A/c —			
						allowances on debtors	—	135	63
						By Sundry Creditors A/c	—	78	—
						By Realisation A/c —profit	156	134	112
						By Bank A/c	—	2,799	—
		6,635	9,068	4,760			6,635	9,068	4,760

Working Notes:

(1) Profit on realisation is a capital profit.

(2) For lack of information, it has been assumed that B and C bring in necessary money to pay off A.

Illustration 12

A, B and C are partners of a firm of Chartered Accountants having offices in Bombay, Hyderabad and Bhopal, sharing profits and losses in the ratio of 5 : 3 :2 respectively. The statement of affairs of the firm as on 31.3.2015 is shown below:

Particulars	₹	₹
Capital A/c — A		15,000
Capital A/c — B		12,000
Capital A/c — C		6,000
Current A/c — A		7,550
Current A/c — B	2,575	
Current A/c — C	1,115	
Accounts Payable		4,915
Accounts Receivable — Bombay	12,000	
Accounts Receivable — Hyderabad	8,625	
Accounts Receivable — Bhopal	9,875	
Goodwill	5,000	
Cash in Hand	575	
Cash with Bank	5,700	
TOTAL	45,465	45,465

On that date, due to old age, A desires to retire from the firm and the other two partners agree and it is decided that B would take over the Bomay and Hyderabad offices and C would take over the Bhopal office with the respective assets and liabilities.

You are given the following additional information :

(a) A's share of goodwill is valued at ₹ 15,000 and would be bought by B and C in their profit-sharing ratio.

(b) Accounts payable include rent of Bhopal office for the month of February and March, 2013 at the monthly rent of ₹ 250 and the balance represents outstanding expenses of Bombay and Hyderabad offices.

(c) Cash in hand is to be utilised to pay A and other settlements inter-se to take place before 1st May, 2013 and

(d) Accounts receivable to be discounted by 2%.

Draw up Realisation Account, Partners' Capital Accounts and Cash Account.

Solution

Working Note : (1) Value of net assets taken over by B and C (all figures in ₹)

	B (Bombay and Hyderabad)	C Bhopal
Account Receivable	20,625	9,875
Less: Discount @ 2%	413	197
	20,212	9,678
Less: Accounts Payable	4,415	500
Net assets taken over	15,797	9,178

In the books of the Firm

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015	To Goodwill A/c	5,000	2015	By Accounts Payable A/c	4,915
April 1	To Accounts Receivable A/c		April 1	By B A/c — net assets taken over (Note 1)	15,797
	(₹ 12,000 + 8,625 + 9,875)	30,500		By C A/c — net assets taken over (Note 1)	9,178
				By Partners' Capital A/c — A	2,805
				By Partners' Capital A/c — B	1.683
				By Partners' Capital A/c — C	1,122
		35,500			35,500

Dr. Partners' Capital Accounts Cr.

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2015	To Partners' Current A/cs	—	2,575	1,115	2015	By Balance b/d	15,000	12,000	6,000
	To Realisation A/c	—	15,797	9,178	April 1	By Partners' Current A/cs	7,550	—	—
	To Realisation A/c — Loss	2,805	1,683	1,122		By B Cap. A/c (Goodwill)	9,000	—	—
	To A Cap. A/c (Goodwill)	—	9,000	6,000		By C Cap. A/c (Goodwill)	6,000	—	—
	To Cash A/c	575	—	—		By Bank A/c	—	17,055	11,415
	To Bank A/c	34,170	—	—					
		37,550	29,055	17,415			37,550	29,055	17,415

Dr. **Cash Account** Cr.

Date	Particulars	Cash	Bank	Date	Particulars	Cash	Bank
2015 April 1	To Balance b/d	575	5,700	2015 ?	By A Capital A/c	575	34,170
	To B Capital A/c	—	17,055				
	To C Capital A/c	—	11,415				
		575	34,170			575	34,170

Illustration 13

X, Y and Z carrying on business since 2002, decided to dissolve their partnership on 30th June 2015, when their Balance Sheet was as under:

Liabilities			₹	Assets	₹
Creditors			34,000	Cash	25,000
Capital Accounts :	X	1,20,000		Debtors	62,000
	Y	90,000		Stock	37,000
	Z	60,000	2,70,000	Tools	8,000
				Motor Cars	12,000
				Machinery	60,000
				Freehold Building	1,00,000
			3,04,000		3,04,000

Y and Z agreed to form a new partnership to carry on the business and it is agreed that they shall acquire from the old firm the following assets at amounts shown hereinunder:

Stock — ₹ 40,000; Tools — ₹ 5,000; Motor Cars — ₹ 25,000; Machinery — ₹ 78,000; Freehold Building — ₹ 84,000; Goodwill — ₹ 60,000.

The partnership agreement of X, Y and Z provided that trading profits and losses shall be divided in the ratio of 3:2:1 and that capital profits or losses shall be divided in proportion of their capitals.

Debtors realise ₹ 59,000 and discount amounting to ₹ 720 is secured on payments due to creditors. Y and Z bring the necessary cash to pay X in the ratio of 3:2.

You are required to prepare: (i) the necessary accounts of the firm X, Y and Z; (a) if the firm Y and Z continue the same books, and (b) if the partners open new books; (ii) The opening Balance Sheet of the firm Y and Z.

Solution

(i) Continuing the same books **In the books of X, Y and Z**

Dr. **Memorandum Realisation Account** Cr.

Date	Particulars	₹	Date	Particulars	₹
2015 July 1	To Tools A/c	3,000	2015 July 1	By Stock A/c	3,000
	To Freehold Buildings A/c	16,000		By Motor Car A/c	13,000
	To X Capital A/c (capital ratio – 12/27)	33,333		By Machinery A/c	18,000
	To Y Capital A/c (capital ratio – 9/27)	25,000		By Goodwill A/c	60,000
	To Z Capital A/c (capital ratio – 6/27)	16,667			
		94,000			94,000
	To Stock A/c	3,000		By Tools A/c	3,000
	To Motor Car A/c	13,000		By Freehold Building A/c	16,000
	To Machinery A/c	18,000		By Y Capital A/c (3/5)	45,000
	To Goodwill A/c	60,000		By Z Capital A/c (2/5)	30,000
		94,000			94,000

Dr. **Realisation Account** Cr.

Date	Particulars	₹	Date	Particulars	₹
2015 July 1	To Debtors A/c	62,000	2015 July 1	By Creditors A/c	34,000
	To Cash A/c	33,280		By Cash A/c	59,000
				By X Capital A/c (capital ratio – 12/27)	1,013
				By Y Capital A/c (capital ratio – 9/27)	760
				By Z Capital A/c (capital ratio – 6/27)	507
		95,280			95,280

Dr. **Partners' Capital Accounts** Cr.

Particulars	X	Y	Z	Particulars	X	Y	Z
To Memorandum Realisation A/c	—	45,000	30,000	By Balance b/d	1,20,000	90,000	60,000
To Realisation A/c	1,013	760	507	By Memorandum Realisation A/c	33,333	25,000	16,667
To Cash A/c	1,52,320	—	—	By Cash A/c	—	60,960	40,640
To Balance c/d	—	1,30,200	86,800				
	1,53,333	1,75,960	1,17,307		1,53,333	1,75,960	1,17,307

Dr. **Cash Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 July 1	To Balance b/d	25,000	2015 July 1	By Realisation A/c — Creditors paid	33,280
	To Realisation A/c — Debtors realised	59,000		By X Capital A/c	1,52,320
	To Y Capital A/c	60,960			
	To Z Capital A/c	40,640			
		1,85,600			1,85,600

Balance Sheet of Y and Z on 1st July, 2015

Liabilities		₹	Assets	₹
Capital Accounts :			Stock	37,000
Y	1,30,200		Tools	8,000
Z	86,800	2,17,000	Motor Cars	12,000
			Machinery	60,000
			Freehold Building	1,00,000
		2,17,000		2,17,000

(ii) Opening new books **In the books of X, Y and Z**

Dr. **Realisation Account** **Cr.**

Date	Particulars		₹	Date	Particulars		₹
2015 July 1	To Debtors A/c		62,000	2015 July 1	By Cash A/c — Debtors realised		59,000
	To Stock A/c		37,000		By Creditors A/c		34,000
	To Tools A/c		8,000		By Y and Z Joint A/c:		
	To Motor Car A/c		12,000		Stock	40,000	
	To Machinery A/c		60,000		Tools	5,000	
	To Freehold Building A/c		1,00,000		Motor Car	25,000	
	To Bank A/c — creditors paid		33,280		Machinery	78,000	
	To Partners' Capital A/cs:				Freehold Building	84,000	
	X (capital ratio)	32,320			Goodwill	60,000	2,92,000
	Y (capital ratio)	24,240					
	Z (capital ratio)	16,160	72,720				
			3,85,000				3,85,000

Dr. **Partners' Capital Accounts** **Cr.**

Particulars	X	Y	Z	Particulars	X	Y	Z
To Cash A/c	1,52,320	—	—	By Balance b/d	1,20,000	90,000	60,000
To Y and Z Joint A/c	—	1,75,200	1,16,800	By Realisation A/c	32,320	24,240	16,160
				By Cash A/c	—	60,960	40,640
	1,52,320	1,75,200	1,16,800		1,52,320	1,75,200	1,16,800

Dr. **Y and Z Joint Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 July 1	To Realisation A/c	2,92,000	2015 July 1	By Y Capital A/c	1,75,200
				By Z Capital A/c	1,16,800
		2,92,000			2,92,000

Balance Sheet of Y and Z on 1st July, 2015

Liabilities		₹	Assets	₹
Capital Accounts :			Stock	40,000
Y	1,75,200		Tools	5,000
Z	1,16,800	2,92,000	Motor Cars	25,000
			Machinery	78,000
			Freehold Building	84,000
			Goodwill	60,000
		2,92,000		2,92,000

Working Notes: (1) Profit on realisation is a capital profit. **(2)** For lack of information, it has been assumed that Y and Z bring in necessary money to pay off X.

Case 2 : Where Some of the Partners are Solvent and Others Insolvent

At the time of dissolution of a partnership firm, the Capital Account of a partner may show a debit balance after his share of any profit or loss on realisation has been included in his account; and if he cannot make good the whole or part of the deficiency, what should be done? In such a situation, this deficiency must be shared by all the solvent partners. Now the question arises in what ratio?

The solvent partners may share such deficiency: (i) in their profit-sharing ratio (like any business loss); or (ii) in the ratio of their last agreed capitals (as has been decided in the case of ***Garner Vs. Murray***)

Decision in Garner Vs. Murray

Garner, Murray and Wilkins were equal partners with unequal capitals.

The assets of the firm on dissolution, after satisfying all the liabilities to creditors and advance (by Murray) from partners were insufficient to repay the capitals in full. There was a deficiency of £ 635 and the capital account of Wilkins was showing a debit balance of £ 263. Nothing could be recovered from Wilkins owing to insolvency. The decision was given by Mr. Justice Joyee in 1904. His decision was as under:

> ***"The solvent partners are only liable to make good their share of the deficiency, and that the remaining assets should be divided among them in proportion to their capitals"***

In effect, the decision in Garner Vs. Murray boiled down to this:

(a) The solvent partners should contribute to the deficiency of capital (caused by loss on realisation) in cash their share only and not the insolvent partners' share.

(b) The net effect of what has been stated above is that the deficiency of capital of the insolvent partner gets distributed among the solvent partners in the ratio of their last agreed capitals.

To Illustrate:

A, B & C are partners. A countributed ₹ 1,600; B ₹ 400; and C ₹ 250; sharing profits and losses equally. (Total Capital: ₹ 1,600 + ₹ 400 + ₹ 250 = ₹ 2,250) ₹ 1,350 were left after paying off all liabilities on dissolution. Hence, capital loss is ₹ 2,250 – ₹ 1,350 = ₹ 900. If all the partners were solvent, ₹ 300 contributed by each would have restored the capital, so that A, B and C would have got back their respective capitals, namely, ₹ 1,600 (A), ₹ 400 (B) and ₹ 250 (C).

But C being insolvent and his personal properties yeilding nothing, A and B would contribute ₹ 300 each. This will bring up the funds of the firm to ₹ 1,950 from ₹ 1,350 (₹ 1350 + ₹ 600). And, according to the decision in Garner Vs. Murray, these assets (cash/bank) amounting to ₹ 1,950 should be distributed between A and B in the ratio of 4:1, that is the last agreed capital. Now let us look at the entire picture of settlement at a glance :

Particulars	A	B
Last agreed Capital	1,600	400
Less: Realisation loss (in profit and loss ratio, that is, equally)	300	300
	1,300	100
Add: Cash brought in to make good their loss	300	300
	1,600	400
Less: Distribution of ₹ 1,950 in 4:1 (ratio of last agreed Capital)	1,560	390
Loss	40	10
(FINAL) Debit balance of C (₹ 300 – ₹ 250)	**₹ 40 + ₹ 10 = ₹ 50**	

Therefore, A and B have shared the loss due to deficiency in the capital account of the insolvent partner C, in the ratio of their last agreed capital (4:1).

Criticism of Garner Vs. Murray

1. It does not apply when the firm is having only two partners.
2. It considers only the book capital of the partners, ignoring the private estate of the solvent partners. If a partner contributed more capital than that of the other partners, he will have to bear more burden than other partners contributing less capital.
3. If a partner is having a nil capital balance or a debit balance, he will not have to bear the deficiency of the insolvent partner.
4. Introduction of cash by the solvent partners to make good their share of loss on realisation is unnecessary, when the balance of the capital accounts of the solvent partners are sufficient to bear the deficiency of the insolvent partner.

Our Comments

1. It is not unjust and inequitable law to ask a partner with larger capital to bear the larger portion of the loss. Psychologically, the partners with lower capital will not react unfavourably.
2. Many authors have described that bringing cash to the extent of loss on realization is meaningless. We do not think it is meaningless. We are aware that some of the decisions of the old English judges have laid the foundation of our modern accounting theory and auditing. In fact, the knowledge of accounting of some of the English judges was far superior to many of our modern accounting stalwarts.

Introduction of such further capital is an epitome of the doctrine of conservatism. As Shakespeare had rightly said that "there are many a slip between the cup and the lip". Who knows that of the C, A or B will not become insolvent without any attachable personal property.

Points to Remember

1. ***Garner Vs. Murray is applicable only when there is no agreement among the partners for sharing the deficiency in capital account of insolvent partner.***
2. ***Realisation loss should be divided in the profit sharing ratio in the usual manner.***
3. ***The solvent partners should bring in cash to make good the loss on realisation.***
4. ***Final debit balance (after debiting realization loss) of insolvent partner should be shared amongst the solvent partners in proportion to their last agreed capital.***
5. ***A solvent partner having debit balance in Capital Account will not share any loss due to insolvency of a partner.***

Applicability of Garner Vs. Murray to India

Section 48 of the Indian Partnership Act 1932 is identical with the section 44 of the Partnership Act in Great Britain and further there has been no case law in India which has examined this question. Therefore, it is justified to assume that Garner Vs. Murray will also apply in India.

Application of Garner Vs. Murray for Fixed and Fluctuating capital

It has already been stated that the deficiency of an insolvent partner is to be borne by the solvent partners in the ratio of their ***last agreed capitals***. In this connection, the distinction between fixed and fluctuating capitals is material.

Fixed Capital When the partners follow fixed capital method, each partner will have one Capital Account and one Current Account. To determine the ratio in which the insolvency loss is to be shared, ***only Capital Accounts*** balances are to be considered (ignoring current account balance).

Fluctuating Capital When the partners follow fluctuating capital method, only one Capital Account is maintained for each partner. To ascertain the last agreed capital, all sorts of adjustments like reserves, undrawn profits or accumulated losses, drawings etc are to be made excepting the profit or loss arising out of realisation of assets and liabilities.

Firm's Debts Vs Private Debts

The joint estate of the partners as a firm and their separate estates as individuals are administered separately.

The separate estate of each partner is to be utilised first for paying his ***private debts***. Any surplus from the separate estate can be utilised for paying firm's debts. But any deficiency of his private estate is not included in the joint estate. Similarly, the joint estate of the firm is to be utilised first for paying the debts of the firm.

Illustration 14

A, B and C had been in partnership for many years and shared profits and losses in the ratio of 1:2:2. Their respective capitals were : A — ₹ 10,000; B — ₹ 10,000; C — ₹ 2,000.

The partners decided to dissolve the partnership after a succession of losses following a fall off in demand. On dissolution, there was a loss of ₹ 15,000 to be shared among the partners. C was insolvent and unable to contribute anything towards his deficiency which had to be borne by his co-partners.

Required : Partners' Capital Accounts to record the above matters [***Apply Garner Vs. Murray***]

Solution

Dr. **Partners' Capital Accounts** **Cr.**

Particulars	A	B	C	Particulars	A	B	C
To Realisation A/c – loss	3,000	6,000	6,000	By Balance b/d	10,000	10,000	2,000
To C Capital A/c (Note 2)	2,000	2,000	—	By Bank A/c (Note 1)	3,000	6,000	—
To Bank A/c	8,000	8,000	—	By A Capital A/c	—	—	2,000
				By B Capital A/c	—	—	2,000
	13,000	16,000	6,000		13,000	16,000	6,000

Working Note: (1) The solvent partners will bring in cash equal to realisation loss.
(2) Deficiency of C is borne by A and B in the capital ratio (1:1).

Illustration 15

A, B and C are in partnership, sharing profits and losses equally. The firm's Balance Sheet at 31.12.2014 was as follows:

Liabilities			₹	Assets		₹
Sundry Creditors			64,000	Cash		1,600
Capital Accounts :	A	24,000		Sundry Debtors		53,000
	B	8,000		Stock		22,200
	C	4,000	36,000	Machinery & Plant		26,000
Current Accounts :	A		10,800	Current Accounts :	B	2,000
					C	6,000
			1,10,800			1,10,800

It was decided to dissolve the firm on that date. The Machinery and Plant, Stock and Debtors were sold by the firm for ₹ 70,000. Creditors were paid off

Assuming that C is insolvent and could not meet his liability to the firm, show necessary Ledger Accounts in the books of the firm. [***Apply Garner Vs. Murray principle***.]

Solution

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014	To Sundry Debtors A/c	53,000	2014	By Creditors A/c	64,000
Dec. 31	To Stock A/c	22,200	Dec. 31	By Cash A/c (Sale of assets)	70,000
	To Machinery & Plant A/c	26,000		By Partners' Capital A/cs:	
	To Cash A/c (Payment to Creditors)	64,000		(A — ₹ 10,400; B — 10,400; C — 10,400)	31,200
		1,65,200			1,65,200

Dr. **Cash Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014	To Balance b/f	1,600	2014	By Realisation A/c	64,000
Dec. 31	To Realisation A/c — sale of assets	70,000	Dec. 31	By A Capital A/c	25,500
	To A Capital A/c	10,400		By B Capital A/c	2,900
	To B Capital A/c	10,400			
		92,400			92,400

Dr. **Partners' Capital Accounts** **Cr.**

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2014	To Current A/cs	—	2,000	6,000	2014	By Balance b/d	24,000	8,000	4,000
Dec. 31	To Realisation A/c (loss)	10,400	10,400	10,400	Dec. 31	By Current A/cs	10,800	—	—
	To C Capital A/c	9,300	3,100	—		By Cash A/c (Note 1)	10,400	10,400	—
	To Cash A/c	25,500	2,900	—		By A Capital A/c	—	—	9,300
						By B Capital A/c	—	—	3,100
		45,200	18,400	16,400			45,200	18,400	16,400

Working Notses : (1) The solvent partners should bring in cash to make good the loss on realisation.
(2) C's total deficiency of ₹ 12,400 (₹ 16,400 – ₹ 4,000) should be shared by A and B in the ratio of their fixed capital ₹ 24,000: ₹ 8,000 or 3 : 1. Current Account balances are to be ignored for this purpose.

Illustration 16

The following was the Balance Sheet as at 31st March, 2015 of M/s Ideal Works in which A, B and C were partners sharing profits and losses in the ratio of 6:3:5.

Liabilities	₹	Assets	₹
A's Capital A/c	25,000	Land and Building	10,000
C's Capital A/c	15,000	Furniture	5,000
A's Current A/c	1,000	Stock-in-trade	23,100
C's Current A/c	500	Sundry Debtors	30,000
Sundry Creditors	30,000	Cash at Bank	2,500
Loan on mortgage of Land and Building	4,000	B's Current A/c	4,900
	75,500		75,500

It was decided to dissolve the partnership as on the date of the Balance Sheet. The assets of the firm is realised as under:

Land and Building ₹ 6,000; Furniture ₹ 2,000; Stock-in-trade ₹15,000 and Sundry Debtors ₹ 20,000. The expenses of realisation amounted to ₹ 2,000. The Sundry Creditors agreed to receive 75 paise in a rupee in full satisfaction of their claim. Loan on mortgage was paid. It was ascertained that B had become insolvent. B's estate had contributed only 50 paise in a rupee.

Write up the Realisation Account, Bank Account, Capital Account of the partners following the rule given in Garner Vs. Murray.

Solution

In the books of M/s Ideal Works

Realisation Account

Date	Particulars	₹	Date	Particulars		₹
2015	To Land and Building A/c	10,000	2015	By Sundry Creditors A/c		30,000
Mar 31	To Furniture A/c	5,000	Mar 31	By Mortgage Loan A/c		4,000
	To Stock-in-trade A/c	23,100		By Bank A/c (assets realised)		43,000
	To Sundry Debtors A/c	30,000		By Partners' Capital A/cs:	A	8,400
	To Bank A/c (creditor @ 75% of ₹ 30,000)	22,500			B	4,200
	To Bank A/c (mortgage Loan)	4,000			C	7,000
	To Bank A/c (expenses)	2,000				
		96,600				96,600

Partners' Capital Accounts

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2015	To Current A/c	—	4,900	—	2015	By Balance b/d	25,000	—	15,000
Mar 31	To Realisation A/c (loss)	8,400	4,200	7,000	Mar 31	By Current A/c	1,000	—	500
	To B Capital A/c (5 : 3)	2,844	—	1,706		By Bank A/c (Note 1)	8,400	—	7,000
	To Bank A/c (final payment)	23,156	—	13,794		By Bank A/c (Note 2)	—	4,550	—
						By A Capital A/c (Note 2)	—	2,884	—
						By C Capital A/c (Note 2)	—	1,706	—
		34,400	9,100	22,500			34,400	9,100	22,500

Bank Account

Date	Particulars	₹	Date	Particulars	₹
2015	To Balance b/d	2,500	2015	By Realisation A/c — creditors paid	22,500
Mar 31	To Realisation A/c — Assets sold	43,000	Mar 31	By Realisation A/c — payment of mortgage loan	4,000
	To B Capital A/c (Note 2)	4,550		By Realisation A/c — expenses	2,000
	To A Capital A/c (Note 1)	8,400		By A Capital A/c	23,156
	To C Capital A/c (Note 1)	7,000		By C Capital A/c	13,794
		65,450			65,450

Working Notes :

(1) The solvent partners should bring in cash to make good the loss on realisation.

(2) B's Capital Account showing a debit balance of ₹ 9,100. But he can bring only 50% of it, i.e., ₹ 4,550. The balance amount, i.e., 4,550 should be shared by A and C in the ratio of their fixed capital, i.e., 25,000 : 15,000 or 5 : 3. The current account balances are to be ignored.

Illustration 17

The following is the Balance Sheet of A, B and C sharing profits in the ratio of 2 : 2 : 1.

Liabilities	₹	Assets	₹
Creditors	32,000	Sundry Assets	98,000
Capital : A	45,000	Cash	4,000
Capital : B	30,000	Capital : C — Overdrawn	5,000
	1,07,000		1,07,000

The firm is dissolved. Sundry assets realised ₹ 94,000 and creditors accepted ₹ 31,000 in full settlement. Expenses amounted to ₹ 2,000. C was insolvent and a final dividend of 60% was received from his estate. Show necessary accounts including Cash Book. [Apply Garner Vs Murray rule]

Solution

Realisation Account

Date	Particulars	₹	Date	Particulars	₹
	To Sundry Assets A/c	98,000		By Creditors A/c	32,000
	To Cash A/c (payment to creditors)	31,000		By Cash A/c (realisation of assets)	94,000
	To Cash A/c (realisation expenses)	2,000		By Partners' Capital A/cs:	
				(A — ₹ 2,000; B — 2,000; C — 1,000)	5,000
		1,31,000			1,31,000

Dr. **Cash Book** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	4,000		By Realisation A/c — creditors paid	31,000
	To Realisation A/c — (realisation of assets)	94,000		By Realisation A/c — (realisation expenses)	2,000
	To Partners' Capital A/cs:			By Partners' Capital A/cs:	
	A (cash brought in to make good the firm)	2,000		A (final payment)	43,560
	B (cash brought in to make good the firm)	2,000		B (final payment)	29,040
	C (final dividend @ 60%)	3,600			
		1,05,600			1,05,600

Dr. **Partners' Capital Accounts** **Cr.**

Particulars	A	B	C	Particulars	A	B	C
To Balance b/d	—	—	5,000	By Balance b/d	45,000	30,000	—
To Realisation A/c (loss)	2,000	2,000	1,000	By Cash A/c (cash brought in)	2,000	2,000	—
To Partners' Capital A/cs — C	1,440	960	—	By Cash A/c (final dividend)	—	—	3,600
To Cash A/c (final payment)	43,560	29,040	—	By Partners' Capital A/cs — A	—	—	1,440
				By Partners' Capital A/cs — B	—	—	960
	47,000	32,000	6,000		47,000	32,000	6,000

Tutorial Note: Deficiency of C : ₹ (6,000 – 3,600 = 2,400) has been borne by A and B in their capital ratio, i.e., 45 : 30 or 3 : 2.

Illustration 18

A, B and C are in partnership sharing profits and losses as 3/6th, 2/6th and 1/6th respectively. The Balance Sheet on the date of dissolution was as follows:

Liabilities	₹	Assets	₹
Sundry Creditors	38,500	Cash in hand	9,860
A's Loan Account	2,750	Sundry Debtors	30,560
Capital Account: A	15,200	Stock	18,440
Capital Account: B	11,200	Furniture	7,200
		Capital Account : C (Dr.)	1,590
	67,650		67,650

The assets realised: Stock ₹ 13,840; Furniture ₹ 5,150; and Debtors ₹ 29,200. The creditors were paid less discount amounted to ₹ 250. A and B are solvent but C is insolvent and he is unable to bring in anything. The expenses of winding up were ₹ 520. You are required to prepare: (i) Realisation Account; (ii) Cash Account; and (iii) Capital Accounts of the Partners.

Solution

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars		₹
	To Sundry Debtors A/c	30,560		By Sundry Creditors A/c		38,500
	To Stock A/c	18,440		By Bank A/c:		
	To Furniture A/c	7,200		Stock	13,840	
	To Bank A/c (payment to creditors)	38,250		Furniture	5,150	
	To Bank A/c (expenses of winding up)	520		Sundry Debtors	29,200	48,190
				By Partners' Capital A/cs:		8,280
				(A — ₹ 4,140; B — ₹ 2,760; C — ₹ 1,380)		
		94,970				94,970

Dr. **A Loan Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Bank A/c	2,750		By Balance b/d	2,750

Dr. **Cash and Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	9,860		By Realisation A/c — creditors paid	38,250
	To Realisation A/c	48,190		By Realisation A/c — (winding-up expenses)	520
	To Partners' Capital A/cs:			By A Loan A/c	2,750
	A (cash brought in to make good the firm)	4,140		By Partners' Capital A/cs:	
	B (cash brought in to make good the firm)	2,760		A (final payment)	13,490
				B (final payment)	9,940
		64,950			64,950

Dr. **Partners' Capital Accounts** **Cr.**

Particulars	A	B	C	Particulars	A	B	C
To Balance b/d	—	—	1,590	By Balance b/d	15,200	11,200	—
To Realisation A/c (loss)	4,140	2,760	1,380	By Cash A/c (cash brought in)	4,140	2,760	—
To Partners' Capital A/cs — C	1,710	1,260	—	By Partners' Capital A/cs — A	—	—	1,710
To Cash A/c (final payment)	13,490	9,940	—	By Partners' Capital A/cs — B	—	—	1,260
	19,340	13,960	2,970		19,340	13,960	2,970

Tutorial Note: C's deficiency of ₹ 2,970 has been borne by A and B in their capital ratio, i.e., 15,200 : 11,200 or 152 : 112.

Illustration 19

P, Q, R and S, carrying on business as partners and sharing profits and losses in the ratio of 2 : 3 : 3 : 2, decided to discontinue their business from 1.1.2015. On 31.12.2014 their Balance Sheet was as follows:

Liabilities	₹	Assets	₹
Capital Accounts:		Plant and Machinery	30,000
(P — ₹ 10,000; Q — 4,000; R — 4,000; S — 3,000)	21,000	Furniture	10,000
Creditors	20,000	Cash at Bank	1,000
Bills Payable	10,000	Loss	15,000
Q Loan A/c	5,000		
	56,000		56,000

Further information regarding partners are stated below:

Partners		P	Q	R	S
Private Estate	(₹)	12,000	22,000	6,000	10,000
Private Liabilities	(₹)	18,000	8,000	5,000	12,000

The assets realised ₹ 26,000. The expenses of dissolution amounted to ₹ 1,000. Close the books of the firm.

Solution

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015	To Plant and Machinery A/c	30,000	2015	By Sundry Creditors A/c	20,000
Jan. 1	To Furniture A/c	10,000	Jan. 1	By Bills Payable A/c	10,000
	To Bank A/c (payment of creditors and B/P)	30,000		By Bank A/c (realisation of assets)	26,000
	To Bank A/c (expenses of dissolution)	1,000		By Partners' Capital A/cs:	
				(P — 3,000; Q — 4,500; R — 4,500; S — 3,000)	15,000
		71,000			71,000

Dr. **Partners' Capital Accounts** **Cr.**

Particulars	P	Q	R	S	Particulars	P	Q	R	S
To Loss	3,000	4,500	4,500	3,000	By Balance b/d	10,000	4,000	4,000	3,000
To Realisation A/c	3,000	4,500	4,500	3,000	By Bank A/c (Note 1)	—	4,500	1,000	—
To Partners' Capital A/cs:					By Partners' Capital A/cs:				
R (Note 1)	4,000	—	—	—	P	—	—	4,000	3,000
S (Note 1)	3,000	—	—	—	By Q Loan A/c	—	5,000	—	—
To Partners' Capital A/cs:					By Partners' Capital A/cs:				
P (Note 2)	—	3,000	—	—	Q (Note 2)	3,000	—	—	—
To Bank A/c	—	1,500	—	—					
	13,000	13,500	9,000	6,000		13,000	13,500	9,000	6,000

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015	To Balance b/d	1,000	2015	By Realisation A/c — (payment of creditors)	30,000
Jan. 1	To Realisation A/c (realisation of assets)	26,000	Jan. 1	By Realisation A/c — (expenses)	1,000
	To Partners' Capital A/cs:			By Partners' Capital A/cs:	
	Q (cash brought in to make good the firm)	4,500		Q (final payment)	1,500
	R (cash brought in to make good the firm)	1,000			
		32,500			32,500

Working Notes:

(1) S cannot pay his personal liabilities, so his balance of deficiency will be ₹ 3,000. R can only pay ₹ 1,000 from his private estate, so his deficiency will be (₹ 5,000 – 1,000) = ₹ 4,000. Therefore, total deficiency of R and S will be (₹ 4,000 + ₹ 3,000) = ₹ 7,000 and this should be borne by the solvent partners (i.e., P and Q) in their capital ratio just before dissolution. But before dissolution only P has credit balance and Q has negative balance, so P will bear the whole deficiency of ₹ 7,000.

(2) After debiting the deficiency of ₹ 7,000, P's Capital Account shows a debit balance of ₹ 3,000 but P cannot bring any money and ultimately Q will have to bear it.

Illustration 20

Ajay, Vijay, Ram and Shyam are partners in a firm sharing profits and losses in the ratio of 4 : 1 : 2 : 3. The following is their Balance Sheet as at 31.3.2015 :

Liabilities			₹	Assets			₹
Creditors			3,00,000	Debtors		3,50,000	
Capital Accounts :	Ajay	7,00,000		Less : Provision for bad debts		50,000	3,00,000
	Shyam	3,00,000	10,00,000	Cash			1,40,000
				Stock			2,00,000
				Other Assets			3,10,000
				Capital Accounts :	Vijay	2,00,000	
					Ram	1,50,000	3,50,000
			13,00,000				13,00,000

On 31.3.2015, the firm is dissolved and the following points are agreed upon :

Ajay is to take over debtors at 80% of book value; Shyam is to take over the stock at 95% of the value; and Ram is to discharge creditors. Other assets realise ₹ 3,00,000 and the expenses of realisation come to ₹ 30,000. Vijay is found insolvent and ₹ 21,900 is realised from his estate.

Prepare Realisation Account, Cash Account and Capital Accounts of the partners. The loss arising out of capital deficiency may be distributed following the decision in Garner vs. Murray.

Solution

In the books of the Firm

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015	To Debtors A/c	3,50,000	2015	By Provision for Bad Debts A/c	50,000
March 31	To Stock A/c	2,00,000	March 31	By Creditors A/c	3,00,000
	To Other Assets A/c	3,10,000		By Ajay Capital A/c (debtors taken over)	2,80,000
	To Ram Capital A/c (creditors discharged)	3,00,000		By Shyam Capital A/c (stock taken over)	1,90,000
	To Cash A/c (expenses)	30,000		By Cash A/c (other assets realised)	3,00,000
				By Partners' Capital A/cs :	
				(Ajay : ₹ 28,000; Vijay : ₹ 7,000;	
				Ram : ₹ 14,000; Shyam : ₹ 21,000)	70,000
		11,90,000			11,90,000

Dr. Cash Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2015	To Balance b/d	1,40,000	2015	By Realisation A/c (expenses)	30,000
March 31	To Realisation A/c (other assets)	3,00,000	March 31	By Partners' Capital A/cs :	
	To Partners' Capital A/cs :			Ajay	2,90,430
	Ajay	28,000		Ram	1,50,000
	Vijay	21,900		Shyam	54,470
	Ram	14,000			
	Shyam	21,000			
		5,24,900			5,24,900

Dr. Partners' Capital Accounts Cr.

Particulars	Ajay	Vijay	Ram	Shyam	Particulars	Ajay	Vijay	Ram	Shyam
To Balance b/d	—	2,00,000	1,50,000	—	By Balance b/d	7,00,000	—	—	3,00,000
To Realisation A/c	2,80,000	—	—	1,90,000	By Realisation A/c	—	—	3,00,000	—
To Realisation A/c (Loss)	28,000	7,000	14,000	21,000	By Cash A/c (Note 1)	28,000	—	14,000	21,000
To Vijay Capital A/c (WN 2)	1,29,570	—	—	55,530	By Cash A/c (Note 3)	—	21,900	—	—
To Cash A/c	2,90,430	—	1,50,000	54,470	By Ajay Capital A/c	—	1,29,570	—	—
					By Shyam Capital A/c	—	55,530	—	—
	7,28,000	2,07,000	3,14,000	3,21,000		7,28,000	2,07,000	3,14,000	3,21,000

Working Notes :

(1) Solvent partners should bring in cash to make good the loss on realisation.

(2) Vijay's deficiency of ₹ 1,85,100 (₹ 2,07,000 – ₹ 21,900) should be shared by Ajay and Shyam in the ratio of their capital, i.e., 7 : 3. Ram will not bear any loss on deficiency, because at the time of dissolution he had a debit balance in his Capital Account.

(3) The amount realised from the estate of Vijay.

Illustration 21

A, B, C and D were partners sharing profits and losses in the ratio of 3 : 3 : 2 : 2. Following was their Balance Sheet as on 31.12.2014 :

Liabilities			₹	Assets			₹
Capital Accounts :	A	60,000		Capital Accounts :	C	48,000	
	B	45,000	1,05,000		D	18,000	66,000
Creditors			46,500	Furniture			12,000
A's Loan			30,000	Trade Marks			21,000
				Stock			30,000
				Debtors		48,000	
				Less: Provision for bad debts		1,500	46,500
				Bank			6,000
			1,81,500				1,81,500

On 31.12.2014, the firm was dissolved and B was appointed to realise the assets and to pay off the liabilities. He was entitled to receive 5% commission on the amounts finally paid to other partners as capital. He was to bear the expenses of realisation. The assets were realised as follows : Debtors ₹ 33,000; Stock ₹ 24,000; Furniture ₹ 3,000; Trade Marks ₹ 12,000.

Creditors were paid off in full, in addition, a contingent liability for Bills Receivable discounted materialised to the extent of ₹ 7,500. Also, there was a joint life policy for ₹ 90,000. This was surrendered for ₹ 9,000. Expenses of realisation amounted to ₹ 1,500. C was insolvent but ₹ 11,100 was recovered from his estate.

Write up Realisation Account, Bank Account and Capital Accounts of the partners.

Solution

This problem could be solved in two ways :

1. When 5% commission payable to B is treated as '***Realisation Expenses***' and debited to Realisation Account.
2. When 5% commission payable to B is ***not*** treated as 'Realisation Expenses' and ***not*** debited to Realisation Account.

1. When 5% Commission to B is treated as Realisation Expenses

It has been given in the problem that B is entitled to 5% commission on the amounts finally payable to other partners as capital. B will bear the realisation expenses as per agreement. The main point in this problem is that B's commission is nothing but a realisation expenses to be given to B in the form of commission.

In this case, the solution of the problem will be as follows :

In the books of the Firm

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014	To Furniture A/c	12,000	2014	By Provision for Bad Debts A/c	1,500
Dec. 31	To Trade Marks A/c	21,000	Dec. 31	By Creditors A/c	46,500
	To Stock A/c	30,000		By Bank A/c (Note 1)	81,000
	To Debtors A/c	48,000		By Partners' Capital A/c :	
	To Bank A/c (Note 2)	54,000		(A : ₹ 11,153; B : ₹ 11,153	
	To B Capital A/c (Note 3) (Commission)	1,176		C : ₹ 7,435; D : ₹ 7,435)	37,176
		1,66,176			1,66,176

Dr. **Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014	To Balance b/d	6,000	2014	By Realisation A/c (Note 2)	54,000
Dec. 31	To Realisation A/c (Note 1)	81,000	Dec. 31	By A's Loan A/c	30,000
	To Partners' Capital A/cs (Note 3)			By Partners' Capital A/cs : (final payment)	
	C	11,100		A	23,512
	D	25,435		B	16,023
		1,23,535			1,23,535

Dr. **Partners' Capital Accounts** **Cr.**

Particulars	A	B	C	D	Particulars	A	B	C	D
To Balance b/d	—	—	48,000	18,000	By Balance b/d	60,000	45,000	—	—
To Realisation A/c (Loss)	11,153	11,153	7,435	7,435	By Bank A/c (final dividend)	—	—	11,100	—
To C Capital A/c (Note 4)	25,335	19,000	—	—	By Realisation A/c (Comm.)	—	1,176	—	—
To Bank A/c (final settlement)	23,512	16,023	—	—	By Bank A/c	—	—	—	25,435

	A	B	C	D		A	B	C	D
					By A Capital A/c (Note 4)	—	—	25,335	—
					By B Capital A/c (Note 4)	—	—	19,000	—
	60,000	46,176	55,435	25,435		60,000	46,176	55,435	25,435

Working Notes :

(1) Total assets realised = ₹ (33,000 + 3,000 + 24,000 + 12,000 + 9,000) = ₹ 81,000.

(2) Total payment = ₹ (46,500 + 7,500) = ₹ 54,000. A's loan has been paid directly.

(3) Calculation of commission payable to B :

Let B's commission = x

We can find out realisation loss before taking into account B's commission. It is ₹ 36,000.

Therefore, realisation loss after B's commission = ₹ 36,000 + x.

Share of A = 3/10 (36,000 + x) = 10,800 + 3x / 10

Share of C = 2/10 (36,000 + x) = 7,200 + 2x / 10

C's deficiency = ₹ 48,000 + (₹ 7,200 x 2x / 10) – ₹ 11,100 = ₹ 44,100 + x / 5

Share of A in C's deficiency = 4/7 of (44,100 + x/5) = ₹ 25,200 + 4x / 35

A will finally get ₹ 60,000 – (₹ 10,800 + 3x / 10 + 25,200 + 4x / 35) = ₹ 60,000 – ₹ 10,800 – 3x / 10 – 25,200 – 4x / 35

= ₹ 24,000 – (21x + 8x) / 70

= ₹ 24,000 – 29x / 70

x = 5% [24,000 – 29x / 70]

or, 5 / 100 [24.000 – 29x / 70]

or, x = 1,200 – .02071x

or, 1.0207x = 1,200

or, x = 1,200 / 1.02071

or, x = 1175.64 = 1,176 (say).

(4) C's deficiency is to be shared by A and B in their capital ratio of 60,000 : 45,000 or 4 : 3. D will not bear any deficiency loss because his capital is negative.

2. When 5% Commission Payable to B is not treated as Realisation Expenses

In this case, the 5% commission payable to B on the amount finally payable to other partners as capital is not debited to Realisation Account. The realisation loss is calculated without this commission. Commission payable to B is adjusted through Capital Account of the partners. The solution in this case will be as follows :

In the books of the Firm

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014	To Furniture A/c	12,000	2014	By Provision for Bad Debts A/c	1,500
Dec. 31	To Trade Marks A/c	21,000	Dec. 31	By Creditors A/c	46,500
	To Stock A/c	30,000		By Bank A/c (Note 1)	81,000
	To Debtors A/c	48,000		By Partners' Capital A/c (Loss) :	
	To Bank A/c (Note 2)	54,000		(A : ₹ 10,800; B : ₹ 10,800	
				C : ₹ 7,200; D : ₹ 7,200)	36,000
		1,65,000			1,65,000

Dr. Bank Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014	To Bank A/c	6,000	2014	By Realisation A/c (Note 2)	54,000
Dec. 31	To Realisation A/c (Note 1)	81,000	Dec. 31	By A's Loan A/c	30,000
	To C Capital A/c (final dividend)	11,100		By A Capital A/c	22,857
	To D Capital A/c	25,200		By B Capital A/c	16,443
		1,23,300			1,23,300

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	D	Particulars	A	B	C	D
To Balance b/d	—	—	48,000	18,000	By Balance b/d	60,000	45,000	—	—
To Realisation A/c (Loss)	10,800	10,800	7,200	7,200	By Bank A/c (final dividend)	—	—	11,100	—
To C Capital A/c (Note 3)	25,200	18,900	—	—	By A Capital A/c	—	—	25,200	—
To B Capital A/c (Note 4)	1,143	—	—	—	By B Capital A/c	—	—	18,900	—
To Bank A/c	22,857	16,443			By Bank A/c	—	—	—	25,200
					By A Capital A/c (Note 4)	—	1,143	—	—
	60,000	46,143	55,200	25,200		60,000	46,143	55,200	25,200

Working Notes :

(1) Total Assets Realised

	₹
Debtors	33,000
Stock	24,000
Furniture	3,000
Trade Mark	12,000
J.L.P. (Surrender Value)	9,000
	81,000

(2) Total Payments

	₹
Creditors	46,500
Contingent Liabilities	7,500
	54,000

(3) Deficiency of C

	₹
Debit balance in Capital Account	48,000
Realisation Loss (2/10 of ₹ 36,000)	7,200
	55,200
Less: Final dividend	11,100
Deficiency	44,100

A and B will share the above deficiency in the capital ratio of 60 : 45 or 12 : 9 or 4 : 3.

A's share of deficiency = 4/7 × ₹ 44,100	25,200
B;s share of deficiency = 3./7 × ₹ 44,100	18,900
	44,100

It is to be noted that D will not share any deficiency because his capital account was having debit balance.

(4) B's Commission

Amount payable to A	₹
Credit balance of Capital Account	60,000
Less: Realisation Loss	(10,800)
Less: C's share of deficiency	(25,200)
Amount payable to A before B's Commission	24,000

$$\text{B's Commission} = \frac{24{,}000}{105} \times 5 = ₹\ 1.143$$

(5) It has not been given in the problem that Garner vs. Murray principle is to be adopted. Therefore, solvent partner will ***not*** bring cash equal to realisation loss.

Students should note the following

Sl.No.	Items	1st Method	2nd Method
1.	Realisation Loss	37,176	36,000
2.	Amount of Commission to B	1,176	1,143
3.	Final Payment to Partners : A B	 23,512 16,023	 22,857 16,443
4.	Share of Deficiency : A B	 25,335 19,000	 25,200 18,900

Authors' View

Solution under 1st method is much more logical as it is taking into consideration the realisation expenses for calculating realisation loss. It is true that under this method, the calculation of commission to B is to some extent complicated. We recommend the solution under 1st method.

In the examination if you have time, then follow 1st method, otherwise you can solve it by the 2nd method.

Case 3 : Where All the Partners are Insolvent

When all the partners are insolvent and the firm's assets fall short of its liabilities, the creditors of the firm cannot be paid in full. The available cash with the firm (cash in hand + final dividend received from the partners' estate) is used first for paying realisation expenses. The balance amount is paid to creditors proportionally.

In order, to close the books of the firm, Realisation Account is prepared in the usual manner without transferring the liabilities to Realisation Account. All liabilities are discharged directly to the extent possible. Any balance left unpaid is transferred to Deficiency Account. The Partners' Capital Accounts are then closed by transferring to Deficiency Account.

The Accounting Entries are :

1. For payment of liabilities

Liabilities Account	Dr.	
To Cash/Bank Account		[Actual amount paid]
To Deficiency Account		[Unpaid amount]

2. For closing Partners' Capital Accounts

Deficiency Account	Dr.
To Partners' Capital Accounts	

Illustration 22

H and N were in equal partnership. Their Balance Sheet stood as under on 31st December, 2014 when the firm was dissolved:

Liabilities	₹	Assets	₹
Creditors	3,200	Machinery and Plant	1,200
H's Capital	400	Furniture	300
		Debtors	500
		Stock-in-trade	400
		Cash	180
		N's Drawings	1,020
	3,600		3,600

The assets realised were as follows: Machinery ₹ 600; Furniture ₹ 100; Debtors ₹ 400; and Stock-in-trade ₹ 300.

The expenses of realisation amounted to ₹ 140. H's private estate is not sufficient even to pay his private debts, whereas in N's private estate there is a surplus of ₹ 140 only. Give accounts to close the books of the firm

Solution

Dr. Realisation Account Cr.

Date	Particulars	₹	Date	Particulars		₹
2014	To Machinery and Plant A/c	1,200	2014	By Cash A/c:		
Dec. 31	To Furniture A/c	300	Dec. 31	Machinery	600	
	To Debtors A/c	500		Furniture	100	
	To Stock-in-trade A/c	400		Debtors	400	
	To Cash A/c (realisation expenses)	140		Stock-in-trade	300	1,400
				By Partners' Capital A/cs:		
				(H — ₹ 570; N — ₹ 570)		1,140
		2,540				2,540

Dr. Cash Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014	To Balance b/d	180	2014	By Realisation A/c (realisation expenses)	140
Dec. 31	To Realisation A/c (assets realised)	1,400	Dec. 31	By Creditors A/c (final payment to creditors)	1,580
	To Partners' Capital A/cs : N	140			
		1,720			1,720

Dr. Creditors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014	To Cash A/c	1,580	2014	By Balance b/d	3,200
Dec. 31	To Deficiency A/c	1,620	Dec. 31		
		3,200			3,200

Dr. **Partners' Capital Accounts** **Cr.**

Date	Particulars	H	N	Date	Particulars	H	N
2014 Dec. 31	To Drawings A/c To Realisation A/c (loss)	— 570	1,020 570	2014 Dec. 31	By Balance b/d By Cash A/c (final dividend) By Deficiency A/c	400 — 170	— 140 1,450
		570	1,590			570	1,590

Dr. **Deficiency Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Partners' Capital A/cs: (H — ₹ 170; N — ₹ 1,450)	1,620	2014 Dec. 31	By Creditors A/c	1,620
		1,620			1,620

Tutorial Note: When all the partners are insolvent, the balance of creditors account should not be transferred to Realisation Account. All available cash is to be used first for paying realisation expenses and the balance cash is paid to creditors. If there is any credit balance in the Creditors Account, it is transferred to Deficiency Account. The Capital Account is closed by transferring to Deficiency Account.

Illustration 23

A, B and C are equal partners, whose Balance Sheet on December 31, 2014 is as follows:

Liabilities	₹	Assets	₹
Sundry Creditors	5,000	Cash in hand	50
A's Loan	1,000	Stock	800
Capital A/cs:		Debtors	1,000
A	800	Plant & Machinery	2,000
C	500	Furniture & Fittings	800
		Land & Buildings	2,000
		B's Capital (overdrawn)	650
	7,300		7,300

Due to lack of liquidity and weak financial position of the partners, the firm is dissolved. A and C are not able to contribute anything and a sum of ₹ 200 received from B. All of them are declared insolvent. The assets are realised: Stock ₹ 500; Plant and Machinery ₹ 1,000; Furniture and Fittings ₹ 200; Land & Buildings ₹ 800; and Debtors ₹ 550 only. Realisation expenses amounted to ₹ 50. You are required to close the firm's books.

Solution

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars		₹
2014	To Stock A/c	800	2014	By Cash A/c:		
Dec. 31	To Debtors A/c	1,000	Dec. 31	Stock	500	
	To Plant & Machinery A/c	2,000		Plant & Machinery	1,000	
	To Furniture & Fittings A/c	800		Furniture & Fittings	200	
	To Land & Buildings A/c	2,000		Land & Buildings	800	
	To Cash A/c (realisation expenses)	50		Debtors	550	3,050
				By Partners' Capital A/cs:		
				(A — ₹ 1,200; B — ₹ 1,200; C — ₹ 1,200)		3,600
		6,650				6,650

Dr. **Cash Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014	To Balance b/d	50	2014	By Realisation A/c (expenses)	50
Dec. 31	To Realisation A/c (assets realised)	3,050	Dec. 31	By Creditors A/c (final payment)	3,250
	To Partners' Capital A/cs : B	200			
		3,300			3,300

Dr. **Sundry Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014	To Cash A/c (final payment)	3,250	2014	By Balance b/d	5,000
Dec. 31	To Deficiency A/c	1,750	Dec. 31		
		5,000			5,000

Dr. **Deficiency Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Partners' Capital A/cs: (B — ₹ 1,650; C — ₹ 700)	2,350	2014 Dec. 31	By Sundry Creditors A/c	1,750
				By Partners' Capital A/cs : A	600
		2,350			2,350

Dr. **Partners' Capital Accounts** **Cr.**

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2014	To Balance b/d	—	650	—	2014	By Balance b/d	800	—	500
Dec. 31	To Realisation A/c (loss)	1,200	1,200	1,200	Dec. 31	By Cash A/c (final div.)	—	200	—
	To Deficiency A/c	600	—	—		By A Loan A/c	1,000	—	—
						By Deficiency A/c	—	1,650	700
		1,800	1,850	1,200			1,800	1,850	1,200

Illustration 24

Following is the Balance Sheet as on 31st March, 2015 of a firm, having three partners, Alfa, Beta and Gama sharing profits and losses equally.

Liabilities	₹	Assets	₹
Sundry Creditors	20,000	Cash	3,120
Loan (secured by furniture)	10,000	Stock	15,630
Capital A/cs:		Debtors	4,720
Alfa	8,000	Furniture	9,530
Beta	6,000	Profit and Loss	12,000
Gama	1,000		
	45,000		45,000

The firm was dissolved due to insolvency of all the partners. Stock was sold for ₹ 9,900 while furniture fetched ₹ 5,000. ₹ 4,100 were recovered from debtors. Realisation expenses totalled ₹ 220.

Nothing could be recovered from Beta and Gamma, but ₹ 600 could be collected from Alfa's private estate. Close the books of the firm.

Solution

In the books of the Firm

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015	To Stock A/c	15,630	2015	By Cash A/c (assets realised) :	
Mar 31	To Debtors A/c	4,720	Mar 31	Stock 9,900	
	To Furniture A/c	9,530		Furniture 5,000	
	To Cash A/c (expenses)	220		Debtors 4,100	19,000
				By Partners' Capital A/cs: (Alfa : 3,700; Beta : 3,700; Gama : 3,700)	11,100
		30,100			30,100

Dr. **Cash Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015	To Balance b/d	3,120	2015	By Realisation A/c (expenses)	220
Mar 31	To Realisation A/c (assets realised)	19,000	Mar 31	By Loan A/c (upto realisable value of furniture)	5,000
	To Partners' Capital A/cs : Alfa	600		By Loan A/c	3,500
				By Sundry Creditors A/c	14,000
		22,720			22,720

Dr. **Loan Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015	To Cash A/c (upto realised value of furniture)	5,000	2015	By Balance b/d	10,000
Mar 31	To Cash A/c (Note 1)	3,500	Mar 31		
	To Deficiency A/c	1,500			
		10,000			10,000

Dr. **Sundry Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015	To Cash A/c (Note 1)	14,000	2015	By Balance b/d	20,000
Mar 31	To Deficiency A/c	6,000	Mar 31		
		20,000			20,000

Dr. **Partners' Capital Accounts** **Cr.**

Date	Particulars	Alfa	Beta	Gama	Date	Particulars	Alfa	Beta	Gama
2015	To Profit and Loss A/c	4,000	4,000	4,000	2015	By Balance b/d	8,000	6,000	1,000
Mar 31	To Realisation A/c (loss)	3,700	3,700	3,700	Mar 31	By Cash A/c	600	—	—
	To Deficiency A/c	900	—	—		By Deficiency A/c	—	1,700	6,700
		8,600	7,700	7,700			8,600	7,700	7,700

Dr. **Deficiency Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015	To Beta Capital A/c	1,700	2015	By Loan A/c	1,500
Mar 31	To Gama Capital A/c	6,700	Mar 31	By Sundry Creditors A/c	6,000
				By Alfa Capital A/c	900
		8,400			8,400

Working Note : (1) Loan is secured by furniture and has a priority over sundry creditors upto the amount realised from furniture — which is ₹ 5,000. For the remaining loan, it is at par with sundry creditors. Total cash available to pay out loan and sundry creditors is ₹ 17,500 (₹ 3,120 + ₹ 19,000 + 600 – 220 – 5,000) which will be shared by Loan and Sundry Creditors in the ratio of their resultant claim, i.e., 5,000 : 20,000 = 1 : 4.

Illustration 25

X, Y and Z were in partnership sharing profits and losses in the ratio of 1/5 : 3/10 : 1/2. They prepared the following Balance Sheet as on 30.6.2014, when they decided to dissolve.

Liabilities	₹	Assets	₹
Capital A/cs:		Plant & Machinery	50,000
X	30,000	Sundry Debtors	2,00,000
Y	40,000	Advance to X	20,000
Z	30,000	Profit and Loss A/c (Balance)	80,000
Trade Creditors	1,20,000	Cash	10,000
Loan from Z (advanced 1.7.2013)	20,000		
Loan from Bank on Book debts and Plant	1,20,000		
	3,60,000		3,60,000

You ascertain that the balance in Profit and Loss Account is prior to charging interest, Plant and Machinery and Debtors realised ₹ 2,00,000. X's private estate which was valued at ₹ 70,000 has a liability thereon ₹ 30,000. The private estate realised only ₹ 40,000. Y is insolvent. Z can pay only 50 paise in the rupee of what is payable on his own account to the partnership.

Show Realisation Account, Cash Account and Partners' Capital Accounts. The loss on realisation is to be determined after considering the amount ultimately paid to creditors.

Solution

Dr. **Realisation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014	To Plant & Machinery A/c	50,000	2014	By Trade Creditors A/c	1,20,000
June 30	To Sundry Debtors A/c	2,00,000	June 30	By Loan from Bank A/c	1,20,000
	To Cash A/c (payment of bank loan)	1,20,000		By Cash A/c (realisation of assets)	2,00,000
	To Cash A/c (payment to creditors)	1,02,933		By Partners' Capital A/cs: (X — ₹ 6,586; Y — ₹ 9,880; Z — 16,467)	32,933
		4,72,933			4,72,933

Dr. **Cash Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014	To Balance b/d	10,000	2014	By Realisation A/c (payment of bank loan)	1,20,000
June 30	To Realisation A/c	2,00,000	June 30	By Realisation A/c (payment to creditors)	1,02,933
	To Partners' Capital A/cs: (X — ₹ 10,000; Z — ₹ 2,933 — Note 4)	12,933			
		2,22,933			2,22,933

Dr. **Deficiency Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014	To Partners' Capital A/cs		2014	By Partners' Capital A/cs : Y	5,760
June 30	(X — ₹ 2,826; Z — ₹ 2,934)	5,760	June 30		
		5,760			5,760

Dr. Partners' Capital Accounts Cr.

Particulars	X	Y	Z	Particulars	X	Y	Z
To Profit & Loss A/c (2 : 3 : 5) (including interest on loan of Z @ 6%)	16,240	24,360	40,600	By Balance b/d	30,000	40,000	30,000
				By Loan A/c (incl. interest @ 6%)	—	—	21,200
To Advance A/c	20,000	—	—	By Cash A/c (₹ 40,000 – 30,000)	10,000	—	2,933
To Realisation A/c	6,586	9,880	16,467	By Deficiency A/c	2,826	—	2,934
To Deficiency A/c	—	5,760	—				
	42,826	40,000	57,067		42,826	40,000	57,067

Working Notes:

Dr. (1) Realisation Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014	To Plant & Machinery A/c	50,000	2014	By Trade Creditors A/c	1,20,000
June 30	To Sundry Debtors A/c	2,00,000	June 30	By Loan from Bank A/c	1,20,000
	To Cash A/c (payment of bank loan)	1,20,000		By Cash A/c (realisation of assets)	2,00,000
	To Cash A/c (payment to creditors)	X + 1,00,000		By Loss on Realisation A/c	X + 30,000
		X + 4,70,000			X + 4,70,000

Dr. (2) Cash Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014	To Balance b/d	10,000	2014	By Realisation A/c (payment of bank loan)	1,20,000
June 30	To Realisation A/c	2,00,000	June 30	By Realisation A/c (payment to creditors)	X + 1,00,000
	To X Capital A/c (₹ 40,000 – ₹ 30,000)	10,000			
	To Z Capital A/c	X			
		X + 2,20,000			X + 2,20,000

Dr. (3) Z Capital Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014	To Profit & Loss A/c	40,600	2014	By Balance b/d	30,000
June 30	To Realisation A/c (1/2 loss)	X/2 + 15,000	June 30	By Loan A/c (including interest)	21,200
				By Cash A/c	1/2 (X/2 + 4,400)
				By Deficiency A/c	1/2 (X/2 + 4,400)
		X/2 + 55,600			X/2 + 55,600

(4) Let the amount brought in by Z = X. X = 1/2 (X/2 + 4,400); or, 2X = X/2 + 4,400; or, 4X = X + 8,800; or, 3X = 8,800; or, X = 2,933. Therefore, Z will bring in ₹ 2,933.

Gradual Realisation of Assets and Piece-meal Distribution

In all the previous illustrations, one of the following two assumptions has been made:

(i) all the assets are realised simultaneously and all the liabilities are settled together, before the partners are paid off; or

(ii) when the assets were sold gradually, partners are paid off after realisation of ***all the assets*** and payment of all the liabilities.

In actual practice, the above assumptions are unrealistic. In fact, when a partnership is in the process of being dissolved, assets are sold gradually one after another to fetch maximum possible price. However, all the assets may be realised at a time if the business is being sold as a single unit.

When the assets are realised individually (some through agent or tender or auction), it may take several months to realise all the assets. The partners, in such a case, do not wish to wait till all the assets are realised. It is universally accepted practice that an interim distribution is made to the partners for their claims (of course, after paying off creditors) as and when cash is available for this purpose. There are two problems associated with this practice.

First, the profit-sharing ratio of the partners may not be as per their capital contribution.

Secondly, there is uncertainty of future realisations.

Therefore, when one asset is realised, partners are not paid off in their profit-sharing ratio. Instead, available cash is distributed in such a fashion that a partner, who has contributed more capital as compared to other partners, gets his surplus capital back in priority.

At the same time, at every stage of distribution, each partner bears his share of possible losses, thus avoiding overpayment to any partner and the necessity of recoupment from him at a subsequent stage. For achieving these objectives, any of the following two methods may be adopted: (i) Surplus Capital Method; or (ii) Maximum Loss Method

Priority of Distribution

When the assets are realised gradually, available cash at any particular point of time should be utilised in the following manner:

1. To meet the realisation expenses.
2. To pay off preferential creditors (e.g., government rates and taxes, etc)
3. To pay off other creditors. All the creditors are to be paid off in the ratio of their individual claim. But a secured creditor get a priority over ordinary creditors upto the amount realised from that particular asset by which his claim is secured by the firm. But for the balance of his claim, he is at par with other ordinary creditors.
4. To pay off partners' loans.
5. To pay off partners' capitals.

Surplus Capital Method

This method is suitable when the following two conditions are satisfied:

(a) the partners' profit-sharing ratio is not as per their capital contribution; and

(b) all the partners are solvent and are likely to remain so.

The partners with the absolute surplus capitals are paid off first, followed by payment to others having surplus capitals. At last, payment is to be made to the partners in the profit-sharing ratio. The surplus capital is calculated as follows :

Step 1 Divide adjusted capital (Capital Account + Current Account + Share of Reserve) of each partner by his profit-sharing ratio. The smallest quotient should be taken as ***Base Capital***.

Step 2 Calculate relative capital by multiplying base capital and profit-sharing ratio of each partner.

Step 3 Calculate surplus capital by deducting relative capital (Step 2) from adjusted capital of each partner.

Step 4 Divide surplus capital (Step 3) by profit-sharing ratio of each partner. The smallest quotient should be taken as ***Revised Base Capital***.

Step 5 Again, calculate relative capital by multiplying revised base capital and profit-sharing ratio.

Step 6 Calculate absolute surplus capital by deducting revised base capital from surplus capital (Step 3).

Illustration 26

From the following information calculate absolute surplus capital:

(i) Partners' Capital Accounts balances as per last Balance Sheet : A ₹ 40,000; B ₹ 25,000; C ₹ 10,000.
(ii) General Reserve as per last Balance Sheet : ₹ 12,000.
(iii) Profit Sharing Ratio 3 : 2 : 1.

Solution **Calculation of Absolute Surplus Capital**

Step	Particulars	A (₹)	B (₹)	C (₹)
	Capital Accounts	40,000	25,000	10,000
	General Reserve (3 : 2 : 1)	6,000	4,000	2,000
	(1) **Adjusted Capital**	46,000	29,000	12,000
	(2) Profit-sharing ratio	3	2	1
STEP 1	(3) [(1)/ (2)]	15,333	14,500	$\boxed{12,000}$
	(4) Base Capital (being smallest)	—	—	12,000
STEP 2	(5) Relative Capital (4) x (2)	36,000	24,000	12,000
STEP 3	(6) [(1) – (5)] = **Surplus Capital**	10,000	5,000	—
STEP 4	(7) [(6) / (2)]	3,333	2,500	—
	(8) Revised Base Capital (being smaller)	—	$\boxed{2,500}$	—
STEP 5	(9) Relative Capital [(8) x (2)]	7,500	5,000	—
STEP 6	(10) [(6) – (9)] **Absolute Surplus Capital**	2,500	Nil	Nil

Illustration 27

P, Q and R are partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1. Their Balance Sheet is as follows :

Liabilities	₹	Assets	₹
P's Capital	24,000	Sundry Assets	50,000
Q's Capital	16,000		
R's Capital	10,000		
	50,000		50,000

They dissolved the firm and the assets were realised as: (i) 1st instalment ₹ 20,000; (ii) 2nd instalment ₹ 12,000 (iii) 3rd instalment ₹ 3,000. Prepare a statement showing how the amounts realised should be distributed as and when they are received.

Solution **Calculation of Absolute Surplus Capital**

		P (₹)	Q (₹)	R (₹)
	(1) Capital Accounts	24,000	16,000	10,000
	(2) Profit sharing ratio	3	2	1
STEP 1	(3) [(1)/(2)]	$\boxed{8,000}$	8,000	10,000
	(4) Base Capital (being smallest)	8,000	—	—
STEP 2	(5) Relative Capital (4) x (2)	24,000	16,000	8,000
STEP 3	(6) [(1) – (5)] **Surplus Capital**	Nil	Nil	2,000

Statement Showing Priority of Distribution

First, ₹ 2,000 to be paid to R. The balance of first realisation ₹ (20,000 – 2,000) = 18,000 to be paid to P, Q and R in the profit-sharing ratio. All subsequent realisations also to be distributed among P, Q and R in the profit-sharing ratio.

Statement Showing Distribution of Proceeds of Realisation

	Amount available (₹)	Capitals P (₹)	Q (₹)	R (₹)
Amount due		24,000	16,000	10,000
First Realisation	20,000			
Less: Paid to R (surplus capital)	2,000	—	—	2,000
Balance	18,000			
Less: Paid to P, Q and R (3 : 2 : 1)	18,000	9,000	6,000	3,000
Balance due		15,000	10,000	5,000
Second Realisation	12,000			
Less: Paid to P, Q and R (3 : 2 : 1)	12,000	6,000	4,000	2,000
Balance due		9,000	6,000	3,000
Third Realisation	3,000			
Less: Paid to P, Q and R (3 : 2 : 1)	3,000	1,500	1,000	500
Balance due (being loss on realisation)		7,500	5,000	2,500

Illustration 28

A, B and C were partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1. The partnership was dissolved on 30.9.2014 when the Balance Sheet was as follows :

Liabilities	₹	Assets	₹
Capitals : A : ₹ 12,000; B : ₹ 11,000; C : ₹ 3,000	26,000	Cash	8,000
Loan : A : ₹ 6,000; B : ₹ 10,000	16,000	Debtors	19,000
Creditors	25,000	Stock	40,000
	67,000		67,000

It was agreed that net realisations should be distributed in due order at the end of each month. The realisations and expenses were as follows (all figures in ₹) :

	October 2014	November 2014	December 2014	January 2015	February 2015
Debtors	5,000	3,000	5,000	2,000	3,000
Stock	8,000	8,000	12,000	10,600	1,000
Expenses	2,000	1,000	1,000	2,000	500

The stock was completely disposed off. It was agreed that C should take over the remaining debtors of ₹ 100.

Show the distribution of cash as and when realised.

Solution

Calculation of Absolute Surplus Capital

Step	Particulars	A (₹)	B (₹)	C (₹)
	(1) Capital Accounts	12,000	11,000	3,000
	(2) Profit sharing ratio	3	2	1
STEP 1	(3) [(1)/(2)]	4,000	5,500	$\boxed{3{,}000}$
	(4) Base Capital (being smallest)	—	—	3,000
STEP 2	(5) Relative Capital (4) x (2)	9,000	6,000	3,000
STEP 3	(6) [(1) – (5)] = **Surplus Capital**	3,000	5,000	—
STEP 4	(7) [(6) / (2)]	$\boxed{1{,}000}$	2,500	—
	(8) Relative Base Capital (being smaller)	1,000	—	—
STEP 5	(9) Relative Capital [(8) x (2)]	3,000	2,000	—
STEP 6	(10) [(6) – (9)] **Absolute Surplus Capital**	—	3,000	—

Statement Showing Priority of Distribution

First, ₹ 25,000 to be paid to the creditors.
Next, ₹ 16,000 to be paid to A and B in the ratio of 3 : 5 for their loan.
Next, ₹ 3,000 to be paid to B for Absolute Surplus.
Next, ₹ 5,000 to be paid to A and B in the ratio of 3 : 2.
Balance to be paid to A, B and C in the ratio of 3 : 2 : 1.

Cash Available in Each Month

Month	Debtors	Stock	Expenses	Cash Available
October 2014	5,000	8,000	2,000	11,000
November 2014	3,000	8,000	1,000	10,000
December 2014	5,000	12,000	1,000	16,000
January 2015	2,000	10,600	2,000	10,600
February 2015	3,000	1,000	500	3,500

Statement Showing Distribution of Proceeds of Realisation

	Amount available	Creditors ₹	Loan A	Loan B	Capitals A	Capitals B	Capitals C
Amount Due		25,000	6,000	10,000	12,000	11,000	3,000
Cash (Note 1)	8,000						
Less : Paid to Creditors	8,000	8,000	—	—	—	—	—
Balance Due		17,000	6,000	10,000	12,000	11,000	3,000
Net Realisation of October 2014	11,000						
Less : Paid to Creditors	11,000	11,000	—	—	—	—	—
Balance Due		6,000	6,000	10,000	12,000	11,000	3,000
Net Realisation of November 2014	10,000						
Less : Paid to Creditors	6,000	6,000					
	4,000						
Less : Paid to A and B (Loan) 3 : 5	4,000	—	1,500	2,500	—	—	—
Balance Due			4,500	7,500	12,000	11,000	3,000
Net Realisation of December 2014	16,000						
Less : Paid to A and B (Loan)	12,000		4,500	7,500	—	—	—
	4,000						
Less : Paid to B (Absolute Surplus)	3,000		—	—	—	3,000	—
	1,000						
Less: Paid to A and B (3 : 2)	1,000		—	—	600	400	—
Balance Due					11,400	7,600	3,000
Net Realisation of January 2015	10,600						
Less : Paid to A and B (3 : 2)	4,000				2,400	1,600	—
	6,600						
Less : Paid to A, B and C (3 : 2 : 1)	6,600				3,300	2,200	1,100
Balance Due					5,700	3,800	1,900
Net Realisation of February 2015	3,500						
Add : Debtors taken over by C	100						
	3,600						
Less : Paid to A, B and C (3 : 2 : 1)	3,600				1,800	1,200	*600
Balance left unpaid (Being loss on realisation)					3,900	2,600	1,300

Working Note : (1) It is assumed that cash was distributed immediately. * It includes ₹ 100 for debtors.

Illustration 29

A, B and C are in partnership sharing profits and losses in the ratio of 3 : 2 : 1. They decided to dissolve the business on 31.12.2014, on which date their Balance Sheet was as follows :

Liabilities			₹	Assets	₹
Capital Accounts :	A	38,700		Land and Buildings	30,810
	B	10,680		Motor Car	5,160
	C	11,100	60,480	Investments	1,080
Loan Account :	C		3,000	Stock	19,530
Creditors			10,320	Debtors	11,280
				Cash	5,940
			73,800		73,800

The assets were realised piece-meal as follows and it was agreed that cash should be distributed as and when realised.

15.1.2015 — ₹ 10,380; 20.2.2015 — ₹ 27,900; 23.3.2015 — ₹ 3,600; 15.4.2015 — C took over investments at a value of ₹ 1,260; 27.4.1996 — ₹ 19,200.

Dissolution expenses were originally provided for an estimated amount of ₹ 2,700 but actual amount spent on 29.3.2015 was ₹ 1,920. The creditors were settled for ₹ 10,080.

You are required to prepare a statement showing distribution of cash amongst the partners.

Solution

Calculation of Absolute Surplus Capital

Step	Particulars	A (₹)	B (₹)	C (₹)
	(1) Capital Accounts	38,700	10,680	11,100
	(2) Profit sharing ratio	3	2	1
STEP 1	(3) [(1)/(2)]	12,900	$\boxed{5,340}$	11,100
	(4) Base Capital (being smallest)	—	5,340	—
STEP 2	(5) Relative Capital (4) x (2)	16,020	10,680	5,340
STEP 3	(6) [(1) – (5)] = **Surplus Capital**	22,680	—	5,760
STEP 4	(7) [(6) / (2)]	7,560	—	$\boxed{5,760}$
	(8) Relative Base Capital (being smaller)	—	—	5,760
STEP 5	(9) Relative Capital [(8) x (2)]	17,280	—	5,760
STEP 6	(10) [(6) – (9)] **Absolute Surplus Capital**	5,400	—	—

Statement Showing Priority of Distribution

First, ₹ 10,080 to be paid to the creditors (adjusting discount) after providing ₹ 2,700 for dissolution expenses.
Next, ₹ 3,000 to be paid to C for loan.
Next, ₹ 5,400 to be paid to A for Absolute Surplus.
Next, ₹ 23,040 to be paid to A and C in the ratio of 3 : 1.
Balance to be paid to A, B and C in the ratio of 3 : 2 : 1.

Statement Showing Distribution of Proceeds of Realisation

	Amount available	Creditors ₹	Loan	Capitals		
			C	A	B	C
Amount Due		10,320	3,000	38,700	10,680	11,100
Cash in hand	5,940					
Less: Provision for dissolution expenses	2,700					
	3,240					
Less: Paid to the Creditors	3,240	3,240				
Balance Due		7,080	3,000	38,700	10,680	11,100
Realisation of 15.1.2015	10,380					
Less: Paid to the Creditors	6,840	6,840	—	—	—	—
	3,540	240	—	—	—	—
Less: Paid to C (Loan)	3,000	—	3,000			
Adjusted for discount received	—	240				
	540					
Less: Paid to A (Absolute Surplus)	540			540		
Balance Due				38,160	10,680	11,100
Realisation of 20.2.2015	27,900					
Less: Paid to A (Absolute Surplus)	4,860			4,860	—	—
	23,040					
Less: Paid to A and C (3 : 1)	23,040			17,280	—	5,760

Balance Due				16,020	10,680	5,340
Realisation of 23.3.2015	3,600					
Less: Paid to A, B and C (3 : 2 : 1)	3,600			1,800	1,200	600
Balance Due				14,220	9,480	4,740
Surplus of dissolution expenses : ₹ (2,700 – 1,920)	780					
Less: Paid to A, B and C (3 : 2 : 1)	780			390	260	130
Balance Due				13,830	9,220	4,610
Investments taken over by C (Note 1)				—	—	1,260
Realisation of 27.4.2015	19,200					
Less: Paid to A and B (Note 2)	6,300			3,780	2,520	—
	12,900					
Less : Paid to A, B and C (3 : 2 : 1)	12,900			6,450	4,300	2,150
Balance left unpaid (Being loss on realisation)				3,600	2,400	1,200

Working Note :

(1) Technically, C will be allowed to take over investments only after the realisation of 27th April.

(2) Out of realisation of 27.4.2015, ₹ 3,780 (1,260 / 1 x 3) to be paid to A and ₹ 2,520 (1,260 / 1 x 2) to B to adjust the value of investments taken over by C. The balance is to be distributed among A, B and C in the ratio of 3 : 2 : 1.

Illustration 30

Vidya, Veena and Vibha were in partnershp sharing profits and losses as 3:2:1 respectively. The partnership was dissolved on 31st March 2015 following Vidya's proceeding abroad. The Balance sheet of the firm on that date was as follows:

Liabilities	₹	Assets	₹
Capital A/cs:		Cash in hand	28,000
Vidya	1,40,000	Sundry Debtors	2,94,000
Veena	70,000	Stock-in-trade	1,12,000
Vibha	14,000		
Creditors	2,10,000		
	4,34,000		4,34,000

There was a contingent liability in respect of a bill for ₹ 10,000 due on 25th August 2015 under discount. It was agreed that the net realisation should be distributed in their due order (at the end of each month) but as safely as possible. The realisation and expenses were as under:

2015	Stock and Debtors (₹)	Expenses (₹)
April	84,000	7,000
May	1,26,000	5,400
June	70,000	4,900
July	77,000	3,500
August	35,500	3,500

The Stock was completely disposed of and amounts due from debtors were realised, the balance being irrecoverable. the acceptor of bill under discount met the bill on due date. Prepare statement showing piecemeal distribution, using Surplus Capital Method.

Solution **Calculation of Absolute Surplus Capital**

Step	Particulars	Vidya (₹)	Veena (₹)	Vibha (₹)
	(1) Capital Accounts	1,40,000	70,000	14,000
	(2) Profit sharing ratio	3	2	1
STEP 1	(3) [(1)/(2)]	46,667	35,000	14,000
	(4) Base Capital (being smallest)	—	—	14,000
STEP 2	(5) Relative Capital (4) x (2)	42,000	28,000	14,000
STEP 3	(6) [(1) – (5)] = **Surplus Capital**	98,000	42,000	—
STEP 4	(7) [(6) / (2)]	32,667	21,000	—
	(8) Revised Base Capital (being smaller)	—	21,000	—
STEP 5	(9) Relative Capital [(8) x (2)]	63,000	42,000	—
STEP 6	(10) [(6) – (9)] **Absolute Surplus Capital**	35,000	Nil	Nil

Cash Available in Each Month

Month	Stock and Debtors	Expenses	Cash available
April	84,000	7,000	77,000
May	1,26,000	5,400	1,20,600
June	70,000	4,900	65,100
July	77,000	3,500	73,500
August	35,500	3,500	32,000

Statement Showing Priority of Distribution

First ₹ 2,10,000 to be paid to the creditors.
Next ₹ 10,000 to be kept for Contingent liability in respect of bill under discount.
Next ₹ 35,000 to be paid to Vidya.
Next ₹ (63,000 + 42,000) = ₹ 1,05,000 to be paid to Vidya and Veena in the ratio 3:2.
Balance in the profit sharing ratio to Vidya, Veena and Vibha.

Statement Showing Distribution of Proceeds of Realisation

	Amount available	Creditors ₹	Capitals		
			Vidya	Veena	Vibha
Amount due		2,10,000	1,40,000	70,000	14,000
Cash in hand	28,000				
Less: Paid to the creditors	28,000	28,000	—	—	—
Balance due		1,82,000	1,40,000	70,000	14,000
Realisation of April	77,000				
Less: Paid to the creditors	77,000	77,000	—	—	—
Balance due		1,05,000	1,40,000	70,000	14,000
Realisation of May	1,20,600				
Less: Paid to the creditors	1,05,000	1,05,000	—	—	—
	15,600				
Less: Retained for contingent liability (See Note)	10,000			—	—
Less: Paid to Vidya (absolute surplus capital)	5,600		5,600		
Balance due			1,34,400	70,000	14,000
Realisation of June	65,100				
Less: Paid to Vidya (Absolute Surplus)	29,400		29,400	—	—
	35,700				
Less: Paid to Vidya and Veena (3:2)	35,700		21,420	14,280	—
Balance due			83,580	55,720	14,000
Realisation of July	73,500				
Less: Paid to Vidya and Veena (3:2)	69,300		41,580	27,720	—
	4,200				
Less: Paid to Vidya, Veena and Vibha (3:2:1)	4,200		2,100	1,400	700
Balance due			39,900	26,600	13,300
Realisation of August	32,000				
Add: Retained amount for contingent liabilities	10,000				
	42,000				
Less: Paid to Vidya, Veena and Vibha (3:2:1)	42,000		21,000	14,000	7,000
Balance left unpaid (Being loss on realisation)			18,900	12,600	6,300

Tutorial Note : After paying creditors in full, an amount should be provided for bill under discount to the extent of ₹ 10,000. If the bill is met at maturity, the amount provided earlier will be available for distribution amongst the partners.

Maximum Loss Method

This method is suitable when a partner or (partners) is known to be insolvent or is likely to be so. Under this method, every instalment realised is considered as final realisation, i.e., the remaining assets and claims are worthless. The maximum possible loss (Balance due *minus* assets realised) is distributed among all the partners in the profit-sharing ratio. Any partner(s) whose apportioned loss exceeds his balance due is assumed for this purpose to be insolvent and his negative balance will be shared by the solvent partners in their capital ratio ***[assuming Garner Vs. Murray]***. This process is repeated till the negative balance is abolished. The partners having positive balance is paid-off first.

The same principle is to be followed for all subsequent realisations.

In this connection, it should be noted that: (i) cash in hand is to be considered as first realisation; and (ii) for calculating capital ratio, balance of capital account and share of reserve and surplus are to be considered when capitals are fluctuating. However, when capitals are fixed, no adjustment is required.

Illustration 31

Partners A, B and C share profits in the proportion of 1/2, 1/3 and 1/6. Their Balance Sheet is as follows:

Liabilities	₹	Assets	₹
Capital Accounts:		Sundry Assets	80,000
A	30,000		
B	30,000		
C	20,000		
	80,000		80,000

The firm is dissolved and assets are realised as follows:

First realisation ₹ 10,000; Second realisation ₹ 15,000; and Third and final realisation ₹ 25,000.

Prepare a statement showing how the distributions should be made applying Garner v. Murray principle.

Statement Showing Distribution of Cash on Capital Accounts

	Total	Capitals		
	₹	A	B	C
(1) Distribution of ₹ 10,000 (first realisation)				
Balance due	80,000	30,000	30,000	20,000
Less: Possible loss, assuming remaining assets proved to be worthless (3 : 2 : 1)	70,000	35,000	23,333	11,667
		(–) 5,000	(+) 6,667	(+) 8,333
Deficiency of A's capital written-off against those of B and C in the ratio of their capitals 3 : 2		(–) 5,000	3,000	2,000
Manner in which ₹ 10,000 is to be distributed		Nil	3,667	6,333
(2) Distribution of ₹ 15,000 (second realisation)				
Balance due after making payment as above	70,000	30,000	26,333	13,667
Less: Possible loss, assuming remaining assets proved to be worthless (3 : 2 : 1)	55,000	27,500	18,333	9,167
Manner in which ₹ 15,000 is to be distributed	15,000	2,500	8,000	4,500
(3) Distribution of ₹ 25,000 (final realisation)				
Balance due after making payment as above	55,000	27,500	18,333	9,167
Less: Possible loss, assuming remaining assets proved to be worthless (3 : 2 : 1)	30,000	15,000	10,000	5,000
Manner in which ₹ 25,000 is to be distributed	25,000	12,500	8,333	4,167

Illustration 32

Rahim, Antony and Prasad were in partnership sharing profits and losses in proportion to 5:4:3.

They agreed to dissolve the firm on 1st January, 2015 on which date their assets and liabilities were as under:

Liabilities		₹	Assets	₹
Creditors		76,000	Debtors	1,45,000
Loan from Antony		9,000	Stock	1,50,000
Capital Accounts:	Rahim	1,20,000	Plant	50,000
	Anthony	90,000	Furniture	10,000
	Prasad	60,000		
		3,55,000		3,55,000

The assets were realised in the following instalments and the proceeds were distributed as and when realised:

1st instalment 50,000; 2nd instalment 30,000; 3rd instalment 21,000; 4th instalment 90,000; 5th instalment 84,000.

The cost of dissolution was estimated at ₹ 5,000 and the amount was kept as reserve before distribution of the proceeds until the 3rd instalment when the actual cost of ₹ 4,000 was met.

Prepare a statement showing the distribution of each instalment realised.

Solution **Statement Showing Realisation and Distribution of Cash**

Particulars	Realisation	Expenses	Creditors	Loan from Anthony	Partners' Capitals
1st instalment	50,000	5,000	45,000	—	—
2nd instalment	30,000	—	30,000	—	—
3rd instalment including excess of realisation expenses	22,000	—	1,000	9,000	12,000
4th instalment	90,000	—	—	—	90,000
5th instalment	84,000	—	—	—	84,000
TOTAL	2,76,000	5,000	76,000	9,000	1,86,000

Statement Showing Distribution of Cash on Capital Accounts

	Total	Capitals		
	₹	Rahim	Anthony	Prasad
(1) Distribution of ₹ 12,000.				
Balance Due	2,70,000	1,20,000	90,000	60,000
Less: Possible loss, assuming remaining assets proved to be worthless (5 : 4 : 3)	2,58,000	1,07,500	86,000	64,500
		12,500	4,000	(–) 4,500
Deficiency of Prasad's capital written-off against those of Rahim and Anthony in the ratio of their capitals 4 : 3		2,571	1,929	(+) 4,500
Manner in which ₹ 12,000 is to be distributed		9,929	2,071	Nil
(2) Distribution of ₹ 90,000 (4th instalment)				
Balance due after making payment as above	2,58,000	1,10,071	87,929	60,000
Less: Possible loss, assuming remaining assets proved to be worthless (5 : 4 : 3)	1,68,000	70,000	56,000	42,000
Manner in which ₹ 90,000 is to be distributed	90,000	40,071	31,929	18,000
(3) Distribution of ₹ 84,000 (5th instalment)				
Balance due after making payment as above	1,68,000	70,000	56,000	42,000
Less: Possible loss, assuming remaining assets proved to be worthless (5 : 4 : 3)	84,000	35,000	28,000	21,000
Manner in which ₹ 84,000 is to be distributed	84,000	35,000	28,000	21,000

Illustration 33

A, B and C were in partnership sharing profits and losses in the ratio of 3:2:1. The partnership firm was dissolved on 30.11.2013 when the position was as follows:

Liabilities	₹	Assets	₹
Sundry creditors	3,15,000	Cash in hand	50,000
Capital Accounts:		Stock-in-trade	1,60,000
A	2,10,000	Sundry Debtors	4,40,000
B	1,05,000		
C	20,000		
	6,50,000		6,50,000

The partners desired that the net realisation should be distributed according to rules at the end of each month. The realisation and expenses were as under:

	Expenses (₹)	Stock + Debtors (₹)
31.12.2013	10,000	1,25,000
31.01.2014	9,000	1,88,600
31.03.2014	7,000	1,04,650
31.08.2014	6,000	1,14,750
30.11.2014	4,000	52,000

The stock was disposed off and debtors were all realised. Set out Cash and Capital Accounts showing monthly distribution of cash realised, applying Maximum Loss Basis.

Solution **Statement Showing Realisation and Distribution of Cash**

Particulars	Realisation	Expenses	Creditors	Partners' Capitals
31.11.2013 (Cash in hand)	50,000	—	50,000	—
31.12.2013	1,25,000	10,000	1,15,000	—
31.01.2014	1,88,600	9,000	1,50,000	29,600
31.03.2014	1,04,650	7,000	—	97,650
31.08.2014	1,14,750	6,000	—	1,08,750
30.11.2014	52,000	4,000	—	48,000
TOTAL	6,35,000	36,000	3,15,000	2,84,000

Statement Showing Distribution of Cash on Capital Accounts

	Total	Capitals		
	₹	A	B	C
(1) Distribution of ₹ 29,600				
Balance Due	3,35,000	2,10,000	1,05,000	20,000
Less: Possible loss, assuming remaining assets proved to be worthless (3 : 2 : 1)	3,05,400	1,52,700	1,01,800	50,900
	29,600	57,300	3,200	(–) 30,900
Deficiency of C's capital written-off against those of A and B in the ratio of their capitals 2 : 1		(–) 20,600	(–) 10,300	30,900

		36,700	(–) 7,100	Nil
Deficiency of B's capital written-off against A's Capital		(–) 7,100	7,100	
Manner in which ₹ 29,600 is to be distributed		29,600	Nil	Nil
(2) Distribution of ₹ 97,650				
Balance due after making payment as above	3,05,400	1,80,400	1,05,000	20,000
Less: Possible loss, assuming remaining assets proved to be worthless (3 : 2 : 1)	2,07,750	1,03,875	69,250	34,625
	97,650	76,525	35,750	(–) 14,625
Deficiency of C's capital written-off against those of A and B in the ratio of their capitals 2 : 1		(–) 9,750	(–) 4,875	14,625
Manner in which ₹ 97,650 is to be distributed	97,650	66,775	30,875	Nil
(3) Distribution of ₹ 1,08,750				
Balance due after making payment as above	2,07,750	1,13,625	74,125	20,000
Less: Possible loss, assuming remaining assets proved to be worthless (3 : 2 : 1)	99,000	49,500	33,000	16,500
Manner in which ₹ 1,08,750 is to be distributed	1,08,750	64,125	41,125	3,500
(4) Distribution of ₹ 48,000				
Balance due after making payment as above	99,000	49,500	33,000	16,500
Less: Possible loss, assuming remaining assets proved to be worthless (3 : 2 : 1)	51,000	25,500	17,000	8,500
Manner in which ₹ 48,000 is to be distributed	48,000	24,000	16,000	8,000

Dr. **Cash Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013			2013		
Dec. 1	To Balance b/d	50,000	Dec. 1	By Creditors A/c	50,000
31	To Realisation A/c	1,25,000	31	By Realisation A/c (expenses)	10,000
			"	By Creditors A/c	1,15,000
		1,75,000			1,75,000
2014			2014		
Jan. 31	To Realisation A/c	1,88,600	Jan. 31	By Realisation A/c (expenses)	9,000
Mar. 31	To Realisation A/c	1,04,650	"	By Creditors A/c	1,50,000
Aug. 31	To Realisation A/c	1,14,750	"	By A Capital A/c	29,600
Nov. 30	To Realisation A/c	52,000	Mar 31	By Realisation A/c (expenses)	7,000
			"	By A Capital A/c	66,775
			"	By B Capital A/c	30,875
			Aug. 31	By Realisation A/c (expenses)	6,000
			"	By A Capital A/c	64,125
			"	By B Capital A/c	41,125
			"	By C Capital A/c	3,500
			Nov. 30	By Realisation A/c (expenses)	4,000
			"	By A Capital A/c	24,000
			"	By B Capital A/c	16,000
			"	By C Capital A/c	8,000
		4,60,000			4,60,000

Dr. **Partners' Capital Accounts** **Cr.**

Date	Particulars	A	B	C	Date	Particulars	A	B	C
2014					2014				
Jan. 31	To Cash A/c	29,600	—	—	Jan. 1	By Balance b/d	2,10,000	1,05,000	20,000
Mar. 31	To Cash A/c	66,775	30,875	—					
Aug. 31	To Cash A/c	64,125	41,125	3,500					
Nov. 30	To Cash A/c	24,000	16,000	8,000					
"	To Realisation A/c (loss)	25,500	17,000	8,500					
		2,10,000	1,05,000	20,000			2,10,000	1,05,000	20,000

KEY POINTS

- The process of breaking up and discontinuing a Partnership business is called ***Dissolution of the firm***. The dissolution of the firm spells an end to the business.
- **Steps in the Dissolution Process**
  - ¤ The ***first step*** in the dissolution process is to prepare a Balance Sheet of the firm as on the date of dissolution.
  - ¤ In the ***next step*** of the dissolution process, non-cash assets that are not acceptable for distribution in their present form are sold and converted into cash.
  - ¤ The ***last step*** in the dissolution is to distribute the available cash to creditors and partners.
- ***In effect, the decision in Garner Vs. Murray boiled down to this:***
  - ¤ The solvent partners should contribute to the deficiency of capital (caused by loss on realisation) in cash their share only and not the insolvent partners' share.
  - ¤ The net effect of what has been stated above is that the deficiency of capital of the insolvent partner gets distributed among the solvent partners in the ratio of their last agreed capitals.
- **Criticism of Garner Vs. Murray**
  - ¤ It does not apply when the firm is having only two partners.
  - ¤ It considers only the book capital of the partners, ignoring the private estate of the solvent partners. If a partner contributed more capital than that of the other partners, he will have to bear more burden than other partners contributing less capital.
  - ¤ If a partner is having a nil capital balance or a debit balance, he will not have to bear the deficiency of the insolvent partner.
  - ¤ Introduction of cash by the solvent partners to make good their share of loss on realisation is unnecessary, when the balance of the capital accounts of the solvent partners are sufficient to bear the deficiency of the insolvent partner.
- **Firm's Debts Vs Private Debts**
  - ¤ The joint estate of the partners as a firm and their separate estates as individuals are administered separately.
  - ¤ The separate estate of each partner is to be utilised first for paying his ***private debts***. Any surplus from the separate estate can be utilised for paying firm's debts. But any deficiency of his private estate is not included in the joint estate. Similarly, the joint estate of the firm is to be utilised first for paying the debts of the firm.
- When all the partners are insolvent and the firm's assets fall short of its liabilities, the creditors of the firm cannot be paid in full. The available cash with the firm (cash in hand + final dividend received from the partners' estate) is used first for paying realisation expenses. The balance amount is paid to creditors proportionally. In order, to close the books of the firm, Realisation Account is prepared in the usual manner without transferring the liabilities to Realisation Account. All liabilities are discharged directly to the extent possible. Any balance left unpaid is transferred to Deficiency Account. The Partners' Capital Accounts are then closed by transferring to Deficiency Account.
- When the assets are realised gradually, available cash at any particular point of time should be utilised in the following manner:
  - ¤ To meet the realisation expenses.
  - ¤ To pay off preferential creditors (e.g., government rates and taxes, etc)
  - ¤ To pay off other creditors. All the creditors are to be paid off in the ratio of their individual claim. But a secured creditor get a priority over ordinary creditors upto the amount realised from that particular asset by which his claim is secured by the firm. But for the balance of his claim, he is at par with other ordinary creditors.
  - ¤ To pay off partners' loans.
  - ¤ To pay off partners' capitals.

THEORETICAL QUESTIONS

1. What do you understand by dissolution of a firm? Bring out clearly the difference between dissolution of partnership and dissolution of firm.
2. What accounting entries have to be passed for closing the books of account of the firm?
3. Explain circumstances under which a firm is dissolved.
4. Explain how the Partners' Capital Account are normally settled in the case of dissolution of the partnership firm.

5. What is the rule in Garner Vs Murray?
   In what situations would it apply?
   Does it apply to firm constituted under the Indian Partnership Act?
6. Explain the application of Garnery Vs Murray when
   (a) Capitals are fixed; and (b) Capitals are fluctuating.
7. Write a short note on Piece-meal distribution.

OBJECTIVE QUESTIONS

Multiple choice

Select the best choice to complete each statement or answer each question below.

1. The court may dissolve a firm when:
   A a partner has become of unsound mind
   B the business was formed for a fixed term
   C none of these.
2. The first step in the dissolution process is to:
   A prepare a balance sheet on the date of dissolution
   B distribute the available cash to the creditors
   C none of these.
3. The solvent partners must share the deficiency of an insolvent partner
   A in the profit-sharing ratio
   B in the capital ratio
   C none of these.
4. Surplus capital method is suitable when all the partners are
   A solvent
   B insolvent
   C none of these.
5. Under maximum loss method, every instalment realised is considered as
   A first realisation
   B final realisation
   C none of these.
6. Garner vs. Murray is applicable only when
   A there is an agreement among the partners for sharing the deficiency in capital account of insolvent partner
   B there is no agreement among the partners for sharing the deficiency in capital account of insolvenet partner
   C there is a court direction

PRACTICAL QUESTIONS

When All Partners are Solvent

1. A, B and C decide to dissolve their partnership on December 31, 2014 on which date the Balance Sheet of the firm stood as follows:

Liabilities	₹	Assets	₹
Capital — A	75,000	Plant and Machinery	2,02,500
Capital — B	52,500	Stock	1,12,500
Capital — C	22,500	Sundry Debtors	90,000
Loan Account — A	75,000		
Sundry Creditors	67,500		
Bank overdraft	1,12,500		
	4,05,000		4,05,000

In order to give effect to the above decision, draw up the Realization Account, Partners' Capital Accounts and the Cash Book after taking the following into consideration:

(a) Profits had been shared amongst A, B and C as 3:2:1.
(b) A agreed to take over part of the business for which he agreed to pay ₹ 37,500 for goodwill together with half of the plant and machinery and the stock, for which he agreed to pay ₹ 1,12,500 and ₹ 60,000 respectively.
(c) The balance of the plant and machinery was sold for ₹ 75,000 and of the stock for ₹ 30,000.
(d) Sundry debtors realized ₹ 84,750.

2. Amal, Bimal and Tamal are partners in a firm sharing profits and losses as Amal 60%, Bimal 30% and Tamal 10%. They agreed to dissolve the firm when the Balance Sheet was as under :

Liabilities	₹	Assets	₹
Capital — Amal	40,000	Land	10,000
Capital — Bimal	65,000	Building	50,000
Reserve	24,000	Plant	30,000
Loan A/c — Amal	18,000	Investments	10,000
Sundry Creditors	9,000	Loose Tools	1,000
Bank Overdraft	5,000	Furniture	2,000
		Stock	41,500
		Sundry Debtors	15,000
		Capital — Tamal	1,500
	1,61,000		1,61,000

Land and Building were taken by Amal at a valuation of ₹ 12,000 and ₹ 40,000 respectively. Plant and Investment were sold at book values. Loose Tools realized ₹ 1,300 and Stock ₹ 40,000. Of the Sundry Debtors ₹ 750 proved bad. Furniture was taken by Bimal at ₹ 1,550. Creditors were paid off subject to a discount of 6%. The expenses of dissolution was ₹ 540 and a contingent liability of ₹ 600 was paid. Show the Realization Account, Bank Account and the Capital Accounts of the partners showing the final distribution.

3. Anil, Balwant and Coomar were partners, carrying on business under the name and style of Anil & Co., sharing profits and losses in the proportion of 4 : 3 : 2. Their Balance Sheet as at 31st December, 2014 was as under:

Liabilities	₹	Assets	₹
Capital A/c — Anil	40,000	Land & Building	55,000
Capital A/c — Balwant	20,000	Motor Car	15,000
Capital A/c — Coomar	10,000	Stock-in-trade	20,000
Sundry Creditors	40,000	Sundry Debtors	18,000
		Cash	2,000
	1,10,000		1,10,000

They agreed to dissolve the partnership on that date. Anil agreed to take over stock and Debtors at a discount of 10%. Balwant took over the Motor Car for ₹ 16,000. Land and Building was sold for ₹ 75,000 and expenses of sale amounted to ₹ 1,600. Creditors were settled at a discount of 1.5%.

Show the relevant Ledger Accounts.

4. Cloud, Storm and Rain were partners in a firm sharing profits and losses in the ratio of 5:3:2. Due to difference in opinion, they decided to dissolve the partnership with effect from 1st April, 2015 on which date the firm's Balance Sheet was as under:

Liabilities	₹	Assets	₹
Capital A/c — Cloud	60,000	Plant & Machineries	80,000
Capital A/c — Storm	40,000	Furniture & Fixtures	45,000
Capital A/c — Rain	30,000	Motor car	25,000
Current A/c — Cloud	8,000	Stock-in-trade	30,000
Current A/c — Storm	10,000	Sundry debtors	71,000
Sundry Creditors	1,20,000	Cash at bank	14,000
		Current A/c — Rain	3,000
	2,68,000		2,68,000

The following information is given :

(i) Plant costing ₹ 40,000 was taken over by Cloud at an agreed valuation of ₹ 45,000 and the remaining machineries realised ₹ 50,000.

(ii) Furniture & Fixtures realised ₹ 40,000.

(iii) Motor car was taken over by Storm for ₹ 30,000.

(iv) Sundry Debtors included a bad debt for ₹ 1,200 and the rest portion was realised subject to a cash discount of 10%.

(v) Stock worth ₹ 5,000 was taken over by Rain for ₹ 5,200 and the rest realised at 20% above their book value.

(vi) A creditor for ₹ 2,000 was untraceable and other creditors accepted payments allowing 15% discount. Realisation expenses amounted to ₹ 5,000.

You are required to show the Realisation Account and the Capital Accounts of the partners on dissolution showing final payments to them.

5. A, B and C give you the following Balance Sheet as on 31.12.2014.

Liabilities	₹	Assets	₹
Loan A/c — A	15,000	Plant & Machinery at cost	30,000
Capital A/c — A	30,000	Fixture & Fittings	2,000

Capital A/c — B	10,000	Stock		10,400
Capital A/c — C	2,000	Debtors	18,400	
Sundry Creditors	17,800	Less: Provision for bad debts	400	18,000
Loan on hypothecation of stock	6,200	Joint Life Policy		15,000
Joint Life Policy Reserve	12,400	Patents and Trade Marks		10,000
		Bank		8,000
	93,400			93,400

The partners shared profits and losses in the ratio of 4:2:3. The firm was dissolved on December 31, 2014 and you are given the following information:

(a) C had taken a loan from Insurers for ₹ 5,000 on the security of the Joint Life Policy. The policy was surrendered and insurers paid a sum of ₹ 10,200 after deducting ₹ 5,000 for C's loan and ₹ 300 interest thereon.

(b) One of the creditors took some of the patents whose book value was ₹ 6,000 at a valuation of ₹ 4,500. The balance to that creditor was paid in cash.

(c) The firm had previously purchased some shares in a joint stock company and had written them off on finding them useless. The shares were now found to be worth ₹ 3,000 and the loan creditor agreed to accept the shares at this value.

(d) The remaining assets realised the following amounts :
Plant and Machinery — ₹ 17,000;
Fixture and Fittings — ₹ 1,000;
Stock — ₹ 9,000;
Debtors — ₹ 16,500;
Patents — 50% of their book value.

(e) The liabilities were paid and a total discount of ₹ 500 was allowed by the creditors.

(f) The expenses of realisation amounted to ₹ 2,300.

Prepare the Realisation Account, Bank Account and the Partners' Capital Accounts.

6. A, B and C sharing profits in the ratio of 3 : 1 : 1 agree upon dissolution. They decide to divide certain assets and liabilities and continue business separately. Their Balance Sheet was as under:

Liabilities	₹	Assets		₹
Creditors	6,000	Cash		3,200
Loan	1,500	Sundry Assets		17,000
Capital A/c — A	27,500	Debtors	24,200	
Capital A/c — B	10,000	Less: Provision for bad debts	1,200	23,000
Capital A/c — C	7,000	Stock		7,800
		Fixtures		1,000
	52,000			52,000

It is agreed that:

(a) Goodwill is to be ignored.

(b) A is to take over all the fixtures at ₹ 800; debtors amounting to ₹ 20,000 at ₹ 17,200. The creditors of ₹ 6,000 to be assumed by A at that figure.

(c) B is to take over all the stocks at ₹ 7,000 and certain of the sundry assets at ₹ 7,200 (being book value less 10%).

(d) C is to take over the remaining sundry assets at 90% of book values, less ₹ 100 allowances and assume responsibility for the discharge of the loan, together with the accruing interest of ₹ 30 which has not been recorded in the books of the firm.

(e) The expenses of dissolution were ₹ 270. The remaining debtors were sold to a debt collecting agency for 50% of book values.

Prepare:
(i) Realisation Account; (ii) Partners' Capital Accounts; and (iii) Cash Account.

7. X, Y and Z, carrying on business from 1980, decided to dissolve their partnership on June 30, 2015, when their Balance Sheet was as under:

Liabilities	₹	Assets	₹
Creditors	34,000	Cash	25,000
Capital Accounts:		Debtors	62,000
X	1,20,000	Stock	37,000
Y	90,000	Tools	8,000
Z	60,000	Motor Cars	12,000
		Machinery	60,000
		Freehold building	1,00,000
	3,04,000		3,04,000

Y and Z agreed to form a new partnership to carry on the business and agreed that they shall acquire from the old firm the following assets at the amounts shown: Stock ₹ 40,000; Tools ₹ 5,000; Motor cars ₹ 25,000; Machinery ₹ 78,000; Freehold building ₹ 84,000; and Goodwill ₹ 60,000.

The partnership agreement of X, Y and Z provided that trading profits or losses shall be divided in the ratio of 3 : 2 : 1 and that capital profits or losses shall be divided in proportion to their capitals.

Debtors realise ₹ 59,000 and discount amounting to ₹ 720 is secured on payments due to creditors.

Prepare the necessary accounts of X, Y and Z giving effect to these transactions and prepare the opening Balance Sheet of Y and Z who bring the necessary cash to pay X in the ratio of 3 : 2.

8. A and B who make up their accounts annually to 31st December were in partnership sharing profits and losses in the ratio of 2:1. No interest was charged on drawings or credited to capital.

The following was the summary of the balances as on 31.12.2014 :

	₹		₹
Fixtures and fittings	22,000	Partners Capital A/c — A	31,000
Leasehold premises	50,000	Partners Capital A/c — B	10,000
Stock (opening)	7,600	Loan from A at 8% p.a.	20,000
Debtors	1,800	Creditors	6,400
Purchases	48,000	Sales	1,04,000
General expenses	16,000	Depreciation on motor vehicle as on 1.1.2014	3,600
Partners Drawings — A	6,000	Bank overdraft	26,200
Partners Drawings — B	4,800		
Motor vehicle, at cost	9,000		
Wages	36,000		
	2,01,200		2,01,200

For the purpose of closing of accounts on 31.12.2014, closing stock was valued at ₹ 6,200 and furniture and fittings at ₹ 18,000. Provision for depreciation on motor vehicle is to be made at 20% p.a. calculated on cost and for accrued general expenses ₹ 1,200. In addition, one year's interest is to be provided on A's loan.

The partnership was dissolved on 1.1.2015, it being agreed that

(i) A should take over stock for ₹ 6,000;

(ii) B should take over motor vehicle at ₹ 2,700 and part of the fittings and fixtures for ₹ 7,500;

(iii) Interest on A's loan should cease w.e.f. 1.1.2015;

During January, 2015 the following transactions took place :

(a) Leasehold premises were sold, realising a net amount of ₹ 60,000;

(b) ₹ 1,600 was collected from debtors and the balance was taken over by A;

(c) A portion of the fittings and fixtures were auctioned and realised ₹ 10,000. It was also agreed that the balance of fixtures and fittings should be taken over by B for ₹ 500;

(d) Creditors and accrued general expenses were paid in full;

(e) Realisation expenses amounted to ₹ 1,400;

(f) All amounts receivable and payable by A and B were settled.

You are required to prepare the following :

1. Profit and Loss Account for the year ended 31.12.2014 excluding profit or loss arising on dissolution;
2. Realisation Account;
3. Cash Account for January 2015;
4. Partners' Accounts showing the final settlement of dissolution.

9. Hill, Stone and Rock were in partnership owning a riding school and livery stables. Profits and losses were shared : Hill three- fifths, Stone one-fifth, Rock one-fifth. No interest was charged on drawings or credited on capital. The firm provided an instructor to the equitation classes of the local agricultural college.

The following was a summary of the Balances as on 31 December, 2014.

	₹			₹
Drawings:		Capital:		
Hill	1,500	Hill		6,000
Stone	1,200	Stone		4,400
Rock	1,000	Rock		1,690
Freehold land and buildings	8,000	Loan : Stone	3,000	
Hay and fodder, balance on January 1, 2014	250	Interest @ 6% to June 30, 2014	90	3,090
Hay and fodder purchased	1,500	Agricultural college equitation fees		150
Harness equipment and fittings	250	Sundry creditors		130
Horses valued on January 1, 2014	1,600	Hire horses and riding lessons		2,905
Horses purchased	100	Receipts from horses at livery		870
Motor vehicles	2,500	Prize money		75
Debtors	600	Sale of horses		60

Salaries and wages	2,500	Bank overdraft	2,500
Veterinary and other fees	180		
General expenses	600		
Loan interest	90		
	21,870		21,870

On 31 December 2014, hay and fodder were valued at ₹ 50, motor vehicles at ₹ 2,000, harness, equipment and fittings at ₹ 200, and horses at ₹ 1,400. Provision was needed for veterinary fees ₹ 50. With the exception of loan interest no further provisions were considered necessary.

The partnership was dissolved on 31 December 2014, on the following terms :

1. Rock was appointed instructor to the local agricultural college, and for this privilege, he paid into the partnership ₹ 200 which is to be divided between Hills and Stone.
2. He also took over assets at the following valuation:
   (i) six horses ₹ 600;
   (ii) the hay and fodder ₹ 40;
   (iii) part of the harness and equipment ₹ 75;
   (iv) a horse box ₹ 800.
3. Hill took over a motor car at a valuation of ₹ 450.
4. Net receipts from the sale of the freehold and buildings amounted to ₹ 8,750.
5. The debtors realised ₹ 530 and the remaining assets were sold by auction, the net receipts being ₹ 1,765.
6. The loan, with interest accrued to date, was repaid on 1 January, 2015.
7. The creditors were paid and a contingent liability, not brought into the accounts, was settled early in January for ₹ 250.
8. Cups and plate, not brought into the accounts, were distributed among the partners at the following valuation : Hill ₹ 20, Stone ₹ 10, Rock ₹ 60.

All transactions were completed and all amounts receivable or payable by the partners were settled before the end of January 2015.

You are required to prepare :

(a) the Profit and Loss Account for the year ended 31 December 2014, excluding any profits or losses arising on dissolution; (b) the Realisation Account; (c) the Cash Account; and (d) Partners' Capital Accounts showing the final settlement on dissolution.

10. Smart and Swift were in partnership as hotel proprietors sharing profits and losses: Smart three-fifths, Swift two-fifths. No interest was charged on drawings or credited on capital. The following was a summary of their trial balance as on 31 December 2014:

	₹		₹
Debtors	600	Bank Overdraft	4,590
Fittings and Fixtures	1,800	Loan : Smart at 6%	3,000
Foodstuffs — stock on December 31, 2013	420	Partners' Capital Accounts:	
Foodstuffs Purchased	2,600	Smart	3,000
Freehold Premises	6,000	Swift	500
General Expenses	810	Sundry Creditors	210
Partners' Drawings:		Takings	5,100
Smart	520		
Swift	750		
Motor Vehicle	700		
Wages	2,200		
	16,400		16,400

For the purposes of accounts as on 31 December 2014, the stock of foodstuffs was valued at ₹ 300 and ₹ 200 was to be written off the book value of the motor vehicle and ₹ 100 off fittings and fixtures. A provision of ₹ 60 was required for accrued general expenses and Smart was to be credited with a year's interest on his Loan Account.

The partnership was dissolved on 31 December 2014, it being agreed that:

1. Smart should take over the stock of foodstuffs for ₹ 250 and part of the fittings and fixtures for ₹ 600;
2. Swift should take over the motor vehicle for ₹ 400;
3. Interest on Smart's loan should cease as on 31 December 2014;
   During January 2015:
   (i) The freehold premises were sold, realising a net amount of ₹ 6,800;
   (ii) ₹ 480 was collected from debtors (the balance proving irrecoverable);
   (iii) The net proceeds from an auction of the balance of fittings and fixtures was received amounting to ₹ 1,400.

It was agreed that the few unsold items should be taken over partly by Smart for ₹ 40 and the rest by Swift for ₹ 20.

(iv) Creditors were paid in full together with incidental realisation and dissolution expenses of ₹ 120;

(v) All amounts receivable or payable by Smart and Swift were settled.

You are required to prepare :

(a) the Profit and Loss Account for the year ended 31 December 2014, excluding any profit or loss arising on dissolution; (b) the Realisation Account; (c) the Cash Account for January 2015, and; (d) Partners' Capital Accounts (in columnar form) showing the final settlement on dissolution.

11. X, Y and Z were partners sharing profits and losses in the ratio of 3:2:1. The position of the firm as on 1.1.2014 was:

Liabilities	₹	Assets	₹
X's capital	30,000	Fixed Assets	40,000
Y's capital	20,000	Debtors	30,000
Z's capital	10,000	Stock	40,000
General Reserve	12,000	Bank Balance	10,000
Capital Reserve	9,000		
Creditors	39,000		
	1,20,000		1,20,000

On this date, the partners decided to change their profit and loss sharing ratio to 1:2:3. Goodwill was valued at ₹ 18,000. No entries were, however, passed to give effect to this change.

On 31.12.2014, the Balance Sheet of the firm was :

Liabilities		₹	Assets	₹
X's Capital	30,000		Fixed Assets	36,000
Less: Drawings	5,000	25,000	Debtors	45,000
Y's Capital	20,000		Stock	55,000
Less: Drawings	3,000	17,000	Advances	14,000
Z's Capital	10,000			
Less: Drawings	4,000	6,000		
General Reserve		36,000		
Capital Reserve		9,000		
Creditors		50,000		
Bank overdraft		7,000		
		1,50,000		1,50,000

On 31.12.2014, the firm was sold as a going concern to Y for ₹ 1,35,000. Y introduced sufficient funds to pay off X and Z.

You are asked to : (a) Pass journal entries on 31.12.2014 to give effect to the above change in the constitution of the firm on 1.1.2014 and to close the books of the firm, on sale of business; and (b) Prepare the Balance Sheet of Y as on 1.1.2015.

When one of the Partners is Insolvent

12. A, B and C were partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1. They decided to dissolve the firm when the state of affairs was as follows:

Liabilities	₹	Assets	₹
Sundry Creditors	14,500	Bank	4,700
A's Loan Account	9,000	Sundry Debtors	18,300
Capital Account: A	25,000	Stock	14,700
Capital Account: B	12,500	Investment	8,500
		Furniture & Fixtures	2,000
		Machine	11,000
		Capital Account : C	1,800
	61,000		61,000

Investment was fully taken by A in full settlement of his loan. The other assets except Cash at bank realised ₹ 47,100. The expenses for dissolution was ₹ 600. A dispute with a creditor was settled reducing his claim by ₹ 200. C was declared insolvent and 25 p in the rupee was recovered from his estate.

Prepare Realisation Account, Bank Account and Capital Accounts of the partners to close the books of the firm. (Use Garner Vs Murray Principle).

13. A, B and C were partners in a firm dealing in toilet articles and share profits and losses in the ratio of 4 : 3 : 3. As of December 31, 2014 they decided to dissolve the firm and B was appointed to realise the assets and distribute the profits. B was to receive 5% of the amounts realised from stock and debtors as his remuneration, he is to bear all the expenses of the realisation. The Balance Sheet as on December 31, 2014 was as under:

Liabilities	₹	Assets		₹
Creditors	5,90,000	Cash at bank		15,000
Capital Accounts:		Debtors	4,55,000	
A	3,00,000	Less: Provision for doubtful debts	25,000	4,30,000
B	2,00,000	Stocks		6,00,000
		Capital Accounts : C		45,000
	10,90,000			10,90,000

B reported that the assets realised were: Debtors ₹ 4,50,000; Stock ₹ 3,50,000; Goodwill ₹ 20,000; Creditors were paid ₹ 5,75,000 in full settlement and other outstanding creditors were paid ₹ 5,000. The expenses of realisation aggregated to ₹ 6,000. A and B received ₹ 30,000 from C in full settlement of the firm's claim on him. You are required to prepare the Realisation Account, the Bank Account and Capital Accounts of the partners.

14. The following was the Balance Sheet of P, Q and R on 31st March, 2015:

Liabilities	₹	Assets	₹
P's Capital Account	25,000	Freehold Property	10,000
R's Capital Account	15,000	Furniture	5,000
P's Current Account	1,000	Stock-in-trade	23,100
R's Current Account	500	Debtors	30,000
Sundry Creditors	30,000	Cash	2,500
Loan on mortgage of Freehold Property	4,000	Q's Current Account	4,900
	75,500		75,500

The partners shared profits and losses in the proportion of 6 : 3 : 5. It was decided to dissolve the partnership as on the date of the Balance Sheet. The assets realised as under: Freehold Property ₹ 6,000; Furniture ₹ 2,000; Stock-in-trade ₹ 15,000; and Debtors ₹ 20,000. The expenses on realisation amounted to ₹ 2,000. The sundry creditors agreed to take 75 paise in the rupee in full satisfaction. It was ascertained that Q has become insolvent. A dividend of 50 p in the rupee was received from the Court Receiver.

Write-up the Realisation Account, Bank Account, Capital and Current Accounts of the partners. [***Apply Garner Vs Murray***]

15. Ram, Indra, Triveni and Umesh were partners sharing profits and losses in the ratio of 3 : 3 : 2 : 2. The Balance Sheet as on 31st March, 2015 was as under:

Liabilities	₹	Assets		₹
Sundry Creditors	46,500	Cash at bank		6,000
Ram's Loan	30,000	Sundry Debtors	48,000	
Capital Accounts:		Less: Provision for bad debts	1,500	46,500
Ram	60,000	Stock		30,000
Indra	45,000	Furniture & Fixtures		12,000
		Trade Marks		21,000
		Capital Accounts:		
		Triveni		48,000
		Umesh		18,000
	1,81,500			1,81,500

On March 31, 2015, the firm was dissolved and Indra was appointed to realise the assets and to pay off the liabilities. He was entitled to receive 5% commission on the amount finally paid to other partners as capital. He was to bear the expenses of realisation.

The assets realised as follows: Debtors ₹ 33,000; Stock ₹ 24,000; Furniture ₹ 3,000; and Trade marks ₹ 12,000.

The creditors were paid off in full, and in addition, contingent liabilities for bills receivable discounted materialised to the extent of ₹ 7,500. There was also a joint life policy for ₹ 90,000. This was surrendered for ₹ 9,000. Expenses of realisation amounted to ₹ 1,500. Triveni was insolvent, but ₹ 11,100 was received from his estate.

Write-up the necessary accounts to close the books of the firm according to the Garner Vs Murray rule.

Piecemeal

16. A partnership firm has three partners : X, Y and Z with capitals as X : ₹ 20,000; Y : ₹ 10,000 and Z ₹ 10,000. The creditors amounted to ₹ 20,000 and sundry assets to ₹ 60,000. In dissolution, the assets were realised as follows: 1st instalment ₹ 20,000; 2nd instalment ₹ 20,000 and final realisation ₹ 10,000.

The partners share profits and losses in the ratio of 3 : 2 : 1.

Show the piece-meal distribution of the realisations on — (i) Surplus Capital Method; (ii) Maximum Loss Method.

17. The firm of LMS was dissolved on 31.3.2015, at which date its Balance Sheet stood as follows :

Liabilities	₹	Assets	₹
Creditors	2,00,000	Fixed assets	45,00,000
Bank Loan	5,00,000	Cash and bank	2,00,000
L's Loan	10,00,000		
Capital : L : ₹ 15,00,000; M : ₹ 10,00,000; S : ₹ 5,00,000	30,00,000		
	47,00,000		47,00,000

Partners share profits equally. A firm of Chartered Accountants is retained to realise the assets and distribute the cash after discharge of liabilities. Their fees which are to include all expenses is fixed at ₹ 1,00,000. No loss is expected on realisation since fixed assets include valuable land and building. Realisations are :

Serial Number	1	2	3	4	5
Amount in ₹	3,00,000	15,00,000	15,00,000	30,00,000	30,00,000

The Chartered Accountant firm decided to pay-off the partners in 'Higher Relative Capital Method'. You are required to prepare a statement showing distribution of cash with necessary workings.

18. The Balance Sheet as on 31st March, 2015 of Abel, Baker and Charley, who share profits and losses in the ratio of 2 : 2 : 1 is given below:

Liabilities	₹	Assets	₹
Abel's Capital A/c	90,000	Fixed Assets	2,00,000
Baker's Capital A/c	72,000	Floating Assets	1,96,000
Charley's Capital A/c	60,000		
Abel's Advance A/c	30,000		
Baker's Advance A/c	24,000		
Sundry Creditors	72,000		
Bills Payable	48,000		
	3,96,000		3,96,000

The amounts were realised piecemeal and it was decided that the amounts received in instalments should be distributed immediately.

1st Realisation ₹ 75,000; 2nd Realisation ₹ 1,47,000; and 3rd Realisation ₹ 1,50,000.

Draw a statement to show the distribution of cash thus realised and ascertain the loss suffered by each partner, if any.

19. Luck, Duck and Pluck were partners sharing profits and losses as 2 : 1 : 1. Their Balance Sheet as on 31.12.2014 is given below and they dissolved their partnership on that date.

Liabilities	₹	Assets	₹
Creditors	15,000	Cash	9,000
Income Tax Payable	4,000	Stock	40,000
Loan from Bank (secured by pledge of stock)	30,000	Debtors	60,000
Duck's Loan	11,000	Furniture	36,000
Capital :		Motor Car	25,000
Luck	40,000		
Duck	40,000		
Pluck	30,000		
	1,70,000		1,70,000

The Bank could realise only ₹ 25,000 on disposal of stock. A sum of ₹ 3,000 was spent for motor car for getting better price. Other assets were realised as follows :

Jan. 2015 ₹ 12,000; Feb. 2015 ₹ 15,000; March 2015 ₹ 10,000; April 2015 ₹ 30,000; May 2015 ₹ 34,000.

Duck took over unsold furniture worth ₹ 1,000 at the end of May, 2015. The partners distributed the cash as and when realised. Show the distribution of Cash.

20. Mini, Midi and Maxi are three partners of the firm Variety Stores sharing profits and losses in the ratio of 1:2:3. On 30th June, 2015 the partnership was disssolved. The Balance Sheet of the firm on the date of dissolution was as follows:

Liabilities	₹	Assets	₹
Mini's Capital	8,000	Cash	6,000
Midi's Capital	12,000	Debtors	16,000
Maxi's Current	20,000	Stock	25,000
Loan from Mrs Maxi	6,000	Furniture & Fittings	15,000
Sundry Creditors	18,000	Bills Receivable	2,000
	64,000		64,000

The partners decided that payments should be made as and when the amounts were realised. Maxi would supervise all realisations and for this he would be entitled to a commission @ 5% on all gross realisations, but his claim would not have priority over the claims of outsiders. The realisations and expenses on various dates were as follows:

	Debtors (₹)	Stock (₹)	Furniture (₹)	Expenses (₹)
July	3,000	5,500	4,500	1,000
August	5,000	6,000	6,000	500
September	5,500	14,000	3,900	1,400
October	2,000	4,000	—	300

The Bills Receivable were drawn in May, 2015 and were payable after three months. These were duly received. You are required to prepare a statement showing distribution of cash.

21. P,Q and R are partners sharing profits and losses in the ratio of 1/4:1/4:1/2. They decided to dissolve their business on 31.3.2015, when their Balance Sheet was as follows:

Liabilities	₹	Assets	₹
P's Capital	10,000	Fixed Assets	82,000
Q's Capital	15,000	Stock	15,000
R's Current	25,000	Debtors	18,000
Trade Creditors	20,000	Cash	5,000
Secured Loan (secured on the fixed assets of the firm)	10,000		
Unsecured Loan	20,000		
Bank overdraft (secured against stock and book debts)	20,000		
	1,20,000		1,20,000

P is insolvent. Realisations are to be distributed monthly to creditors and partners in the order of priority. Realisations monthwise were:

	April	May	June	July
Fixed Assets (₹)	17,000	15,000	12,000	8,800
Stock and Debtors (₹)	4,000	2,000	4,000	—

Prepare a statement showing distribution of cash and the capital accounts of the partners.

22. The firm of Richpersons presented you with the following Balance Sheet drawn as at 31st March, 2015:

Liabilities	₹	Assets	₹
Sundry Creditors	37,000	Cash in hand	3,000
Partners' Capital A/cs:		Sundry Debtors	34,000
A	40,000	Stock-in-trade	39,000
B	30,000	Plant and Machinery	51,000
C	27,000	B's Current Account	4,000
		C's Current Account	3,000
	1,34,000		1,34,000

Partners shared profits and losses in the ratio of 4:3:3. Due to differences among the partners, it was decided to wind up the firm, realise the assets and distribute cash among the partners at the end of each month.

The following realisations were made:

(i) May 2015 : ₹ 15,000 from debtors and ₹ 20,000 by sale of stock. Expenses on realisation were ₹ 500

(ii) June 2015 : Balance of debtors realised ₹ 10,000. Balance stock fetched ₹ 24,000.

(iii) August 2015 : Part of machinery was sold for ₹ 18,000. Expenses incidental to sale were ₹ 600.

(iv) September 2015 : Part of machinery valued in the books at ₹ 5,000 was taken by A in part discharge at an agreed value of ₹ 10,000. Balance of machinery was sold for ₹ 30,000 (net).

Partners decided to keep a minimum cash balance of ₹ 2,000 in the first 3 months and ₹ 1,000 thereafter.

Show how the amounts due to partners will be settled. All workings should form part of your answer.

23. A, B and C were partners in a firm sharing profits and losses in the ratio of 5 : 3 : 2. On 31.3.2015, their Balance Sheet was as follows :

Liabilities	₹	Assets	₹
Creditors	40,000	Furniture	8,000
A's Loan	16,000	Stock	52,000
B's Loan	12,000	Debtors	64,000
Capitals : A ₹ 30,000; B ₹ 24,000; C ₹ 6,000	60,000	Bank	4,000
	1,28,000		1,28,000

The firm was dissolved on 1.4.2015. The assets realised were as follows (all figures in ₹) :

	Stock	Debtors	Furniture	Expenses
April 30	12,000	10,000	3,000	1,000
June 30	12,000	10,000	—	1,600
July 31	16,000	30,000	4,000	3,000
August 31	10,000	4,000	—	1,000

Cash received was paid to the rightful claimants at the end of each month. Prepare the statement showing the distribution of cash.

24. A, B and C carrying on business in the partnership decided to dissolve it on and from 30th September 2014. The following was their Balance Sheet on that date:

Liabilities	₹	Assets	₹
Creditors	20,000	Fixed Assets	50,000
A's Capital	40,000	Current Assets	42,000
B's Capital	10,000	Bank	10,000
C's Capital	20,000		
General Reserve	12,000		
	1,02,000		1,02,000

As per the arrangement with the bank, the partners were entitled to withdraw an amount of ₹ 5,000 only at present and the balance amount of ₹ 5,000 could be withdrawn after 1st December, 2014. It was actually withdrawn on 20th December, 2014.

It was decided that after keeping aside an amount of ₹ 2,000 for estimated realization expenses the available cash should be distributed between the partners immediately.

The following were the realisations:

Fixed Assets: 31st October, 2014 ₹ 10,000; 25th November, 2014 ₹ 26,000; 20th December, 2014 (Final) ₹ 10,000.

Current Assets: 31st October, 2014 ₹ 19,000; 25th November, 2014 ₹ 20,000; 20th December, 2014 (Final) ₹ 9,000.

Actual realization expenses amounted to ₹ 1,550 only.

Prepare a statement showing the distribution of cash between the partners applying the ''surplus capital method".

When all Partners are Insolvent

25. H and N were in equal partnership. Their Balance Sheet stood as under on 31st December, 2014 when the firm was dissolved:

Liabilities	₹	Assets	₹
Creditors	3,200	Machinery and Plant	1,200
H's Capital	400	Furniture	300
		Debtors	500
		Stock-in-trade	400
		Cash	180
		N's Drawings	1,020
	3,600		3,600

The assets realised were as follows: Machinery ₹ 600; Furniture ₹ 100; Debtors ₹ 400; and Stock-in-trade ₹ 300.

The expenses of realisation amounted to ₹ 140.

H's private estate is not sufficient even to pay his private debts, whereas in N's private estate there is a surplus of ₹ 140 only.

Give accounts to close the books of the firm

26. A, B and C are equal partners, whose Balance Sheet on December 31, 2014 is as follows:

Liabilities	₹	Assets	₹
Sundry Creditors	5,000	Cash in hand	50
A's Loan	1,000	Stock	800
Capital A/cs:		Debtors	1,000
A	800	Plant & Machinery	2,000
C	500	Furniture & Fittings	800
		Land & Buildings	2,000
		B's Capital (overdrawn)	650
	7,300		7,300

Due to lack of liquidity and weak financial position of the partners, the firm is dissolved. A and C are not able to contribute anything and a sum of ₹ 200 received from B.

All of them are declared insolvent.
The assets are realised:
Stock ₹ 500; Plant and Machinery ₹ 1,000; Furniture and Fittings ₹ 200; Land & Buildings ₹ 800; and Debtors ₹ 550 only.
Realisation expenses amounted to ₹ 50.
You are required to close the firm's books.

Guide to Answers

Multiple Choice

1. A; 2. A; 3. B; 4. A; 5. B.

Practical Questions

1. **Loss on realisation ₹ 5,250; A brings in cash ₹ 62,524 after adjustment of A's loan; Final payments : B ₹ 50,750 and C ₹ 21,625.**
2. **Loss on realisation ₹ 11,000; Tamal brought ₹ 200; Final payment : Amal ₹ 13,800 after adjustment of loan; Bimal ₹ 67,350.**
3. **Profit on realisation ₹ 16,200; Final payments : Anil ₹ 13,000; Balwant ₹ 9,400; and Kumar ₹ 13,600.**
4. **Profit on realisation ₹ 26,720; Final payments : Cloud ₹ 36,360; Storm ₹ 28,016; Rain ₹ 27,144.**
5. **Loss on realisation ₹ 18,700; C brings in cash ₹ 5,400; Final payments : A ₹ 27,200; B ₹ 8,600.**
6. **Loss on realisation ₹ 6,800; B brings in cash ₹ 5,560; C brings in cash ₹ 830; Final payment to A ₹ 11,420.**
7. **Profit on realisation ₹ 72,720; Balance Sheet total ₹ 2,92,000; Y brings in cash ₹ 60,900; Z brings in cash ₹ 40,640.**
8. **Trading loss during 2014 ₹ 6,000; Realisation profit ₹ 7,500; B brings in cash ₹ 5,000; Final payments : A ₹ 19,800.**
9. **Trading loss during 2014 ₹ 2,000; Profit on realisation ₹ 600; Rock brings in cash ₹ 1,165; Final payments : Hill ₹ 3,340; Stone ₹ 2,960.**
10. **Trading loss during 2014 ₹ 1,170; Profit on realisation ₹ 770; Swift brings in cash ₹ 830; Final payment : Smart ₹ 1,530.**
11. **Profit on realisation ₹ 24,000; Final payments : X ₹ 52,500; Z ₹ 36,500; Balance Sheet ₹ 1,92,000; Goodwill (balancing figure ₹ 42,000)**
12. **Profit on realisation on ₹ 1,200; C's deficiency of ₹ 1,200 is to be shared by A and B in the ratio of 2 : 1.**
13. **Loss on realisation ₹ 2,40,000.**
14. **Loss on realisation ₹ 19,600; Final payment : P ₹ 23,156; R ₹ 13,794.**
15. **Loss on realisation ₹ 37,175.64; Ram received ₹ 23,512.95; and Indra received ₹ 14,522.18.**
16. **Surplus capital of Z ₹ 3,333; Realisation loss ₹ 10,000.**
17. **Surplus capital of ₹ 5,00,000; Realisation profit : L ₹ 15,66,667; M ₹ 15,66,667; S ₹ 15,66,667.**
18. **Surplus Capital of Charley ₹ 15,000; Loss on realisation: Abel ₹ 9,600; Baker ₹ 9,600 and Charley ₹ 4,800.**
19. **Loss on realisation ₹ 37,000. Share of Loss : Luck ₹ 18,500; Duck ₹ 9,250; and Pluck ₹ 9,250.**
20. **Surplus Capital of Mini ₹ 1,333; Loss on realisation: Mini ₹ 478; Midi ₹ 957; and Maxi ₹ 1,437.**
21. **After realisation of all assets, all the liabilities cannot be satisfied. Total shortfall is ₹ 2,200. To pay off creditors and unsecured loan, the partners would contribute in the following manner: P ₹ 550; Q ₹ 550; and R ₹ 1,100. P being insolvent, his deficiency is to be borne by Q and R in their capital ratio. Finally, Q's share of deficiency is ₹ 756 and R's share of deficiency is ₹ 1,444.**
22. **Profit on realisation A ₹ 760; B ₹ 570; C ₹ 570.**
23. **Loss on realisation A ₹ 9,800; B ₹ 5,880; C ₹ 3,920. Absolute surplus capital of B ₹ 6,000.**
24. **Profit on realisation A ₹ 150; B ₹ 150; C ₹ 150. Absolute surplus capital of A ₹ 20,000.**
25. **Realisation loss ₹ 1,140; Deficiency ₹ 1,620.**
26. **Realisation loss ₹ 3,600; Deficiency ₹ 1,750.**

32

Amalgamation of Firms

Introduction

In case of amalgamation of firms, two or more partnership firms join under common management. The partners of the old firms will become the partners of the new firm. The business of the old firms will continue as before, though under a single name.

Reasons for Amalgamation

1. ***Economics of Scale*** : The amalgamated firm can have operating cost advantage by distributing fixed expenses to a more number of units.
2. ***Growth*** : Internal growth is time consuming. Growth can be achieved through acquisition of another firm(s).
3. ***Diversification*** : In an amalgamated firm, the risk of the firm can be reduced by diversifying into two or more industries.
4. ***Financial Economies*** : Financial economies can be in the form of higher debt capacity and lower rate of borrowing, reduction of common expenses, e.g., sales promotion.
5. ***Supnferior Management*** : More talented people can be hired for management of the firm.

Forms of Amalgamation

Amalgamation of firms may take one of the following forms :

(a) When one existing partnership firm absorbs another partnership firm; and

(b) When two or more partnership firms form a new partnership firm.

(a) When one existing partnership firm absorbs another partnership firm

In this case, the books of accounts of the liquidating / selling firm will be closed.

To close the existing sets of books, the following steps are followed :

Step 1 : Prepare the Balance Sheet of the selling firm on the date of dissolution.

Step 2 : Open a Realisation Account and transfer all assets and liabilities, except cash in hand and cash at bank, at their book values.

It should be noted that cash in hand and cash at bank are transferred to Realisation Account only when they are taken over by the purchasing firm.

Step 3 : Calculate purchase consideration on the basis of terms and conditions agreed upon by the parties. Generally, purchase consideration is calculated on the basis of agreed value of assets and liabilities taken over by the purchasing firm. The purchase consideration is calculated as under :

Agreed values of assets taken over	***
Less : Agreed values of liabilities assumed	***
Purchase consideration	***

The purchase consideration is shared between partners of the selling firm in the ratio of their respective interests in the old business.

Step 4 : Credit Realisation Account by purchase consideration.

Step 5 : If there are any unrecorded assets or liabilities, they are to be recorded.

Step 6 : The entire purchase consideration is matched against the book values of assets *minus* liabilities, to ascertain the profit or loss on realisation. This is done in the Realisation Account. The profit or loss is then transferred to the Capital Account of the partners in the profit sharing ratio.

Step 7 : To ensure that the resultant claim of the partners is equal to the purchase consideration and no account is left with a balance.

Accounting Entries in the Books of Selling / Liquidating Firm

1. For transferring different assets to Realisation Account

Realisation Account Dr.
To Sundry Assets Account [Individually]

Note : If cash in hand and cash at bank are not taken over by the purchasing firm, it should not be transferred to Realisation Account.

2. For transferring different liabilities to Realisation Account

Liabilities Account Dr. [Individually]
To Realisation Account

3. For purchase consideration due

Purchasing Firm Account Dr.
To Realisation Account

4. For assets taken over by the partners

Partners' Capital Accounts Dr.
To Realisation Account

5. For realisation of assets not taken over by the purchasing firm

Bank Account Dr.
To Realisation Account

6. For recording unrecorded assets

Assets Account	Dr.
To Partners' Capital Accounts	

7. For realisation of unrecorded assets

Bank Account	Dr.
To Assets Account	

Note : If unrecorded assets are taken over by the purchasing firm, it is also transferred to Realisation Account along with other assets.

8. For payment of liabilities not taken over

Realisation Account	Dr.
To Bank Account	

9. For recording unrecorded liabilities

Partners' Capital Accounts	Dr.
To Liabilities Account	

10. For payment of unrecorded liabilities

Liabilities Account	Dr.
To Bank Account	

Note : If unrecorded liabilities are taken over by the purchasing firm, it is also transferred to Realisation Account along with other liabilities.

11. For liabilities assumed by the partners

Realisation Account	Dr.
To Partners' Capital Accounts	

12. For realisation expenses

Realisation Account	Dr.
To Bank Account	

13. For profit on realisation

Realisation Account	Dr.
To Partners' Capital Accounts	

14. For loss on realisation

Partners' Capital Accounts	Dr.
To Realisation Account	

15. For accumulated profits / reserves

Reserves Account	Dr.
Profit and Loss Account	Dr.
To Partners' Capital Accounts	

16. For accumulated losses

Partners' Capital Accounts	Dr.
To Profit and Loss Account (if any)	

17. For settlement of purchase consideration by the purchasing firm

Capital in Purchasing Firm Account	Dr.
To Purchasing Firm Account	

18. For final adjustment

Partners' Capital Accounts Dr.
To Capital in Purchasing Firm Account
To Bank Account (if any)

Accounting Entries in the Books of the Purchasing Firm

The purchasing firm records all the assets and liabilities at the values it has decided to take over. If the purchase consideration payable is more than the net assets (assets *minus* liabilities) acquired, it represents ***goodwill***. Conversely, if the purchase consideration payable is less than the net assets acquired, it represents ***capital reserve***.

1. If the net acquired assets is equal to purchase consideration, the following entry is passed:

Assets Account	Dr.	[Acquired value]
To Liabilities Account		[Assumed value]
To Partners' Capital Accounts		[Purchase consideration]

2. If the net acquired assets is ***more*** *than the purchase consideration, it represents* ***capital reserve***

The following entry is passed :

Assets Account	Dr.	[Acquired value]
To Liabilities Account		[Assumed value]
To Partners' Capital Accounts		[Purchase consideration]
To Capital Reserve Account		

3. If the net acquired assets is ***less*** *than the purchase consideration, it represents* ***goodwill***

The following entry is passed :

Asset Account	Dr.	[Acquired Value]
Goodwill Account	Dr.	[Difference]
To Liabilities Account		[Assumed Value]
To Partners' Capital Accounts		[Purchase consideration]

The assets and liabilities of the liquidating / selling firm, taken over by the purchasing firm are added with the existing assets and liabilities respectively.

Illustration 1

The Balance Sheets of two partnership firms PQ and RS as on 31.12.2014 are as below (all figures in rupees):

Liabilities	PQ	RS	Assets	PQ	RS
Capitals: P	60,000	—	Machinery	60,000	20,000
Q	30,000	—	Furniture	8,000	6,000
R	—	36,000	Stock	32,000	24,000
S	—	24,000	Debtors	18,000	30,000
Bank loan	10,000	—	Investments	—	18,000
Bills payable	30,000	40,000	Cash	12,000	2,000
	1,30,000	1,00,000		1,30,000	1,00,000

PQ absorbed RS on 01.01.2015 on the following terms :

(a) that the investments of RS to be sold out and the investment realised ₹ 24,000;
(b) that the stock of RS to be reduced to ₹ 22,000;
(c) that the machinery of RS will be increased by 40%;
(d) that the furniture of RS will be reduced by 10%.

It was further decided that for PQ, following are the adjustments to be made :

(i) Assets are to be revalued as follows: Stock: ₹ 40,000; Machinery: ₹ 84,000; Furniture: ₹ 7,200; and
(ii) Bank loan to be repaid.

You are required to show necessary Ledger Accounts to close the books of RS and to prepare necessary Journal Entries and Balance Sheet of PQ after absorption.

Solution

Working Notes : **Calculation of Purchase Consideration**

	₹
Assets taken over :	
Machinery	28,000
Furniture	5,400
Stock	22,000
Debtors	30,000
Cash (₹ 24,000 + ₹ 2,000)	26,000
	1,11,400
Less: Liability taken over — Bills payable	40,000
Purchase Consideration	71,400

In the books of RS

Dr. **Realisation Account** **Cr.**

Date	Particulars		₹	Date	Particulars	₹
2015	To Machinery A/c		20,000	2015	By Bills Payable A/c	40,000
Jan. 1	To Furniture A/c		6,000	Jan. 1	By PQ A/c	71,400
	To Stock A/c		24,000			
	To Debtors A/c		30,000			
	To Cash A/c		26,000			
	To Partners' Capital A/cs :					
	R —	2,700				
	S —	2,700	5,400			
			1,11,400			1,11,400

Dr. **PQ Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Jan. 1	To Realisation A/c	71,400	2015 Jan. 1	By Capital in PQ A/c	71,400

Dr. **Cash Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015	To Balance b/d	2,000	2015	By Realisation A/c	26,000
Jan. 1	To Investments A/c	24,000	Jan. 1		
		26,000			26,000

Dr. **Partners' Capital Accounts** **Cr.**

Date	Particulars	R	S	Date	Particulars	R	S
2015	To Capital in PQ A/c	41,700	29,700	2015	By Balance b/d	36,000	24,000
Jan. 1				Jan. 1	By Profit on Sale of Investment A/c	3,000	3,000
					By Realisation A/c (Profit)	2,700	2,700
		41,700	29,700			41,700	29,700

In the books of PQ

Journal **Dr.** **Cr.**

Date	Particulars		Dr. ₹	Cr. ₹
2015	Bank Loan A/c	Dr.	10,000	
Jan. 1	To Cash A/c			10,000
	(Being the bank loan repaid)			
	Stock A/c	Dr.	8,000	
	Machinery A/c	Dr.	24,000	
	To Revaluation A/c			32,000
	(Being the increase in the value of assets)			
	Revaluation A/c	Dr.	800	
	To Furniture A/c			800
	(Being the decrease in the value of furniture)			

	Revaluation A/c Dr.		31,200	
	To P Capital A/c			15,600
	To Q Capital A/c			15,600
	(Being the profit on revaluation transferred to Partners' Capital A/cs in the profit-sharing ratio)			
	Machinery A/c Dr.		28,000	
	Furniture A/c Dr.		5,400	
	Stock A/c Dr.		22,000	
	Debtors A/c Dr.		30,000	
	Cash A/c Dr.		26,000	
	To Bills Payable A/c			40,000
	To R Capital A/c			41,700
	To S Capital A/c			29,700
	(Being the introduction of capital by R & S)			

Dr. Partners' Capital Accounts Cr.

Date	Particulars	P	Q	Date	Particulars	P	Q
	To Balance c/d	75,600	45,600		By Balance b/d	60,000	30,000
					By Revaluation A/c (Profit)	15,600	15,600
		75,600	45,600			75,600	45,600

Balance Sheet as on 1st January, 2015

Liabilities	₹	Assets	₹
Capital Accounts		Machinery	1,12,000
P	75,600	Furniture	12,600
Q	45,600	Stock	62,000
R	41,700	Debtors	48,000
S	29,700	Cash	28,000
Bills payable	70,000		
	2,62,600		2,62,600

(b) When two or more partnership firms form a new partnership firm

When two or more pantnership firms amalgamate to form a new partnership firm, the books of account of the old firm is to be closed. In the books of each old firm, a Realisation Account is opened. All the assets and liabilities are transferred to Realisation Account at book values.

There are many Indian authors who prefer to open a Revaluation Account in place of Realisation Account, but we totally disagree with their views.

It should be remembered that Revaluation Account is opened when assets are retained in the same business but a Realisation Account is opened where assets are sold and books of account are closed.

Accounting Entries in the Books of Amalgamating Firms

1. For transferring different assets to realisation account

Realisation Account Dr.
To Sundry Assets Account (Individually)

2. For transferring different liabilities to realisation account

Liabilities Account Dr.
To Realisation Account

3. For purchase consideration due

New Firm Account Dr.
To Realisation Account

4. For assets taken over by the partners		
Partners' Capital Accounts	Dr.	
To Realisation Account		
5. For realisation of assets not taken over by the new firm		
Bank Account	Dr.	
To Realisation Account		
6. For recording unrecorded assets		
Assets Account	Dr.	
To Partners' Capital Accounts		(profit-sharing ratio)
7. For realisation of unrecorded assets		
Bank Account	Dr.	
To Assets Account		

Note: if unrecorded assets are also taken over by the new firm, it is also transferred to Realisation Account along with other assets.

8. For payment of liabilities not taken over by the new firm		
Realisation Account	Dr.	
To Bank Account		
9. For recording unrecorded liabilities		
Partners' Capital Accounts	Dr. (profit-sharing ratio)	
To Liabilities Account		
10. For payment of unrecorded liabilities		
Liabilities Account	Dr.	
To Bank Account		

Note: if unrecorded liabilities are also taken over by the new firm, it is also transferred to Realisation Account along with other liabilities.

11. Liabilities assumed by the partners		
Realisation Account	Dr.	
To Partners' Capital Accounts		
12. For realisation expenses		
Realisation Account	Dr.	
To Bank Account		
13. For profit on realisation		
Realisation Account	Dr.	
To Partners' Capital Accounts		(profit-sharing ratio)
14. For loss on realisation		
Capital Accounts	Dr. (profit-sharing ratio)	
To Realisation Account		
15. For accumulated profits/reserves		
Reserve Account	Dr.	
Profit and Loss Account	Dr.	
To Partners' Capital Accounts		(profit-sharing ratio)

16. For accumulated losses

Partners' Capital Accounts Dr.
    To Profit and Loss Account

17. For transferring partners current accounts to capital accounts

Partners' Current Accounts Dr.
    To Partners' Capital Accounts

18. For settlement of purchase consideration by the new firm

Partners' Capital in New firm Account Dr.
    To New Firm Account

19. For final adjustment

Partners' Capital Accounts Dr.
    To Partners' Capital in New Firm Account

Illustration 2

Two partnership firms, carrying on business under the style of Black & Co. and White & Co. respectively, decided to amalgamate into Grey & Co. with effect from 1st January 2015. The respective Balance Sheets are:

Balance Sheet of Black & Co. as on 31st December, 2014

Liabilities	₹	Assets	₹
Mr B's Capital Accounts	19,000	Plant and Machinery	10,000
Sundry Creditors	10,000	Stock-in-trade	20,000
Bank Overdraft	15,000	Sundry Debtors	10,000
		Mr A's Capital Account	4,000
	44,000		44,000

A and B share profits and losses in the proportion of 1 : 2.

Balance Sheet of White & Co. as on 31st December, 2014

Liabilities	₹	Assets	₹
Mr X's Capital Account	10,000	Investment	5,000
Mr Y's Capital Account	2,000	Stock-in-trade	5,000
Sundry Creditors	9,500	Sundry Debtors	10,000
		Cash in hand	1,500
	21,500		21,500

X and Y share profit and losses equally. The following further information is given :

1. All fixed assets are to be devalued by 20%.
2. All stock in trade is to be appreciated by 50%.
3. Black and Company owes ₹ 5,000 to White & Co. as on 31st December 2014. This debit is settled at ₹ 2,000
4. Investment is to be ignored for the purpose of amalgamation, being valueless.
5. The fixed capital accounts in the new firm are to be : Mr A ₹ 2,000; Mr B ₹ 3,000 Mr X ₹ 1,000 Mr Y ₹ 4,000
6. Mr B takes over bank overdraft of Black & Co. and gifts to Mr A the amount of money to be brought in by Mr A to make up his capital contribution.
7. Mr X is paid off in cash from White & Co. and Mr Y brings in sufficient cash to make up his required capital contribution.

Pass necessary Journal Entries to close the books of both the firms as on 31st December 2014.

Solution

In the books of Black & Company

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2014	Realisation A/c	Dr.	40,000	
Dec. 31	To Plant and Machinery A/c			10,000
	To Stock-in-trade A/c			20,000
	To Sundry Debtors A/c			10,000
	(Being the different assets transferred to Realisation Account)			

	Sundry Creditors A/c Dr. To Realisation A/c (Being sundry creditors transferred to Realisation Account)	10,000	10,000
	Bank Overdraft A/c Dr. To B Capital A/c (Being overdraft taken over by B)	15,000	15,000
	Grey & Co. A/c (Note 1) Dr. To Realisation A/c (Being purchase consideration due from Grey & Co.)	41,000	41,000
	Realisation A/c (Note 2) Dr. To A Capital A/c To B Capital A/c (Being profit on realisation transferred to partners capital in the ratio of 1 : 2)	11,000	 3,667 7,333
	B Capital A/c (Note 5) Dr. To A Capital A/c (Being deficit in A's capital made good by B)	2,333	2,333
	A Capital A/c Dr. B Capital A/c (See Tutorial Note) Dr. To Grey & Co. A/c (Being the capital accounts of the partners closed by transfer to Grey & Co.)	2,000 39,000	 41,000

Tutorial Note : It should be noted that the credit balance in B's capital account is ₹ 39,000. His agreed capital in Grey & Co is ₹ 3,000 only. Since there is no liquid assets in Black & Co. from which B can be repaid, the excess amount of ₹ 36,000 should be taken over by Grey & Co. as loan from B.

In the books of White & Company
Journal

Date	Particulars	Dr. ₹	Cr. ₹
2014 Dec. 31	Realisation A/c Dr. To Investment A/c To Stock-in-trade A/c To Sundry Debtors A/c (Being the different assets transferred to Realisation Account)	20,000	 5,000 5,000 10,000
	Sundry Creditors A/c Dr. To Realisation A/c (Being sundry creditors transferred to Realisation Account)	9,500	9,500
	Grey & Co. A/c (Note 1) Dr. To Realisation A/c (Being purchase consideration due from Grey & Co.)	5,000	5,000
	X Capital A/c Dr. Y Capital A/c Dr. To Realisation A/c (Note 2) (Being loss on realisation transferred to Partners' Capital Accounts equally)	2,750 2,750	 5,500
	Cash A/c Dr. To Y Capital A/c (Being the necessary amount brought in by Y to make up his required capital contribution)	4,750	4,750
	X Capital A/c Dr. To Cash A/c (Being the excess capital paid by cash)	6,250	6,250
	X Capital A/c Dr. Y Capital A/c Dr. To Grey & Co. A/c (Being the capital accounts of the partners closed by transfer to Grey & Co.)	1,000 4,000	 5,000

Working Notes: **(1) Calculations of Purchase Consideration**

		Black & Co.	White & Co.
Assets taken over :			
Plant & Machinery		8,000	—
Stock-in-trade		30,000	7,500
Sundry Debtors [(* After adjustment of ₹ 3,000 (₹ 5,000 – ₹ 2,000)]		10,000	*7,000
	(A)	48,000	14,500
Liability taken over :			
Sundry Creditors : *₹ (10,000 – 3,000)	(B)	* 7,000	9,500
Purchase Consideration	(A – B)	41,000	5,000

Dr. **(2) Realisation Account** **Cr.**

Date	Particulars	Black & Co.	White & Co.	Date	Particulars	Black & Co.	White & Co.
2014	To Investment A/c	—	5,000	2014	By Sundry Creditors A/c	10,000	9,500
Dec. 31	To Plant & Machinery A/c	10,000	—	Dec. 31	By Grey & Co. A/c	41,000	5,000
	To Stock-in-trade A/c	20,000	5,000		By X Capital A/c (loss)	—	2,750
	To Sundry Debtors A/c	10,000	10,000		By Y Capital A/c (loss)	—	2,750
	To A Capital A/c (profit)	3,667	—				
	To B Capital A/c (profit)	7,333	—				
		51,000	20,000			51,000	20,000

Dr. **(3) Partners' Capital Accounts** **Cr.**

Date	Particulars	A	B	Date	Particulars	A	B
2014	To Balance b/d	4,000	—	2014	By Balance b/d	—	19,000
Dec. 31	To A Capital A/c	—	2,333	Dec. 31	By Realisation A/c (profit)	3,667	7,333
	To Grey & Co. A/c	2,000	39,000		By B Capital A/c	2,333	—
					By Bank Overdraft A/c	—	15,000
		6,000	41,333			6,000	41,333

Dr. **(4) Partners' Capital Accounts** **Cr.**

Date	Particulars	X	Y	Date	Particulars	X	Y
2014	To Realisation A/c	2,750	2,750	2014	By Balance b/d	10,000	2,000
Dec. 31	To Grey & Co. A/c	1,000	4,000	Dec. 31	By Cash A/c	—	4,750
	To Cash A/c	6,250	—				
		10,000	6,750			10,000	6,750

(5) In the new firm, A's capital should be ₹ 2,000 but his Capital Account is showing a debit balance of ₹ 333. Therefore, to make good the deficit, B will gift ₹ 2,333 to A.

Illustration 3

A and B are partners of AB Co. sharing profits and losses in the ratio of 3 : 1 and B and C are partners of BC & Co. sharing profits and losses in the ratio of 2 : 1. On 31st March, 2015, they decided to amalgamate and form a new firm ABC & Co. wherein A, B and C would be partners sharing profits and losses in the ratio of 3 : 2 : 1.

The Balance Sheet of two firms on the above date were as under :

Liabilities	AB & Co. ₹	BC & Co. ₹	Assets	AB & Co. ₹	BC & Co. ₹
Capital :			**Fixed Assets** :		
A	96,000	—	Building	20,000	—
B	64,000	80,000	Machinery	60,000	64,000
C	—	40,000	Furniture	8,000	2,400
Reserves	20,000	60,000	**Current Assets** :		
Creditors	48,000	46,400	Stock	48,000	56,000
Due to AB & Co.	—	40,000	Debtors	64,000	80,000
Bank Loan	32,000	—	Cash	20,000	40,000
			Due from BC & Co.	40,000	—
			Advances	—	24,000
	2,60,000	2,66,400		2,60,000	2,66,400

The amalgamated new firm ABC & Co. took over the business on the following terms :

(a) Building of AB & Co. was valued at ₹ 40,000.

(b) Machinery of AB & Co. was valued at ₹ 90,000 and that of BC & Co. at ₹ 80,000.

(c) Goodwill of AB & Co. was valued at ₹ 20,000 and that of BC & Co. at ₹ 16,400 but no goodwill account was to appear in the books of ABC & Co.

(d) Partners of the new firm will bring necessary cash to pay other partners to adjust their capital according to the profit sharing ratio.

Show journal entries in the books of ABC & Co. and prepare the Balance Sheet as on 31st March, 2015.

Solution

In the books of ABC & Co

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2015	Building A/c	Dr.	40,000	
Mar 31	Machinery A/c	Dr.	90,000	
	Furniture A/c	Dr.	8,000	
	Stock A/c	Dr.	48,000	
	Debtors A/c	Dr.	64,000	
	Cash A/c	Dr.	20,000	
	Due from BC & Co A/c	Dr.	40,000	
	Goodwill A/c	Dr.	20,000	
	To Creditors A/c			48,000
	To Bank Loan A/c			32,000
	To A Capital A/c			1,63,500
	To B Capital A/c			86,500
	(Being the different assets and liabilities taken over from AB & Co)			
	Machinery A/c	Dr.	80,000	
	Furniture A/c	Dr.	2,400	
	Stock A/c	Dr.	56,000	
	Debtors A/c	Dr.	80,000	
	Cash A/c	Dr.	40,000	
	Advance A/c	Dr.	24,000	
	Goodwill A/c	Dr.	16,400	
	To Creditors A/c			46,400
	To Due to AB & Co A/c			40,000
	To B Capital A/c			1,41,600
	To C Capital A/c			70,800
	(Being different assets and liabilities taken over from BC & Co)			
	Due to AB & Co A/c	Dr.	40,000	
	To Due to BC & Co A/c			40,000
	(Being the adjustment of mutual indebtedness)			
	Goodwill A/c (20,000 + 16,400)	Dr.	36,400	
	To A Capital A/c			18,200
	To B Capital A/c			12,133
	To C Capital A/c			6,067
	(Being the goodwill written-off in the ratio of 3 : 2 : 1)			
	Cash A/c	Dr.	73,967	
	To A Capital A/c			67,700
	To C Capital A/c			6,267
	(Being necessary cash brought in by partners to make their capital in profit sharing ratio)			
	B Capital A/c	Dr.	73,967	
	To Cash A/c			73,967
	(Being the cash paid to B)			

(ii) Balance Sheet of ABC & Co. as at 31st March, 2015

Liabilities	₹	Assets	₹
Partners' Capitals :		**Fixed Assets** :	
A	2,13,000	Building	40,000
B	1,42,000	Machinery	1,70,000
C	71,000	Furniture	10,400

Creditors	94,400	**Current Assets** :	
Bank Loan	32,000	Stock	1,04,000
		Debtors	1,44,000
		Advances	24,000
		Cash	60,000
	5,52,400		5,52,400

Working Notes :

(1) Calculation of Purchase Consideration

Assets taken over :		AB & Co. (₹)	BC & Co. (₹)
Building		40,000	—
Machinery		90,000	80,000
Furniture		8,000	2,400
Stock		48,000	56,000
Debtors		64,000	80,000
Cash		20,000	40,000
Due from BC & Co		40,000	—
Advances		—	24,000
Goodwill		20,000	16,400
	(A)	3,30,000	2,98,800
Liabilities taken over:			
Creditors		48,000	46,400
Due to AB & Co		—	40,000
Bank Loan		32,000	—
	(B)	80,000	86,400
Purchase Consideration	(A – B)	2,50,000	2,12,400

Dr. (2) Realisation Account Cr.

Date	Particulars	AB & Co.	BC & Co.	Date	Particulars	AB & Co.	BC & Co.
	To Building A/c	20,000	—		By Creditors	48,000	46,400
	To Machinery A/c	60,000	64,000		By Due to AB & Co	—	40,000
	To Furniture A/c	8,000	2,400		By Bank Loan A/c	32,000	—
	To Stock A/c	48,000	56,000		By ABC & Co A/c	2,50,000	2,12,400
	To Debtors a/c	64,000	80,000		(Purchase Consideration)		
	To Cash A/c	20,000	40,000				
	To Due from BC & Co A/c	40,000	—				
	To Advance A/c	—	24,000				
	To Partners' Capital A/cs :						
	A	52,500	—				
	B	17,500	—				
	B	—	21,600				
	C	—	10,800				
		3,30,000	2,98,800			3,30,000	2,98,800

In the books of AB & Co.

Dr. (3) Partners' Capital Accounts Cr.

Particulars	A	B	Particulars	A	B
To Balance c/d	1,63,500	86,500	By Balance b/d	96,000	64,000
			By Reserve A/c	15,000	5,000
			By Realisation A/c (Profit)	52,500	17,500
	1,63,500	86,500		1,63,500	86,500

In the books of BC & Co.

Dr. (4) Partners' Capital Accounts Cr.

Particulars	B	C	Particulars	B	C
To Balance c/d	1,41,600	70,800	By Balance b/d	80,000	40,000
			By Reserve A/c	40,000	20,000
			By Realisation A/c (Profit)	21,600	10,800
	1,41,600	70,800		1,41,600	70,800

In the books of ABC & Co.

Dr. (5) Partners' Capital Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
To Goodwill A/c (written-off)	18,200	12,133	6,067	By Balance b/d :			
To Cash A/c	—	73,967	—	AB & Co	1,63,500	86,500	—
To Balance c/d (Note 6)	2,13,000	1,42,000	71,000	BC & Co	—	1,41,600	70,800
				By Cash A/c	67,700	—	6,267
	2,31,200	2,28,100	77,067		2,31,200	2,28,100	77,067

(6) Total Capital of Partners in ABC & Co :

	₹
A — 1,63,500 + 0	1,63,500
B — 86,500 + 1,41,600	2,28,100
C — 0 + 70,800	70,800
	4,62,400
Less: Goodwill written-off	36,400
Total Capital after Goodwill adjustment	4,26,000

A's capital = 3/6 × 4,26,000 = 2,13,000

B's capital = 2/6 × 4,26,000 = 1,42,000

C's capital = 1/6 × 4,26,000 = 71,000

Illustration 4

B and S are partners of S & Co sharing profits and losses in the ratio of 3 : 1. S and T are partners of T & Co sharing profits and losses in the ratio of 2 : 1. On 31.10.2011, they decided to amalgamate and form a new firm M/s BST & Co wherein B, S and T would be partners sharing profits and losses in the ratio of 3 : 2 : 1.

The Balance sheet on the date were as under :

Liabilities	S & Co (₹)	T & Co (₹)	Assets	S & Co (₹)	T & Co (₹)
Capital :			Buildings	25,000	—
B	1,20,000	—	Machinery	75,000	—
S	80,000	1,00,000	Vehicles	—	80,000
T	—	50,000	Furniture	10,000	3,000
Reserves	25,000	50,000	Stock	60,000	70,000
Other Creditors	60,000	58,000	Other Debtors	80,000	1,00,000
Due to X & Co	40,000	—	Cash in Hand	10,000	5,000
Due to S & Co	—	50,000	Cash at Bank	15,000	20,000
			Due from T & Co	50,000	—
			Due from X & Co	—	30,000
	3,25,000	3,08,000		3,25,000	3,08,000

The amalgamated firm took over the business on the following terms :

(a) Goodwill of S & Co was worth ₹ 60,000 and that of T & Co ₹ 50,000. Goodwill Account was not to be opened in the books of the new firm, the adjustments being recorded through capital accounts of the partners.

(b) Building, Machinery and Vehicles were taken over at ₹ 50,000, ₹ 90,000 and ₹ 1,00,000 respectively.

(c) Provisions for doubtful debts has to be carried forward at ₹ 4,000 in respect of debtors of S & Co and ₹ 5,000 in respect of debtors of T & Co.

You are required to prepare the Balance Sheet of the new firm, assuming that excess / deficit capitals (taking T's capital as base) with reference to share in profits are to be transferred to Current Accounts.

[St. Xavier's College (Kolkata) — Semester II, 2012]

Balance Sheet of XY & Co. as at 31st March, 2010

Liabilities	₹	Assets	₹
Partners' Capitals :		**Fixed Assets** :	
B	2,10,000	Buildings	50,000
S	1,40,000	Machinery	90,000
T	70,000	Vehicles	1,00,000
Current Accounts :		Furniture	13,000
S	1,10,250	**Current Assets** :	
X & Co A/c	10,000	Stock	1,30,000

Other Creditors	1,18,000	Other Debtors (Net)	1,71,000
		Bank	35,000
		Cash	15,000
		Partners' Current A/cs : B	54,250
	6,58,250		6,58,250

Working Notes : **(1) Calculation of Purchase Consideration**

		S & Co. (₹)	T & Co. (₹)
Assets taken over :			
Buildings		50,000	—
Machinery		90,000	—
Vehicles		—	1,00,000
Furniture		10,000	3,000
Stock		60,000	70,000
Other Debtors		80,000	1,00,000
Cash in Hand		10,000	5,000
Cash at Bank		15,000	20,000
Due from T & Co		50,000	—
Due from X & Co		—	30,000
Goodwill		60,000	50,000
	(A)	4,25,000	3,78,000
Liabilities taken over:			
Other Creditors		60,000	58,000
Due to X & Co		40,000	—
Due to S & Co		—	50,000
Provision for Doubtful Debts		4,000	5,000
	(B)	1,04,000	1,13,000
Purchase Consideration	(A – B)	3,21,000	2,65,000

Dr. **(2) Realisation Account** **Cr.**

Date	Particulars	S & Co.	T & Co.	Date	Particulars	S & Co.	T & Co.
	To Buildings A/c	25,000	—		By Other Creditors A/c	60,000	58,000
	To Machinery A/c	75,000	—		By Due to X & Co	40,000	—
	To Vehicles A/c	—	80,000		By Due to S & Co	—	50,000
	To Furniture A/c	10,000	3,000		By BST & Co A/c (Note 1)	3,21,000	2,65,000
	To Stock A/c	60,000	70,000		(Purchase Consideration)		
	To Other Debtors A/c	80,000	1,00,000				
	To Cash in Hand	10,000	5,000				
	To Cash at Bank	15,000	20,000				
	To Due from T & Co	50,000	—				
	To Due from X & Co	—	30,000				
	To Partners' Capital A/cs :						
	B	72,000	—				
	S	24,000	—				
	S	—	43,333				
	T	—	21,667				
		4,21,000	3,73,000			4,21,000	3,73,000

In the books of S & Co.

Dr. **(3) Partners' Capital Accounts** **Cr.**

Date	Particulars	B	S	Date	Particulars	B	S
	To Balance c/d	2,10,750	1,10,250		By Balance b/d	1,20,000	80,000
					By Reserve A/c	18,750	6,250
					By Realisation A/c (Profit)	72,000	24,000
		2,10,750	1,10,250			2,10,750	1,10,250

In the books of T & Co.

(4) Partners' Capital Accounts

Dr. | **Cr.**

Date	Particulars	S	T	Date	Particulars	S	T
	To Balance c/d	1,76,666	88,334		By Balance b/d	1,00,000	50,000
					By Reserve A/c	33,333	16,667
					By Realisation A/c (Profit)	43,333	21,667
		1,76,666	88,334			1,76,666	88,334

In the books of M/s BST & Co.

(5) Partners' Capital Accounts

Dr. | **Cr.**

Particulars	B	S	T	Particulars	B	S	T
To Goodwill (written off)	55,000	36,666	18,334	By Balance b/d :			
To Balance c/d	1,55,750	2,50,250	70,000	S & Co.	2,10,750	1,10,250	—
				T & Co.	—	1,76,666	88,334
	2,10,750	2,86,916	88,334		2,10,750	2,86,916	88,334
To Current A/c	—	1,10,250	—	By Balance c/d	1,55,750	2,50,250	70,000
To Balance c/d (Note 6)	2,10,000	1,40,000	70,000	By Current A/c	54,250	—	—
	2,10,000	2,50,250	70,000		2,10,000	2,50,250	70,000

(6) Taking T's capital as base, the total capital of the new firm M/s BST & Co will be : ₹ 70,000 × 6 = **₹ 4,20,000**.

B's capital = ₹ 4,20,000 / 6 × 3	2,10,000
S's capital = ₹ 4,20,000 / 6 × 2	1,40,000
T's capital = ₹ 4,20,000 / 6 × 1	70,000
	4,20,000

Illustration 5

Firm X & Co. consists of partners A and B sharing profits and losses in the ratio of 3 : 2. The firm Y & Co. consists of partners B and C sharing profits and losses in the ratio of 5 : 3.

On 31st March, 2015 it was decided to amalgamate both the firms and form a new firm XY & Co. wherein A, B and C would be partners sharing profits and losses in the ratio of 4 : 5 : 1.

Balance Sheet as at 31.3.2013

Liabilities	X & Co. (₹)	Y & Co. (₹)	Assets	X & Co. (₹)	Y & Co. (₹)
Capital :			Cash in hand / bank	40,000	30,000
A	1,50,000	—	Debtors	60,000	80,000
B	1,00,000	75,000	Stock	50,000	20,000
C	—	50,000	Vehicles	—	90,000
Reserve	50,000	40,000	Machinery	1,20,000	—
Creditors	1,20,000	55,000	Building	1,50,000	—
	4,20,000	2,20,000		4,20,000	2,20,000

The folowing were the terms of amalgamation :

(i) Goodwill of X & Co. was valued at ₹ 75,000. Goodwill of Y & Co. was valued at ₹ 40,000. Goodwill Account not to be opened in the books of the new firm but adjusted through the Capital Accounts of the partners.

(ii) Building, Machinery and Vehciles are to be taken over at ₹ 2,00,000, ₹ 1,00,000 and ₹ 74,000 respectively.

(iii) Provision for doubtful debts at ₹ 5,000 in respect of X & Co. and ₹ 4,000 in respect of Y & Co. are to be provided.

You are required to :

(i) Show how the Goodwill value is adjusted amongst the partners.

(ii) Prepare the Balance Sheet of XY & Co. as at 31.3.2015 by keeping partners capital in their profit sharing ratio by taking capital of 'B' as the basis. The excess or deficiency to be kept in the respective Partners' Current Account.

Solution **(i) Statement Showing the Adjustment for Goodwill**

	A (₹)	B (₹)	C (₹)
Rights of Goodwill **before** Amalgamation of X & co. (3 : 2)	45,000	30,000	—
Rights of Goodwill **before** Amalgamation of Y & co. (5: 3)	—	25,000	15,000
	45,000	55,000	15,000
Rights of Goodwill **after** Amalgamation (4 : 5 : 1)	46,000	57,500	11,500
	(1,000)	(2,500)	3,500
	(Gain) Dr.	(Gain) Dr.	Sacrifice Cr.

Journal for Goodwill Adjustment

A Capital Account	Dr.	₹ 1,000	
B Capital Account	Dr.	₹ 2,500	
To C Capital Account			₹ 3,500

(ii) Balance Sheet of XY & Co. as at 31st March, 2015

Liabilities	₹	Assets	₹
Partners' Capitals :		**Fixed Assets** :	
A (Note 6)	1,72,000	Building	2,00,000
B (Note 6)	2,15,000	Machinery	1,00,000
C (Note 6)	43,000	Vehicles	74,000
Current Accounts :		**Current Assets** :	
A (Note 5)	22,000	Stock	70,000
B (Note 5)	18,000	Debtors	1,31,000
Creditors	1,75,000	Cash and Bank	70,000
	6,45,000		6,45,000

Working Notes : **(1) Calculation of Purchase Consideration**

		X & Co. (₹)	Y & Co. (₹)
Assets taken over :			
Cash in Hand / Bank		40,000	30,000
Debtors		60,000	80,000
Stock		50,000	20,000
Vehicles		—	74,000
Machinery		1,00,000	—
Building		2,00,000	—
Goodwill		75,000	40,000
	(A)	5,25,000	2,44,000
Liabilities taken over:			
Creditors		1,20,000	55,000
Provision for Doubtful Debts		5,000	4,000
	(B)	1,25,000	59,000
Purchase Consideration	(A – B)	4,00,000	1,85,000

Dr. **(2) Realisation Account** **Cr.**

Date	Particulars	X & Co.	Y & Co.	Date	Particulars	X & Co.	Y & Co.
	To Cash in Hand	40,000	30,000		By Creditors	1,20,000	55,000
	To Debtors	60,000	80,000		By XY & Co. A/c	4,00,000	1,85,000
	To Stock	50,000	20,000		(Purchase consideration)		
	To Vehicles	—	90,000				
	To Machinery	1,20,000	—				
	To Building	1,50,000	—				
	To Partners' Capital A/cs :						
	A	60,000	—				
	B	40,000	—				
	B	—	12,500				
	C	—	7,500				
		5,20,000	2,40,000			5,20,000	2,40,000

In the books of X & Co.

Dr. **(3) Partners' Capital Accounts** **Cr.**

Date	Particulars	A	B	Date	Particulars	A	B
	To Balance c/d	2,40,000	1,60,000		By Balance b/d	1,50,000	1,00,000
					By Reserve A/c	30,000	20,000
					By Realisation A/c (Profit)	60,000	40,000
		2,40,000	1,60,000			2,40,000	1,60,000

In the books of Y & Co.

Dr. **(4) Partners' Capital Accounts** **Cr.**

Date	Particulars	B	C	Date	Particulars	B	C
	To Balance c/d	1,12,500	72,500		By Balance b/d	75,000	50,000
					By Reserve A/c	25,000	15,000
					By Realisation A/c	12,500	7,500
		1,12,500	72,500			1,12,500	72,500

In the books of XYZ Co.

Dr. **(5) Partners' Capital Accounts** **Cr.**

Particulars	A	B	C	Particulars	A	B	C
To Goodwill (written off)	46,000	57,500	11,500	By Balance b/d :			
To Balance c/d	1,94,000	2,15,000	61,000	X & Co.	2,40,000	1,60,000	—
				Y & Co.	—	1,12,500	72,500
	2,40,000	2,72,500	72,500		2,40,000	2,72,500	72,500
To Current A/c (bal. fig.)	22,000	—	18,000	By Balance c/d	1,94,000	2,15,000	61,000
To Balance c/d (Note 6)	1,72,000	2,15,000	43,000				
	1,94,000	2,15,000	61,000		1,94,000	2,15,000	61,000

(6) Taking B's capital as base, the total capital of the firm $= \frac{2,15,000}{5} \times 10 = ₹\ 4,30,000$

A's Capital $= \frac{4,30,000}{10} \times 4 = ₹\ 1,72,000$

B's Capital $= \frac{4,30,000}{10} \times 5 = ₹\ 2,15,000$

C's Capital $= \frac{4,30,000}{10} \times 1 = ₹\ 43,000$

Illustration 6

M/s A and Co., having A and B as equal partners, decided to amalgamate with C and Co., having C and D as equal partners on the following terms and conditions :

1. The new firm AC and Co. to pay ₹ 12,000 to each firm for Goodwill.
2. The new firm to take over investments at 10% depreciation, land at ₹ 66,800, premises at ₹ 53,000, machinery at ₹ 9,000 and only the trade liabilities of both the firms. The debtors being taken over at given value.
3. Typewriters (written-off) worth ₹ 800, belonging to C and Co., and not appearing in the Balance Sheet was also not taken over by the new firm.
4. Bills payable pertain to trade transactions only.
5. All the four partners in the new firm to bring in ₹ 1,60,000 as capital in equal shares.

The following were the Balance Sheets of both the firms on the date of amalgamation :

Liabilities	A & Co.	C & Co.	Assets		A & Co.	C & Co.
Trade creditors	20,000	10,000	Cash		15,000	12,000
Bills payable	5,000	—	Investments		10,000	8,000
Bank overdraft	2,000	10,000	Debtors	₹ 10,000		
A's Loan	6,000	—	Less: Provision	₹ 1,000	9,000	4,000

Capitals :			Furniture	12,000	6,000
A	35,000	—	Premises	30,000	—
B	22,000	—	Land	—	50,000
C	—	36,000	Machinery	15,000	—
D	—	20,000	Goodwill (Purchased)	9,000	—
General Reserve	8,000	3,000			
Investment Fluctuation Fund	2,000	1,000			
	1,00,000	80,000		1,00,000	80,000

Assuming immediate discharge of bank overdraft, pass necessary Journal Entries to close the books of A & Co and C & Co.

Also pass Journal Entries in the books and prepare the Balance Sheet of the New firm.

Solution

In the books of A & Company

Journal

Date	Particulars		Dr. ₹	Cr. ₹
	Bank Overdraft A/c	Dr.	2,000	
	To Cash A/c			2,000
	(Being the payment of overdraft)			
	Realisation A/c	Dr.	99,000	
	To Cash A/c			13,000
	To Investments A/c			10,000
	To Debtors A/c			10,000
	To Furniture A/c			12,000
	To Premises A/c			30,000
	To Machinery A/c			15,000
	To Goodwill A/c			9,000
	(Being the transfer of different assets to Realisation Account)			
	Provision for Bad Debts A/c	Dr.	1,000	
	Trade Creditors A/c	Dr.	20,000	
	Bills Payable A/c	Dr.	5,000	
	To Realisation A/c			26,000
	(Being the different liabilities and provisions transferred to Realisation Account)			
	M/s AC & Co. (new firm) A/c	Dr.	80,000	
	To Realisation A/c (Note 1)			80,000
	(Being the purchase consideration due from the new firm)			
	A Capital A/c (Note 6)	Dr.	6,000	
	B Capital A/c	Dr.	6,000	
	To Realisation A/c			12,000
	(Being furniture taken over by the partners equally)			
	General Reserve A/c	Dr.	8,000	
	Investment Fluctuation Fund A/c	Dr.	2,000	
	To A Capital A/c			5,000
	To B Capital A/c			5,000
	(Being the reserve and surplus distributed between the partners equally)			
	Realisation A/c (Note 2)	Dr.	19,000	
	To A Capital A/c			9,500
	To B Capital A/c			9,500
	(Being the profit on realisation transferred to the Partners' Capital Accounts equally)			
	A's Loan A/c	Dr.	6,000	
	To A Capital A/c			6,000
	(Being A's loan transferred to his Capital Account)			
	Cash A/c	Dr.	9,500	
	To B Capital A/c			9,500
	(Being cash brought in by B to raise his capital equal to ₹ 40,000)			

	A & B Capital in M/s AC & Co. A/c	Dr.	80,000	
	To M/s AC & Co. A/c			80,000
	(Being the settlement of purchase consideration)			
	A Capital A/c	Dr.	49,500	
	B Capital A/c	Dr.	40,000	
	To A Capital in AC & Co. A/c			40,000
	To B Capital in AC & Co. A/c			40,000
	To Cash A/c			9,500
	(Being the final adjustment to close the books of account)			

In the books of C & Company
Journal **Dr.** **Cr.**

Date	Particulars		₹	₹
	Bank Overdraft A/c	Dr.	10,000	
	To Cash A/c			10,000
	(Being the payment of overdraft)			
	Office Equipment (Typewriters) A/c	'Dr.	800	
	To C Capital A/c			400
	To D Capital A/c			400
	(Being recording of typewriters previously written-off)			
	Realisation A/c	Dr.	68,800	
	To Investments A/c			8,000
	To Debtors A/c			4,000
	To Furniture A/c			6,000
	To Land A/c			50,000
	To Office Equipment A/c			800
	(Being the transfer of different assets to Realisation Account)			
	Trade Creditors A/c	Dr.	10,000	
	To Realisation A/c			10,000
	(Being the liability transferred to Realisation Account)			
	M/s AC & Co. (new firm) A/c	Dr.	80,000	
	To Realisation A/c (Note 1)			80,000
	(Being the purchase consideration due from the new firm)			
	C Capital A/c	Dr.	3,400	
	D Capital A/c	Dr.	3,400	
	To Realisation A/c			6,800
	(Being furniture and typewriters taken over by the partners equally)			
	General Reserve A/c	Dr.	3,000	
	Investment Fluctuation Fund A/c	Dr.	1,000	
	To C Capital A/c			2,000
	To D Capital A/c			2,000
	(Being the reserve and surplus distributed between the partners equally)			
	Realisation A/c	Dr.	28,000	
	To C Capital A/c			14,000
	To D Capital A/c			14,000
	(Being the profit on realisation transferred to the Partners' Capital Accounts equally)			
	Cash A/c	Dr.	7,000	
	To D Capital A/c			7,000
	(Being cash brought in by D to raise his capital equal to ₹ 40,000)			
	C and D Capital in A & Co. A/c	Dr.	80,000	
	To M/s AC & Co. A/c			80,000
	(Being the settlement of purchase consideration)			
	C Capital A/c	Dr.	49,000	
	D Capital A/c	Dr.	40,000	
	To C Capital in AC & Co. A/c			40,000
	To D Capital in AC & Co. A/c			40,000
	To Cash A/c			9,000
	(Being the final adjustment to close the books of account)			

In the books of AC & Company
Journal

Date	Particulars		Dr. ₹	Cr. ₹
	Goodwill A/c	Dr.	12,000	
	Cash A/c	Dr.	13,000	
	Investments A/c	Dr.	9,000	
	Debtors A/c	Dr.	10,000	
	Premises A/c	Dr.	53,000	
	Machinery A/c	Dr.	9,000	
	To Provision for Bad Debts A/c			1,000
	To Trade Creditors A/c			20,000
	To Bills Payable A/c			5,000
	To A Capital A/c			40,000
	To B Capital A/c			40,000
	(Being the assets and liabilities taken over by the new firm)			
	Goodwill A/c	Dr.	12,000	
	Investments A/c	Dr.	7,200	
	Debtors A/c	Dr.	4,000	
	Land A/c	Dr.	66,800	
	To Trade Creditors A/c			10,000
	To C Capital A/c			40,000
	To D Capital A/c			40,000
	(Being the assets and liabilities taken over by the new firm)			

Balance Sheet of AC & Co. as at ...

Liabilities	₹	Assets	₹
Partners' Capitals :		Goodwill	24,000
A	40,000	Land	66,800
B	40,000	Premises	53,000
C	40,000	Machinery	9,000
D	40,000	Investments	16,200
Creditors	30,000	Debtors *less* Provision (₹ 14,000 – ₹ 1,000)	13,000
Bills Payable	5,000	Cash	13,000
	1,95,000		1,95,000

Working Notes : **(1) Calculation of Purchase Consideration**

Assets taken over :		A & Co. (₹)	C & Co. (₹)
Cash (See Tutorial Note below)		13,000	—
Investments		9,000	7,200
Debtors		9,000	4,000
Premises		53,000	—
Machinery		9,000	—
Land		—	66,800
Goodwill		12,000	12,000
	(A)	1,05,000	90,000
Liabilities taken over:			
Trade Creditors		20,000	10,000
Bills Payable		5,000	—
	(B)	25,000	10,000
Purchase Consideration	(A — B)	80,000	80,000

Tutorial Note : Total capital of the new firm should be ₹ 1,60,000. Combined capital of A and B will be ₹ 80,000 and that of C and D will be ₹ 80,000. Net assets (other than cash) taken over by the new firm are as follows :

Assets taken over :		A & Co.	C & Co.
Investments		9,000	7,200
Debtors		9,000	4,000
Premises		53,000	—
Machinery		9,000	—
Land		—	66,800
Goodwill		12,000	12,000
	(A)	92,000	90,000

Liabilities taken over:			
Trade Creditors		20,000	10,000
Bills Payable		5,000	—
	(B)	25,000	10,000
Net Assets Taken over	(A — B)	67,000	80,000

It should be noted that A & Co.'s net assets (other than cash) comes to ₹ 67,000 whereas required capital of A and B should be ₹ 80,000. Therefore, the cash of A & Co. ₹ 13,000 is also to be taken over to make the capital of A and B equal to ₹ 80,000.

But in case of C & Co., the net assets comes to ₹ 80,000 and the required capital of C and D also ₹ 80,000. Therefore, the cash of C & Co. will not be taken over by the new firm.

Dr. (2) Realisation Account Cr.

Date	Particulars	A & Co.	C & Co.	Date	Particulars	A & Co.	C & Co.
	To Cash A/c	13,000	—		By Prov. for Bad Debts A/c	1,000	—
	To Investments A/c	10,000	8,000		By Trade Creditors A/c	20,000	10,000
	To Debtors A/c	10,000	4,000		By Bills Payable A/c	5,000	—
	To Furnitures A/c	12,000	6,000		By M/s AC & Co. A/c	80,000	80,000
	To Premises/Land A/c	30,000	50,000		By A Capital A/c (Note 6)	6,000	—
	To Office Equipment A/c	—	800		By B Capital A/c (Note 6)	6,000	—
	To Machinery A/c	15,000	—		By C Capital A/c (Note 7)	—	3,400
	To Goodwill A/c	9,000	—		By D Capital A/c (Note 7)	—	3,400
	To A Capital A/c (profit)	9,500	—				
	To B Capital A/c (profit)	9,500	—				
	To C Capital A/c (profit)	—	14,000				
	To D Capital A/c (profit)	—	14,000				
		1,18,000	96,800			1,18,000	96,800

Dr. (3) Partners' Capital Accounts Cr.

Date	Particulars	A	B	Date	Particulars	A	B
	To Realisation A/c (Note 6)	6,000	6,000		By Balance b/d	35,000	22,000
	To Capital in AC & Co. A/c	40,000	40,000		By General Reserve A/c	4,000	4,000
	To Cash A/c	9,500	—		By Inv. Fluctuation Fund A/c	1,000	1,000
	(final settlement)				By A's Loan A/c	6,000	—
					By Realisation A/c (profit)	9,500	9,500
					By Cash A/c (final settlement)	—	9,500
		55,500	46,000			55,500	46,000

Dr. (4) Partners' Capital Accounts Cr.

Date	Particulars	C	D	Date	Particulars	C	D
	To Realisation A/c (Note 7)	3,400	3,400		By Balance b/d	36,000	20,000
	To Capital in AC & Co. A/c	40,000	40,000		By General Reserve A/c	1,500	1,500
	To Cash A/c	9,000	—		By Inv. Fluctuation Fund A/c	500	500
	(final settlement)				By Office Equipment A/c	400	400
					By Realisation A/c (profit)	14,000	14,000
					By Cash A/c (final settlement)	—	7,000
		52,400	43,400			52,400	43,400

Dr. (5) Cash Book of C & Co. Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	12,000		By Bank Overdraft A/c	10,000
	To D Capital A/c	7,000		By C Capital A/c	9,000
		19,000			19,000

(6) Furniture has not been taken over by the new firm. It has been distributed between the partners equally.

(7) Furniture and Typewriters has not been taken over by the new firm. It has been distributed between the partners equally.

Key Notes

- **Reasons for Amalgamation—** 1. Economics of Scale : The amalgamated firm can have operating cost advantage by distributing fixed expenses to a more number of units. 2. Growth: Internal growth is time consuming. Growth can be achieved through acquisition of another firm(s). 3. Diversification : In an amalgamated firm, the risk of the firm can be reduced by diversifying into two or more industries. 4. Financial Economies : Financial economies can be in the form of higher debt capacity and lower rate of borrowing, reduction of common expenses, e.g., sales promotion. 5. Supnferior Management : More talented people can be hired for management of the firm.
- The purchasing firm records all the assets and liabilities at the values it has decided to take over. If the purchase consideration payable is more than the net assets (assets *minus* liabilities) acquired, it represents ***goodwill***. Conversely, if the purchase consideration payable is less than the net assets acquired, it represents ***capital reserve***.
- When two or more pantnership firms amalgamate to form a new partnership firm, the books of account of the old firm is to be closed. In the books of each old firm, a Realisation Account is opened. All the assets and liabilities are transferred to Realisation Account at book values.

THEORETICAL QUESTIONS

1. (a) What do you mean by amalgamation of a firm ?
   (b) What are the objectives of amalgamation of firms ?
2. What are the different accounting entries to be passed in the books of the amalgamating firms to close their books of account ?
3. What are the different accounting entries to be passed in the books of the new firm at the time of amalgamation of the firms?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below.

1. For closing the books of account of the amalgamating firms, the assets and liabilities are transferred to :
   A revaluation account
   B realisation account
   C reconciliation account.
2. Accumulated losses of amalgamating firm are transferred to :
   A realisation account
   B partners' capital accounts
   C new firm's account.
3. Profit on realisation is transferred to Partners' Capital Accounts in the :
   A profit-sharing ratio
   B capital ratio
   C equally.
4. If the unrecorded liabilities are taken over by the new firm, it is transferred to :
   A realisation account along with other liabilities
   B partners' capital accounts
   C partners' drawings accounts.

PRACTICAL QUESTIONS

1. B and S are partners of S & Co. sharing profits and losses in the ratio of 3:1. S and T are partners of T & Co. sharing profits and losses in the ratio of 2:1.
   On 31.12.2014, they decided to amalgamate and form a new firm M/s B S T & Co. wherein B, S and T would be partners sharing profits and losses in the ratio of 3:2:1. Their Balance Sheet on that date were as under :

Liabilities	S & Co.	T & Co.	Assets	S & Co.	T & Co.
Due to X & Co.	40,000	—	Cash in hand	10,000	5,000
Due to S & Co.	—	50,000	Cash at bank	15,000	20,000
Other creditors	60,000	58,000	Due from T & Co.	50,000	—
Reserve	25,000	50,000	Due from X & Co.	—	30,000
			Other debtors	80,000	1,00,000
Capitals :			Stock	60,000	70,000
B	1,20,000	—	Furniture	10,000	3,000
S	80,000	1,00,000	Vehicles	—	80,000
T	—	50,000	Machinery	75,000	—
			Building	25,000	—
	3,25,000	3,08,000		3,25,000	3,08,000

The amalgamated firm took over the business on the following terms :

(a) Goodwill of S & Co. was worth ₹ 60,000 and that of T & Co. ₹ 50,000. Goodwill account was not to be opened in the books of the new firm, the adjustments being recorded through capital accounts of the partners.

(b) Buildings, machinery and vehicles were taken over at ₹ 50,000, ₹ 90,000 and ₹ 1,00,000 respectively.

(c) Provision for doubtful debts have to be carried forward at ₹ 4,000 in respect of debtors of S & Co. and ₹ 5,000 in respect of debtors of T & Co.

You are required to :

(i) Compute the adjustment necessary for goodwill;

(ii) Pass the Journal wentries in the books of BST & Co., assuming that excess/deficit capitals (taking T's capital as base) with reference to share in profits are to be transferred to current accounts.

2. In similar type businesses, Red and Yellow are in partnership as Orange Co. and Violet and Blue as Indigo Co. It was mutually agreed that as on January 1, 2015 the partnership be amalgamated into one firm, Rainbow Co. The profit-sharing ratios in the various firms were and are to be as follows :

Particulars	Red	Yellow	Violet	Blue
Old firm	4	3	3	2
New firm	6	5	4	3

As on December 31, 2014 the Balance Sheets of the firms were as follows (all figures in rupees) :

Liabilities	Orange	Indigo	Assets	Orange	Indigo
Capital Accounts :			Property	7,400	10,000
Red	15,300	—	Fixtures	1,800	1,400
Yellow	11,000	—	Vehicles	3,000	1,800
Violet	—	11,300	Stock	8,300	6,600
Blue	—	7,400	Investment	800	—
Creditors	5,200	6,000	Debtors	6,800	5,800
Bank overdraft	—	900	Bank Balance	3,400	—
	31,500	25,600		31,500	25,600

The agreement to amalgamate contains the following provisions :

(a) Provision for doubtful debts at the rate of 5% be made in respect of debtors, and a provision for discount receivable at the rate of 2.5% be made in respect of creditors.

(b) Rainbow Co. to take over the old partnership assets at the following values :

Assets	Orange Co. (₹)	Indigo Co. (₹)
Stock	8,450	6,390
Vehicles	2,800	1,300
Fixtures	1,600	—
Property	10,000	—
Goodwill	6,300	4,500

(c) The property and fixtures of Indigo Co. not to be taken over by Rainbow Co. These assets were sold for ₹ 13,500 cash on January 1, 2015.
(d) Yellow to take over his firm's investments at a value of ₹ 760.
(e) The capital of Rainbow Co. to be ₹ 54,000 and to be contributed by the partners in profit-sharing ratios, any adjustments to be made in cash.

You are required to give Journal entries reflecting the closing of the old partnerships and opening of the new firm after taking into account the provisions of the agreement.

3. The Balance Sheets of M/s A & B and M/s C & D as on December 31, 2014 were as follows :

Liabilities	A & B (₹)	C & D (₹)	Assets	A & B (₹)	C & D (₹)
Capital Accounts :			Land and Workshops	10,000	12,000
A	10,000	—	Machinery & Tools	7,000	8,000
B	10,000	—	Furnitures & Fixtures	3,000	3,500
C	—	10,000	Sundry Debtors	6,000	8,500
D	—	10,000	Stock	8,000	10,000
Creditors	15,000	10,000	Cash & Bank	3,000	1,000
Loan	—	10,000			
Outstanding Expenses	2,000	3,000			
	37,000	43,000		37,000	43,000

The two firms decided to amalgamate and form into AB & Co. with effect from January 1, 2015. Partners would share profit and loss equally between themselves as they were doing prior to amalgamation and they agreed to following revaluation of assets and liabilities :

	A & B	C & D		A & B	C & D
Land and Workshops	10,000	10,000	Sundry Debtors	5,500	7,000
Machinery & Tools	7,000	8,000	Stock	8,000	8,000
Furniture & Fixtures	2,500	2,500	Outstanding Expenses	2,000	3,500

In addition to the above it was decided :
(a) that the new firm would not take over the loan of C and D;
(b) that the goodwills of A & B and C & D were valued at ₹ 10,000 and ₹ 5,000 respectively in the first instant but for the purpose of the Balance Sheet of the new firm, the combined goodwill would be valued at ₹ 12,000;
(c) that the reconstructed capitals of partners should be ₹ 14,000 each, partners introducing cash if necessary.

You are required to show : (i) The Realisation Accounts of M/s A & B and M/s C & D and their Capital Accounts; (ii) The opening Balance Sheet of the new firm assuming that all arrangements have been duly carried out.

4. Suresh and Kishan were in partnership as wine merchants sharing profits and losses :
Suresh 2/3, Kishan 1/3.
They agreed to amalgamate their business with that of Laxmanas on March 31, 2015.
As on that date summarised balance sheets of the two firms were as follows (all figures in rupees) :

Liabilities	Suresh & Kishan	Laxman	Assets		Suresh & Kishan	Laxman
Capital Accounts :			Freehold Premises		8,000	—
Suresh	10,000	—	Shop fittings		2,400	1,500
Kishan	8,000	—	Investments		—	3,000
Laxman	—	6,000	Stock		6,000	4,500
Current Accounts :			Debtors	2,400		
Suresh	3,400	—	Less: Provision	200	2,200	1,800
Kishan	2,800	—	Balance at bank		8,200	—
Laxman	—	800				
Loan from Mahendra	—	2,000				
Creditors	2,600	1,600				
Bank overdraft	—	400				
	26,800	10,800			26,800	10,800

The two firms were amalgamated on the following terms :
(a) Profits and losses were to be shared : Suresh 2/5, Kishan 2/5 and Laxman 1/5.
(b) An account for goodwill is to be maintained in the books of the new partnership, agreed values of goodwill of each firm being : Suresh and Kishan ₹ 12,000, Laxman ₹ 4,000.

(c) The new firm was to take over all the assets and assume the liabilities of Suresh and Kishan, certain of their assets being revalued as follows :
Freehold Premises—₹ 11,000; Shop Fittings —₹ 2,100; Stock — ₹ 6,900; Debtors — ₹ 2,320.

(d) Laxman's investments had been realised and the proceeds amounting to ₹ 4,600 were received by him on April 1, 2015. Out of this sum he discharged the loan to Mahendra and cleared his bank overdraft, the balance being taken over by the new firm. Laxman was to collect his own debts and the new firm took over his remaining assets and liabilities at book values after providing a further provision of ₹ 600 for a creditor which had not been entered in his books.

(e) The capital of the new firm was to be ₹ 40,000 contributed by the partners in their profit-sharing ratios, any differences being transferred to their current accounts.

You are required to show : (i) the Partners' Capital Accounts, in columnar form, recording these transactions; and (ii) the opening Balance Sheet of the new firm.

5. Until December 31, 2014 A,B and C were partners in A & Co. sharing capital and profits equally; D, E and F were partners in D & Co. sharing capital and profits in the proportions of 4:4:1 and G was a sole practitioner. The Balance Sheets of the respective practices at that date were as follows :

Liabilities		A & Co.	D & Co.	G	Assets	A & Co.	D & Co.	G
Capital		28,500	13,500	2,500	Goodwill	5,000	3,550	800
Current Accounts: ₹					Office Furniture	1,500	1,400	500
A	900				Work-in-Progress	6,000	3,500	800
B	1,200				Debtors	17,500	8,750	750
C	400	2,500			Cash	2,500	1,000	550
D	2,000							
E	1,300							
F	200		3,500	500				
Creditors		1,500	1,200	400				
		32,500	18,200	3,400		32,500	18,200	3,400

The respective parties agreed to amalgamate into a new partnership, New & Co., from January 1, 2015 on the following terms :

(a) A retired on December 31, 2014 and D, E and F agreed that their proportion in New & Co. would be 3:3:1.

(b) The capital of New & Co. was to be ₹ 50,000 and the profit-sharing ratio and capital contributions were to be: B & C 30% each; D & E 15% each; F and G 5% each.

(c) In the opening balance sheet of New & Co., office furniture was to be brought in at old book values except for A & Co. where the value was agreed at ₹ 1,000. Work-in-progress was agreed at book values and goodwill at ₹ 10,000.

(d) Debtors were taken into New & Co. at book values, less 20% discount, and creditors were paid by the old practices. A and G took any cash remaining in their old practices and D contributed the necessary cash in his old practice.

(e) Partners introduced their balances of capital in cash.

(f) A salary of ₹ 2,000 p.a. per partner was to be charged, and a monthly drawing of ₹ 150 each was to be allowed. Also at the end of each half year, each partner was allowed to draw ₹ 100 each 2.5% of his profit-sharing ratio.

On July 2015 it was agreed to take H into the partnership on similar terms as to salary and drawings with a 2.5% share, and at the same time the capital and profit-sharing ratios were altered as follows :
B and C 22.5% each; D and E 20% each; F 5%; G 7.5%. G and H intimated that they could only provide one half each of their additional capital requirement on July 1, 2015 and it was agreed that the remaining half should remain as a debit on their current accounts, to be cleared against future profits. B and C withdrew the cash capital introduced on July 1, 2015 by D, E, G and H.

The profit for the year ending December 2015 after deducting partners' salaries was ₹ 16,000 and this figure was deemed to have accrued evenly over the year. All allowable drawings were made.

You are required to prepare:

(a) Opening journal entries of New & Co.;

(b) Capital and current accounts of each partner

(i) in the old practices, so as to indicate the resultant indebtedness between partners; and

(ii) in the new practices, so as to indicate the balances on January 1, July 1, and December 31, 2015.

Guide to Answers

Multiple Choice

1. A; 2. B; 3. A; 4. A.

Practical Questions

1. (i) For goodwill, B will be debited with ₹ 10,000 and T will be debited with ₹ 1,667. S will be credited with ₹ 11,667.
(ii) Capital balances on transferring : (a) for S & Co. : B - ₹ 1,65,750; S - ₹ 92,250;
(b) For T & Co. S - ₹ 1,43,337; T - ₹ 71,667.
(iii) Excess / Deficit transferred to Current Accounts : B - ₹ 54,250 (Dr.); S - ₹ 1,10,250 (Cr.).

2. (i) Profit on realisation : Orange Co. - ₹ 8,400; Indigo Co. - ₹ 5,750.
(ii) Capital in Rainbow Co. : Red - ₹ 18,000; Yellow - ₹ 15,000; Violet - ₹ 12,000; Blue - ₹ 9,000.

3. Profit on realisation: A & B - ₹ 7,500; C & D - ₹ 3,500 (Loss).

4. Partners' Capital Accounts: Suresh ₹ 16,000; Kishan ₹ 16,000; Laxman ₹ 8,000 Partners' current accounts: Suresh ₹ 7,880; Kishan ₹ 40; Laxman ₹ 2,000. Balance Sheet total ₹ 54,720

5. (i) Goodwill paid: A & Co. ₹ 6,000; D & Co. ₹ 3,500; G ₹ 1,000
(ii) Cash brought in: B ₹ 5,300; C ₹ 6,100; D ₹ 300; E ₹ 1,000; F ₹ 1,000;
(iii) Cash Withdrawn: G ₹ 50; Cash paid to A ₹ 9,400;
(iv) Partner's capital after admission of H: B ₹ 11,250, C ₹ 10,000 E ₹ 10,000; F ₹ 2,500; G ₹ 3,750; H ₹ 1,250.
(v) Partners' Current Account balances on December 31st :
B ₹ 2,925; C ₹ 2925; D ₹ 1,600 E ₹ 1,600; F ₹ 1,600; G ₹ 75; H ₹ 425 (Dr).

Profit on realisation: ₹ 25,000. shares in AB Ltd: A ₹ 57,000; B ₹ 38,000. Purchase consideration ₹ 95,000.
Balance sheet total ₹ 2,45,000 (goodwill ₹ 30,000; other fixed assets ₹ 28,500 current assets ₹ 1,86,500).

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Conversion of Partnership into a Limited Company

Conversion into a Company

Introduction

As a partnership continues to grow, the partners may decide to convert the partnership business into a limited company (Private or Public) in order to :

(a) limit their personal liability;
(b) have access to additional equity financing;
(c) obtain selected tax advantages;
(d) explore other sound business opportunities;
(e) continue business for a long time.

At the time of conversion, the partnership is dissolved and a new company is floated

Dissolution of the Partnership

The books of account of the partnership firm will be closed in the usual manner.

To close the books of account of the partnership firm, the following steps are generally followed :

Step 1 Prepare the Balance Sheet of the partnership firm on the date of conversion.

Step 2 Open a Realisation Account and transfer all assets and liabilities (excluding fictitious assets) to this account.

Step 3 Calculate purchase consideration on the basis of terms and conditions agreed upon.

Step 4 Credit Realisation Account with purchase consideration.

Step 5 Calculate profit or loss on realisation.

Step 6 Transfer realisation profit or loss to Partners Capital Accounts in the profit sharing ratio.

Step 7 Transfer all reserve and surplus / fictitious assets to Partners' Capital Accounts in the profit sharing ratio.

Step 8 Receiving of purchase consideration in the form of shares / debentures of the new company.

Step 9 Distribution of shares / debentures amongst the partners.

In the absence of any agreement, share received from the new company should be distributed among the partners in the same ratio as profits and losses are shared.

Accounting Entries in the Books of Partnership Firm

1. For transferring different assets to realisation account

Realisation Account Dr.
To Sundry Assets Account (Individually)

2. For transferring different liabilities to realisation account

Liabilities Account Dr.
To Realisation Account

3. For purchase consideration due

New Company Account Dr.
To Realisation Account

4. For assets taken over by the partners

Partners' Capital Accounts Dr.
To Realisation Account

5. For realisation of assets not taken over by the company

Bank Account Dr.
To Realisation Account

6. For recording unrecorded assets

Assets Account Dr.
To Partners' Capital Accounts

7. For realisation of unrecorded assets

Bank Account Dr.

Note : If unrecorded assets are taken over by the company, it is also transferred to Realisation Account along with other assets.

To Assets Account

8. For payment of liabilities not taken over by the Company

Realisation Account Dr.
To Bank Account

9. For recording unrecorded liabilities

Partners' Capital Accounts Dr.
To Liabilities Account

10. For payment of unrecorded liabilities

Liabilities Account Dr.
To Bank Account

Note : If the unrecorded liabilities are taken over by the company, it is also transferred to Realisation Account along with other liabilities.

1. Liabilities assumed by the partners		
Realisation Account	Dr.	
To Partners' Capital Accounts		
12. For realisation expenses		
Realisation Account	Dr.	
To Bank Account		
13. For profit on realisation		
Realisation Account	Dr.	
To Partners' Capital Accounts		(profit-sharing ratio)
14. For Loss on realisation		
Partners' Capital Accounts	Dr.	(profit-sharing ratio)
To Realisation Account		
15. For accumulated profits/reserves		
Reserve Account	Dr.	
Profit & Loss Account	Dr.	
To Partners' Capital Accounts		(profit-sharing ratio)
16. For accumulated Loss		
Partners' Capital Accounts	Dr.	(profit-sharing ratio)
To Profit and Loss Account		
17. For transferring partners' current accounts to capital accounts		
Partners' Current Accounts	Dr.	
To Partners' Capital Accounts		
18. For Settlement of purchase consideration by the new company		
Shares in New Co. Account	Dr.	
Debentures in New Co. Account	Dr.	
Cash Account	Dr.	
To New Company Account		
19. For final adjustment		
Partners' Capital Accounts	Dr.	
To Shares in New Co. Account		
To Debenture in New Co. Account		
To Cash Account		

Accounting Entries in the Books of the New Company

The new company will record all the assets and liabilities at the values it has decided to take over. If the purchase consideration payable is more than the net assets acquired, it represents ***goodwill***. Conversely, if the purchase consideration payable is less than the net assets acquired, it represents ***capital reserve***.

For assets and liabilities taken over

Assets Account	Dr.	(Acquired Value)
Goodwill Account	Dr.	(Balancing figure)
To Liabilities Account		(Assumed Value)
To Share Capital Account		(Face value of shares issued)
To Securities Premium Account		(if any)

Illustration 1

Ranjit, Manjit and Paramjit are equal partners of M/s. Hindal & Co. The Balance Sheet of the firm as on 31.12.2014 was as follows :

Liabilities	₹	₹	Assets	₹	₹
Capital Account :			**Fixed Assets :**		
Ranjit	50,000		Land	50,000	
Manjit	1,00,000		Building	70,000	
Paramjit (Debit Balance)	(30,000)	1,20,000	Plant and Machinery	2,00,000	3,20,000
Loan from Bank		5,00,000	**Current Assets :**		
Creditors		1,00,000	Stock	3,00,000	
			Debtors	1,00,000	4,00,000
		7,20,000			7,20,000

On that date, it is decided to convert the partnership into Limited Company called Hindal Limited on the following terms :

(1) Land to be revalued at ₹ 1,50,000.
(2) Plant and Machinery to be revalued at ₹ 2,50,000.
(3) Depreciation amounting to ₹ 20,000 to be written off on building.
(4) A provision of 10% of book value to be made for obsolete stocks.
(5) A provision for doubtful debts to be made at 10% of the debtors.
(6) A discount of 6% would be earned on creditors when paid out.
(7) The new company will issue 12,000 equity shares of ₹ 10 each credited as fully paid up, such share capital being valued at ₹ 1,50,000 and the balance payable is to be discharged by issue of 10% debentures of ₹ 100 each.

Show the necessary Ledger Accounts to close the books of Hindal & Co and show the opening Balance Sheet of the new Company. All partners are solvent and have sufficient cash resources as may be necessary to settle the respective accounts, shares and debentures are divided equaly among the partners.

Solution **In the book of Hindal & Co.**

Dr. **Realisation Account** **Cr.**

Particulars	₹	Particulars	₹
To Land A/c	50,000	By Loan from Bank A/c	5,00,000
To Building A/c	70,000	By Creditors A/c	1,00,000
To Plant and Machinery A/c	2,00,000	By New Company A/c	2,16,000
To Stock A/c	3,00,000	(Purchase consideration)	
To Debtors A/c	1,00,000		
To Partners' Capital A/cs :			
Ranjit	32,000		
Manjit	32,000		
Paramjit	32,000		
	8,16,000		8,16,000

Dr. **Partners' Capital Accounts** **Cr.**

Particulars	Ranjit	Manjit	Paramjit	Particulars	Ranjit	Manjit	Paramjit
To Balance b/d	—	—	30,000	By Balance b/d	50,000	1,00,000	—
To Equity Sh. in New Company	50,000	50,000	50,000	By Realisation A/c (Profit)	32,000	32,000	32,000
To 10% Debentures in New Co.	22,000	22,000	22,000	By Bank A/c (cash brought in)	—	—	70,000
To Bank A/c (final payment)	10,000	60,000	—				
	82,000	1,32,000	1,02,000		82,000	1,32,000	1,02,000

Dr. **Bank Account** **Cr.**

Particulars	₹	Particulars	₹
To Paramjit Capital A/c	70,000	By Ranjit Capital A/c	10,000
		By Manjit Capital A/c	60,000
	70,000		70,000

Hindal Limited
Balance Sheet as at 31st December, 2014

Particulars	Note No.	Figures as at the end of current reporting period (₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	1,20,000
(b) Reserves and Surplus	(2)	30,000
(c) Money Received against Share Warrants		—
(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		
(a) Long-term Borrowings	(3)	5,66,000
(b) Deferred Tax Liabilities (Net)		—
(c) Other Long-term Liabilities		—
(d) Long-term Provisions		—
(4) Current Liabilities :		
(a) Short-term Borrowings		—
(b) Trade Payables		94,000
(c) Other Current Liabilities		—
(d) Short-term Provisions		—
TOTAL		8,10,000
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets	(4)	4,50,000
(ii) Intangible Assets		—
(iii) Capital Work-in-progress		—
(iv) Intangible Assets under Development		—
(b) Non-current Investments		—
(c) Deferred Tax Assets (Net)		—
(d) Long-term Loans and Advances		—
(e) Other Non-current Assets		—
(2) Current Assets :		
(a) Current Investments		—
(b) Inventories		2,70,000
(c) Trade Receivables		90,000
(d) Cash and Cash Equivalents		—
(e) Short-term Loans and Advances		—
(f) Other Current Assets		—
TOTAL		8,10,000

Notes to Accounts :

(1) Share Capital

Particulars	₹
Authorised Share Capital :	
... Equity Shares of ₹ ... each	***
Issued and Subscribed Capital :	
12,000 Equity Shares of ₹ 10 each	1,20,000

(3) Long-Term Borrowing

	₹
(i) Secured Loans :	
10% Debentures	66,000
(ii) Unsecured Bank Loans	5,00,000
	5,66,000

(2) Reserve and Surplus

Particulars	₹
Secrities Premium	30,000

(4) Fixed Assets

Tangible Assets :	
Land	1,50,000
Building	50,000
Building	50,000
Plant and Machinery	2,50,000
	4,50,000

Working Notes **(1) Calculation of Purchase Consideration**

Particulars	(₹)	(₹)
Assets Takenover by the New Company		
Land	1,50,000	
Building (₹ 70,000 – 20,000)	50,000	
Plant and Machinery	2,50,000	
Stock	2,70,000	
Debtors (₹ 1,00,000 – 10,000)	90,000	8,10,000
Liabilities Taken Over by the New Company		
Loan from Bank	5,00,000	
Creditors (₹ 1,00,000 – 6,000)	94,000	5,94,000
Total Purchase Consideration		2,16,000

(2) Discharge of Purchase Consideration

Particulars	(₹)
Equity Shares (12,000 of ₹ 10 each issued at a premium of ₹ 2.50 each)	1,50,000
10% Debentures of ₹ 100 each (Balancing figure)	66,000
	2,16,000

Illustration 2

Nandan and Parijat were partners in a firm sharing profits and losses in the ratio of 3 : 2. The firm was following calendar year as its accounting year. The following is the Balance Sheet of the firm on 31st December, 2014 :

Liabilities	₹	Assets	₹
Partners' Capital :		Goodwill	30,000
Nandan	2,40,000	Land and Buildings	1,00,000
Parijat	2,18,000	Plant and Machinery	2,10,000
Bills Payable	35,000	Furniture and Fittings	1,00,000
Creditors for Goods	25,000	Stock-in-trade	65,000
Creditors for Expenses	40,000	Debtors	25,000
		Cash and Bank Balance	28,000
	5,58,000		5,58,000

On 1st January, 2015 a new company, Nap Ltd. was formed to take over the business of the firm on the following terms:

(a) The company would not take over creditors for expenses to the extent of ₹ 17,000.

(b) Assets are to be valued as follows :
Goodwill ₹ 50,000; Land and Buildings ₹ 1,68,000; Plant and Machinery ₹ 50,000 above book value; Furniture and fittings to be depreciated by 10%; ₹ 5,000 of Debtors to be treated as bad and of the balance 5% is to be treated as doubtful of recovery. Cash and Bank balance to be taken over in full except to meet the creditors for expenses not taken over by the company.

(c) The purchase consideration is to be satisfied by issuing 20,000 equity shares of ₹ 10 each at a premium of 20%, ₹ 1,50,000 by issuing 8% preference shares of ₹ 100 each at par and the balance in the form of 6% debentures issued at 5% discount.

Pass necessary journal entries in the books of the company and prepare the Balance Sheet after acquisition.

Solution **In the books of the Nap Ltd.**

Journal **Dr.** **Cr.**

Date	Particulars		₹	₹
2015	Goodwill A/c	Dr.	50,000	
Jan. 1	Land and Buildings A/c	Dr.	1,68,000	
	Plant and Machinery A/c	Dr.	2,60,000	
	Furniture and Fittings A/c	Dr.	90,000	
	Stock-in-trade A/c	Dr.	65,000	
	Debtors A/c	Dr.	20,000	
	Cash and Bank A/c	Dr.	11,000	
	Discount on Issue of Debentures A/c	Dr.	10,000	
	To Provision for Bad Debts A/c			1,000
	To Bills Payable A/c			35,000
	To Creditors for Goods A/c			25,000

	To Creditors for Expenses A/c		23,000
	To Equity Shares Capital A/c		2,00,000
	To 8% Preference Shares Capital A/c		1,50,000
	To 6% Debentures A/c		2,00,000
	To Securities Premium A/c		40,000
	(Being the assets and liabilities of the firm taken over at agreed value and the purchase consideration has been satisfied by issue of 20,000 equity shares at a premium of 20%; 8% preference shares of ₹ 1,50,000 at par and the balance amount was paid by issuing 2,000, 8% Debentures of ₹ 100 each at a discount of 5%)		
	Securities Premium A/c Dr.	10,000	
	To Discount on Issue of Debentures A/c		10,000
	(Being the discount on issue of debentures adjusted against securities premium)		

Nap Ltd
Balance Sheet as at 1st January, 2015

Particulars	Note No.	Figures as at the end of current reporting period (₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	3,50,000
(b) Reserves and Surplus	(2)	30,000
(c) Money Received against Share Warrants		—
(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		
(a) Long-term Borrowings	(3)	2,00,000
(b) Deferred Tax Liabilities (Net)		—
(c) Other Long-term Liabilities		—
(d) Long-term Provisions		—
(4) Current Liabilities :		
(a) Short-term Borrowings		—
(b) Trade Payables		25,000
(c) Other Current Liabilities	(4)	58,000
(d) Short-term Provisions		—
TOTAL		6,63,000
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets	(5)	5,18,000
(ii) Intangible Assets	(5)	50,000
(iii) Capital Work-in-progress		—
(iv) Intangible Assets under Development		—
(b) Non-current Investments		—
(c) Deferred Tax Assets (Net)		—
(d) Long-term Loans and Advances		—
(e) Other Non-current Assets		—
(2) Current Assets :		
(a) Current Investments		—
(b) Inventories		65,000
(c) Trade Receivables		19,000
(d) Cash and Cash Equivalents		11,000
(e) Short-term Loans and Advances		—
(f) Other Current Assets		—
TOTAL		6,63,000

Notes to Accounts :

(1) Share Capital

Particulars	₹
Authorised Share Capital :	
... Equity Shares of ₹ ... each	***
Issued and Subscribed Capital :	
20,000 Equity Shares of ₹ 10 each fully paid	2,00,000
1,500, 8% Preference Shares of ₹ 100 each	1,50,000
	3,50,000
(All the shares have been issued for consideration other than cash)	
(5) Fixed Assets	
(i) *Tangible Assets* :	
Land and Building	1,68,000
Plant and Machinery	2,60,000
Furniture and Fittings	90,000
	5,18,000
(ii) *Intangible Assets* :	
Goodwill	50,000

(2) Reserve and Surplus

Particulars	₹
Secrities Premium	30,000
(3) Long-term Borrowing	
Secured Loan :	
2,000, 6% Debentures of ₹ 100 each	2,00,000
(4) Other Current Liabilities	
Creditors for Expenses	23,000
Bills Payable	35,000
	58,000

Working Notes

(1) Calculation of Purchase Consideration

Particulars	(₹)	(₹)
Assets Takenover by Nap Limited		
Goodwill	50,000	
Land and Buildings	1,68,000	
Plant and Machinery	2,60,000	
Furniture and Fittings	90,000	
Stock-in-trade	65,000	
Debtors (₹ 25,000 – 5,000 – 1,000)	19,000	
Cassh and Bank Balance (₹ 28,000 – 17,000)	11,000	6,63,000
Liabilities Taken Over by Nap Limited		
Bills Payable	35,000	
Creditors for Goods	25,000	
Creditors for Expenses (₹ 40,000 – 17,000)	23,000	83,000
Total Purchase Consideration		5,80,000

(2) Discharge of Purchase Consideration

Particulars	(₹)
Equity Shares (20,000 x ₹ 12)	2,40,000
8% Preference Shares (15,000 x ₹ 10)	1,50,000
6% Debentures (2,000 x 100 x 95%)	1,90,000
	5,80,000

Illustration 3

A, B and C carried on business in partnership sharing profits and losses in the ratio of 1 : 2 : 3. They decided to form a private limited company, AB (P) Ltd. and C is not interested to take over the shares in AB (P) Ltd. The authorised share capital of the company is ₹ 12,00,000 divided into 12,000 equity shares of ₹ 100 each. The company was incorporated and took over goodwill as valued and certain assets of the partnership firm on 31.3.2015. The Balance Sheet of the partnership firm on that date was as follows :

Liabilities		₹	Assets	₹
Capital Accounts :			**Fixed Assets** :	
A		1,00,000	Machinery	1,20,000
B		2,00,000	Land	1,74,000
C		3,00,000	Motorcycles	30,000
Current Accounts :			Furniture and Fittings	11,000
A		39,420	**Current Assets** :	
B		60,580	Stock	2,35,000
A's Loan A/c	28,000		Debtors	43,000
Add: Interest accrued	2,000	30,000	Cash in Hand	87,000
Current Liability :			C's Overdrawn	1,00,000
Creditors		70,000		
		8,00,000		8,00,000

C who retired was presented by the other partners (A and B) with one motorcycle valued in the books of the firm ₹ 9,000. The remaining motorcycles were sold in the open market for ₹ 13,000. C also received certain furnitures for which he was charged ₹ 2,000. The debtors which were all considered good were taken over by C for ₹ 40,000. A and B were charged in their profit sharing ratio for the book value of motorcycle presented by them to C.

It was agreed that C who is not willing to take the shares in AB (P) Ltd. was discharged first by providing necessary cash. A and B should bring cash, if necessary.

AB (P) Ltd. took over the remaining furniture and fittings at a price of ₹ 13,000, the machinery for ₹ 1,25,000, the stock at an agreed value of ₹ 2,00,000 and the land at its book value. The value of the goodwill of the partnership firm was agreed at ₹ 88,000. The creditors of the firm were settled by the firm for ₹ 70,000. A's loan account together with interest accrued was transferred to his capital account.

The purchase consideration was discharged by the company by the issue of equal number of fully paid-up equity shares at par to A and B.

Prepare Realisation Account, Capital Account of the Partners and Cash Account. Also draw the Balance Sheet of AB (P) Ltd.

Solution

In the book of the Firm

Dr. Realisation Account Cr.

Particulars	₹	Particulars	₹
To Machinery	1,20,000	By Creditors	70,000
To Land	1,74,000	By AB (P) Ltd.	6,00,000
To Motor Cycles	30,000	By Cash (Sale of Motor Cycles)	13,000
To Furniture and Fittings	11,000	By C Capital (Assets takenover) :	
To Stock	2,35,000	Furniture	2,000
To Debtors	43,000	Debtors	40,000
To Cash (Payment to Creditors)	70,000	By A Capital (Motor Cycle Presented)	3,000
To Partners' Capital A/cs :		By B Capital (-do-)	6,000
A	8,500		
B	17,000		
C	25,500		
	7,34,000		7,34,000

Dr. Cash Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	87,000	By Realisation (Payment to Creditors)	70,000
To Realisation A/c (Sale of Motor Cycles)	13,000	By C Capital A/c	1,83,500
To A Capital A/c	1,25,080		
To B Capital A/c	28,420		
	2,53,500		2,53,500

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
To Current A/c	—	—	1,00,000	By Balance b/d	1,00,000	2,00,000	3,00,000
To Realisation A/c	3,000	6,000	42,000	By Current A/cs	39,420	60,580	—
To Shares in AB (P) Ltd.	3,00,000	3,00,000	—	By A Loan A/c	30,000	—	—
To Cash (Final Payment)	—	—	1,83,500	By Realisation A/c	8,500	17,000	25,500
				By Cash (Brought-in)	1,25,080	28,420	—
	3,03,000	3,06,000	3,25,500		3,03,000	3,06,000	3,25,500

AB(P) Ltd

Balance Sheet as at 31st March, 2015

Particulars	Note No.	Figures as at the end of current reporting period (₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	6,00,000
(b) Reserves and Surplus		—
(c) Money Received against Share Warrants		—

(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		
(a) Long-term Borrowings		—
(b) Deferred Tax Liabilities (Net)		—
(c) Other Long-term Liabilities		—
(d) Long-term Provisions		—
(4) Current Liabilities :		
(a) Short-term Borrowings		—
(b) Trade Payables		—
(c) Other Current Liabilities		—
(d) Short-term Provisions		—
TOTAL		6,00,000
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets	(2)	3,12,000
(ii) Intangible Assets	(3)	88,000
(iii) Capital Work-in-progress		—
(iv) Intangible Assets under Development		—
(b) Non-current Investments		—
(c) Deferred Tax Assets (Net)		—
(d) Long-term Loans and Advances		—
(e) Other Non-current Assets		—
(2) Current Assets :		
(a) Current Investments		—
(b) Inventories		2,00,000
(c) Trade Receivables		—
(d) Cash and Cash Equivalents		—
(e) Short-term Loans and Advances		—
(f) Other Current Assets		—
TOTAL		6,00,000

Notes to Accounts :

(1) Share Capital

Particulars	₹
Authorised Share Capital :	
12,000 Equity Shares of ₹ 100 each	12,00,000
Issued and Subscribed Capital :	
6,000 Equity Shares of ₹ 100 each fully paid	6,00,000
(All the shares have been issued for consideration other than cash)	

(2) Fixed Assets

Particulars	₹
(i) *Tangible Assets* :	
Land	1,74,000
Machinery	1,25,000
Furniture and Fittings	13,000
	3,12,000
(ii) *Intangible Assets* :	
Goodwill	88,000

Working Notes **(1) Calculation of Purchase Consideration**

Particulars	(₹)
Assets Takenover by AB (P) Ltd.	
Furniture and Fittings	13,000
Machinery	1,25,000
Stock	2,00,000
Land	1,74,000
Goodwill	88,000
	6,00,000

Total 600 Equity Shares of ₹ 100 each will be issued by AB (P) Ltd. A will get 300 shares and B will get 300 shares. All shares will be issued at par.

Illustration 4

A, B and C were partners in business sharing profit and losses in the ratio of 2 : 1 : 1. Their Balance Sheet as at 31.3.2015 is as follows :

Balance Sheet as at 31.3.2015

Liabilities		₹	Assets		₹
Fixed Capital :			Fixed Assets		3,00,000
A	2,00,000		Investments		50,000
B	1,00,000		Current Assets :		
C	1,00,000	4,00,000	Stock	1,00,000	
Current Accounts			Debtors	60,000	
A	40,000		Cash & Bank	1,50,000	3,10,000
B	20,000	60,000			
Unsecured Loans		2,00,000			
		6,60,000			6,60,000

On 1.4.2015, it is agreed among the partners that BC (P) Ltd, a newly formed company with B and C having each taken up 100 shares of ₹ 10 each will take over the firm as a going concern including goodwill but excluding cash and bank balances. The following points are also agreed upon :

(a) Goodwill will be valued at 3 years purchase of super profits.
(b) The actual profit for the purpose of goodwill valuation will be ₹ 1,00,000.
(c) Normal rate of return will be 15% on fixed capital.
(d) All other assets and liabilities will be taken over at book values.
(e) The purchase consideration will be payable partly in shares of ₹ 10 each and partly in cash. Payment in cash being to meet the requirement to discharge A, who has agreed to retire.
(f) B and C are to acquire capital interest in the new company.
(g) Expenses of liquidation ₹ 40,000.

You are required to prepare the necessary Ledger Accounts.

Solution

In the book of the Firm

Dr. Realisation Account Cr.

Particulars	₹	Particulars		₹
To Fixed Assets A/c	3,00,000	By Unsecured Loans A/c		2,00,000
To Investment A/c	50,000	By BC (P) Ltd (Note 2)		4,30,000
To Stock A/c	1,00,000	By Partners' Capital A/cs :		
To Debtors A/c	60,000	A	20,000	
To Goodwill A/c (Note 1 & 3)	1,20,000	B	10,000	
To Bank A/c (Expenses)	40,000	C	10,000	40,000
	6,70,000			6,70,000

Dr. Partners' Capital Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
To Realisation A/c	20,000	10,000	10,000	By Balance b/d	2,00,000	1,00,000	1,00,000
To Cash A/c	2,80,000	—	—	By Current A/c	40,000	20,000	—
To Cash A/c (Note 6)	—	10,000	—	By Goodwill A/c (Note 3)	60,000	30,000	30,000
To Shares in BC (P) Ltd A/c	—	1,30,000	1,30,000	By Cash A/c (Note 6)	—	—	10,000
	3,00,000	1,50,000	1,40,000		3,00,000	1,50,000	1,40,000

Dr. BC (P) Ltd Account Cr.

Particulars	₹	Particulars	₹
To Realisation A/c (Purchase consideration)	4,30,000	By Cash A/c (Note 4)	1,70,000
		By Shares in BC (P) Ltd A/c	2,60,000
	4,30,000		4,30,000

Dr. Cash and Bank Account Cr.

Particulars	₹	Particulars	₹
To Balance c/d	1,50,000	By Realisation A/c (Expenses)	40,000
To C Capital A/c (Note 6)	10,000	By B Capital A/c (Note 6)	10,000
To BC (P) Ltd A/c (Note 4)	1,70,000	By A Capital A/c	2,80,000
	3,30,000		3,30,000

Working Notes :

(1) Calculation of Goodwill	₹	**(2) Calculation of Purchase Consideration**	₹
Capital Employed (Fixed Capital)	4,00,000	Goodwill (Note 1)	1,20,000
Actual Profit	1,00,000	Fixed Assets	3,00,000
Less: Normal Profit @ 15% of capital employed	60,0000	Investments	50,000
Super Profit	40,000	Stock	1,00,000
Goodwill = ₹ 40,000 x 3	1,20,000	Debtors	60,000
			6,30,000
		Less: Unsecured Loans	2,00,000
			4,30,000

(3) Goodwill has been recorded in the books by debiting Goodwill Account and crediting Partners' Capital Accounts in the profit sharing ratio of 2 : 1 : 1. After recording goodwill in the books, it is transferred to Realisation Account by debiting Realisation Account and crediting Goodwill Account.

(4) Amount payable to A is ₹ 2,80,000. After meeting realisation expenses cash in hand is ₹ 1,10,000. Therefore, ₹ 1,70,000 must be received from BC (P) Ltd to discharge A in full.

(5) Purchase consideration was agreed at ₹ 4,30,000. ₹ 1,70,000 (Note 4) was paid in cash and the balance ₹ 2,60,000 will be paid in shares in BC (P) Ltd

B's share in BC (P) Ltd will be ₹ 1,30,000 and C's share in BC (P) Ltd will be also ₹ 1,30,000.

(6) C's Capital Account of the firm is showing a balance of ₹ 1,20,000 (₹ 1,00,000 + ₹ 30,000 – ₹ 10,000). therefore, he will bring ₹ 10,000 in cash to make up the deficit.

B's Capital Account of the firm is showing a balance of ₹ 1,40,000 (₹ 1,00,000 + ₹ 20,000 + ₹ 30,000 – ₹ 10,000). Therefore, B will take away ₹ 10,000 from the firm.

Illustration 5

Star and Moon had been carrying on business independently. They agreed to amalgamate and form a new company Neptune Ltd with an authorised share capital of ₹ 2,00,000 divided into 40,000 equity shares of ₹ 5 each.

On 31st December, 2014, the respective Balance Sheets of Star and Moon were as follows :

Particulars	Star (₹)	Moon (₹)
Fixed Assets	3,17,500	1,82,500
Current Assets	1,63,500	83,875
	4,81,000	2,66,375
Less: Current Liabilities	2,98,500	90,125
Representing Capital	1,82,500	1,76,250

Additional information :

(a) Revalued figures of Fixed and Current Assets were as follows :

Particulars	Star (₹)	Moon (₹)
Fixed Assets	3,55,000	1,95,000
Current Assets	1,49,750	78,875

(b) The debtors and creditors include ₹ 21,675 owned by Star to Moon.

The purchase consideration is satifsied by issue of the following shares and debentures :

(i) 30,000 equity shares of Neptune Ltd, to Star and Moon in the proportion to the profitability of their respective business based on the average net profit during the last three years which were as follows:

Particulars	Star (₹)	Moon (₹)
2009 Profit	2,24,788	1,36,950
2010 (Loss) / Profit	(1,250)	1,71,050
2014 Profit	1,88,962	1,79,500

(ii) 15% debentures in Neptune Ltd, at par to provide an income equivalent to 8% return on capital employed in their respective business as on 31st December, 2014 after revaluation of assets.

You are requested to :

(1) Compute the amount of debentures and shares to be issued to Star and Moon.

(2) A Balance Sheet of Neptune Ltd, showing the position immediately after amalgamation.

Solution **Computation of Amount of Debentures and Shares to be Issued**

Particulars			
(i) Average Profit :	₹ (2,24,788 – 1,250 + 1,88,962) / 3	1,37,500	—
	₹ (1,36,950 + 1,71,050 + 1,79,500) / 3	—	1,62,500

(ii) Equity Shares Issued :		
(a) Ratio of Distribution	1,375	1,625
(b) No. of Shares	13,750	16,250
(c) Amount : 13,750 @ ₹ 5	68,750	—
16,250 @ ₹ 5	—	81,250
(iii) Capital Employed (after revaluation of assets) :	₹	₹
Fixed Assets	3,55,000	1,95,000
Current Assets	1,49,750	78,875
	5,04,750	2,73,875
Less: Current Liabilities	2,98,500	90,125
	2,06,250	1,83,750
(iv) Debentures Issued :	₹	₹
8% Return on Capital Employed	16,500	14,700
15% Debentures to be issued to provide equivalent income :		
Star : ₹ 16,500 x 100 / 15	1,10,000	
Moon : ₹ 14,700 x 100 / 15		98,000

Neptune Ltd
Balance Sheet as at 31st December, 2014

Particulars	Note No.	Figures as at the end of current reporting period (₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	1,50,000
(b) Reserves and Surplus	(2)	32,000
(c) Money Received against Share Warrants		—
(2) Share Application Money Pending Allotment :		—
(3) Non-current Liabilities :		
(a) Long-term Borrowings	(3)	2,08,000
(b) Deferred Tax Liabilities (Net)		—
(c) Other Long-term Liabilities		—
(d) Long-term Provisions		—
(4) Current Liabilities :		
(a) Short-term Borrowings		—
(b) Trade Payables		—
(c) Other Current Liabilities		3,66,950
(d) Short-term Provisions		—
TOTAL		7,56,950
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets		
(i) Tangible Assets		5,50,000
(ii) Intangible Assets		—
(iii) Capital Work-in-progress		—
(iv) Intangible Assets under Development		—
(b) Non-current Investments		—
(c) Deferred Tax Assets (Net)		—
(d) Long-term Loans and Advances		—
(e) Other Non-current Assets		—
(2) Current Assets :		
(a) Current Investments		—
(b) Inventories		—
(c) Trade Receivables		—
(d) Cash and Cash Equivalents		—
(e) Short-term Loans and Advances		—
(f) Other Current Assets		2,06,950
TOTAL		7,56,950

Notes to Accounts :

(1) Share Capital

Particulars	₹
Authorised Share Capital :	
40,000 Equity Shares of ₹ 5 each	2,00,000
Issued and Subscribed Capital :	
30,000 Equity Shares of ₹ 5 each fully paid	1,50,000
(All the shares have been issued for consideration other than cash)	

(2) Reserve and Surplus

Particulars	₹
Capital Reserve (Note 2)	32,000
(3) Long-term Borrowing	
Secured Loan :	
15% Debentures	2,08,000

Working Notes **(1) Calculation of Purchase Consideration**

Particulars	Star (₹)	Moon (₹)	Total (₹)
Equity Shares Issued	68,750	81,250	1,50,000
15% Debentures Issued	1,10,000	98,000	2,08,000
	1,78,750	1,79,250	3,58,000

(2) Calculation of Capital Reserve

Particulars	Star (₹)	Moon (₹)	Total (₹)
(a) Net Assets taken over :	3,55,000	1,95,000	5,50,000
Fixed Assets	1,49,750	*57,200	2,06,950
Current Assets	5,04,750	2,52,200	7,56,950
	**2,76,825	90,125	3,66,950
Less: Current Liabilities	2,27,925	1,62,075	3,90,000
(b) Purchase Consideration	1,78,750	1,79,250	3,58,000
(c) Capital Reserve [(a) – (b)]	49,175	—	—
(d) Goodwill [(b) – (a)]	—	17,175	—
(e) Final figure of Capital Reserve [(c) – (d)]	—	—	32,000

* ₹ 78,875 – ₹ 21,675 ** ₹ 2,98,5000 – ₹ 21,675

Illustration 6

Avinash, Rohit and Madwesh were carrying on business in partnership sharing profits and losses in the ratio of 5 : 4 : 3 respectively. The Trial Balance of the firm as on 31st March, 2015 was the following :

Particulars	Dr. (₹)	Cr. (₹)
Plant and Machinery at cost	1,05,000	—
Stock	60,200	—
Sundry Debtors	85,000	—
Sundry Creditors	—	1,05,200
Capital A/cs :		
Avinash	—	70,000
Rohit	—	50,000
Madwesh	—	30,000
Drawings A/c :		
Avinash	30,000	—
Rohit	25,000	—
Madwesh	20,000	—
Depreciation on Plant and Machinery	—	35,000
Trading Profit for the year	—	1,29,800
Cash at Bank	94,800	—
	4,20,000	4,20,000

Additional Information :

(a) Interest on Capital Accounts at 10% on the amount standing to the credit of Partners' Capital Accounts at the beginning of the year was not provided before preparing the above Trial Balance.

(b) On 31st March, 2015 they formed a Private Limited Company Anagha (P) Ltd. to take over the partnership business.

(c) You are further informed as under :

(i) Plant and Machinery is to be transferred at ₹ 80,000.

(ii) Equity Shares of ₹ 10 each of the company are to be issued to the partners at par in such numbers to ensure that by reason of their share holdings alone, they will have the same rights of sharing profits and losses as they had in the partnership. Balance, if any in their Capital Accounts, will be settled by giving 7.5% Preference Shares at par.

(iii) Before transferring the business, the partners withdrew by cash from partnership the following amounts over and above the drawings as shown in the Trial Balance :
(a) Avinash — ₹ 20,000; (b) Rohit — ₹ 10,600; (c) Madwesh — ₹ 14,200.

(iv) All assets and liabilities except Plant and Machinery and the Bank Balance are to be transferred at their value in the books of the partnership as at 31st March, 2015.

You are required to prepare :

(a) Profit and Loss Adjustment Account for the year ending 31st March, 2015.
(b) Capital Accounts showing all the adjustments required to dissolve the partnership.
(c) A statement showing the number of shares of each class to be issued by the company to each of the partners to settle their accounts.
(d) Balance Sheet of the company Anagha (P) Ltd. as on 31.03.2015 after take over of the business.

Solution

In the book of the Firm

Dr. (a) Profit and Loss Adjustment Account for the year ended 31st March, 2015 Cr.

Particulars	₹	Particulars	₹
To Interest on Capital :		By Net Profit b/d	1,29,800
Avinash	7,000	By Plant and Machinery	10,000
Rohit	5,000		
Madwesh	3,000		
To Partners' Capital A/cs :			
Avinash	52,000		
Rohit	41,600		
Madwesh	31,200		
	1,39,800		1,39,800

Dr. (b) Partners' Capital Accounts Cr.

Particulars	Avinash	Rohit	Madwesh	Particulars	Avinash	Rohit	Madwesh
To Drawings (as per Trial Balance)	30,000	25,000	20,000	By Balance b/d	70,000	50,000	30,000
To Drawings (after Trial Balance)*	20,000	10,600	14,200	By P&L Adjustment A/c	52,000	41,600	31,200
By Balance c/d	79,000	61,000	30,000	By Interest on Capital	7,000	5,000	3,000
	1,29,000	96,600	64,200		1,29,000	96,600	64,200
To Equity Shares	50,000	40,000	30,000	By Balance b/d	79,000	61,000	30,000
To 7.5% Preference Shares	29,000	21,000					
	79,000	61,000	30,000		79,000	61,000	30,000

(c) Statement Showing the Number and Classes of Shares Issued to the Partners

	Avinash	Rohit	Madwesh
Capital balance after adjustment	79,000	61,000	30,000
Taking Madwesh's Capital as base for ensuring same rights of sharing profits and losses —Equity Shares allotted	50,000	40,000	30,000
7.5% Preference Shares issued	29,000	21,000	—

Anggha (P) Ltd
Balance Sheet as at 31st March, 2015

Particulars	Note No.	Figures as at the end of current reporting period (₹)
(1)	(2)	(3)
I. EQUITY AND LIABILITIES		
(1) Shareholders' Funds :		
(a) Share Capital	(1)	1,70,000
(b) Reserves and Surplus		—
(c) Money Received against Share Warrants		—
(2) Share Application Money Pending Allotment :		—

(3) Non-current Liabilities :		
(a) Long-term Borrowings		—
(b) Deferred Tax Liabilities (Net)		—
(c) Other Long-term Liabilities		—
(d) Long-term Provisions		—
(4) Current Liabilities :		
(a) Short-term Borrowings		—
(b) Trade Payables		—
(c) Other Current Liabilities		1,05,200
(d) Short-term Provisions		—
TOTAL		2,75,000
II. ASSETS		
(1) Non-current Assets :		
(a) Fixed Assets	(2)	80,000
(i) Tangible Assets		—
(ii) Intangible Assets		—
(iii) Capital Work-in-progress		—
(iv) Intangible Assets under Development		—
(b) Non-current Investments		—
(c) Deferred Tax Assets (Net)		—
(d) Long-term Loans and Advances		—
(e) Other Non-current Assets		—
(2) Current Assets :		
(a) Current Investments		—
(b) Inventories		60,200
(c) Trade Receivables		85,000
(d) Cash and Cash Equivalents		50,000
(e) Short-term Loans and Advances		—
(f) Other Current Assets		—
TOTAL		2,75,000

Notes to Accounts :

(1) Share Capital

Particulars	₹
Authorised Share Capital :	
... Equity Shares of ₹ ... each	***
Issued and Subscribed Capital :	
12,000 Equity Shares of ₹ 10 each fully paid	1,20,000
7.5% Preference Shares	50,000
	1,70,000
(All the shares have been issued for consideration other than cash)	

(2) Fixed Assets

Particulars	₹
Tangible Assets :	
Plant and Machinery	80,000

Working Notes

(1) Calculation of Purchase Consideration

Particulars	₹
Plant and Machinery	80,000
Stock	60,200
Debtors	85,000
Cash at Bank (₹ 94,800 – ₹ 44,800*)	50,000
	2,75,200
Less: Sundry Creditors	1,05,200
	1,70,000

* Drawings (₹ 20,000 of Avinash + ₹ 10,600 of Rohit + ₹ 14,200 of Madwesh.)

Sale to a Company

Introduction

Sometimes, partners may decide to sell their partnership firm to an existing limited company. In this case, the company will take over different assets and liabilities of the firm and the partners will get the shares/debentures of that company and will become the shareholders/debentureholders of the company.

The books of account of the partnership firm will be closed in the usual manner as done in case of conversion of a company.

Illustration 8

P, Q, R and S were partners in a firm sharing profits and losses in the ratio of 5 : 3 : 2 : 2. Their Balance Sheet as on 31st March, 2012 stood as follows :

Liabilities	₹	Assets	₹
Capital Accounts :		Goodwill	20,000
P	60,000	Machinery	90,000
Q	40,000	Debtors	16,000
R	6,000	Stocks	8,000
Creditors	10,000	Capital Accounts :	
Accounts Payable	20,000	S	2,000
	1,36,000		1,36,000

S did not have any private assets or liabilities. The firm was dissolved and the partners agreed to sell the fixed assets to ABC Ltd. which allotted 4,500 fully paid equity shares of ₹ 10 each (at the market value of ₹ 15 each) and paid cash ₹ 15,000. Stock and Debtors were realised at book value and the cost of realisation amounted to ₹ 2,500. R was settled off in cash and P and Q were distributed shares in ABC Ltd in their capital ratio.

Prepare Ledger Accounts to close the books of the firm.

[St. Xavier's College (Kolkata) — Semester II, 2012]

Solution

In the book of the Firm

Realisation Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Goodwill A/c	20,000	By Creditors A/c	10,000
To Machinery A/c	90,000	By Accounts Payable A/c	20,000
To Debtors A/c	16,000	By ABC Ltd A/c	82,500
To Stock A/c	8,000	By Cash A/c (₹ 16,000 + 8,000)	24,000
To Cash A/c (Expenses)	2,500	(Realisation of Debtors and Stock)	
To Cash A/c :		By Partners' Capital A/c :	
Creditors	10,000	P (₹ 30,000 x 5/12)	12,500
Accounts Payable	20,000	Q (₹ 30,000 x 3/12)	7,500
		R (₹ 30,000 x 2/12)	5,000
		S (₹ 30,000 x 2/12)	5,000
	1,66,500		1,66,500

ABC Ltd Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Realisation A/c	82,500	By Shares in ABC Ltd A/c (4,500 shares @ ₹ 15)	67,500
		By Cash A/c	15,000
	82,500		82,500

Shares in ABC Ltd Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To ABC Ltd A/c	67,500	By P Capital A/c (Note 2)	40,500
		By Q Capital A/c (Note 2)	27,000
	67,500		67,500

Dr. **Partners' Capital Accounts** **Cr.**

Particulars	P	Q	R	S	Particulars	P	Q	R	S
To Balance b/d	—	—	—	2,000	By Balance b/d	60,000	40,000	6,000	—
To Realisation A/c (Loss)	12,500	7,500	5,000	5,000	By P Capital A/c	—	—	—	3,962
To S Capital A/c	3,962	2,642	396	—	By Q Capital A/c	—	—	—	2,642
To Shares in ABC Ltd A/c	40,500	27,000	—	—	By R Capital A/c	—	—	—	396
To Cash A/c (Note 2)	3,038	2,858	604	—					
	60,000	40,000	6,000	7,000		60,000	40,000	6,000	7,000

Dr. **Cash Account** **Cr.**

Particulars	₹	Particulars	₹
To ABC Ltd A/c (Purchase Consideration)	15,000	By Realisation A/c (Payment of liabilities)	30,000
To Realisation A/c (Assets sale)	24,000	By Realisation A/c (Expenses)	2,500
		By P Capital A/c	3,038
		By Q Capital A/c	2,858
		By R Capital A/c	604
	39,000		39,000

Working Notes :

(1) S Capital Account is showing a debit balance of ₹ 7,000. S is insolvent. Therefore, P, Q and R will share the ***debit*** balance in their capital ratio, i.e. : 60 : 40 : 6 or 30 : 20 : 3

	₹
P's share = ₹ 7,000 / 53 × 30	3,962
Q's sjhare = ₹ 7,000 / 53 × 20	2,642
R's share = ₹ 7,000 / 53 × 3	396
	7,000

(2) Statement Showing the Distribution of Shares in ABC Ltd

Particulars	P (₹)	Q (₹)	R (₹)
Opening Balance	60,000	40,000	6,000
Less: Realisation Loss	(12,500)	(7,500)	(5,000)
Less: Share of Deficiency of S	(3,962)	(2,642)	(396)
Net Balance due	43,538	29,858	604
Less: Shares in ABC Ltd in the ratio of capital between P and Q, i.e., 6 : 4	40,500	27,000	—
Amount to be settled in Cash	3,038	2,858	604

Accounting Entries in the Books of Purchasing Company

The purchasing company records all the assets and liabilities at the values it has decided to take over. If the purchase consideration payable is more than the net assets (assets *minus* liabilities) acquired, it represents goodwill. Conversely, if the purchase consideration payable is less than the net assets acquired, it represents capital reserve.

1. If the net acquired assets is equal to purchase consideration, the following entry is passed:

Assets Account	Dr.	[Acquired value]
To Liabilities Account		[Assumed value]
To Share Capital Account		[Purchase consideration]

2. If the net acquired assets is more than the purchase consideration, it represents capital reserve. The following entry is passed :

Assets Account	Dr.	[Acquired value]
To Liabilities Account		[Assumed value]
To Share Capital Account		[Purchase consideration]
To Capital Reserve Account		

3. Conversely, if the net acquired assets is less than the amount of purchase consideration, it represents goodwill. The following entry is passed :

Assets Account	Dr. [Acquired value]
Goodwill Account	Dr. [Purchase consideration *minus* net assets]
To Liabilities Account	[Assumed value]
To Share Capital Account	[Purchase consideration]

Illustration 9

P and Q were in partnership sharing profits in the proportions 3:2. On 31st March 2015, they accepted an offer from S. Ltd to acquire at that date their fixed assets and stock at an agreed price of ₹ 7,20,000. Debtors, creditors and bank overdraft would be collected and discharged by the partnership.

The purchase consideration of ₹ 7,20,000 consisted of cash ₹ 3,60,000, debentures in S. Ltd (at par) ₹ 1,80,000 and 12,000 Equity Shares of ₹ 10 each in S. Ltd. P will be employed in S. Ltd but, since Q was retiring, P agreed to allow him ₹ 30,000 in compensation, to be adjusted through their Capital Accounts. Q was to receive 1,800 shares in S. Ltd and the balance due to him in cash.

Balance Sheet as at 31.3.2015

Liabilities	₹	Assets	₹
P Capital Account	1,20,000	Fixed Assets	4,80,000
Loan : P	2,10,000	Stock	45,000
Bank overdraft	1,50,000	Debtors	75,000
Creditors	1,80,000	Q Capital Account	60,000
	6,60,000		6,60,000

The sale of the assets to S. Ltd took place as agreed; the debtors realised ₹ 60,000 and creditors were settled for ₹ 1,71,000. The partnership then ceased business.

You are required to pass necessary Journal Entries and show: (a) Realisation Account (b) Bank Account (c) Partners' Capital Accounts, in columnar form, showing the final settlement.

Solution

In the books of the Firm

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2015	Realisation A/c	Dr.	6,00,000	
Mar. 31	To Fixed Assets A/c			4,80,000
	To Stock A/c			45,000
	To Debtors A/c			75,000
	(Being different assets transferred to Realisation Account)			
	Creditors A/c	Dr.	1,80,000	
	To Realisation A/c			1,80,000
	(Being creditors account transferred to Realisation Account)			
	P Loan A/c	Dr.	2,10,000	
	To P Capital A/c			2,10,000
	(Being P's loan transferred to his Capital Account)			
	S Ltd A/c	Dr.	7,20,000	
	To Realisation A/c			7,20,000
	(Being purchase consideration due from S Ltd)			
	Bank A/c	Dr.	3,60,000	
	Debentures in S Ltd A/c	Dr.	1,80,000	
	Shares in S Ltd A/c	Dr.	1,80,000	
	To S Ltd A/c			7,20,000
	(Being purchase consideration received)			
	Bank A/c	Dr.	60,000	
	To Realisation A/c			60,000
	(Being realisation of debtors)			
	Realisation A/c	Dr.	1,71,000	
	To Bank A/c			1,71,000
	(Being payment to creditors)			
	Realisation A/c	Dr.	1,89,000	
	To P Capital A/c			1,13,400
	To Q Capital A/c			75,600
	(Being the profit on realisation trans. to Partners' Capital Accounts in the ratio of 3 : 2)			

P Capital A/c	Dr.	30,000	
To Q Capital A/c			30,000
(Being adjustment for compensation)			
P Capital A/c	Dr.	4,13,400	
To Shares in S Ltd A/c			1,53,000
To Debentures in S Ltd A/c			1,80,000
To Bank A/c			80,400
(Being the final settlement of accounts)			
Q Capital A/c	Dr.	45,600	
To Shares in S Ltd A/c (See note)			27,000
To Bank A/c			18,600
(Being the final settlement of accounts)			

Dr. **Realisation Account** **Cr.**

Particulars	₹	Particulars	₹
To Fixed Assets A/c	4,80,000	By Creditors A/c	1,80,000
To Stock A/c	45,000	By Bank A/c (Debtors realised)	60,000
To Debtors A/c	75,000	By S Ltd A/c (purchase consideration) :	
To Bank A/c (creditors payment)	1,71,000	Cash	3,60,000
To P Capital A/c (profit)	1,13,400	Debentures in S Ltd	1,80,000
To Q Capital A/c (profit)	75,600	Shares in S Ltd (See note)	1,80,000
	9,60,000		9,60,000

Dr. **Bank Account** **Cr.**

Particulars	₹	Particulars	₹
To Realisation A/c (Debtors realised)	60,000	By Balance b/d	1,50,000
To S Ltd A/c (purchase consideration)	3,60,000	By Realisation A/c (Creditors payment)	1,71,000
		By Capital A/c — P	80,400
		By Capital A/c — Q	18,600
	4,20,000		4,20,000

Dr. **Partners' Capital Accounts** **Cr.**

Date	Particulars	P	Q	Date	Particulars	P	Q
	To Balance b/d	—	60,000		By Balance b/d	1,20,000	—
	To Capital A/c — Q	30,000			By Loan A/c	2,10,000	—
	To Shares in S Ltd A/c	1,53,000	27,000		By Realisation A/c (profit)	1,13,400	75,600
	To Debentures in S Ltd A/c	1,80,000	—		By Capital A/c — P	—	30,000
	To Bank A/c (final payment)	80,400	18,600				
		4,43,400	1,05,600			4,43,400	1,05,600

Note : The ₹ 10 equity shares in S Ltd have a value of ₹ 15 each placed upon them.

Illustration 10

Somsons Ltd. agreed to purchase the business of a firm consisting of two brothers, K. Som and D. Som as on 31st March, 2015. The Balance Sheet of the firm on that date was as follows :

Liabilities	₹	Assets	₹
Capital Account :		Land and Building	47,000
K. Som	76,000	Plant and Machinery	28,000
D. Som	58,000	Furniture and Fixtures	7,000
General Reserve	30,000	Stock-in-Trade	62,000
Sundry Creditors	37,000	Sundry Debtors	55,000
Outstanding Expenses	3,000	Cash	5,000
	2,04,000		2,04,000

The company agreed to take over the liabilities and all the assets with the exception of cash, the agreed purchase price being ₹ 1,80,000 to be satisfied as to 1/4 in cash and 3/4 by the issue of fully paid equity shares of ₹ 10 each at an agreed value of ₹ 12.50 per share.

The company made the following revaluations of the assets taken over when bringing them into books : Land and Building ₹ 62,000; Plant and Machinery ₹ 25,000; Furniture and Fixtures ₹ 5,000; Stock-in-trade ₹ 58,000; Sundry Debtors ₹ 50,000.

Give the entries necessary to record the acquisition of the business in the books of the company.

Solution **In the books of the Somsons Ltd.**

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2015	Goodwill A/c (Note 1)	Dr.	20,000	
April 1	Land and Building A/c	Dr.	62,000	
	Plant and Machinery A/c	Dr.	25,000	
	Furniture and Fixtures A/c	Dr.	5,000	
	Stock-in-trade A/c	Dr.	58,000	
	Sundry Debtors A/c	Dr.	50,000	
	To Sundry Creditors A/c			37,000
	To Outstanding Expenses A/c			3,000
	To Business Purchase A/c			1,80,000
	(Being different assets and liabilities of the firm taken over at agreed value. The difference between purchase consideration and net assets has been transferred to Goodwill Account)			
	Business Purchase A/c	Dr.	1,80,000	
	To Cash A/c			45,000
	To Equity Share Capital A/c			1,08,000
	To Securities Premium A/c			27,000
	(Being the purchase consideration paid off by issuing 10,800 equity shares of ₹ 10 each at a premium of ₹ 2.50 each as per Board's Resolution No. ... dated ...))			

Working Note: **(1) Calculation of Goodwill / Capital Reserve**

Particulars	(₹)	(₹)
Assets Takenover (at agreed value)		
Land and Building	62,000	
Plant and Machinery	25,000	
Furniture and Fixtures	5,000	
Stock-in-trade	28,000	
Sundry Debtors	50,000	2,00,000
Liabilities Taken Over (at agreed value)		
Sundry Creditors	37,000	
Outstanding Expenses	3,000	40,000
(A) Net Assets Taken Over		1,60,000
(B) Purchase Consideration Paid		1,80,000
Goodwill (B – A)		20,000

KEY POINTS

- The partners may decide to convert the partnership business into a limited company (Private or Public) in order to: (a) limit their personal liability; (b) have access to additional equity financing; (c) obtain selected tax advantages; (d) explore other sound business opportunities; (e) continue business for a long time.
- At the time of conversion, the partnership is dissolved and a new company is floated.
- To close the books of account of the partnership firm, the following steps are generally followed:
  Step 1 : Prepare the Balance Sheet of the partnership firm on the date of conversion.
  Step 2 : Open a Realisation Account and transfer all assets and liabilities (excluding fictitious assets) to this account.
  Step 3 : Calculate purchase consideration on the basis of terms and conditions agreed upon.
  Step 4 : Credit Realisation Account with purchase consideration.
  Step 5 : Calculate profit or loss on realisation.
  Step 6 : Transfer realisation profit or loss to Partners Capital Accounts in the profit sharing ratio.
  Step 7 : Transfer all reserve and surplus / fictitious assets to Partners' Capital Accounts in the profit sharing ratio.
  Step 8 : Receiving of purchase consideration in the form of shares / debentures of the new company.
  Step 9 : Distribution of shares / debentures amongst the partners.
- The new company will record all the assets and liabilities at the values it has decided to take over. If the purchase consideration payable is more than the net assets acquired, it represents ***goodwill***. Conversely, if the purchase consideration payable is less than the net assets acquired, it represents ***capital reserve***.

KEY POINTS (contd.)

Step 4 : Credit Realisation Account with purchase consideration.
Step 5 : Calculate profit or loss on realisation.
Step 6 : Transfer realisation profit or loss to Partners Capital Accounts in the profit sharing ratio.
Step 7 : Transfer all reserve and surplus / fictitious assets to Partners' Capital Accounts in the profit sharing ratio.
Step 8 : Receiving of purchase consideration in the form of shares / debentures of the new company.
Step 9 : Distribution of shares / debentures amongst the partners.

- The new company will record all the assets and liabilities at the values it has decided to take over. If the purchase consideration payable is more than the net assets acquired, it represents ***goodwill***. Conversely, if the purchase consideration payable is less than the net assets acquired, it represents ***capital reserve***.

THEORETICAL QUESTIONS

1. What are the accounting implications of conversion of a partnership firm to a company ?
2. Explain the process of conversion of a partnership to a company.
3. What are the advantages of conversion of a partnership firm into a company ?
4. How shares of the new company is distributed amongst the partners ?
5. Why realisation account is prepared in place of revaluation account at the time of conversion of a partnership to a company ?
6. Why a partnership firm is sold to a company ?

PRACTICAL QUESTIONS

Conversion to a Company / Sale to a Company

1. A and B are partners sharing profits & losses in the ratio of 3 : 2. Their Balance Sheet as on 31.12.2014 was :

Liabilities	₹	Assets	₹
A's Capital	30,000	Goodwill	5,000
B's Capital	20,000	Other Fixed Assets	30,000
Reserve	15,000	Joint Life Policy	20,000
Current Liabilities	30,000	Other Assets	40,000
	95,000		95,000

On 30.6.2015, AB Ltd. was formed to take over the partnership business upto that date, a net profit of ₹ 10,000 was made after charging depreciation on fixed assets @ 10% p.a. For the purpose of transfer, Goodwill was valued at ₹ 30,000. The joint life policy was surrendered for ₹ 15,000 and nothing was withdrawn by the partners. Purchase consideration was paid by shares of ₹ 10 each. The company also issued 15,000 shares of ₹ 10 each to the public as fully paid. All shares were sold.

Close the books of the firm and prepare the opening Balance Sheet of AB Ltd.

2. Mr Brown had been trading under the name of BS. On 1st January, 2015 a company, X Limited, was formed with an authorised share capital of ₹ 8,00,000. On the same date the entire business of BS, except investments but including cash was transferred to X Limited.

From the information given below you are required to prepare:

(a) a Profit and Loss Account for BS for the year ended 31st December, 2014 and a balance sheet at that date;
(b) a realisation account showing the transfer of the business of BS at 1st January, 2015;
(c) a capital account of Mr Brown at 1st January, 2015;
(d) a balance sheet of X Limited on the completion of the takeover of the business of BS on 1st January, 2015. (Taxation is to be ignored and workings must be shown).

1. All assets taken over by X Limited were transferred at book values except the following, which were taken over by the company at the following valuations:
   Land and buildings at ₹ 4,00,000; Plant and machinery at ₹ 1,00,000;
2. Investments were valued at ₹ 40,000 and were taken over by Mr Brown at that value.

3. The shares of the new company, X Limited, were of ₹ 10 each and issued at par. Mr Brown received 8,00,000 shares in the new company and gave his wife one of these shares so that she would be a shareholder in X Limited.
4. The trial balance of BS as at 31st December, 2014 was as follows:

Debit Balances	₹	Credit Balances	₹
Land and Buildings	4,40,000	Plant Depreciation	2,20,000
Plant and Machinery	4,00,000	Fixture Depreciation	16,000
Fixtures & Fittings	40,000	Bad debts provision	6,000
Investments	20,000	Trade creditors	1,70,000
Stock	96,000	Capital – Mr Brown	7,66,000
Debtors	1,80,000	Sales	12,00,000
Cash	66,000		
Drawings – Mr Brown	1,56,000		
Purchases	8,18,000		
Wages	1,40,000		
Rates & Insurance	10,000		
Heat and Light	7,000		
Travel	3,000		
Sundries	2,000		
	23,78,000		23,78,000

5. The following adjustments were still to be recorded :
   (a) Depreciation was to be charged at 5% straight-line on plant and machinery and 10% straight line on fixtures and fittings;
   (b) At the year end a bad debts provision of ₹ 20,000 was thought necessary;
   (c) Accrued expenses at 31st December, 2014 were:
   Wages — ₹ 5,000; Head and light — ₹ 3,000; Travel — ₹ 2,000;
   (d) Stock at December, 2014 was ₹ 1,14,000.

3. Abraham, Benjamin and Chapman are in partnership sharing profits and losses in the proportion of 5 : 3 : 2 respectively. Their Balance Sheet as on March 31, 2015 was as follows:

Liabilities	₹	Assets	₹
Capitals :		Sundry assets	1,88,400
Abraham	94,000	Cash	2,700
Benzamin	61,000	Bank balance	5,500
Chapman	26,000		
Creditors	15,600		
	1,96,600		1,96,600

On April 1, 2015 they sold their business including the bank balance to ABC Ltd, on the following terms:
(a) The company to satisfy the purchase consideration by issue of ₹ 25,000 6% debentures; 9,600 equity shares of ₹ 8 each at a premium of ₹ 2 per share; and ₹ 72,000 8% preference shares of ₹ 100 each.
(b) The partners will draw cash before transfer to the company and divide the same equally among them.
(c) Out of the purchase consideration the debentures and the preference shares are agreed to be divided as follows:
Debentures : Abraham – ₹ 16,000; Benzamin – ₹ 9,000.
Preference Shares – To be shared by all in proportion to original capital amounts after adjustment of debenture value as above.
Draw up Realisation Account and the Partners'Capital Accounts showing distribution of shares amongst them.

4. Lion and Tiger were in partnership sharing profits and losses in the ratio of 3 : 1. The following is the Balance Sheet of the partnership as on March 31, 2015.

Liabilities	₹	Assets	₹
Capital Accounts:		Fixed assets	21,000
Lion	24,000	Stock	11,200
Tiger	8,000	Debtors	19,600
Current Accounts :		Cash at bank	3,720
Lion	4,200		
Tiger	2,000		
Loan – Tiger	3,000		
Creditors	14,320		
	55,520		55,520

Elephant Ltd agreed to take over stock and fixed assets, excluding the value of motor car ₹ 4,100 for a consideration of ₹ 48,000 which is to be satisfied by payment of cash ₹ 16,000, allotment of 160 preference shares of ₹ 100 each valued at ₹ 75 per share, and the balance by allotment of 1,600 equity shares of the face value of ₹ 10 each. The debtors realised ₹ 19,200 and the creditors were settled for ₹ 14,000.

The following were agreed between the partners.

(a) The equity shares should be allotted in the ratio of the Partners' Capital Accounts as per the Balance Sheet.
(b) Lion to take over the motor car at an agreed value of ₹ 4,200.
(c) The preference share to be allotted to Tiger to the value of his loan and the remainder to be allotted equally between the partners.
(d) Balance remaining to be settled in cash.

You are required to show :
(i) The Realisation Account;
(ii) Partners' Capital Accounts;
(iii) Bank Account;
(iv) Statement showing distribution of shares.

5. Mr B and Mr E are partners sharing profits and losses in the ratio of 3 : 2. On 30th September, 2014, they admit Mr C as a partner, and the new profit ratio is 2 : 2 : 1. C brought in Fixture ₹ 3,000 and cash ₹ 10,000, the goodwill being (i) B and E ₹ 20,000 and (ii) C ₹ 10,000 but neither figure is to be brought into the books.
On 31st March 2015, the partnership is dissolved. B retiring and the other two partners forming a company called BC Limited with equal capitals, taking over all remaining assets and liabilities, goodwill being agreed at ₹ 40,000 and brought into books of the company. B agrees to take over the business car at ₹ 3,700; Plant was sold for ₹ 3,000 being in excess of requirements. The profits of the two preceding year were ₹ 17,200 and ₹ 19,000 respectively and it was agreed that for the half year ended 30th September 2014, the net profit was to be taken as equal to the average of the two preceding years and the current year. No entries had been made when C entered, except cash. No new book being opened by BC Company Ltd, B agreed to have ₹ 50,000 as loan to the company, secured by 12% Debentures. the following is the Trial Balance as on 31st March, 2015 :

Heads of Account	Dr (₹)	Cr (₹)	Heads of Account	Dr (₹)	Cr (₹)
Capital Accounts :			Debtors and Creditors	31,000	12,000
B	—	35,000	Plant (B.V. of plant sold ₹ 4,000)	23,000	—
E	—	20,000	Fixtures	7,000	—
C	—	10,000	Motor Car	2,700	—
Drawing Accounts :			Stock on 31st March 2015	13,000	—
B	6,000	—	Bank	16,300	—
E	5,000	—	P&L Account for the year	—	29,800
C	2,800	—		1,06,800	1,06,800

Prepare :
(a) Goodwill Adjustment Account;
(b) Capital Accounts of Partners;
(c) Profit and Loss Appropriation Account;
(d) Balance Sheet of BC Ltd as on 31st March, 2015.

6. Riu, Inu and Sinu were running partnership business sharing profits and losses in 2 : 2 : 1 ratio. Their Balance Sheet as on 31st March, 2015 stood as follows : (all figures in ₹ '000)

Liabilities	₹	₹	Assets	₹	₹
Fixed Capital :			Fixed Assets		400
Riu	300		Investments		50
Inu	200		Current Assets :		
Sinu	100	600	Stock	100	
Current Accounts :			Debtors	275	
Riu	60		Cash and Bank	125	500
Sinu	40	100			
Unsecured Loans		100			
Current Liabilities		150			
		950			950

On 01.04.2015, they agreed to form a new company RIS (P) Ltd. with Inu and Sinu each taking up 200 shares of ₹ 10 each, which shall take over the firm as a going concern including Goodwill, but excluding Cash and Bank balances. The following are also agreed upon :

(a) Goodwill will be valued at 3 year's purchase of super profits.
(b) The actual profit for the purpose of Goodwill valuation will be ₹ 2,00,000.
(c) The normal rate of return will be 18% per annum on Fixed Capital.
(d) All other assets and liabilities will be taken over at book values.
(e) The Purchase Consideration will be payable partly in shares of ₹ 10 each and partly in cash. Payment in cash being to meet the requirement to discharge Riu, who has agreed to retire.
(f) Inu and Sinu are to acquire interest in the new company at the ratio 3 : 2.
(g) Realisation expenses amounted to ₹ 51,000.

You are required to prepare Realisation Account, Cash and Bank Account, RIS (P) Limited Account and Capital Account of Partners.

7. C & R and K & T are two partnerships, trading separately as steel stockholders. The leasehold premises of C & R are due to revert to the freeholders in five years time. K of K & T who is nearing his 70th birhday wishes to retire. It is agreed to amalgamate the two firms as at 1st April 2015 and to form a new company S Limited.

You are required, using the information given, to :

(a) prepare Journal Entries closing the books of the two partnerships;
(b) show in columnar form the Capital Accounts of the partners to include the final cash payment and shares received;
(c) prepare the opening Balance Sheet of the new company after the various adjustments have been made.

The Balance Sheet of the partnerships prior to amalgamation were (all figures in rupees) :

Liabilities	C & R	K & T	Assets	C & R	K & T
Capital Accounts :			Goodwill	4,000	—
C	7,100	—	Freehold Premises	—	15,000
R	4,800	—	Leasehold Premises	1,500	—
K	—	24,200	Plant and Equipment	1,200	2,700
T	—	10,000	Vehicles	2,500	4,000
Provision for Dilapidations	2,200	—	Investment (at cost)	—	2,600
Creditors	4,200	8,400	Stock	3,900	8,000
Bank Overdraft	—	1,700	Debtors	5,000	12,000
			Balance at Bank	200	—
	18,300	44,300		18,300	44,300

All the profits of the two firms, whether revenue or capital, were shared in the ratios : C : R – 5 : 3; K : T – 4 : 3.

You are given the following information :

1. C & R immediately surrendered the lease to the freeholder, who agreed to waive his right to dilapidations and pay them ₹ 1,000.
2. The amounts agreed for the assets and liabilities taken over by S Limited were :

	C & R	K & T		C & R	K & T
Goodwill	8,000	12,000	Stock	3,700	7,500
Freehold premises	—	25,000	Debtors	4,500	11,000
Plant and equipment	1,000	2,500	Creditors	4,100	8,300
Vehicles	2,500	3,500			

3. The investments were taken over by K at an agreed value of ₹ 6,400.
4. T agreed to pay off the bank overdraft and the final balance at the bank of C & R were shared equally between the partners.
5. C, R and T paid in such amounts as were necessary to enable K to be paid in full, so that their respective shareholders were finally C — 30%; R — 30%; T — 40%.
6. S Limited allotted shares of ₹ 10 each at par as consideration for the assets taken over.

8. A and B were in partnership sharing profits and losses in the ratio of 2 : 1. Their Summarised Balance Sheet as on March 31, 2015 was as under:

Liabilities	₹	₹	Assets	₹	₹
Fixed Capital Accounts :			Fixed Assets		70,000
A	50,000		Current Assets:		
B	40,000	90,000	Stock	35,000	

Current Accounts :			Debtors	65,000	
A	20,000		Bank	15,000	1,15,000
Less : B	10,000	10,000			
Loan — B		30,000			
Creditors		55,000			
		1,85,000			1,85,000

The fixed assets included two motor cars having book values at ₹ 8,000 and ₹ 6,000 respectively. The partners, desiring to retire from business, accepted the offer of Western Indian Limited to acquire the stock and fixed assets, other than the motor cars, at an agreed purchase price of ₹ 1,60,000. The purchase consideration was to be satisfied by a cash payment of ₹ 56,000, the allotment by the company to the partners of 400, 5% preference shares of ₹ 100 each, and the balance by the allotment by the company to the partners of 900 equity shares of ₹ 100 each.

The debtors realised ₹ 61,000 and the creditors were settled for ₹ 51,000. The partners agreed that the following should be the basis of distribution on dissolution of the partnership:

(1) A to take over one car at a valuation of ₹ 12,000 and B the other at ₹ 8,000.

(2) B to be allotted preference shares to the value of his loan, the remainder to be allotted to A.

(3) The equity shares to be allotted in proportion of fixed capitals.

(4) Both the preference and equity shares to be valued at ₹ 80 per share.

(5) The balances to be settlled in cash.

You are required to prepare :

(a) The Realisation Account;

(b) The Partners' Capital Accounts showing the final settlement between them; and (c) The Bank Account.

Guide to Answers

Practical Questions

1. **Profit on realisation ₹ 20,000.**
2. **(a) Gross Profit ₹ 4,00,000; Net Profit ₹ 1,90,000; (b) Profit on realisation ₹ 40,000**
   (c) Balance Sheet of B as at 31.12.2014: Land & Building ₹ 40,000; Plant ₹ 1,60,000; Fittings ₹ 20,000; Investments ₹ 20,000; Stock ₹ 1,14,000; Debtors ₹ 1,60,000; Cash ₹ 66,000; Capital ₹ 8,00,000; Creditors ₹ 1,70,000; Accruals ₹ 10,000, Total ₹ 9,80,000.
   (d) Balance Sheet of X Ltd: Goodwill ₹ 1,20,000; Land & Building ₹ 4,00,000; Plant & Machinery ₹ 1,00,000; Fixtures and Fittings ₹ 20,000; Stock ₹ 1,14,000; Debtors ₹ 1,60,000; Cash ₹ 66,000; Share Capital ₹ 8,00,000; Creditors ₹ 1,70,000; Accruals ₹ 10,000; Total ₹ 9,80,000.
3. **Profit on realisation: Abraham ₹ 7,350; Benjamin ₹ 4,410; Chapman ₹ 2,940.**
4. **Profit on realisation ₹ 19,920.**
5. **Profit for 1st half : ₹ 22,000 (B : ₹ 13,200; E : ₹ 8,800); Profit of 2nd half : ₹ 7,800 (B : ₹ 3,120; E : ₹ 3,120; C : ₹ 1,560). Balance Sheet total : ₹ 1,24,680.**
6. **Realisation loss : ₹ 51,000; Goodwill : ₹ 2,76,000; Purchase consideration : ₹ 8,51,000.**
7. **Purchase consideration — C & R : ₹ 15,600; K & T : ₹ 53,200. Profit on Realisation — C & R : ₹ 4,800; K & T : ₹ 23,600. Shareholding in S Ltd. : C — ₹ 20,640; R — ₹ 20,640; T — ₹ 27,520.**
8. **Realisation profit : ₹ 75,000; Final payment by cheque : A — ₹ 66,000; B — ₹ 15,000.**

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Branch Accounting

Introduction

A branch may be defined as a section of an enterprise, geographically separated from the rest of the business, controlled by a ***head office***, and generally carrying on the same activities as of the enterprise. As a business grows, it may open up branches in different towns and cities in order to market its products/services over a large territory and thus increase its profits. For example, Bata Shoe Co. Ltd. has branches in various cities all over the country. The same example holds good for a commercial bank also.

As per the provisions of Section 2(9) of the Companies Act, 1956, branch office in relation to a company means—

(a) any establishment described as a branch by the company; or

(b) any establishment carrying on either the same or substantially the same activity as that carried on by the head office of the company; or

(c) any establishment engaged in any production, processing or manufacture,

but does not include any establishment specified in any order made by the Central Government under Section 8 of the Companies Act, 1956.

It should be mentioned that a branch is ***not a separate legal entity***; it is simply a segment of a business. From an accounting standpoint, a branch is a clearly identifiable ***profit centre***. In order to exercise greater control over the branches it is necessary to ascertain profit or loss made by such branches separately. Apart from this, specialised accounting techniques have to be adopted for controlling various branch activities and for their smooth running, both at the branch level and at the head office level. The systems of accounting vary between different enterprises in accordance with their type of activities, methods of operation and the preferences of their managements.

Need for Branch Accounting

Though a branch is typically located at some distance from the head office, it carries on all its activities under its direction and control. Therefore, it is necessary that the head office and the branch obtain information from either side at regular intervals about the proper functioning of the branch. This requires the head office and the branch to keep proper books of accounts. The need for branch accounting arises as to :

(a) ascertain the profitability of each branch separately for a particular accounting period,

(b) ascertain the financial position of each branch separately at the end of that accounting period,

(c) assess the progress and performances of each branch,
(d) fulfill the audit requirements under Section 228 of the Companies Act, 1956,
(e) incorporate the profit or loss made by the branch and its assets and liabilities in the firm's final accounts,
(f) ascertain the requirements of stock and cash for each branch,
(g) ascertain whether the branch is yielding a satisfactory rate of return on capital invested in it,
(h) ascertain whether the branch should be expanded or closed,
(i) ascertain the quantity of stock held by each branch at the end of that accounting period, and
(j) ascertain the amount of commission payable to the manager, if that is based on profits.

Types of Branches

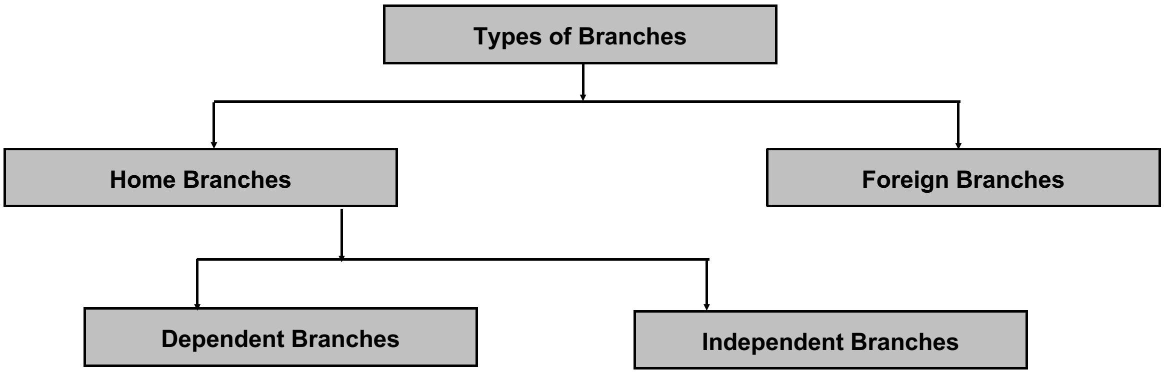
From an accounting point of view, the branches can be divided into the following main classes:

(1) Home Branches

(a) Dependent branches (where the head office maintains all the accounts)
(b) Independent branches (where the branch keeps its own accounts)

(2) Foreign Branches

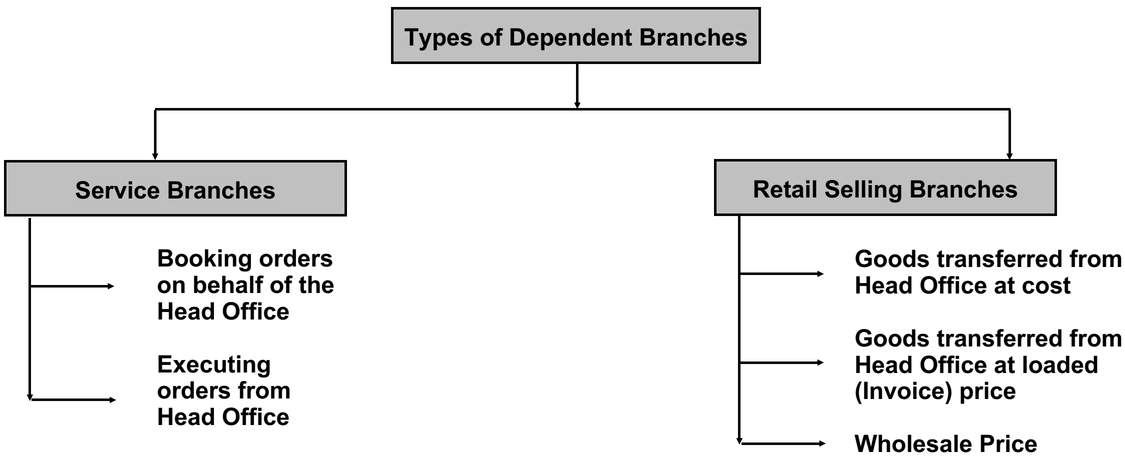
They almost invariably trade independently and record their transactions in foreign currency.



Dependent Branches

When the policies and administration of a branch are totally controlled by the head office, who also maintains its accounts, the branch is called a ***dependent branch***.

The following are the different types of dependent branches:



Service Branches

These branches are booking or executing orders on behalf of the head office. The accounts relating to these types of branches consist mainly of expenditure accounts for salaries, wages, travelling and miscellaneous expenses, etc. Generally the branch manager is provided with a small fund (similar to a petty cash fund, which is replenished periodically) to pay for small items of expense. The branch manager is required to submit periodical (weekly or monthly) expenditure statements to the head office, upon receipt of which, the head office forwards a replacement cheque for the total amount of expenditure. For proper control of branch expenditure, the expenditure returns are analysed and total of each type of expenditure are debited to the appropriate Branch Expenditure Account and credited to the Branch Cash Account in the head office books. At the time of preparation of final accounts of the head office, the different Branch Expenditure Accounts are transferred to the Profit and Loss Account of the head office.

Retail Selling Branches

For retail selling branches, the head office not only maintains all accounting records but also manufactures or purchases all or most of the required stock in bulk quantity. It is often found the most practical and economical way for the head office, (particularly with increasingly widespread use of sophisticated computers which can communicate with one another using telephone services), to undertake all the book-keeping and accounting work required, as it simply involves asking for regular 'returns' from the various branches. This practice is very useful for those organisations which operate on a large scale with numerous branches, with each branch practically being no more than a sales depot or selling outlet. The main features of retail branches are as follows:

1. A separate record of branch assets, liabilities, revenues and expenses is maintained by the head office. These branches maintain records of sales and petty expenses only but may also keep debtors accounts, if necessary. They also maintain stock register and furnish weekly or monthly stock statements to H.O.
2. All business documents originating at the branches are transmitted to the head office.
3. Goods are transferred by the head office to such branches either at cost or at loaded (invoice) price which are fixed nationally or on a local basis by the head office. The branch manager has no discretion in the fixation of price and has to sell the goods at agreed upon prices.
4. Except with the permission of the head office, such branches are not allowed to buy goods locally from the open market.
5. Goods are generally sold by such branches in cash. Though granting of credit is usually forbidden, such branches can sell goods on credit with the permission of the head office.
6. The amount collected from cash sales or debtors is either remitted to head office immediately (the same or next day) or banked intact in the account of the head office in some local bank.
7. A working fund for the branch is established and is replenished as needed. All major expenses of the branch are paid, as far as possible, by the head office. The branch manager is allowed to pay salaries and wages of the branch staff. He is allowed to incur only petty expenses like postage, telephone, etc.

Accounting Arrangements of Retail Dependent Branches

The accounting arrangement of a branch depends upon its size, the type of activities, the method of operation and the degree of control to be exercised by the head office. There are three main methods of accounting for branch transactions, viz.

1. Debtors System
2. Stock and Debtors System
3. Final Accounts System

Debtors System

This system of accounting is suitable for the small-size branches. Under this, a Branch Account is opened for each branch in the head office ledger. All transactions relating to that branch are recorded in this account. The Branch Account is prepared in such a way that it discloses the profit or loss of the branch.

Head office may send goods to branch either at "cost price" or "selling price" (also called invoice price). The accounting procedure in these two cases is slightly different. Therefore, we discuss them separately.

Cost Price Method : Under this method, at the beginning of the year the Branch Account is debited with the opening balances of assets such as stock (at cost), debtors, petty cash, furniture, prepaid expenses, accrued income, etc., lying with the branch. Similarly, it is credited with the opening balances of liabilities of the branch such as, creditors, outstanding salaries, rent etc.

The Branch Account is then debited with the amount of goods sent to the branch (at cost) and other amounts remitted to meet various expenses such as, salaries, rent, rates and taxes, etc. Likewise, the Branch Account is credited with the return of goods (at cost) by the branch, and receipts from debtors and cash sales. At the year end, Branch Account is debited with the closing values of liabilities and credited with the closing values of assets. The difference between the two sides represents profit or loss for the branch for a particular period.

Journal Entries

1. For opening balances of assets at the branch	
Branch Account	Dr.
To (Individual) Branch Assets Account	
2. For opening balances of liabilities at the branch	
(Individual) Branch Liabilities Account	Dr.
To Branch Account	
3. For goods sent to branch	
Branch Account	Dr. [At cost]
To Goods Sent to Branch Account	
4. For return of goods by branch to head office	
Goods Sent to Branch Account	Dr.
To Branch Account	
5. For remittance of cash/cheque to branch for expenses (e.g., salaries, rent, petty expenses, etc.)	
Branch Account	Dr. [Actual]
To Cash/Bank Account	
6. For cash/cheque received from branch (Cash sales plus collection from debtors)	
Cash/Bank Account	Dr. [Actual including direct from debtors]
To Branch Account	
7. For 'closing balances of assets' at the branch	
(Individual) Branch Assets Account	Dr.
To Branch Account	
8. For 'closing balances of liabilities' at the branch	
Branch Account	Dr.
To Liabilities (Individual) Account	
9. For closing goods sent to branch account	
Goods Sent to Branch Account	Dr.
To Purchase Account	[Trader]
To Trading Account	[Manufacturer]
10. For credit sales	
[No entry]	
11. For normal loss	
[No entry]	
12. For goods returned by customers	
[No entry]	
13. For abnormal loss	
(a) Abnormal Loss Account	Dr. [Total]
To Branch Account	

(b) General Profit and Loss Account Dr. [Loss]
Insurance Claim Account Dr. [Claim]
To Abnormal Loss Account [Total]

In this context, it should be noted that Branch Account is prepared to know the correct profit of the branch without being affected by any abnormal loss.

14. Pilferage

One of the commonest feature of retail trade is 'shoplifting' and this has come to be regarded as a normal business loss — hence no entry is required for it.

15. Branch expenses paid by the branch

[No entry]

16. Bad debts, discount allowed to debtors

[No entry]

Reasons for not passing any entry for 10, 12 and 14 have been discussed later in details.

17. For transferring profit or loss of the branch

(i) If profit:

Branch Account Dr.
To General Profit and Loss Account

(ii) If loss:

General Profit and Loss Account Dr.
To Branch Account

It should be noted that the closing balances of branch assets and liabilities are shown in the Balance Sheet of the head office.

The Branch Account appears as follows:

In the books of the Head Office

Dr. ... Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance b/d:		2014 Jan. 1	By Balance b/d:	
	Stock			Creditors	
	Debtors			Outstanding Expenses	
	Petty Cash		Dec. 31	By Bank A/c:	
	Furniture			Cash Sales	
	Prepaid Expenses			Collection from Debtors	
Dec. 31	To Goods Sent to Branch A/c			By Goods Sent to Branch A/c	
	To Bank A/c:			(Returned by Branch)	
	Rent, Rates & Taxes			By Balance c/d:	
	Petty Cash (remittance)			Stock	
	To Balance c/d:			Debtors	
	Creditors			Petty Cash	
	Outstanding Expenses			Furniture	
	To General Profit & Loss A/c (Profit)			Prepaid Expenses	
				By General Profit & Loss A/c (Loss)	

Some Typical Items

The following items are to be ignored while preparing Branch Account under this method:

(i) Credit sales; Sales returns; Bad debts; Discount allowed; etc., (ii) Depreciation of fixed assets, (iii) Petty cash expenses paid by the branch, (iv) Shortage or surplus of stock, and (v) Profit or loss arising out of sale of a fixed asset.

The reasons are explained below:

(i) Credit sales and other related matters (such as, sales returns, bad debts, discount allowed, etc.) The Branch Account is debited with the opening balance of debtors and credited with cash received from debtors and closing balance of debtors. Credit sale, sales returns, bad debts, discount allowed, etc., are related to Debtors Account. For calculating closing debtors balance all these items have already been taken into consideration. Therefore, these items are to be ignored for the preparation of Branch Account.

(ii) Depreciation on Fixed Assets The Branch Account is debited with the opening balance of fixed assets and credited with the closing balances of fixed assets after deducting depreciation. Depreciation is automatically accounted for and it should not be shown in the Branch Account separately.

(iii) Petty Cash Expenses paid by the Branch The Branch Account is debited with the opening balance of petty cash and the amount of petty cash sent by the head office and is credited with the closing petty cash. For calculating closing petty cash, all expenses paid by the branch are taken into consideration. Therefore, it should be ignored for preparation of Branch Account.

(iv) Shortage or Surplus of Stock The Branch Account is debited with the opening balance of branch stock and credited with its closing balance. At the time of calculating closing balance of branch stock, shortage/surplus is taken into consideration. Therefore, it should be ignored for preparation of Branch Account.

(v) Profit/Loss on Sale of a Fixed Asset If an asset is sold for cash, the Branch Account is credited with the remittances. If it is sold on credit, the Branch Account will be credited with the Debtor for sale of asset. The profit/loss on sale of asset is already included in the remittance/debtors figure. Therefore, at the time of preparing Branch Account, profit/loss on sale of asset should not be shown separately.

(vi) Purchases by Branch The Branch Account is debited with the amount of remittance from head office. Therefore, any direct purchase by branch should not be shown separately in the Branch Account.

Illustration 1

From the following information relating to the Calcutta Branch for the year ending 31st March, 2015, prepare the Branch Account in the books of head office.

Opening balances on 1.4.2014 :	₹	Cheque sent to Branch:	₹
Stock at Branch	37,500	Salaries	22,500
Debtors at Branch	75,000	Rent & Taxes	3,750
Petty cash at Branch	750	Petty Cash	2,750
Goods Sent to Branch	6,30,000	Closing balances on 31.3.2015:	
Cash sales	1,50,000	Stock at Branch	62,500
Cash received from Debtors	5,25,000	Debtors at Branch	1,20,000
Goods returned by Branch	5,000	Petty Cash at Branch	500
Credit sales	5,70,000		

Solution

In the books of Head Office

Dr. Calcutta Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Apr. 1	To Balance b/d:		2015 Mar. 31	By Goods Sent to Branch A/c (Returns)	5,000
	Stock	37,500		By Bank A/c:	
	Debtors	75,000		Cash sales	1,50,000
	Petty Cash	750		Cash received from Debtors	5,25,000
2015 Mar. 31	To Goods Sent to Branch A/c:	6,30,000		By Balance c/d:	
	To Bank A/c:			Stock	62,500
	Salaries	22,500		Debtors	1,20,000
	Rent & Taxes	3,750		Petty Cash	500
	Petty Cash	2,750			
	To General profit & Loss A/c	90,750			
		8,63,000			8,63,000

Tutorial Note: Under this method, credit sales and petty expenses are to be ignored.

The students should note that the Branch Account is a Nominal Account in nature and is peculiar in the sense that profit is ascertained here by applying the Balance Sheet approach of income determination.

We know that the difference between assets and liabilities represents capital and can be ascertained either by deducting liabilities from assets or by showing the assets and liabilities on the two sides of the same account.

Recording opening and closing assets and liabilities in the two sides of the Branch Account represents opening and closing capital of the head office in the branch.

Now, if we consider goods sent to the branch and other amounts remitted as further capital introduced into the branch, and likewise, return of goods, and receipts from debtors or cash sales as capital withdrawn from the branch, it resembles determination of profit by the networth method under single entry system. The Branch Account exhibits the profit or loss for an accounting period as well as the net assets lying with the branch.

Illustration 2

From the following particulars, prepare Branch Account in the books of the head office assuming that the sales at branch are on cash basis. (all figures are in ₹)

Opening stock at the branch	30,000	Expenses met by head office:	
Goods sent to branch	90,000	Salaries	10,000
Cash sales	1,20,000	Other expenses	4,000

Closing stock could not be ascertained, but it is known that the branch usually sells at cost plus 20%. The branch manager is entitled to a commission of 5% on the profit of the branch before charging such commission.

Solution **In the books of the Head Office**

Dr. **Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d:			By Bank A/c:	
	Stock	30,000		Cash sales	1,20,000
	To Goods Sent to Branch A/c	90,000		By Balance c/d:	
	To Bank A/c:			Stock (Note 1)	20,000
	Salaries	10,000			
	Other expenses	4,000			
	To Balance c/d:				
	Manager's commission (Note 2)	300			
	To General Profit & Loss A/c	5,700			
		1,40,000			1,40,000

(1) Calculation of Closing Stock

	₹
Opening stock	30,000
Goods sent to branch (at cost)	90,000
	1,20,000
Less: Cost of goods sold (₹ 1,20,000 x 100/120)	1,00,000
	20,000

(2) Profit before commission is ₹ (1,20,000 + 20,000) – ₹ (30,000 + 90,000 + 10,000 + 4,000) = ₹ 6,000. Manager's commission is payable @ 5%. So commission is ₹ 6,000 x 5/100 = ₹ 300. Manager's commission is still payable, and, therefore, is a liability for the business at the end of the accounting period.

Illustration 3

X of Calcutta has a branch at Bombay. Goods are supplied to the branch at cost. The expenses of the branch are paid from Calcutta and the branch keeps a sales journal and the debtors ledger only. From the following information supplied by the branch, prepare a Branch Account in the books of the head office. (all figures in ₹)

Opening stock (1.4.2014)	24,000	Sundry Debtors on 31.3.2015	9,160
Closing stock (31.3.2015)	18,000	Goods received from H.O.	33,600
Credit sales	41,000	Expenses paid by H.O. for the Branch	10,400
Cash sales	17,500	Pilferage of goods by the employees	2,000
Receipt from Debtors	37,900		

Solution — **In the books of the Head Office (Calcutta)**

Dr. Bombay Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Apr. 1	To Balance b/d:		2015 Mar. 31	By Bank A/c:	
	Stock	24,000		Cash sales	17,500
	Debtors (Note 1)	6,060		Received from Debtors	37,900
2015 Mar. 31	To Bank A/c: (expenses)	10,400		By Balance c/d:	
	To Goods Sent to Branch A/c	33,600		Stock	18,000
	To General Profit & Loss A/c	8,500		Debtors	9,160
		82,560			82,560

Tutorial Note : **(1)** In this problem, the opening balance of debtors has not been given. Memorandum Branch Debtors Account is prepared below for finding out the opening balance of debtors.

Dr. Memorandum Branch Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d (balancing figure)	6,060	By Cash	37,900
To Sales (credit)	41,000	By Balance c/d	9,160
	47,060		47,060

(2) Pilferage of goods by the employees is very common to all businesses. So, it should be treated as a normal event. In the Branch Account, pilferage is to be ignored.

Illustration 4

From the following details regarding West Coast Branch of Bombay Trading Co., prepare a Branch Account in respect of the year 2014: (all figures in ₹)

Stock on 1.1.2014	12,000	Returns to head office	4,800
Stock on 31.12.2014	9,600	Bad debts	600
Debtors on 1.1.2014	10,000	Discounts allowed	310
Debtors on 31.12.2014	11,500	Returns from customers	3,000
Goods sent to branch during 2014	42,000	Expenses paid by head office:	
Cash sales	25,800	Salaries and wages	8,400
Credit sales	36,000	Rent (from 1.1.2014 to 31.3.2015)	5,250
Normal loss	2,000	Sundry expenses	3,600

Solution — **In the books of Bombay Trading Co.**

Dr. West Coast Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Jan.1	To Balance b/d:		2014 Dec. 31	By Goods Sent to Branch A/c (Returns)	4,800
	Stock	12,000		By Bank A/c:	
	Debtors	10,000		Cash sales	25,800
Dec. 31	To Goods Sent to Branch A/c	42,000		Collection from debtors (Note 2)	30,590
	To Bank A/c:			By Balance c/d:	
	Salaries & wages	8,400		Stock	9,600
	Rent	5,250		Debtors	11,500
	Sundry expenses	3,600		Prepaid Rent (Note 3)	1,050
	To General Profit & Loss A/c	2,090			
		83,340			83,340

Tutorial Notes:

(1) Under this method, normal loss, credit sales, sales returns, bad debts, discount allowed to debtors, etc., are to be ignored.

(2) The amount of cash received from debtors is not given. It has been found out by preparing Memorandum Debtors Account as follows:

Dr. Memorandum Branch Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	10,000	By Bad Debts	600
To Sales (credit)	36,000	By Discount allowed	310
		By Returns inward	3,000
		By Bank (Balancing figure)	30,590
		By Balance c/d	11,500
	46,000		46,000

(3) Pre-paid Rent = ₹ 5,250/15 x 3 = ₹ 1,050.

Illustration 5

The head office of a company invoices goods to its Shillong Branch at cost, who also purchases goods independently from local parties for which payments are made by the head office. All the cash collected by the Branch is banked on the same day to the credit of the head office and all expenses are directly paid by the head office except for a Petty Cash Account maintained by the branch for which periodical transfers are made from the head office.

From the following particulars, show the Branch Account as maintained in the head office books, reflecting the branch profit for the year ending 31.12.2014 :

Imprest Cash : 1.1.2014	2,000	Returns from Customers	3,000
Imprest Cash : 31.12.2014	1,850	Goods sent to Branch from H.O.:	50,000
Sundry Debtors on 1.1.2014	25,000	Transfer from H.O. for petty cash expenses	2,500
Stock on 1.1.2014		Bad debts	1,000
Transferred from H.O.	20,000	Discount to customers	2,000
Directly purchased by Branch	16,000	Cash received from customers	1,25,000
Shortage of stock	4,000	Branch Expenses	30,000
Cash Sales	45,000	Stock on 31.12.2014:	
Credit Sales	1,30,000	Transferred from H.O.	15,000
Direct Purchases	45,000	Directly purchased by Branch	12,000

Solution

In the books of the Head Office

Dr. Shillong Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Jan.1	To Balance b/d:		2014 Dec. 31	By Bank A/c:	
	Imprest cash	2,000		Cash sales	45,000
	Sundry debtors	25,000		Cash received from customers	1,25,000
	Stock ₹ (20,000 + 16,000)	36,000		By Balance c/d:	
Dec. 31	To Bank A/c:			Imprest cash	1,850
	Purchases (direct)	45,000		Sundry debtors (Note 1)	24,000
	Branch expenses	30,000		Stock ₹ (15,000 + 12,000)	27,000
	Petty cash	2,500			
	To Goods Sent to Branch A/c	50,000			
	To General Profit & Loss A/c	32,350			
		2,22,850			2,22,850

Tutorial Note: Under this method, shortage of stock, credit sales and returns by customers are to be ignored.

Working Note :

Dr. (1) Memorandum Branch Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	25,000	By Bank	1,25,000
To Sales	1,30,000	By Bad debts	1,000
		By Discount to customers	2,000
		By Returns	3,000
		By Balance c/d	24,000
	1,55,000		1,55,000

Illustration 6

XYZ Company is having its branch at Kolkata. Goods are invoiced to the branch at 20% profit on sale. Branch has been instructed to send all cash daily to head office. All expenses are paid by head office except petty expenses which are met by the Branch Manager. From the following particulars, prepare Branch Account in the books of Head Office.

Particulars	₹	Particulars	₹
Stock on 1st April, 2014 (Invoice Price)	30,000	Discount Allowed to Debtors	160
Sundry Debtors on 1st April, 2014	18,000	Expenses Paid by Head Office :	
Cash in Hand as on 1st April, 2014	800	Rent	1,800
Office Furniture on 1st April, 2014	3,000	Salary	3,200
Goods Invoiced from the Head Office (Invoice Price)	1,60,000	Stationery and Printing	800
Goods Return to Head Office	2,000	Petty Expenses Paid by the Branch	600
Goods Return by Debtors	960	Depreciation to be Provided on Branch Furniture	
Cash Received from Debtors	60,000	at 10% p.a.	
Cash Sales	1,00,000	Stock on 31st March, 2015 (at Invoice Price)	28,000
Credit Sales	60,000		

Solution **In the books of XYZ Company (H.O.)**

Dr. **Kolkata Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014			2015		
April 1	To Balance b/d :		March 31	By Stock Reserve A/c (Note 1)	6,000
	Stock	30,000		By Bank A/c (Remittances)	1,60,000
	Sundry Debtors	18,000		By Goods Sent to Branch A/c	
	Cash in Hand	800		(Returned to H.O.)	2,000
	Office Furniture	3,000		By Goods Sent to Branch A/c (Note 2)	31,600
2015				By Balance c/d :	
March 31	To Goods Sent to Branch A/c	1,60,000		Stock	28,000
	To Bank A/c :			Sundry Debtors (Note 4)	16,880
	Rent	1,800		Cash (Note 4) (₹ 800 – 600)	200
	Salary	3,200		Furniture (₹ 3,000 – 300)	2,700
	Stationery & Printing	800			
	To Stock Reserve A/c (Note 3)	5,600			
	To General Profit and Loss A/c	24,180			
		2,47,380			2,47,380

Working Notes :

(1) Loading on opening stock = 20% of ₹ 30,000 = ₹ 6,000.

(2) Loading on goods sent = 20% (₹ 1,60,000 – 2,000) = ₹ 31,600.

(3) Loading on closing stock = 20% of ₹ 28,000 = ₹ 5,600.

Dr. **(4) Memorandum Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d	18,000	31.3.2015	By Discount Allowed A/c	160
31.3.2015	To Sales A/c	60,000		By Sales Return A/c	960
				By Bank A/c	60,000
				By Balance c/d (Balancing figure)	16,880
		78,000			78,000

Illustration 7

From the following particulars relating to Patiala Branch for the year ending 31.12.2014, prepare Branch Account in the books of head office and show how the relevant items will appear in the head office Balance Sheet as on that date.

Balances on 1.1.2014:	₹	Cash paid by debtors direct to head office	22,000
Stock	40,000	Discount allowed	1,100
Debtors	14,000	Cash sent to branch for expenses:	
Petty cash	1,500	Rent : ₹ 12,000; Salaries : ₹ 5,400; Petty cash : ₹ 4,000	
Furniture	12,000	Insurance (from 1.4.2014 to 31.3.2015)	1,600
Prepaid fire insurance	1,150	Goods returned by the branch	4,000
Outstanding salaries	2,100	Goods returned by the debtors	7,000
Goods sent to branch	2,80,000	Stock on 31.12.2014	38,000
Cash sales	3,30,000	Petty expenses paid by the branch	2,850
Credit sales	1,83,000	Provide depreciation on furniture @ 10% p.a.	
Cash received from debtors	1,35,000	Loss of stock by fire	4,800

Solution **In the books of the Head Office**

Dr. **Patiala Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Jan.1	To Balance b/d:		2014 Jan. 1	By Balance b/d:	
	Stock	40,000		Outstanding salaries	2,100
	Debtors	14,000	Dec. 31	By Bank A/c:	
	Petty cash	1,500		Cash sales	3,30,000
	Furniture	12,000		Collection from Debtors	1,35,000
	Prepaid fire insurance	1,150		Direct payment to H.O.	22,000
Dec. 31	To Goods Sent to Branch A/c	2,80,000		By Goods sent to Branch (Returns)	4,000
	To Bank A/c:			By Loss of stock by fire (Note 5)	4,800
	Rent	12,000		By Balance c/d:	
	Salaries	5,400		Stock	38,000

	Petty cash	4,000		Debtors (Note 1)	31,900
	Insurance	1,600		Furniture (Note 3)	10,800
	To General Profit & Loss A/c	2,10,000		Petty cash (Note 2)	2,650
				Prepaid fire insurance (Note 4)	400
		5,81,650			5,81,650

Balance Sheet of Head Office [Extract]
As at 31st December, 2014

Liabilities	₹	Assets	₹
Branch Profit	2,10,000	Branch Furniture	10,800
		Branch Stock	38,000
		Branch Debtors	31,900
		Branch Petty Cash	2,650
		Branch Prepaid Fire Insurance	400

Working Notes :

Dr. (1) Memorandum Branch Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	14,000	By Bank ₹ (1,35,000 + 22,000)	1,57,000
To Sales	1,83,000	By Discount allowed	1,100
		By Returns	7,000
		By Balance c/d	31,900
	1,97,000		1,97,000

Dr. (2) Branch Petty Cash Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	1,500	By Petty expenses	2,850
To Bank	4,000	By Balance c/d	2,650
	5,500		5,500

(3) Value of furniture after depreciation will be = ₹ 12,000 – ₹ 1,200 = ₹ 10,800.

(4) Prepaid insurance = ₹ 1,600/12 x 3 = ₹ 400.

(5) The Branch Account is prepared to know the correct profit of the branch without being affected by any abnormal loss. Here, goods lost by fire is an abnormal event. Therefore, abnormal is to be debited to General Profit and Loss Account and credited to Branch Account.

Illustration 8

A company with its head office at Bombay has a branch at Calcutta. The branch receives all goods from head office, who also remits cash for all expenses. Sales are made by the branch on credit as well as for cash.

Total sales by the branch for the year ending 31.3.2015 amounted to ₹ 5,60,000 out of which 20% is cash sales. The following further information is relevant:

1.4.2014: Stock — ₹ 25,000; Debtors — ₹ 60,000; Cash — ₹ 120

31.3.2015: Stock — ₹ 36,000; Debtors — ₹ 48,000; Cash — ₹ 180.

Expenses incurred by the branch: Salaries — ₹ 36,000; Rent — ₹ 12,000; Petty expenses — ₹ 5,600.

All sales are made by the branch at cost plus 25%.

You are required to prepare the Calcutta Branch Account in the books of the head office for the year ended 31st March, 2015.

Solution

In the books of the Head Office (Bombay)

Dr. Calcutta Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Apr. 1	To Balance b/d:		2015 Mar. 31	By Bank A/c (remittances received):	
	Stock	25,000		Cash sales (Note 1)	1,12,000
	Debtors	60,000		Collection from debtors (Note 3)	4,60,000
	Petty cash	120		By Balance c/d:	
2015 Mar. 31	To Goods Sent to Branch A/c (Note 2)	4,59,000		Stock	36,000
	To Bank A/c (remittances for expenses):			Debtors	48,000
	Salaries	36,000		Petty cash	180
	Rent	12,000			
	Petty expenses (Note 4)	5,660			
	To General Profit & Loss A/c	58,400			
		6,56,180			6,56,180

Working Notes:

(1) Cash and Credit sales	₹	(2) Goods sent to Branch	₹
Total sales	5,60,000	Total sales	5,60,000
Less: Cash sales (20% of ₹ 5,60,000)	1,12,000	Less: Profit (25/125 x ₹ 5,60,000)	1,12,000
Credit sales	4,48,000	Cost of sales	4,48,000
		Add: Closing stock	36,000
			4,84,000
		Less: Opening stock	25,000
		Goods sent to Branch	4,59,000

Dr. (3) Memorandum Branch Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	60,000	By Bank A/c (Balancing figure)	4,60,000
To Credit Sales (Note 1)	4,48,000	By Balance c/d	48,000
	5,08,000		5,08,000

Dr. (4) Branch Petty Cash Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	120	By Petty expenses	5,600
To Bank A/c (remittances for petty exp. - balancing fig.)	5,660	By Balance c/d	180
	5,780		5,780

Illustration 9

Sonali Chain Stores of Calcutta has a branch in Burdwan. Goods are sent to branch at cost. Branch sells only goods received from head office. Branch sales are partly cash and partly credit. All cash collected by branch are sent to head office immediately and branch expenses are paid by head office. Following are the details of transactions relating to branch for the year ended on 31st December, 2014 (all figures in ₹) :

Stock at branch on 1.1.2014	6,800	Returns by branch customers	500
Debtors at branch on 1.1.2014	7,000	Cash received on Ledger Account	33,000
Goods in transit on 1.1.2014	4,800	Branch salary and wages paid by H.O.	6,700
Goods sent to branch during the year	78,600	Branch sundry expenses paid by H.O.	800
Goods received by branch during the year	74,800	Branch outstanding salary	1,200
Goods returned by branch	2,000	Branch prepaid wages	500
Returned goods received by H.O. during the year	1,600	Bad debts written-off	200
Cash sales at branch during the year	54,000	Wastage of stock at branch	400
Credit sales at branch during the year	35,500		

Other particulars are given below:

(a) Goods-in-transit ₹ 4,800 included goods costing ₹ 3,200 sent by H.O. to branch and goods costing ₹ 1,600 returned by branch to H.O. in previous year.

(b) During this year cash ₹ 5,000 sent by branch to H.O. on 27.12.2014 which is received by H.O. on 3.1.2015.

(c) Branch maintains a steady gross profit @ 20% on sales.

Show Branch Account in the books of head office to record the above transactions.

Solution **In the books of Sonali Chain Stores**

Dr. Burdwan Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance b/d:		2014 Dec. 31	By Bank A/c (Note 1)	
	Stock at branch	6,800		Amount received from branch	82,000
	Goods-in-transit to branch	3,200		By Goods Sent to Branch A/c	1,600
	Goods-in-transit from branch	1,600		(Goods returned by branch)	
	Debtors	7,000		By Balance c/d:	
Dec. 31	To Goods Sent to Branch A/c	78,600		Stock at branch (Note 2)	8,000
	To Bank A/c:			Goods-in-transit to branch (Note 3)	7,000
	Branch Salaries & Wages	6,700		Goods-in-transit from br. (Note 4)	2,000
	Sundry expenses	800		Debtors (Note 5)	8,800
	To Balance c/d (Outstanding salaries)	1,200		Prepaid wages	500
	To General Profit & Loss A/c	9,000		Cash in transit (given)	5,000
		1,14,900			1,14,900

Tutorial Note: (1) Profit from branch can be verified with the help of the following statement:

Dr. Supplementary Verification Statement of Profit for Branch Cr.

Particulars		₹	Particulars	₹
To Sundry expenses		800	By Gross Profit	
To Salaries & Wages	6,700		(Being 20% on net sales of (₹ 54,000 + 35,500 – 500)	17,800
Add: Outstanding	1,200		= 20% of ₹ 89,000	
	7,900			
Less: Prepaid	500	7,400		
To Bad debts		200		
To Wastage of goods		400		
To Profit (Balancing figure)		9,000		
		17,800		17,800

(2) The wastage of stock has been treated separately and it has been transferred to Profit and Loss Account. If the wastage is treated as normal, then gross profit will go down to ₹ 17,800 – ₹ 400 = ₹ 17,400. This will distrot the 'norms of steady Gross Profit of 20% on sales'. Hence, it has not been treated as normal wastage.

Working Notes: **(1)** Amount remitted by branch = ₹ 54,000 (cash sales) + ₹ 33,000 (collection from debtors) = ₹ 87,000 less ₹ 5,000 (cash in transit from branch on closing date) = ₹ 82,000.

(2) Closing Stock at Branch

This can be ascertained by considering only the physical movement (actual) of stock to and from branch as follows:

		₹
Opening stock at branch		6,800
Goods received from H.O.		74,800
Total		81,600
Less: Returned to H.O.		2,000
		79,600
Less: Goods physically leaving the branch:		
Credit sales	35,500	
Less returns	500	
Net credit sales	35,000	
Cash sales	54,000	
Total sales	89,000	
Less: Gross Profit 20%	17,800	
Cost of goods sold		71,200
		8,400
Less: Wastage		400
Closing stock (physical) at branch		8,000

(3) Closing Goods-in-Transit to Branch	₹
Opening goods-in-transit to branch	3,200
Add: Goods sent by H.O.	78,600
Total goods travelling towards branch	81,800
Less: Goods actually received by branch	74,800
Closing goods-in-transit to branch (from H.O.)	7,000

(4) Closing goods in transit from Branch	₹
Opening goods-in-transit from branch	1,600
Add: Goods sent to H.O.	2,000
	3,600
Less: Goods received by H.O.	1,600
Closing goods in transit from branch (to H.O.)	2,000

Dr. Branch Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	7,000	By Bank (collection)	33,000
To Sales (credit)	35,500	By Returns	500
		By Bad debts	200
		By Balance c/d (Balancing figure)	8,800
	42,500		42,500

Invoice Price Method : Sometimes, the head office may prefer to send goods to the branch at a higher price than cost (termed as invoice price). Method of sending goods at invoice price is excellent from the point of view of stock control. As the goods are invoiced at selling price, the head office can dictate pricing policy to its branches, as well as save work at the branch because prices have already been decided. Invoicing at selling price is generally done where goods are of standard type, pre-packed and unlikely to fluctuate in price. Where head office has little control over selling prices (as for example, with perishable goods like fruits, fish, milk, etc.) the most suitable method is that of invoicing at cost price. In addition, goods may be invoiced at selling price to keep the margin of profit a secret from the branch manager.

The method of preparation of Branch Account is the same as in the cost price method, excepting that all journal entries relating to the goods (opening stock, goods sent to branch, goods returned to head office and closing stock) are made at invoice price and proper adjustments for loading (difference between cost price and invoice price) are made at the end of the accounting period by passing some additional entries.

Journal Entries

1. For 'opening balances of assets' at the branch

Branch Account	Dr.	
To (Individual) Branch Assets Account		[Opening stock at invoice price]

2. For 'opening balances of liabilities' at the branch

(Individual) Branch Liabilities Account	Dr.	
To Branch Account		

3. For loading on opening stock

Stock Reserve Account	Dr.	[Loading on opening stock]
To Branch Account		

4. For goods sent to branch

Branch Account	Dr.	[Invoice price]
To Goods Sent to Branch Account		

5. For return of goods by branch to head office

Goods Sent to Branch Account	Dr.	[Invoice price]
To Branch Account		

6. For loading (Net) on goods sent to branch

Goods Sent to Branch Account	Dr.	[Loading]
To Branch Account		

7. For remittance of cash/cheque to branch for expenses (e.g., salaries, rent, petty expenses, etc.)

Branch Account	Dr.	[Actual]
To Cash/Bank Account		

8. For cash/cheque received from branch (cash sales plus collection from debtors)

Cash/Bank Account	Dr.	[Actual including direct from debtors]
To Branch Account		

9. For 'closing balances of assets' at the branch

(Individual) Branch Assets Account	Dr.	[Closing stock at invoice price only]
To Branch Account		

10. For 'closing balances of liabilities' at the branch

Branch Account	Dr.	
To Branch Liabilities (Individually) Account		

11. For closing goods sent to branch account

Goods Sent to Branch Account	Dr.	
To Purchases Account		[Trader]
To Trading Account		[Manufacturers]

12. For loading on closing stock

Branch Account	Dr.	[Loading on closing stock]
To Stock Reserve Account		

13. For credit sales, normal loss, normal pilferage, goods returned by customers, etc. [No entry]

14. For abnormal loss

(a) Abnormal Loss Account	Dr.	[Invoice price]
To Branch Account		
(b) Branch Account	Dr.	[Loading on abnormal loss]
To Abnormal Loss Account		
(c) Bank Account	Dr.	[Insurance claim received]
General Profit & Loss Account	Dr.	[Loss]
To Abnormal Loss Account		

15. Normal pilferage, branch expenses paid by the branch, bad debts, discount allowed to debtors, etc.

[No entry]

16. For transferring profit or loss of the branch

(i) If profit:

Branch Account Dr.

To General Profit and Loss Account

(ii) If loss:

General Profit and Loss Account Dr.

To Branch Account

Illustration 10

Relax Ltd. supply goods to its New Delhi branch at cost plus 25%. All cash sales at branch are daily remitted to the head office, and the latter directly pays all the branch expenses. From the following particulars, show by Debtors System the result of the branch operations for the year ended December 31, 2014 :

	₹		₹
Stock at branch 1.1.2014 (invoice price)	3,000	Cash paid by H.O. for rent & rates	600
Goods sent to branch (invoice price)	24,000	Cash paid by H.O. for sundry expenses	2,000
Remittances from the branch	25,000	Returns from the branch (invoice price)	150
Cash paid by H.O. for salaries & wages	1,900	Stock at branch on 31.12.2014 (invoice price)	8,000

Solution **In the books of the Relax Ltd. (H.O.)**

Dr. **New Delhi Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance b/d:		2014 Dec. 31	By Bank A/c (Remitances)	25,000
	Stock	3,000		By Stock Reserve A/c (Note 1)	600
Dec. 31	To Goods Sent to Branch A/c	24,000		By Goods Sent to Branch A/c	
	To Bank A/c:			(Returns)	150
	Salaries & wages	1,900		By Goods Sent to Branch A/c (Note 2)	4,770
	Rent & rates	600		By Balance c/d:	
	Sundry expenses	2,000		Stock	8,000
	To Stock Reserve A/c (Note 3)	1,600			
	To General Profit & Loss A/c	5,420			
		38,520			38,520

Working Notes:

(1) Loading on opening stock

Loading is 25% on cost but the given data are related to invoice price. Thus, if cost is ₹ 100, the invoice price will be ₹ (100 + 25) = ₹ 125. Hence, loading on invoice price = 25/125 = 1/5 or 20%. Therefore, loading on opening stock will be ₹ 3,000 x 1/5 = ₹ 600.

(2) Loading on Goods sent : Total goods sent , ₹ 24,000. Goods returned by branch at invoice price = ₹ 150. The loading on net goods sent will be ₹ 23,850 x 1/5 = ₹ 4,770.

(3) Loading on closing stock = ₹ 8,000 x 1/5 = ₹ 1,600.

Illustration 11

S. P. who carried on a retail business, opened a branch X on 1.1.2015 where all sales were on credit basis. All goods required by the branch were supplied from the head office and were invoiced to the branch at 10% above cost. The following were the transactions (all figures are in ₹) :

	Jan 2015	Feb 2015	Mar 2015
Goods sent to branch (purchase price)	40,000	50,000	60,000
Sales as shown by the branch monthly report	38,000	42,000	55,000
Cash received from debtors and remitted to head office	20,000	51,000	35,000
Returns to head office (invoice price to branch)	1,200	600	2,400

The stock of goods held by the branch on 31.3.2015 amounted to ₹ 53,400 at invoice price to branch. Record these transactions in the head office books, showing balances as on 31.3.2015 and the branch gross profit for the three months ended on that date. All working should be part of your answer.

Solution

In the books of S.P. (H.O.)

X Branch Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Mar. 31	To Goods Sent to Branch A/c (Note 1)	1,65,000	2015 Mar. 31	By Goods Sent to Branch A/c (Returns)	4,200
	To Stock Reserve A/c (Note 3)	4,855		By Bank A/c	1,06,000
	To General Profit & Loss A/c	37,363		By Goods Sent to Branch A/c (Note 2) (Loading on net goods sent)	14,618
				By Balance c/d:	
				Stock	53,400
				Debtors (Note 4)	29,000
		2,07,218			2,07,218

Goods Sent to Branch Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Mar. 31	To X Branch A/c (Returns)	4,200	2015 Mar. 31	By X Branch A/c	1,65,000
	To X Branch A/c (Loading)	14,618			
	To Purchases A/c	1,46,182			
		1,65,000			1,65,000

Working Notes:

(1) Total goods sent = ₹ 40,000 + ₹ 50,000 + ₹ 60,000 = ₹ 1,50,000. Loading 10% of ₹ 1,50,000 = ₹ 15,000. Invoice price of goods sent = ₹ 1,50,000 + ₹ 15,000 = ₹ 1,65,000.

(2) Net loading on goods sent = 1/11 ₹ (1,65,000 – 4,200) = ₹ 14,618.

(3) Loading on closing stock 1/11 x ₹ 53,400 = ₹ 4,855.

(4) Memorandum Branch Debtors Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2015	To Balance b/d	—	31.3.2015	By Bank A/c	1,06,000
31.3.2015	To Sales	1,35,000	31.3.2015	By Balance c/d	29,000
		1,35,000			1,35,000

Illustration 12

Mr. X has a branch in Calcutta. He invoices goods to the branch at selling price which is cost plus $33^1/_3$%. From the following particulars prepare Branch Account and Goods Sent to Branch Account in the books of Mr. X (all figures in ₹)

Stock on 1st January 2014 (invoice price)	15,000	Discount allowed to customers	300
Debtors on 1st January 2014	11,400	Bad debt written-off	250
Goods sent to branch at invoice price	67,000	Cheque sent to branch:	
Cash sales	31,000	Salaries	5,000
Credit sales	37,400	Sundry expenses	1,700
Cash received from debtors	40,000	Stock on 31st December 2014 (invoice price)	13,400

Solution

In the books of Mr. X (H.O.)

Calcutta Branch Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance b/d:		2014 Dec. 31	By Bank A/c:	
	Stock	15,000		Cash sales	31,000
	Debtors	11,400		Cash received from Debtors	40,000
Dec. 31	To Goods Sent to Branch A/c	67,000		By Stock Reserve A/c (Note 2)	3,750
	To Bank A/c :			By Goods Sent to Branch A/c (Note 3)	16,750
	Salaries	5,000		By Balance c/d:	
	Sundry expenses	1,700		Stock	13,400
	To Stock Reserve A/c (Note 4)	3,350		Debtors (Note 1)	8,250
	To General Profit & Loss A/c	9,700			
		1,13,150			1,13,150

Goods Sent to Branch Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Calcutta Branch A/c (Loading)	16,750	?	By Calcutta Branch A/c	67,000
?	To Purchases A/c (Note 2)	50,250			
		67,000			67,000

Working Notes:

Dr. **(1) Memorandum Branch Debtors Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	11,400	By Discount allowed	300
To Sales (credit)	37,400	By Bad debts	250
		By Bank	40,000
		By Balance c/d	8,250
	48,800		48,800

(2) Loading on Opening Stock

Loading is $33^1/_3$ % on cost but the given data relates to invoice price. Thus, if cost is ₹ 100, the invoice price will be ₹ $(100 + 33^1/_3)$ or ₹ $133^1/_3$. Hence, loading on invoice price = $33^1/_3$ / $133^1/_3$ = 1/4 or 25%.

Therefore, loading on opening stock will be ₹ 15,000 x 1/4 = ₹ 3,750.

(3) Loading on goods sent to Branch = ₹ 67,000 x 1/4 = ₹ 16,750.

(4) Loading on closing stock = ₹ 13,400 x 1/4 = ₹ 3,350.

Illustration 13

A head office in Patna has two branches at Madras and Delhi. Goods are consigned to them at loaded figures of 10% and 20% on cost respectively. During the year, the invoices to the branches are ₹ 44,000 and ₹ 60,000 respectively.

Included in the item ₹ 44,000 are invoices for goods costing ₹ 12,000 and invoices to the Madras branch at ₹ 13,200 which should have been invoiced to the Delhi branch. Sales are all for cash, with that of Madras branch, being ₹ 22,000 and of Delhi branch ₹ 50,400. It may be assumed that the closing stocks are correct.

You are required to prepare: (i) Madras Branch Account, and (ii) Delhi Branch Account.

Solution **In the books of the Head Office (Patna)**

Dr. **Branch Account** **Cr.**

Date	Particulars	Madras	Delhi	Date	Particulars	Madras	Delhi
	To Goods Sent to Branch A/c (Note 1)	30,800	74,400		By Goods Sent to Branch A/c (Note 2)	2,800	12,400
	To Stock Reserve A/c	800	4,000		By Bank A/c (Sales)	22,000	50,400
	To Profit & Loss A/c	2,000	8,400		By Balance c/d : Stock (Note 3)	8,800	24,000
		33,600	86,800			33,600	86,800

Working Notes:

(1) Net goods sent to Madras branch = ₹ 44,000 – ₹ 13,200 = ₹ 30,800.

Net goods sent to Delhi branch = ₹ 60,000 + (₹ 12,000 x 120/100) = ₹ 60,000 + ₹ 14,400 = ₹ 74,400.

(2) Loading on goods sent = Madras : 1/11 x ₹ 30,800 = ₹ 2,800; Delhi : 1/6 x ₹ 74,400 = ₹ 12,400.

(3) Value of Closing Stock at Invoice Price

	Madras (₹)	Delhi (₹)
Invoice price of goods sent	30,800	74,400
Less: Goods sold	22,000	50,400
	8,800	24,000

Illustration 14

S Ltd. maintains a branch at Calcutta to which it sends goods at cost plus 25%. Calcutta branch sells goods both in cash and on credit. All collections and cash sales are directly deposited to head office Bank Account and all expenses are paid by the head office directly. From the following information, prepare Calcutta Branch Account in the books of head office:

Balances on 1.4.2014:	₹	Cash sales	30,000
Branch stock at invoice price	30,000	Bad debts	2,000
Branch debtors	40,000	Discount allowed	3,000
Transactions during the year:		Abnormal loss of goods at invoice price	8,000
Goods sent to branch at cost	1,40,000	Cheque sent by head office to branch :	
Goods returned by branch at invoice price	10,000	Rent : ₹ 4,000; Salaries : ₹ 6,000; Petty expenses : ₹ 2,000	
Goods returned by debtors to branch	3,000	Balances on 31.3.2015:	
Credit sales	1,20,000	Debtors : ₹ 45,000; Stock at invoice price : ₹ 40,000; Outstanding rent : ₹ 1,000	

Solution

In the books of S. Ltd.

Dr. Calcutta Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Apr. 1	To Balance b/d:		2015 Mar. 31	By Stock Reserve A/c (Note 1)	6,000
	Stock	30,000		By Goods Sent to Branch A/c (Returns)	10,000
	Debtors	40,000		By Goods Sent to Branch A/c (Note 3)	33,000
2015 Mar. 31	To Goods Sent to Branch A/c (Note 2)	1,75,000		By Bank A/c:	
	To Bank A/c:			Cash sales	30,000
	Rent	4,000		Collection from Debtors (Note 4)	1,07,000
	Salaries	6,000		By Abnormal Loss A/c (Note 6)	8,000
	Petty expenses	2,000		By Balance c/d:	
	To Abnormal Loss A/c (Note 6)	1,600		Debtors	45,000
	To Stock Reserve A/c	8,000		Stock	40,000
	To Balance c/d:				
	Outstanding Rent	1,000			
	To General Profit & Loss A/c	11,400			
		2,79,000			2,79,000

Working Notes:

(1) Loading on opening stock

Loading is 25% on cost but the given data are related to invoice price. Thus, if cost is ₹ 100, the invoice price will be ₹ (100 + 25) = ₹ 125. Hence, loading on invoice price = 25/125 = 1/5 or 20%. Therefore, loading on opening stock = 30,000 x 1/5 = ₹ 6,000.

(2) Invoice prices of goods sent = ₹ 1,40,000 + 25% of ₹ 1,40,000 = ₹ 1,40,000 + ₹ 35,000 = ₹ 1,75,000.

(3) Loading on net goods sent

Total goods sent, ₹ 1,75,000. Goods returned by branch at invoice price, ₹ 10,000. The loading on net goods sent is 1/5 x ₹ 1,65,000 = ₹ 33,000.

Dr. (4) Memorandum Branch Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	40,000	By Returns	3,000
To Sales (credit)	1,20,000	By Bad debts	2,000
		By Discount allowed	3,000
		By Bank (Balancing figure)	1,07,000
		By Balance c/d	45,000
	1,60,000		1,60,000

(5) Under this method, credit sales, sales returns, bad debts, discount allowed to debtors, etc. are to be ignored.

(6) Branch Account is prepared to know the correct profit of the branch without being affected by any abnormal loss. Here, abnormal loss at invoice price = ₹ 8,000. To calculate correct profit, ₹ 8,000 is to be credited to Branch Account and loading on such loss of ₹ 1,600 is to be debited to Branch Account. The cost of goods loss ₹ 8,000 – ₹ 1,600 = ₹ 6,400 is to be charged to General Profit and Loss Account.

Stock and Debtors System

Stock and Debtors system is generally used when the goods are sent to the branch at an invoice price and the size of the branch is large. Under this system, the branch maintains a few central accounts to exercise greater control over the branch stock and other related expenses. These accounts usually are: (i) Branch Stock Account; (ii) Branch Debtors Account; (iii) Goods Sent to Branch Account; (iv) Branch Adjustment Account; (v) Branch Cash Account; (vi) Branch Expenses Account; (vii) Branch Profit and Loss Account; and (viii) Branch Fixed Assets Account. The nature and functions of different accounts are given below:

Branch Stock Account : Branch Stock Account is a practical means of controlling stock at branch. This account records the transactions in regard to the stock in the branch at ***invoice price***. The debit side of this account records the inflow of stock into the branch and credit side records its outflow from the branch.

The Branch Stock Account is opened with the opening value of stock at branch and in transit (at invoice price) and debited with the invoice value of goods sent to branch and goods returned by the customers.

This account is credited with the sales (cash and credit) and goods returned to the head office (at invoice price). Ultimately, this account is credited with the closing stock of the branch at invoice price. Sometimes, it is also credited with goods in transit at the end of the year (at invoice price).

Since this account is a statement showing the reconciliation of stock, both the sides should tally and, in effect, this account cannot have any balance. But, this is only a theoretical view. In practice, there are often slight differences — usually deficiencies. For example, it is practically impossible to weigh up exactly 100 separate kg. of butter from one quintal butter slab. In some cases, there may be a surplus for different reasons such as, sale of goods above invoice price and absorption of moisture (in case of sugar, fertiliser, etc.)

In practice, it is usual to make certain allowances in respect of such unavoidable differences. If it is more than normal allowance, enquiries should be made as to the causes of the difference. Shortage/deficiency is recorded on the credit side and surplus is recorded on the debit side.

Important features of Branch Stock Account are as under:

(i) It controls branch stock.
(ii) It is maintained at invoice price.
(iii) Actual stock with the branch is shown as the balance in this account.

The ruling of the Branch Stock Account is given below:

Dr. **Branch Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance b/d:		2014 Dec. 31	By Goods Sent to Branch A/c)	
	at branch			(Returns to H.O.	
	in-transit			By Bank A/c (Cash sales)	
Dec. 31	To Goods Sent to Branch A/c			By Branch Debtors A/c (Credit sales)	
	To Branch Debtors A/c:			By Abnormal Loss by Fire A/c	
	(Returned by customers)			By Shortage in Stock (if any)	
Dec. 31	To Surplus in Stock A/c (if any)			By Balance c/d:	
				at branch	
				in-transit	
2015 Jan. 1	To Balance b/d:				
	at branch				
	in-transit				

Branch Debtors Account : Branch Debtors Account is maintained when the branch is allowed to sell goods on credit. It is used to exercise control over branch debtors. This account records transactions with the branch debtors and is prepared like any Sundry Debtors Account. Opening balance of branch debtors is brought down on the debit side of this account and this account is debited with credit sales at the branch. It is credited with the cash received, discount allowed, sales returns, bad debts, bills receivable, etc. The balance of this account represents the closing balance of debtors.

Dr. **Branch Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance b/d:		2014 Dec. 31	By Bank A/c (Collection)	
Dec. 31	To Branch Stock A/c (Credit sales)			By Branch Expenses A/c:	
				Discount allowed	
				Bad debts	
				By Branch Stock A/c (Returned)	
				By Balance c/d:	
2015 Jan. 1	To Balance b/d:				

Goods Sent to Branch Account : Goods Sent to Branch Account is credited with the invoice price of goods sent to the branch by the head office and transferred from other branches and debited with the invoice price of the goods returned/transferred by the branch. This account is also debited with loading on net goods sent to the branch. The balancing figure on the debit side represents the cost of the net goods sent to the branch which is adjusted against Purchase/Trading Account by the head office. This account cannot have any opening or closing balance.

Dr. **Goods Sent to Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec.31	To Branch Stock A/c (Returns)		2014 Dec. 31	By Branch Stock A/c	
	To Branch Stock A/c (Transfer)			By Branch Stock A/c (Transfer)	

	To Branch Adjustment A/c (Loading) To Purcahses/Trading A/c*				

* For a trader — Purchases Account and for a manufacturer — Trading Account (In the Head Office Book).

Branch Cash Account : Branch Cash Account is prepared with a view to exercise control over the branch cash. This account is generally opened where the branch is allowed to hold cash received from debtors and use it for branch expenses and remit the balance to head office after certain interval. Generally for big branch a separate Cash Account is maintained.

This account is debited with the opening balance of cash, the cash remitted by the head office or the branches and the cash collected from the debtors. It is credited with the branch expenses and amount remitted to head office or other branches. The balance of this account represents the closing cash lying with the branch.

Dr. **Branch Cash Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1 Dec. 31	To Balance b/d: To Bank A/c (Remittance) To Bank A/c (Transfer from other branch)		2014 Dec. 31	By Bank A/c (Remittance to H.O.) By Branch Expenses A/c: By Bank A/c (Transfer to other branch) By balance c/d:	

Branch Expenses Account : Branch Expenses Account records all branch expenses in cash. In addition, this account is debited with the items like bad debts, discount allowed, depreciation on branch fixed assets, etc. The balance of this account is transferred to Branch Profit and Loss Account and, thereby closed. (When no separate Branch Profit and Loss Account is opened, it is closed by transferring to "Branch Adjustment Account")

Dr. **Branch Expenses Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec.31	To Branch Cash A/c (Returns) To Branch Assets A/c (Depreciation) To Branch Debtors A/c Bad debts Discount allowed		2014 Dec. 31	By Branch Profit & Loss A/c	

Branch (Stock) Adjustment Account : Branch Adjustment Account is prepared with a view to ascertain the gross profit of the branch. This account summarises the profit "loading" on all transactions. This account is credited with the "stock reserve" on opening stock and loading on net goods sent to branch. It is credited with the loading on surplus in stock. This account is debited with the loading on shortage- in-stock; spoilage, pilferage, theft, loss by fire, loss in transit and "stock reserve" on closing stock. The balance of this account is transferred to Branch Profit and Loss Account.

Dr. **Branch (Stock) Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec.31	To Shortage in Stock A/c (Loading) To Loss by Fire A/c (Loading) To Loss in transit A/c (Loading) To Loss by Theft A/c (Loading) To Pilferage A/c (Loading) To Stock Reserve A/c* (Loading on closing stock) To Gross Profit c/d		2014 Dec. 31	By Stock Reserve A/c* (Loading on opening stock) By Goods Sent to Branch A/c (Loading on net goods sent) By Surplus in Stock A/c (Loading on surplus) By Gross Loss c/d	

* It may be shown as **By Balance b/d** and **To Balance c/d**.

Branch Profit and Loss Account : Branch Profit and Loss Account is prepared to ascertain the net profit or loss of the branch. This account is credited with the gross profit as ascertained from the Branch Adjustment Account and cost of surplus in stock. This account is debited with the branch expenses and cost of shortage in stock, pilferage, theft, etc. If the credit side is more, it represents net profit, and it is net loss when the debit side is more.

The students should note that the branch profit should not be affected by the abnormal events beyond the control of the branch such as loss by fire, loss in transit etc. The cost of such goods should be charged to General Profit and Loss Account instead of Branch Profit and Loss Account to calculate the correct profit of the branch.

If the nature of the loss is normal (such as spoilage, pilferage, theft, etc.) and if it can be identified with the branch, the cost of such goods should be charged to Branch Profit and Loss Account.

Dr. **Branch Profit and Loss Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec.31	To Branch Expenses A/c To Loss by Theft A/c (Cost) To Shortage in Stock A/c (Cost) To Pilferage A/c (Cost) To General Profit & Loss A/c		2014 Dec. 31	By Gross Profit b/d By Surplus in Stock A/c (Cost)	

Sometimes, a separate Branch Profit and Loss Account is not opened. In that situation, the Branch Adjustment Account will show net profit/loss of the branch. In this case, branch expenses, pilferage (cost + loading), theft (cost + loading), and shortage in stock (cost + loading) are charged to Branch Adjustment Account. Similarly, surplus in stock (cost + loading) is credited to Branch Adjustment Account.

Branch Fixed Assets Account : The head office may maintain separate asset accounts for each fixed asset. This account is debited with the opening value of asset and purchase of an asset, if any. This account is credited with the depreciation provided on the asset. The balance of the account represents the closing value of the asset.

Journal Entries

1. For goods sent to branch

Branch Stock Account Dr. [Invoice Price]
To Goods Sent to Branch Account

2. For goods returned by branch to head office

Goods Sent to Branch Account Dr. [Invoice Price]
To Branch Stock Account

3. For goods received from other branches

Branch Stock Account Dr. [Invoice Price]
To Goods Sent to Branch Account

4. For goods transferred to other branches on advice of head office

Goods Sent to Branch Account Dr. [Invoice Price]
To Branch Stock Account

5. For cash sales

Bank Account Dr. [Actual sales proceeds]
To Branch Stock Account

6. For credit sales

Branch Debtors Account Dr.
To Branch Stock Account

7. For bills accepted by Branch Debtors		
Bills Receivable Account	Dr.	
To Branch Debtors Account		
8. For cash collected from debtors		
Bank Account	Dr.	
To Branch Debtors Account		
9. For bad debts, discount allowed, etc.		
Branch Expenses Account	Dr.	
To Branch Debtors Account		
10. For depreciation on branch fixed assets		
Branch Expenses Account	Dr.	
To Branch Fixed Assets Account		
11. For branch expenses incurred in cash		
Branch Expenses Account	Dr.	
To Cash/Bank Account		
12. For transferring branch expenses to Branch Profit and Loss Account/Branch Adjustment Account		
Branch Profit and Loss Account	Dr.	
Or, Branch Adjustment Account	Dr.	
To Branch Expenses Account		
13. For shortage in stock/pilferage/theft		
(i) Shortage in Stock/Pilferage/Theft Account	Dr.	[Invoice Price]
To Branch Stock Account		
(ii) Branch Adjustment Account	Dr.	[Loading]
Branch Profit and Loss Account	Dr.	[Cost]
To Shortage in Stock/Pilferage/Theft Account		
14. For loss by fire/loss in transit		
(i) Accidental Loss Account	Dr.	[Invoice Price]
To Branch Stock Account		
(ii) Branch Adjustment Account	Dr.	[Loading]
Bank Account (insurance claim received)	Dr.	
Insurance Company (claim yet to receive)	Dr.	
General Profit and Loss Account	Dr.	[Loss]
To Accidental Loss Account		
15. For loading on opening stock including stock in transit at the beginning		
Stock Reserve Account	Dr.	[Loading]
To Branch Adjustment Account		
16. For loading on net goods sent		
Goods Sent to Branch Account	Dr.	[Loading]
To Branch Adjustment Account		
17. For loading on closing stock including stock-in-transit at the end		
Branch Adjustment Account	Dr.	[Loading]
To Stock Reserve Account		
[In the Balance Sheet of head office, the Stock Reserve is shown as a deduction from branch stock at the end]		
18. For transferring gross profit		
(i) Branch Adjustment Account	Dr.	
To Gross Profit Account		
(ii) Gross Profit Account	Dr.	
To Branch Profit and Loss Account		

19. For transferring net profit of the branch
Branch Profit and Loss Account Dr.
To General Profit and Loss Account
(For net loss, reverse entry)

20. For closing Goods Sent to Branch Account
Goods Sent to Branch Account Dr.
To Purchases Account [Trader]
To Trading Account [Manufacturer]

Treatment of Some Typical Items

Normal loss : No treatment is required even if it is given specifically in the examination problem. However, for calculating Branch Closing Stock (when it is not given) normal loss is credited to Branch Stock Account at invoice price. Normal Loss Account is closed by debiting to Branch Adjustment Account.

Pilferage/Theft : In retail trade, pilferage or shoplifting is very common and this has come to be regarded as a normal business loss. The loading of such goods is charged to Branch Adjustment Account and cost is charged to Branch Profit and Loss Account.

Shortage in stock : Shortage in stock may be due to spoilage, leakage, sales in small quantity, etc. Loading on shortage in stock should be charged to Branch Adjustment Account and cost of such goods should be charged to Branch Profit and Loss Account.

Surplus in stock : Loading on surplus in stock is credited to Branch Adjustment Account and cost of such goods is credited to Branch Profit and Loss Account.

Loss by fire/loss-in-transit : Loading on goods lost by fire/in-transit should be charged to Branch Adjustment Account and the cost of such goods should be charged to **General Profit and Loss Account**.

Students should note that the branch profit should not be affected by the abnormal items. Some authors prefer to charge the cost of the goods lost by fire to Branch Profit and Loss Account. But, in our opinion, this practice should not be encouraged because heavy loss due to fire by converting branch profit into branch loss may mislead the management at the time of decision-making.

Inter-branch transfer of goods : Sometimes goods may be transferred by one branch to another branch. At the time of making entry for transferring branch, it should be treated as a transfer to head office (though the goods is actually transferred to a particular branch). Similarly, for receiving branch it will be treated as received from head office.

For the transferring branch, the entry will be:
Goods Sent to Branch Account Dr. [Invoice Price]
To Branch Stock Account

For the receiving branch, the entry will be:
Branch Stock Account Dr. [Invoice Price]
To Goods Sent to Branch Account

Illustration 15

On 1st January, 2014 goods costing ₹ 1,32,000 were invoiced by Madras head office to its new branch at Delhi and charged at selling price to produce a gross profit of 25% on the selling price.

At the end of the year, the return from Delhi Branch showed that the credit sales were ₹ 1,50,000.

Goods invoiced at ₹ 2,000 to Delhi branch have been returned to Madras head office.

The closing stock at Delhi branch was ₹ 24,000 at selling price.

Record the above transactions in the

(i) Delhi Branch Stock Account;
(ii) Goods Sent to Delhi Branch Account;
(iii) Delhi Branch Adjustment Account; and,
(iv) Delhi Branch Debtors Account in the head office book and close the said accounts on 31st December, 2014.

Solution **In the books of the Head Office, Madras**

Dr. **Delhi Branch Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Goods Sent to Delhi Br. A/c	1,76,000	2014 Dec. 31	By Goods Sent to Delhi Br. A/c (Returns)	2,000
				By Branch Debtor A/c (Credit sales)	1,50,000
				By Balance c/d	24,000
		1,76,000			1,76,000

Dr. **Goods Sent to Delhi Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Delhi Branch Stock A/c (Returns)	2,000	2014 Dec. 31	By Delhi Branch Stock A/c	1,76,000
	To Delhi Branch Adjustment A/c (Note 1)	43,500			
	To Purchases A/c (Transferred)	1,30,500			
		1,76,000			1,76,000

Dr. **Delhi Branch Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Delhi Branch Stock A/c	1,50,000	2014 Dec. 31	By Balance c/d	1,50,000

Dr. **Delhi Branch Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Stock Reserve A/c (Note 2)	6,000	2014 Dec. 31	By Goods Sent to Delhi Branch A/c (Note 1)	43,500
	To General Profit & Loss A/c	37,500			
		43,500			43,500

Working Notes:

(1) Total goods sent to Delhi branch at selling price is ₹ 1,76,000. Goods returned to head office at selling price is ₹ 2,000. Net goods sent is ₹ 1,74,000. Loading @ 25% on selling price = 25% of ₹ 1,74,000 = ₹ 43,500.

(2) Value of closing stock at selling price = ₹ 24,000. Loading on closing stock = 25% of ₹ 24,000 = ₹ 6,000.

(3) When no separate Branch Profit and Loss Account is prepared, the Branch Adjustment Account will disclose the branch profit.

Illustration 16

On January 1, 2014, the goods invoiced by Calcutta head office of a trader to its Madras branch were ₹ 48,000 at selling price, being $33^{1}/_{3}$ % on cost price. For six months ending June 30, 2014 the branch return showed that the credit sales were ₹ 29,200. The goods invoiced at ₹ 2,000 were returned by the branch to the head office. The closing stock at Madras branch on June 30, 2014 was ₹ 16,800 at selling price.

Record the above transactions, showing the Madras Branch Stock Account, Madras Branch Adjustment Account and the Goods Sent to Branch Account in Calcutta head office books and balance them on June 30, 2014.

Solution **In the books of the Head Office, Calcutta**

Dr. **Madras Branch Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Goods Sent to Branch A/c	48,000	2014 June 30	By Goods Sent to Branch A/c (Returns)	2,000
				By Branch Debtors A/c	29,200
				By Balance c/d	16,800
		48,000			48,000
July 1	To Balance b/d	16,800			

Dr. **Madras Branch Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 June 30	To Stock Reserve A/c (Note 2)	4,200	2014 June 30	By Goods Sent to Branch A/c (Note 1)	11,500
	To Branch Profit & Loss A/c	7,300			
		11,500			11,500

Dr. **Goods Sent to Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 June 30	To Branch Stock A/c	2,000	2014 Jan. 1	By Branch Stock A/c	48,000
	To Branch Adjustment A/c (Net loading)	11,500			
	To Purchases A/c (Transfer)	34,500			
		48,000			48,000

Working Notes:

(1) Loading on goods sent (net) : Loading in $33^1/_3$ on cost but the given data are related to invoice price. Thus, if cost is ₹ 100, the invoice price will be (₹ 100 + $33^1/_3$) = ₹ $133^1/_3$. Hence, loading on invoice price = $33^1/_3$ / $133^1/_3$ = 1/4 or 25%. Therefore, loading on net goods sent (after return) = 1/4 (₹ 48,000 – ₹ 2,000) = ₹ 11,500.

(2) Loading on Closing stock = 1/4 x ₹ 16,800 = ₹ 4,200.

Tutorial Note: Where no separate Branch Profit and Loss Account is opened, the Branch Adjustment Account will disclose the branch profit or loss.

Illustration 17

B Ltd of Kanpur has a branch in Ambala. Goods sent to branch are invoiced at selling price, i.e., cost plus $33^1/_3$%. From the following particulars, you are required to prepare the Branch Stock Account and Branch Adjustment Account as they would appear in the head office books.

	₹
Stock on 01.04.2014 at invoice price	15,000
Stock on 31.03.2015 at invoice price	12,000
Goods sent to Ambala during the year at invoice price	1,00,000
Sales at branch :	
On Credit	32,000
For Cash	75,000
Returns to head office at invoice price	5,000
Invoice value of goods lost by fire not covered by Insurance	1,000

Solution

In the books of B Ltd., (H.O.)

Ambala Branch Stock Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Apr 1	To Balance b/d	15,000	2015 Mar 31	By Goods Sent to Branch (Returns)	5,000
2015 Mar 31	To Goods Sent to Branch	1,00,000	"	By Cash A/c (Cash Sales)	75,000
"	To Branch Adjustment A/c (Surplus)	10,000	"	By Branch Debtors A/c (Credit Sales)	32,000
			"	By Goods Lost by Fire A/c (Note 4)	1,000
			"	By Balance c/d	12,000
		1,25,000			1,25,000

Ambala Branch Adjustment Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Mar 31	To Goods Sent to Branch A/c (Note 3)	1,250	2014 Apr 1	By Stock Reserve A/c (Note 1)	3,750
"	To Goods Lost by Fire A/c (Note 4)	250	2015 Mar 31	By Goods Sent to Branch A/c (Note 2)	25,000
"	To Stock Reserve A/c (Loading on Closing Stock)	3,000	"	By Branch Stock A/c (Surplus) (Note 6)	10,000
"	To General Profit & Loss A/c (Note 5)	34,250			
		38,750			38,750

Working Notes :

(1) Goods are sent at cost + $33^1/_3$%. Therefore, the loading is 25% of Invoice Price. Loading on opening stock = 25% of ₹ 15,000 = ₹ 3,750.

(2) Loading on goods sent = 25% of ₹ 1,00,000 = ₹ 25,000.

(3) Loading on goods returned = 25% of ₹ 5,000 = ₹ 1,250.

(4) Loading on goods lost by fire = 25% of ₹ 1,000 = ₹ 250.

(5) Cost of goods lost by fire (₹ 1,000 – 250) = ₹ 750 should not be charged to Branch as it is an abnormal loss.

(6) No separate Branch Profit and Loss Account has been asked to prepare. Therefore, entire ***surplus*** has been credited to Branch Adjustment Account.

Illustration 18

BT Ltd. sends goods to the Chennai Branch at cost plus 25% on cost. From the following particulars, you are required to show the Branch Stock Account, Branch Stock Adjustment Account and Branch Profit and Loss Account in the head office books:

Opening stock at branch at invoice price	20,000
Goods sent to branch at invoice price	80,000
Loss-in-transit at invoice price	10,000
Pilferage at invoice price	4,000

Sales	1,22,000
Expenses	32,000
Closing stock at branch at invoice price	24,000
Recovered from insurance company against loss-in-transit	6,000

Solution

In the books of BT Ltd., (H.O.)

Dr. Chennai Branch Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	20,000		By Goods Lost in Transit A/c	10,000
	To Goods Sent to Branch A/c	80,000		By Pilferage A/c	4,000
	To Surplus in Stock A/c	60,000		By Sales A/c	1,22,000
				By Balance c/d	24,000
		1,60,000			1,60,000

Dr. Chennai Branch Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Goods Lost in Transit A/c (Note 3)	2,000		By Stock Reserve A/c	4,000
	To Pilferage A/c (Note 2)	800		(Loading on opening stock)	
	To Stock Reserve A/c	4,800		By Goods Sent to Branch A/c (Loading)	16,000
	To Chennai Branch Profit & Loss A/c	24,400		By Susplus in Stock A/c	12,000
		32,000			32,000

Dr. Chennai Branch Profit and Loss Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Pilferage A/c	3,200		By Surplus in Stock A/c	48,000
	To Branch Expenses A/c	32,000		By Chennai Branch Adjustment A/c	24,400
	To General Profit and Loss A/c (Profit)	37,200			
		74,400			72,400

Dr. Surplus in Stock Account Cr.

Particulars	₹	Particulars	₹
To Chennai Branch Adjustment A/c (Note 1)	12,000	By Chennai Branch Stock A/c	60,000
To Chennai Branch Profit & Loss A/c (Note 1)	48,000		
	60,000		60,000

Working Notes :

(1) Surplus in stock represents excess realisation from sales by selling goods above the fixed price (i.e., cost + 25% profit). When Branch Adjustment Account and Branch Profit and Loss Account are prepared separately, loading on surplus is credited to Branch Adjustment Account and the balance of the surplus is credited to Branch Profit and Loss Account. However, when only Branch Adjustment Account is prepared, the entire surplus is credited to Branch Adjustment Account ***(See Illustration 17)***.

(2) Loading on pilferage = 25% of ₹ 4,000 = ₹ 1,000. The loading is charged to Branch Adjustment Account. The cost of goods pilfered ₹ 3,000 (₹ 4,000 – ₹ 1,000), however, is to be charged to Branch Profit and Loss Account. Generally, pilferage is treated as ***normal loss*** and that is why it is charged to Branch Profit and Loss Account [Not General Profit and Loss Account].

(3) Loading on goods lost-in-transit = 25% of ₹ 10,000 = ₹ 2,500. The loading on goods lost-in-transit is charged to Branch Adjustment Account. The net cost of goods lost in transit ₹ 2,000 (Note 4) should be charged to General Profit and Loss Account being abnormal in nature.

Dr. (4) Goods Lost-in-Transit Account Cr.

Particulars	₹	Particulars	₹
To Chennai Branch Stock A/c	10,000	By Chennai Branch Adjustment A/c (Loading)	2,000
		By Bank A/c (claim received)	6,000
		By General Profit and Loss A/c	2,000
	10,000		10,000

Illustration 19

Ram Limited of Chennai has a branch at Nagpur to which office, goods are invoiced at cost plus 25%. The branch makes sales both by cash and on credit. Branch expenses are paid direct from Head Office and the branch has to remit all cash received into the Head Office Bank Account at Nagpur.

From the following details, relating to the year 2014, prepare the accounts in Head Office Ledger and ascertain Branch Profit as per stock and debtors method. Branch does not maintain any books of accounts, but sends weekly returns to head office :

Particulars	₹
Goods Received from Head Office at invoice price	1,20,000
Returns to Head Office at invoice price	2,400
Stock at Nagpur Branch on 1.1.2014 at invoice price	12,000
Sales during the year — Cash	40,000
Credit	72,000
Debtors at Nagpur branch as at 1.1.2014	14,400
Cash received from Debtors	64,000
Discounts allowed to Debtors	1,200
Bad Debts during the year	800
Sales Returns at Nagpur branch	1,600
Salaries and Wages at Branch	12,000
Rent, Rates and Taxes at Branch	3,600
Office Expenses at Nagpur Branch	1,200
Stock at Branch on 31.12.2014 at invoice price	24,000

Solution

In the books of Ram Limited (H.O.)

Dr. Nagpur Branch Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Jan. 1	To Balance b/d	12,000	Dec. 31	By Bank A/c (Cash Sales)	40,000
Dec. 31	To Goods Sent to Branch A/c	1,20,000		By Branch Debtors A/c (Credit Sales)	72,000
	To Branch Debtors A/c (Returns by customers)	1,600		By Goods Sent to Branch A/c (Return by branch)	2,400
	To Branch Adjustment A/c (Surplus over Invoice Price)	4,800		By Balance c/d	24,000
		1,38,400			1,38,400

Dr. Nagpur Branch Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Dec. 31	To Stock Reserve A/c (Note 3)	4,800	Jan. 1	By Stock Reserve A/c (Note 1)	2,400
	To Gross Profit c/d (Transferred to Branch P/L Account)	25,920	Dec. 31	By Goods Sent to Branch A/c (Note 2)	23,520
				By Branch Stock A/c (Surplus)	4,800
		30,720			30,720

Dr. Nagpur Branch Profit and Loss Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014	To Branch Expenses A/c	18,800	2014	By Gross Profit b/d	25,920
Dec. 31	To General Profit and Loss A/c	7,120	Dec. 31		
		25,920			25,920

Dr. Nagpur Branch Expenses Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Dec. 1	To Bank A/c (Rent)	3,600	Dec. 31	By Branch Profit and Loss A/c	18,800
	To Bank A/c (Salaries)	12,000			
	To Bank A/c (Office expenses)	1,200			
	To Branch Debtors A/c (Bad Debts)	800			
	To Branch Debtors A/c (Discount Allowed)	1,200			
		18,800			18,800

Dr. **Nagpur Branch Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Jan. 1	To Balance b/d	14,400	Dec. 31	By Branch Stock A/c	1,600
	To Branch Stock A/c (Credit Sales)	72,000		(Return by customers)	
				By Bank A/c	64,000
				By Branch Expenses A/c	2,000
				(Bad Debts and Discount)	
				By Balance c/d	18,800
		86,400			86,400

Dr. **Goods Sent to Nagpur Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014	To Branch Stock A/c (Returned)	2,400	2014	By Branch Stock A/c	
Dec. 31	To Branch Adjustment A/c (Loading)	23,520	Dec. 31	(Goods Sent to Branch)	1,20,000
	To Purchases A/c	94,080			
		1,20,000			1,20,000

Working Notes :

(1) Stock Reserve on Opening Stock : Loading is 25% of cost, i.e., 20% of invoice price. Therefore, loading on opening stock = 20% of ₹ 12,000 = ₹ **2,400**.

(2) Loading on Goods Sent to Branch : 20% of ₹ 1,17,600 (₹ 1,20,000 – 2,400) = ₹ **23,520**.

(3) Loading on Closing Stock = 20% of ₹ 24,000 = ₹ **4,800**.

Illustration 20

X Ltd. of Calcutta has a branch at Delhi. Goods are invoiced to the branches at cost plus $33^1/_3$%. The branch remits all cash received to the head office and all expenses are paid by the head office. From the following particulars prepare Branch Stock Account, Branch Adjustment Account, Branch Debtors' Account and Branch Profit and Loss Account in the books of the head office (all figures in ₹) :

Branch Debtors on 1.1.2014	6,000	Cash received from Debtors	57,600
Branch Stock on 1.1.2014 (Invoice price)	2,400	Discount allowed to Debtors	1,400
Sales : Cash	3,000	Bad debts	300
Credit	60,000	Branch expenses paid by H.O.	15,000
Goods from head office (Invoice price)	72,000	Branch stock on 31.12.2014 (Invoice price)	11,400

Solution **In the books of X Ltd., (H.O.)**

Dr. **Branch Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance b/d	2,400	2014 Dec. 31	By Bank A/c (Cash sales)	3,000
Dec. 31	To Goods Sent to Branch A/c	72,000		By Branch Debtors A/c	60,000
				By Balance c/d	11,400
		74,400			74,400

Dr. **Branch Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Stock Reserve A/c (Note 3)	2,850	2014 Dec. 31	By Stock Reserve A/c (Note 1)	600
	To Gross Profit c/d	15,750		By Goods Sent to Branch A/c (Note 2)	18,000
	(Transferred to Branch Profit & Loss A/c)				
		18,600			18,600

Dr. **Branch Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance b/d	6,000	2014 Dec. 31	By Bank A/c	57,600
				By Branch Expenses A/c :	
				Discount allowed	1,400
				Bad debts	300
Dec. 31	To Branch Stock A/c	60,000		By Balance c/d	6,700
		66,000			66,000

Dr. Branch Profit & Loss Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Branch Expenses A/c:		2014 Dec. 31	By Gross Profit b/d	15,750
	Discount allowed	1,400		By General Profit & Loss A/c (Loss)	950
	Bad debts	300			
	Cash expenses	15,000			
		16,700			16,700

Working Notes:

(1) Stock reserve on opening stock : Loading is $33^1/_3$ on cost, i.e., $33^1/_3$ %/ $133^1/_3$ % or 1/4 of invoice price. Therefore, loading on opening stock = 1/4 x ₹ 2,400 = ₹ 600.

(2) Loading on goods sent : 1/4 of ₹ 72,000 = ₹ 18,000. **(3) Loading on closing stock** : 1/4 of ₹ 11,400 = ₹ 2,850.

Turotial Note: When a separate Branch Profit and Loss Account is opened, Branch Adjustment Account will show gross profit and Branch Profit and Loss Account will show net profit of the branch.

Illustration 21

A Calcutta firm has a retail branch at Dhanbad. All goods are supplied to the branch by the head office which invoices the goods at the selling price which is calculated at cost plus 25 per cent. All expenses incurred by the branch are paid out of an imprest account of ₹ 10,000 which is replenished by the head office every week. All collections by the branch are banked intact to the credit of the head office. The branch maintains no books of account except a memorandum debtors ledger. Physical verification of stock at the branch is done annually and the difference between the actual stock and the book balance is adjusted. (figures in ₹)

Branch Debtors A/c (Jan. 1)	25,000	Cash collections at Br. (including cash sales of ₹ 85,000)	2,85,000
Branch Stock A/c (at Invoice value — Jan. 1)	80,000	Discounts allowed to debtors	10,000
Cash at Branch	10,000	Credit sales at Branch	2,40,000
Goods sent to Branch (at Invoice value)	3,00,000	Amount sent to Branch for expenses	36,000

As at 31st December, 2014, the branch had cash on hand representing unspent imprest of ₹ 8,000. The stock on hand on 31st December, 2014 valued at invoice value was ₹ 43,000.

Prepare the following accounts as appearing in the books of the head office: (a) Branch Stock Account; (b) Branch Adjustment Account; (c) Branch Debtors Account; and, (d) Branch Profit and Loss Account.

Solution

In the books of Head Offce (Calcutta)

Dr. Branch Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance b/d	80,000	2014 Dec. 31	By Bank A/c (Cash sales)	85,000
Dec. 31	To Goods Sent to Branch A/c	3,00,000		By Branch Debtors A/c	2,40,000
				By Shortage in Stock A/c	12,000
				By Balance c/d	43,000
		3,80,000			3,80,000

Dr. Branch Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Stock Reserve A/c (Note 6)	8,600	2014 Dec. 31	By Stock Reserve A/c (Note 4)	16,000
	To Shortage in Stock A/c (Note 3)	2,400		By Goods Sent to Branch A/c (Note 5)	60,000
	To Gross Profit c/d	65,000			
		76,000			76,000

Dr. Branch Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance b/d	25,000	2014 Dec. 31	By Bank A/c ₹ (2,85,000 – 85,000)	2,00,000
Dec. 31	To Branch Stock A/c	2,40,000		By Br. Expenses A/c (Discount allowed)	10,000
				By Balance c/d	55,000
		2,65,000			2,65,000

Dr. Branch Profit and Loss Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Branch Expenses A/c (Note 1)	48,000	2014 Dec. 31	By Gross Profit b/d	65,000
	To Shortage in Stock A/c (Note 3)	9,600			
	To General Profit & Loss A/c	7,400			
		65,000			65,000

Working Notes:

(1) Branch Expenses Account

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Branch Debtors A/c	10,000	2014 Dec. 31	By Branch P/L A/c	48,000
	To Branch Petty Cash A/c	38,000			
		48,000			48,000

(2) Branch Petty Cash Account

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance b/d	10,000	2014 Dec. 31	By Branch Expenses A/c (Balancing figure)	38,000
Dec. 31	To Bank A/c (Remittance for expenses)	36,000		By Balance c/d	8,000
		46,000			46,000

(3) Shortage in Stock Account

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Branch Stock A/c	12,000	2014 Dec. 31	By Branch Adjustment A/c (Loading)	2,400
				By Branch Profit & Loss A/c (Cost)	9,600
		12,000			12,000

Tutorial Note: Shortage in stock may be due to different reasons, e.g., shoplifting, normal loss, etc. Loading on shortage in stock (1/5 of ₹ 12,000 = ₹ 2,400) is to be charged to Branch Adjustment Account and cost of shortage (4/5 of ₹ 12,000 = ₹ 9,600) is to be charged to Branch Profit and Loss Account assuming that it is normal in nature.

(4) Loading on opening stock is 1/5 of ₹ 80,000 = ₹ 16,000.

(5) Loading on goods sent to branch is 1/5 of ₹ 3,00,000 = ₹ 60,000.

(6) Loading on closing stock = 1/5 of ₹ 43,000 = ₹ 8,600.

Illustration 22

Maruti Ltd. has a branch at Lucknow. Goods are invoiced from head office at cost plus 50%. Branch remits all cash received to head office and all expenses are met by head office.

Prepare (i) Lucknow Branch Account; (ii) Surplus in Stock Account; (iii) Lucknow Branch Debtors Account; (iv) Goods Sent to Branch Account; (v) Stock Reserve Account; (vi) Lucknow Branch Adjustment Account; (vii) Lucknow Branch Expenses Account; and, (viii) Lucknow Branch Profit and Loss Account in the books of Maruti Ltd. under Stock and Debtors system to show profit earned at the branch from the following: (all figures in ₹)

Stock on 1st April 2014 (Invoice price)	15,600	Cash collected from Debtors	29,800
Debtors on 1st April 2014	8,700	Goods returned by Debtors	1,500
Goods invoiced at cost during the year	36,000	Surplus in stock (Invoice price)	300
Sales at Branch : Cash sales	35,000	Discount allowed by Debtors	350
Credit sales	30,100	Expenses at Branch	6,700

Solution

In the books of Maruti Ltd.

Lucknow Branch Stock Account

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d	15,600	31.3.2015	By Bank A/c (Cash sales)	35,000
31.3.2015	To Goods Sent to Branch A/c (Note 1)	54,000		By Lucknow Br. Debtors A/c (Credit sales)	30,100
	To Lucknow Br. Debtors A/c (Returns)	1,500		By Balance c/d	6,300
	To Surplus in Stock A/c	300			
		71,400			71,400

Surplus in Stock Account

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Branch Adjustment A/c (Loading)	100	31.3.2015	By Lucknow Br. Stock A/c	300
	To Branch Profit & Loss A/c (Cost)	200			
		300			300

Dr. **Lucknow Branch Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d	8,700	31.3.2015	By Bank A/c	29,800
31.3.2015	To Lucknow Br. Stock A/c (Credit sales)	30,100		By Lucknow Br. Stock A/c (Sales returns)	1,500
				By Br. Expenses A/c (Discount allowed)	350
				By Balance c/d	7,150
		38,800			38,800

Dr. **Goods Sent to Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Branch Adjustment A/c (Note 1)	18,000	31.3.2015	By Lucknow Br. Stock A/c	54,000
	To Purchases A/c (Transferred)	36,000			
		54,000			54,000

Dr. **Stock Reserve Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Branch Adjustment A/c (Transferred)	5,200	1.4.2014	By Balance b/d (Loading on opening stock)	5,200
	To Balance c/d	2,100	31.3.2015	By Branch Adjustment A/c (Loading on closing stock)	2,100
		7,300			7,300

Dr. **Lucknow Branch Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Stock Reserve A/c (Loading on closing stock)	2,100	31.3.2015	By Stock Reserve A/c (Loading on opening stock)	5,200
	To Gross Profit c/d (Transferred to Branch A/c)	21,200		By Goods Sent to Branch A/c (Loading on goods sent)	18,000
				By Surplus in Stock A/c (Loading)	100
		23,300			23,300

Dr. **Lucknow Branch Expenses Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Bank A/c	6,700	31.3.2015	By Lucknow Branch Profit & Loss A/c	7,050
	To Lucknow Branch Debtors A/c (Discount allowed)	350			
		7,050			7,050

Dr. **Lucknow Branch Profit and Loss Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Sundry Expenses	7,050	31.3.2015	By Gross Profit b/d	21,200
	To Net Profit (Transferred to General Profit & Loss A/c)	14,350		By Surplus in Stock A/c	200
		21,400			21,400

Working Notes:

(1) Invoice Price of Goods Sent	₹
Cost of goods sent	36,000
Add: Loading 50% of cost	18,000
	54,000

(2) Loading on Opening Stock

Loading is 50% of cost, i.e., 50/150 or 1/3 of invoice price. Therefore, loading on opening stock = ₹ 15,600/3 = ₹ 5,200.

(3) Loading on Closing Stock = 1/3 of ₹ 6,300 = ₹ 2,100.

Tutorial Note: "Loading" of surplus in stock (₹ 100) is to be credited to Branch Adjustment Account and "Cost" of surplus in stock (₹ 200) is to be credited to Branch Profit and Loss Account.

Illustration 23

Red and Co. of Mumbai started a branch at Bangalore on 1.4.2014 to which goods were sent at 20% above cost. The branch makes both cash sales and credit sales. Branch expenses are met from branch cash and balance money returned to H.O. The branch does not maintain double entry books of account and necessary accounts relating to branch are maintained by H.O. Following further details are given for the year ending on 31.3.2015:

	₹
Cost of Goods Sent to Branch	1,00,000
Goods Received by Branch till 31.3.2015 at invoice price	1,08,000
Credit Sales for the year	1,16,000
Closing Debtors on 31.3.2015	41,600
Bad Debts written off during the year	400
Cash remitted to H.O.	86,000
Closing Cash on Hand at Branch on 31.3.2015	4,000
Cash Remitted by H.O. to Branch during the year	6,000
Closing Stock in Hand at Branch at invoice price	12,000
Expenses incurred at Branch	24,000

Draw up the necessary ledger accounts like Branch Debtors Account, Branch Stock Account, Goods Sent to Branch Account, Branch Cash Account, Branch Expenses Account and Branch Adjustment Account for ascertaining gross profit and Branch Profit and Loss Account for ascertaining branch profit.

Solution **In the books of Red and Co.**

Dr. **Branch Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Mar 31	To Branch Stock A/c	1,16,000	2015 Mar 31	By Branch Cash A/c (Balancing figure)	74,000
				By Bad Debts	400
				By Balance c/d	41,600
		1,16,000			1,16,000

Dr. **Branch Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Mar 31	To Goods Sent to Branch A/c	1,20,000	2015 Mar 31	By Branch Debtors A/c	1,16,000
	To Branch Adjustment A/c (Note 3)	54,000		By Branch Cash A/c	34,000
				By Goods in Transit (Note 2)	12,000
				By Balance c/d	12,000
		1,74,000			1,74,000

Dr. **Goods Sent to Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Mar 31	To Branch Adjustment A/c (Note 1)	20,000	2015 Mar 31	By Branch Stock A/c	1,20,000
"	By Purchases / Trading A/c	1,00,000			
		1,20,000			1,20,000

Dr. **Branch Cash Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Mar 31	To Debtors A/c	74,000	2015 Mar 31	By Branch Expenses A/c	24,000
"	To H.O. (Remittance from H.O.)	6,000	"	By H.O. (Cash remitted)	86,000
"	To Branch Stock A/c		"	By Balance c/d	4,000
	(Cash Sales — Balancing figure)	34,000			
		1,14,000			1,14,000

Dr. **Branch Expenses Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Mar 31	To Branch Cash A/c	24,000	2015 Mar 31	By Branch Profit and Loss A/c	24,400
"	To Bad Debts A/c	400			
		24,400			24,400

Dr. **Branch Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Mar 31	To Stock Reserve A/c :		2015 Mar 31	By Goods Sent to Branch A/c (Note 1)	20,000
	in Hand (Note 4)	2,000	"	By Branch Stock A/c (Note 3)	54,000
	in Transit (Note 5)	2,000			
"	To Branch Profit and Loss A/c	70,000			
		74,000			74,000

Dr. **Branch Profit and Loss Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015 Mar 31	To Branch Expenses A/c	24,400	2015 Mar 31	By Branch Adjustment A/c	70,000
"	To General Profit and Loss A/c	45,600			
		70,000			70,000

Working Notes :

(1) Loading on Goods Sent = ₹ 1,20,000 – ₹ 1,00,000 = ₹ 20,000.

(2) Goods in Transit = Invoice Price of goods sent – Invoice price of goods received by the branch
= ₹ 1,20,000 – ₹ 1,08,000 = ₹ 12,000 (at invoice price).

(3) Surplus in Branch Stock Account represents excess price realisation over and above the invoice price.

(4) Loading on closing stock = 1/6 of ₹ 12,000 = ₹ 2,000.

(5) Loading on goods in transit = 1/6 of ₹ 12,000 = ₹ 2,000.

Illustration 24

Eastern Chemicals Ltd. has two branches at Bombay and Nagpur. Goods are invoiced to branches at cost plus 50%. Branches remit all cash received to the head office and all expenses are also met by head office. From the following particulars, prepare (i) Branch Stock Account; (ii) Branch Stock Adjustment Account; (iii) Branch Debtors Account; (iv) Goods Sent to Branch Account; and, (v) Branch Profit and Loss Account for the year ended 31.12.2014:

	Bombay (₹)	Nagpur (₹)		Bombay (₹)	Nagpur (₹)
Stock on 1.1.2014 (Invoice price)	18,600	31,200	Goods returned to head office	3,000	—
Debtors on 1.1.2014	13,600	17,400	Transfer from Nagpur to Bombay	4,200	4,200
Goods invoiced (Cost price)	68,000	72,000	Shortage of stock	900	—
Cash sales	50,020	70,000	Surplus in stock	—	600
Credit sales	62,000	60,200	Discount allowed to customers	400	700
Collections from debtors	60,800	59,600	Expenses at branches	10,800	13,400
Returns from debtors	2,400	3,000			

Solution **In the books of Eastern Chemicals Ltd.**

Dr. **Branch Stock Accounts** **Cr.**

Date	Particulars	Bombay	Nagpur	Date	Particulars	Bombay	Nagpur
2014 Jan. 1	To Balance b/d	18,600	31,200	2014 Dec. 31	By Bank A/c (Cash sales)	50,020	70,000
Dec. 31	To Goods Sent to Branch A/c	1,02,000	1,08,000		By Branch Debtors A/c	62,000	60,200
	To Branch Debtors A/c	2,400	3,000		By Goods Sent to Br. A/c (Returns)	3,000	—
	To Goods Sent to Branch A/c (Transfer)	4,200	—		By Goods Sent to Branch A/c (Transfer)	—	4,200
	To Surplus in Stock A/c	—	600		By Shortage in Stock A/c	900	—
					By Balance c/d	11,280	8,400
		1,27,200	1,42,800			1,27,200	1,42,800

Dr. **Branch Stock Adjustment Accounts** **Cr.**

Date	Particulars	Bombay	Nagpur	Date	Particulars	Bombay	Nagpur
2014 Dec. 31	To Shortage in Stock A/c (Note 1)	300	—	2014 Dec. 31	By Stock Reserve A/c	6,200	10,400
	To Stock Reserve A/c	3,760	2,800		By Goods sent to Br. A/c (Note 3)	34,400	34,600
	To Gross Profit c/d	36,540	42,400		By Surplus in Stock A/c (Note 2)	—	200
		40,600	45,200			40,600	45,200

Dr. **Branch Debtors Account** **Cr.**

Date	Particulars	Bombay	Nagpur	Date	Particulars	Bombay	Nagpur
2014 Jan. 1	To Balance b/d	13,600	17,400	2014 Dec. 31	By Bank A/c	60,800	59,600
?	To Branch Stock A/c	62,000	60,200		By Branch Stock A/c	2,400	3,000
					By Branch Exp. A/c (Disc. allowed)	400	700
					By Balance c/d	12,000	14,300
		75,600	77,600			75,600	77,600

Dr. **Goods Sent to Branch Accounts** **Cr.**

Date	Particulars	Bombay	Nagpur	Date	Particulars	Bombay	Nagpur
2014 Dec. 31	To Branch Stock A/c	3,000	—	2014 Dec. 31	By Branch Stock A/c	1,02,000	1,08,000
	To Branch Stock A/c (Transfer)	—	4,200		By Branch Stock A/c (Transfer)	4,200	—

	To Branch Stock Adj. A/c (Note 3)	34,400	34,600				
	To Purchases A/c (Transfer)	68,800	69,200				
		1,06,200	1,08,000			1,06,200	1,08,000

Dr. Branch Profit & Loss Accounts Cr.

Date	Particulars	Bombay	Nagpur	Date	Particulars	Bombay	Nagpur
2014 Dec. 31	To Branch Expenses A/c (Note 4)	11,200	14,100	2014 Dec. 31	By Gross Profit b/d	36,540	42,400
	To Shortage-in-stock A/c	600	—		By Surplus in Stock A/c	—	400
	To General Profit & Loss A/c	24,740	28,700				
		36,540	42,800			36,540	42,800

Working Notes :

Dr. (1) Shortage in Stock Accounts Cr.

Date	Particulars	Bombay	Nagpur	Date	Particulars	Bombay	Nagpur
2014 Dec. 31	To Branch Stock A/c	900	—	2014 Dec. 31	By Branch Stock Adjustment A/c	300	—
					By Branch Profit & Loss A/c	600	—
		900	—			900	—

Dr. (2) Surplus in Stock Account Cr.

Date	Particulars	Bombay	Nagpur	Date	Particulars	Bombay	Nagpur
2014 Dec. 31	To Branch Stock Adjustment A/c	—	200	2014 Dec. 31	By Branch Stock A/c	—	600
	To Branch Profit & Loss A/c	—	400				
		—	600			—	600

(3) **Loading on net goods sent including transfer to Bombay branch**: Goods sent to branch (direct) ₹ 1,02,000 plus goods received from Nagpur ₹ 4,200 Less goods returned to head office ₹ 3,000. Therefore, net goods sent = ₹ 1,03,200. Loading is 1/3 of ₹ 1,03,200 = ₹ 34,400.
Nagpur Branch: Goods sent to branch directly ₹ 1,08,000 less goods transferred to Bombay ₹ 4,200. Therefore, net goods sent to branch = ₹ 1,03,800. Loading is 1/3 of ₹ 1,03,800 = ₹ 34,600.

(4) **Branch expenses** : Total branch expenses are actual expenses plus discount allowed, i.e., ₹ 10,800 + ₹ 900 = ₹ 11,200 for Bombay Branch and ₹ 13,400 + ₹ 700 = ₹ 14,100 for Nagpur Branch.

Tutorial Note: In case of transfer of goods between the branches, the sending branch will treat the transfer 'as if returned to head office' and receiving branch will treat that 'as if received from H.O.'

Illustration 25

A Company with its head office at Calcutta has a branch at New Delhi. Goods are invoiced to the branch at cost plus $33^1/_3$%, which is the selling price. The following information is given in respect of the branch for the year ended 31st March, 2015:

	₹		₹
Goods Sent to branch (Invoice value)	4,80,000	Discount allowed	1,000
Stock at branch (1.4.2014) at selling price	24,000	Bad debts	1,500
Cash sales	1,80,000	Stock at branch (31.3.2015) at selling price	48,000
Returns from Debtors	6,000	Branch Debtors' balance (31.3.2015)	36,500
Branch expenses paid for cash	53,500	Collections from Debtors	2,70,000
Branch Debtors' balance (1.4.2014)	30,000	Branch Debtors' cheques returned dishonoured	5,000

You are required to prepare the Branch Stock Account, Branch Debtors' Account and the Branch Adjustment Account to reveal the profit of the branch for the year 2014-15.

Solution

In the books of Head Office, Calcutta

Dr. New Delhi Branch Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d	24,000	31.3.2015	By Bank A/c (cash sales)	1,80,000
31.3.2015	To Goods Sent to Branch A/c	4,80,000		By New Delhi Branch Debtors A/c (Note 1)	2,80,000
	To New Delhi Br. Debtors A/c (Returns)	6,000		By Shortage-in-stock A/c (Balancing figure)	2,000
				By Balance c/d	48,000
		5,10,000			5,10,000

Dr. **New Delhi Branch Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d	30,000	31.3.2015	By Bank A/c (Collection)	2,70,000
31.3.2015	To Bank A/c (Dishonour of cheques)	5,000		By New Delhi Branch Stock A/c	6,000
	To New Delhi Branch Stock A/c (Note 1)	2,80,000		By New Delhi Branch A/c:	
				Bad debt ₹ 1,500	
				Discount allowed ₹ 1,000	2,500
				By Balance c/d	36,500
		3,15,000			3,15,000

Dr. **New Delhi Branch Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Branch Expenses A/c (Note 4)	56,000	1.4.2014	By Stock Reserve A/c (Note 2)	6,000
	To Shortage-in-stock A/c (Note 5)	2,000		By Goods Sent to Branch A/c (Note 3)	1,20,000
	To Stock Reserve A/c (Note 6)	12,000			
	To Net Profit (Trans. to General P & L A/c)	56,000			
		1,26,000			1,26,000

Working Notes:

(1) Credit sales have not been given in the problem. So, the balancing figure of Branch Debtors Account is to be taken as credit sales.

(2) Loading is $33^1/_3$ on cost, i.e., $33^1/_3\%/\ 133^1/_3$ % or 1/4 on invoice value. Therefore, loading on opening stock is ₹ 24,000/4 = ₹ 6,000.

(3) Loading on goods sent = ₹ 4,80,000/4 = ₹ 1,20,000.

(4) Total branch expenses = Cash expenses are ₹ 53,500 + Bad Debts ₹ 1,500 + Discount allowed ₹ 1,000 = ₹ 56,000.

(5) When no separate Branch Profit and Loss Account is prepared, the entire amount of shortage or surplus in stock is transferred to Branch Adjustment Account.
If the Branch Adjustment Account and Branch Profit and Loss Account are prepared separately, the loading on shortage/surplus is transferred to Branch Adjustment Account and cost is transferred to Branch Profit and Loss Account.

(6) Loading on closing stock = ₹ 48,000/4 = ₹ 12,000.

Illustration 26

X Ltd. has a retail branch at Allahabad. Goods are sent by the H.O. to the branch marked at selling price which is cost *plus* 25%. All the expenses of the branch are paid by the H.O. All cash collected by the branch (from customers and cash sales) is deposited to the credit of H.O. Account.

From the following particulars of the branch, prepare Branch Stock Account, Branch Debtors Account, Branch Expenses Account and Branch Adjustment Account in the books of the H.O.: (all figures in ₹)

Debtors on 1.1.2014	12,000	Goods returned to H.O. at Invoice Price	5,000
Debtors on 31.12.2014	14,000	Salaries paid	6,000
Inventory with Branch at Invoice Price on 1.1.2014	16,000	Rent paid	4,000
Inventory with Branch at Invoice Price on 31.12.2014	17,000	Discount allowed to customers	2,000
Cash sales during the year	60,000	Bad debts written-off	1,000
Amount deposited in the H.O. A/c during the year	1,27,000	Spoilage at Invoice price	2,000

Solution

In this problem, credit sales and goods sent to branch are missing. Therefore, the balancing figure of Branch Debtors Account will be treated as credit sales and the balancing figure of Branch Stock Account will be treated as goods sent to branch.

In the books of X Ltd. (H.O.)

Dr. **Branch Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance b/d	16,000	2014 Dec. 31	By Cash A/c (cash sales)	60,000
Dec. 31	To Goods Sent to Branch A/c (Note 2)	1,40,000		By Goods Sent to Branch A/c (Returns)	5,000
				By Branch Debtors A/c (Credit sales)	72,000
				By Spoilage A/c	2,000
				By Balance c/d	17,000
		1,56,000			1,56,000

Dr. **Branch Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance b/d	12,000	2014 Dec. 31	By Bank A/c (Note 1)	67,000
Dec. 31	To Branch Stock A/c (Balancing figure)	72,000		By Discount Allowed A/c	2,000
				By Bad Debts A/c	1,000
				By Balance c/d	14,000
		84,000			84,000

Dr. **Branch Expenses Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Cash A/c (Rent + Salaries)	10,000	2014 Dec. 31	By Branch Profit & Loss A/c	13,000
	To Discount Allowed A/c	2,000			
	To Bad Debts A/c	1,000			
		13,000			13,000

Dr. **Branch Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Spoilage A/c (Note 3)	400	2014 Dec. 31	By Stock Reserve A/c	3,200
	To Stock Reserve A/c	3,400		By Goods Sent to Branch A/c (Note 2)	27,000
	To Branch Profit & Loss A/c	26,400			
		30,200			30,200

Dr. **Branch Profit & Loss Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Branch Expenses A/c	13,000	2014 Dec. 31	By Branch Adjustment A/c	26,400
	To Spoilage A/c (Cost)	1,600			
	To General Profit & Loss A/c	11,800			
		26,400			26,400

Working Notes:

(1) Total amount deposited in H.O. Account is ₹ 1,27,000 but it includes ₹ 60,000 for cash sales. Therefore, amount collected from debtors = ₹ 1,27,000 – ₹ 60,000 = ₹ 67,000.

(2) Goods sent to branch have not been given. The balancing figure of Branch Stock Account will be treated as goods sent to branch. Total goods sent to branch = ₹ 1,40,000. ₹ 5,000 (at invoice price) has been returned to head office. Loading on net goods sent = 1/5 of ₹ 1,35,000 = ₹ 27,000.

(3) **Loading on spoilage** ₹ 400 is to be debited to Branch Adjustment Account and the balance amount ₹ 2,000 – ₹ 400 = ₹ 1,600 is to be charged to Branch Profit and Loss Account.

(4) **Loading on opening stock** = 1/5 of ₹ 16,000 = ₹ 3,200; **Loading on closing stock** = 1/5 of ₹ 17,000 = ₹ 3,400.

Illustration 27

Multichained Stores Ltd., Delhi has its branches at Lucknow and Madras. It charges goods to its branches at cost plus 25%. Following information is available of the transactions of the Lucknow branch for the year ended on 31st March, 2015.

Balances on 1.4.2014: Stock ₹ 30,000; Debtors ₹ 10,000 and Petty Cash ₹ 50.

Transactions during 2014-15 (Lucknow branch) (all figures in ₹) :

Goods sent to Lucknow branch at Invoice price	3,25,000	Cash sent for Petty expenses	34,000
Goods returned to Head Office at Invoice price	10,000	Bad debts at Branch	500
Cash sales	1,00,000	Goods transferred to Madras branch under H.O. advice	15,000
Credit sales	1,75,000	Insurance charges paid by H.O.	500
Goods pilferred (Invoice price)	2,000	Goods returned by Debtors	500
Goods lost in fire (Invoice price)	5,000	Insurance Co. paid to H.O. for loss by fire at Lucknow	3,000

Balances on 31.3.2015: Petty Cash ₹ 230; Debtors ₹ 14,000. Goods worth ₹ 15,000 (included above) sent by Lucknow branch to Madras branch was in transit on 31.3.2015. Show the following accounts in the books of Multichained Stores Ltd. : (a) Lucknow Branch Stock Account; (b) Lucknow Branch Debtors Account; (c) Lucknow Branch Adjustment Account; (d) Lucknow Branch Profit and Loss Account; (e) Stock Reserve Account; and, (f) Goods Sent to Lucknow Branch Account.

Solution In the books of Multichained Stores Ltd.

Dr. **Lucknow Branch Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d	30,000	31.3.2015	By Goods sent to Lucknow Br. A/c (Returns)	10,000
31.3.2015	To Goods Sent to Lucknow Branch A/c	3,25,000		By Bank A/c (Cash sales)	1,00,000
	To Lucknow Branch Debtors A/c (Returns)	500		By Goods Pilferred A/c	2,000
				By Goods Lost by Fire A/c	5,000
				By Goods Sent to Lucknow Br. A/c (Transfer)	15,000
				By Lucknow Branch Debtors A/c	1,75,000
				By Balance c/d	48,500
		3,55,500			3,55,500

Dr. **Lucknow Branch Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d	10,000	31.3.2015	By Bad Debts A/c	500
31.3.2015	To Lucknow Branch Stock A/c	1,75,000		By Bank A/c (Bal. fig.) (coll. from debtors)	1,70,000
				By Lucknow Branch Stock A/c (Returns)	500
				By Balance c/d	14,000
		1,85,000			1,85,000

Dr. **Lucknow Branch Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Goods Pilferred A/c	400	31.3.2015	By Stock Reserve A/c	6,000
	To Goods Lost by Fire A/c	1,000		By Goods Sent to Branch A/c (Note 5)	60,000
	To Stock Reserve A/c	9,700			
	To Gross Profit c/d	54,900			
		66,000			66,000

Dr. **Lucknow Branch Profit & Loss Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Goods Pilferred A/c	1,600	31.3.2015	By Gross Profit b/d	54,900
	To Branch Expenses A/c	34,820			
	To General Profit & Loss A/c (Note 6)	18,480			
		54,900			54,900

Dr. **Stock Reserve Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Lucknow Branch Adjustment A/c	6,000	1.4.2014	By Balance c/d	6,000
	To Balance c/d	9,700	31.3.2015	By Lucknow Branch Adjustment A/c	9,700
		15,700			15,700

Dr. **Goods Sent to Lucknow Branch Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Lucknow Branch Stock A/c (Returns)	10,000	31.3.2015	By Lucknow Branch A/c	3,25,000
	To Lucknow Branch Stock A/c (Transfer)	15,000			
	To Lucknow Branch Adjustment A/c (Note 5)	60,000			
	To Purchases A/c	2,40,000			
		3,25,000			3,25,000

Working Notes :

Dr. **(1) Petty Cash Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d	50	31.3.2015	By Branch Expenses A/c	33,820
31.3.2015	To Bank A/c	34,000		By Balance c/d	230
		34,050			34,050

Dr. **(2) Branch Expenses Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Bad Debts A/c	500	31.3.2015	By Lucknow Branch Profit & Loss A/c	34,820
	To Bank A/c (Insurance charge)	500			
	To Petty Cash A/c	33,820			
		34,820			34,820

Dr. (3) Goods Pilferred Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Lucknow Branch Stock A/c	2,000	31.3.2015	By Lucknow Branch Adj. A/c (Loading)	400
				By Lucknow Branch P & L A/c (Cost)	1,600
		2,000			2,000

Dr. (4) Goods Lost by Fire Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Lucknow Branch Stock A/c	5,000	31.3.2015	By Lucknow Branch Adj. A/c (Loading)	1,000
				By Bank A/c (Claim received)	3,000
				By General Profit & Loss A/c (Note 6)	1,000
		5,000			5,000

(5) Net Goods sent to Branch

Goods sent to branch = ₹ 3,25,000 *less* goods returned by the branch ₹ 10,000 *less* goods transferred to Madras branch ₹ 15,000 = ₹ **3,00,000. Loading = 1/5 of ₹ 3,00,000 = ₹ 60,000.**

(6) For calculating true profit of the branch, any abnormal loss should be debited to General Profit & Loss Account. Here, ₹ 1,000 has been charged to General Profit & Loss Account. However, if it is charged to Branch Profit & Loss Account, the profit would be ₹ 17,480.

Illustration 28

Madras Ltd. invoices goods to its branch at cost plus $33^1/_3$%. From the following particulars prepare Branch Stock Account, Branch Stock Adjustment Account and Branch Profit and Loss Account as they would appear in the books of head office: (all figures in ₹)

Stock at commencement at branch at invoice price	1,50,000	Return of goods to head office (invoice price)	50,000
Stock at close at branch at invoice price	1,20,000	Credit sales at branch	50,000
Goods sent to branch during the year at invoice price (including goods invoiced at ₹ 20,000 to branch on 31.3.2015 but not recd. by branch before close of the year)	10,00,000	Invoice value of goods pilferred	10,000
		Normal loss at branch due to wastage and deterioration of stock (at invoice value)	15,000
		Cash sales at branch	9,00,000

Madras Ltd. closes its books on March 31, 2015.

Solution

In the books of Madras Ltd.

Dr. Branch Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d	1,50,000	31.3.2015	By Bank A/c (Cash sales)	9,00,000
31.3.2015	To Goods Sent to Branch A/c	10,00,000		By Goods Sent to Branch A/c (Returns)	50,000
				By Branch Debtors A/c (Credit sales)	50,000
				By Goods Pilferred A/c	10,000
				By Balance c/d: at branch	1,20,000
				in-transit	20,000
		11,50,000			11,50,000

Dr. Branch Stock Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Goods Pilferred A/c (Loading)	2,500	31.3.2015	By Stock Reserve A/c	37,500
	To Stock Reserve A/c (Note 2)	35,000		By Goods Sent to Branch A/c (Note 1)	2,37,500
	To Gross Profit c/d	2,37,500			
		2,75,000			2,75,000

Dr. Branch Profit & Loss Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Goods Pilferred A/c (Cost)	7,500	31.3.2015	By Gross Profit b/d	2,37,500
	To General Profit & Loss A/c	2,30,000			
		2,37,500			2,37,500

Tutorial Note: No entry is required to be passed for normal loss, though it is given specifically in the question. The effect of normal loss is automatically adjusted in the Branch Stock Account. In this problem, normal loss of ₹ 15,000 has been neutralised by the profit on sales above invoice price of ₹ 15,000. If the entry is made for normal loss, the Branch Stock Account will be as under:

Dr. **Branch Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d	1,50,000	31.3.2015	By Bank A/c (Cash sales)	9,00,000
31.3.2015	To Goods Sent to Branch A/c	10,00,000		By Goods Sent to Branch A/c	50,000
	To Branch Stock Adjustment A/c	15,000		By Branch Debtors A/c	50,000
	(Profit on sales above invoice price)			By Goods Pilferred A/c	10,000
				By Normal Loss A/c*	15,000
				By Balance c/d: at branch	1,20,000
				in transit	20,000
		11,65,000			11,65,000

*Normal loss is to be debited to Branch Stock Adjustment Account by ₹ 15,000 and it will be credited by ₹ 15,000 for profit on sales, above invoice prices. The gross profit will remain ***unchanged***. **In the examination it is better to ignore normal loss.**

Working Notes:

(1) Total goods sent to branch is ₹ 10,00,000. Goods of ₹ 50,000 has been returned by the Branch. Therefore, net goods sent is ₹ 9,50,000. Loading on goods sent (Net) = 1/4 of ₹ 9,50,000 = ₹ 2,37,500.

(2) Stock reserve is also to be created on goods in transit in addition to closing stock at branch. Therefore, the loading is 1/4 of ₹ (1,20,000 + 20,000) = ₹ 35,000.

(3) Loading on goods pilferred is to be charged to Branch Stock Adjustment Account and cost is to be charged to Branch Profit and Loss Account.

Illustration 29

Subhash Electricals has its branches at Chandigarh and Gwalior to whom goods are invoiced at cost plus 25%.

Following information is available of the transactions at Chandigarh Branch for the year ended 31.3.2015 :

Balances on 1.4.2014 : Stock at invoice price ₹ 40,000; Debtors ₹ 12,000; Petty Cash ₹ 150.

Transactions during 2014-15 : (all figures in ₹)

Goods sent to branch at invoice price	4,20,000	Insurance company paid to head office	3,000
Goods returned to head office at invoice price	15,000	Cash sent for petty expenses	32,000
Cash sales	1,05,000	Bad debts	400
Credit sales	1,80,000	Goods transferred to Gwalior branch at invoice price	12,000
Normal loss at invoice price	350	Insurance charges paid by head office	200
Goods pilfered at invoice price	3,000	Goods returned by debtors	500
Goods lost by fire at invoice price	4,000		

Balances on 31.3.2015 : Debtors ₹ 11,000; Petty Cash ₹ 250; Stock ?

Note : Goods transferred to Gwalior Branch were in transit on 31.3.2015.

Prepare for Chandigarh Branch : (i) Branch Stock Account; (ii) Branch Adjustment Account; (iii) Branch Profit and Loss Account; (iv) Stock Reserve Account; and (v) Branch Debtors Account.

Solution

In the books of Subhas Electricals

Dr. **Branch Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d	40,000	31.3.2015	By Goods Sent to Branch A/c (Returns)	15,000
31.3.2015	To Goods Sent to Branch A/c	4,20,000		By Bank A/c (Cash Sales)	1,05,000
	To Branch Debtors A/c (Returns)	500		By Branch Debtors A/c (Credit Sales)	1,80,000
				By Goods Pilfered A/c	3,000
				By Goods Lost by Fire A/c	4,000
				By Goods Sent to Gwalior Branch A/c (Trans.)	12,000
				By Normal Loss A/c (Note 1)	350
				By Balance c/d	1,41,150
		4,60,500			4,60,500

Dr. **Branch Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Normal Loss A/c (Note 1)	350	1.4.2014	By Branch Stock Reserve A/c (Note 6)	8,000
	To Goods Pilfered A/c (Loading-Note 4)	600		By Goods Sent to Branch A/c (Note 2)	81,000
	To Goods Lost by Fire A/c (Loading-Note5)	800			
	To Goods Sent to Gwalior Branch A/c (Note 3)	2,400			
	To Branch Stock Reserve A/c (Note 7)	28,230			
	To Branch Profit and Loss A/c	56,620			
		89,000			89,000

Dr. Branch Profit and Loss Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Goods Pilfered A/c (Cost)	2,400	31.3.2015	By Branch Adjustment A/c	56,620
	To Branch Expenses A/c :				
	Bad Debts	400			
	Insurance Charges	200			
	Petty Expenses (Note 8)	31,900			
	To Net Profit (Transferred to General P&L A/c)	21,720			
		56,620			56,620

Dr. Stock Reserve Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Branch Adjustment A/c	8,000	1.4.2014	By Balance b/d (Note 6)	8,000
31.3.2015	To Balance c/d	28,230	31.3.2015	By Branch Adjustment A/c (Note 7)	28,230
		36,230			36,230

Dr. Branch Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d	12,000	31.3.2015	By Branch Expenses A/c (Bad Debts)	400
31.3.2015	To Branch Stock A/c	1,80,000		By Branch Stock A/c (Returns)	500
				By Bank A/c (Cash Collected)	1,80,100
			31.3.2015	By Balance c/d	11,000
		1,92,000			1,92,000

Working Notes :

(1) For calculating Branch Closing Stock (when it is not given), normal loss is credited to Branch Stock Account at invoice price. Normal Loss Account is closed by debiting to Branch Adjustment Account.

(2) Loading on net goods sent: Goods sent to branch ₹ 4,20,000 less goods returned to head office ₹ 15,000. Therefore, net goods sent = ₹ 4,05,000. Loading is 1/5 of ₹ 4,05,000 = ₹ 81,000.

(3) Loading on goods transferred to Gwalior Branch: 1/5 of ₹ 12,000 = ₹ 2,400.

(4) Loading on goods pilfered: 1/5 of ₹ 3,000 = ₹ 600. Cost of goods pilfered ₹ 2,400 (₹ 3,000 – ₹ 600) will be debited to *Branch Profit and Loss Account.*

(5) Loading on goods lost by fire: 1/5 of ₹ 4,000 = ₹ 800. Cost of goods lost by fire ₹ 3,200 (₹ 4,000 – ₹ 800) will be debited to *General Profit and Loss Account.*

(6) Loading on opening stock: 1/5 of ₹ 40,000 = ₹ 8,000.

(7) Loading on closing stock: 1/5 of ₹ 1,41,150 = ₹ 28,230.

(8) Petty Expenses = Opening petty cash ₹ 150 *plus* cash sent by head office for petty cash = ₹ 32,000 *less* closing petty cash ₹ 250 = ₹ 31,900.

Sometimes, Branch Stock Account may be maintained under two columns on both the sides — Invoice Price Column and Cost Price Column. The 'Invoice Price Column' being a mere memorandum column, all double entries are with the 'Cost Price Column'.Gross Profit or Loss is disclosed by the 'Cost Price Column'. The sales and sales returns are same for both the columns.

Illustration 30

Atlantic Paper Products sends goods to their Bhopal branch at cost plus 25%. You are given the following particulars:

	₹		₹
Opening stock at branch at its cost	5,000	Sales	25,500
Goods sent to branch at invoice price	20,000	Expenses	8,000
Loss in transit at invoice price	2,500	Closing stock at branch at cost to branch	6,000
Theft at invoice price	1,000	Claim recd. from the insurance company for loss in transit	2,000
Loss in weight (normal) at invoice price	500		

You are required to prepare in the head office books:
(a) Branch Stock Account;
(b) Branch Adjustment Account;
(c) Branch Profit and Loss Account;
(d) Surplus in Stock Account;
(e) Loss-in-transit Account; and (f) Loss by Theft Account.

Solution **In the books of Atlantic Paper Products**

Dr. **Branch Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d (Note 1)	5,000		By Loss in transit A/c	2,500
	To Goods Sent to Branch A/c	20,000		By Loss by Theft A/c	1,000
	To Surplus in Stock A/c	10,000		By Branch Debtors A/c (Note 3)	25,500
				By Balance c/d	6,000
		35,000			35,000

Dr. **Branch Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Loss-in-transit A/c (Loading)	500		By Stock Reserve A/c (Note 3)	1,000
	To Loss by Theft A/c	200		By Goods Sent to Branch A/c (Note 4)	4,000
	To Stock Reserve A/c	1,200		By Surplus in Stock A/c (Note 5)	2,000
	To Gross Profit c/d	5,100			
		7,000			7,000

Dr. **Branch Profit & Loss Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Expenses A/c	8,000		By Gross Profit b/d	5,100
	To Loss by Theft A/c (Note 6)	800		By Surplus in Stock A/c	8,000
	To General Profit & Loss A/c	4,300			
		13,100			13,100

Dr. **Surplus in Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Branch Adjustment A/c	2,000		By Branch Stock A/c	10,000
	To Branch Profit & Loss A/c	8,000			
		10,000			10,000

Dr. **Loss-in-transit Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Branch Stock A/c	2,500		By Branch Adjustment A/c	500
				By Bank A/c (Claim received)	2,000
		2,500			2,500

Dr. **Loss by Theft Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
	To Branch Stock A/c	1,000		By Branch Adjustment A/c	200
				By Branch Profit & Loss A/c	800
		1,000			1,000

Tutorial Note: (1) No entry is required for normal loss; (2) Loss by theft should be treated as normal because 'shoplifting' is very common to all businesses particularly in the retail trade.

Working Notes:

(1) Here, opening stock value has been given at cost to the branch, i.e., at invoice price. Therefore, there is no need for converting that into the invoice price.

(2) It is assumed that all sales are made on credit.

(3) Loading is 25% on cost, i.e., 25/125 or 1/5 of invoice price. So, Loading on opening stock = 1/5 of ₹ 5,000 = ₹ 1,000.

(4) Loading on goods sent is 1/5 of ₹ 20,000 = ₹ 4,000.

(5) Loading on surplus in stock is 1/5 of ₹ 10,000 = ₹ 2,000. Loading on surplus in stock is credited to Branch Adjustment Account and cost is credited to Branch Profit and Loss Account.

(6) Loading on lost-in-transit is 1/5 of ₹ 2,500 = ₹ 500. Loading on lost-in-transit is debited to Branch Adjustment Account. Cost of goods lost-in-transit (₹ 2,000) is equal to insurance claim received. So, there is no abnormal loss which is to be transferred to the General Profit and Loss Account.

Sale of Goods Above / Below Invoice Price

Sometimes goods may be sold by the branch below or above the invoice price as a matter of policy, for example, cash sales at invoice price but credit sales at 10% above invoice price. In such a situation, the Branch Stock Account does not balance. For adjusting excess/short amount realised over the invoice price, the following entries are passed:

(i) *When goods are sold above invoice price*

Branch Stock Account To Branch Adjustment Account	Dr. [Difference between actual selling price and invoice price]

(ii) *When goods are sold below invoice price*

Branch Adjustment Account To Branch Stock Account	Dr. [Difference between invoice price and actual selling price]

Illustration 31

B. Ltd., Bombay has a branch in Calcutta. Goods are sent to Branch at cost plus 50% (all figures in ₹):

Opening stock at branch at invoice price	6,00,000	Debtors paid during the year	11,00,000
Opening debtors at branch	2,00,000	Stock shortage (detected at the end of the year) at invoice price	60,000
Goods received by branch during the year	18,00,000		
Goods in transit to branch (opening) at invoice price	30,000	Goods returned by branch during the year (invoice price)	90,000
Cash sales during the year (₹ 30,000 below invoice price)	6,30,000	Bad debts written-off	20,000
Credit sales during the year (₹ 75,000 above invoice price)	12,00,000	Branch expenses	40,000

From the above information, you are required to prepare: Branch Stock Account; Branch Adjustment Account and Branch Profit and Loss Account for the year ended 31st December, 2013. (You may assume that there is stock in transit at the year-end).

Solution

In the books of B Ltd.

Dr. Branch Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 Jan. 1	To Balance b/d:		2013 Dec. 31	By Bank A/c (Cash sales)	6,30,000
	at branch	6,00,000		By Branch Adjustment A/c (Note 2)	30,000
	in-transit	30,000		By Branch Debtors A/c	12,00,000
Dec. 31	To Goods Sent to Branch A/c (Note 1)	17,70,000		By Shortage in Stock A/c (Note 4)	60,000
	To Branch Adjustment A/c (Note 3)	75,000		By Goods Sent to Branch A/c	90,000
				By Balance c/d (Balancing figure)	4,65,000
		24,75,000			24,75,000

Dr. Branch Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 Dec. 31	To Branch Stock A/c (Note 2)	30,000	2013 Dec. 31	By Branch Stock A/c (Note 3)	75,000
	To Shortage-in-Stock A/c	20,000		By Stock Reserve A/c (Note 5)	2,10,000
	To Stock Reserve A/c (Note 7)	1,55,000		By Goods Sent to Branch A/c (Note 6)	5,60,000
	To Gross Profit c/d	6,40,000			
		8,45,000			8,45,000

Dr. Branch Profit & Loss Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 Dec. 31	To Branch Expenses A/c:		2013 Dec. 31	By Gross Profit b/d	6,40,000
	Bad debts	20,000			
	Cash expenses	40,000			
	To Shortage-in-Stock A/c (Loading)	40,000			
	To General Profit & Loss A/c	5,40,000			
		6,40,000			6,40,000

Working Notes:

(1) Goods received by branch during the year is ₹ 18,00,000. It includes ₹ 30,000 opening stock in transit. Therefore, actual goods sent to branch during the year is ₹ 18,00,000 – ₹ 30,000 = ₹ 17,70,000.

(2) For sale of goods ***below*** invoice price, Branch Adjustment Account is debited and Branch Stock Account is credited.

(3) For sale of goods ***above*** invoice price, Branch Stock Account is debited and Branch Adjustment Account is credited.
(4) Loading of shortage in stock is debited to Branch Adjustment Account and "cost" is debited to Branch Profit and Loss Account. Loading of shortage-in-stock = 1/3 of ₹ 60,000 = ₹ 20,000 and Cost = ₹ 60,000 – ₹ 20,000 = ₹ 40,000.
(5) Loading on opening stock including goods-in-transit = 1/3 of ₹ (6,00,000 + 30,000) = ₹ 2,10,000.
(6) Loading on net goods sent to branch during the year = 1/3 of ₹ (17,70,000 – 90,000) = ₹ 5,60,000.
(7) Loading on closing stock = 1/3 of ₹ 4,65,000 = ₹ 1,55,000.

Illustration 32

White Ltd. with their head office at Kolkata, invoiced goods to their Ranchi branch at 20% less than list price, which is cost plus 100%, with instruction that cash sales are made at invoice price and credit sales at list price. From the following particulars, prepare Branch Stock Account and Branch Stock Adjustment Account for the year ended 31.12.2014 :

Stock on 1st 1.1.2014 (at invoice price)		2,400	Cash received from debtors	17,127
Debtors on 1.1.2014		2,000	Expenses at branch	3,473
Goods received from H.O. (at invoice price)		26,400	Remittance to H.O.	24,000
Goods returned to H.O.		200	Debtors on 31.12.2014	4,873
Sales —	Cash	9,200	Stock on 31.12.2014	3,520
	Credit	20,000		

Solution

In the books of White Ltd.

Ranchi Branch Stock Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance b/d	2,400	2014 Dec. 31	By Goods Sent to Branch A/c (Return)	200
Dec. 31	To Goods Sent to Branch A/c	26,400		By Bank A/c (Cash Sales)	9,200
	To Surplus in Stock A/c	120		By Branch Debtors A/c	20,000
	To Ranchi Branch Adjustment A/c (Note 1)	4,000		By Balance c/d	3,520
		32,920			32,920

Dr. **Ranchi Branch Stock Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Stock Reserve A/c (Note 6)	1,320	2014 Dec. 31	By Ranchi Branch Stock A/c (Note 1)	4,000
	To Gross Profit c/d	13,450		By Stock Reserve A/c (Note 4)	900
	[Transferred to Branch P/L A/c]			By Surplus in Stock A/c (Note 3)	45
				By Goods Sent to Branch A/c (Note 5)	9,825
		14,770			14,770

Working Notes :

(1) Let cost price be ₹ 100. The list price is 100% of cost price. Therefore, list price = ₹ 100 + ₹ 100 = ₹ 200. The invoice price is 20% less than list price, i.e., ₹ 200 – 20% of ₹ 200 = ₹ 200 – ₹ 40 = ₹ 160. Cash sales are made at invoice price, i.e., ₹ 160, whereas credit sales are made at list price, i.e., ₹ 200. Amount charged on credit sales is more than invoice price = ₹ 200 – ₹ 160 = ₹ 40, i.e., 40 / 200 × 100 = 20% of list price.
Goods sold on credit = ₹ 20,000 – amount charged in excess of invoice price = 20% of ₹ 20,000 = ₹ **4,000**.
(2) If cost is ₹ 100 then invoice price is ₹ 160. Therefore, loading on invoice price = 60 / 160 × 100 = 37.5%.
(3) Loading on surplus : 37.5% of 120 = ₹ 45. This ₹ 45 represents loading. Therefore, it is to be credited to Branch Stock Adjustment Account. The balance ₹ 75 (120 – 45) is to be credited to Branch Profit and Loss Account. [***See next Illustration***]
(4) Loading on opening stock = 37.5% of ₹ 2,400 = ₹ **900**.
(5) Loading on goods sent to branch (net) : 37.5% of (26,400 – 200) = ₹ **9,825**.
(6) Loading on closing stock : 37.5% of ₹ 3,520 = ₹ **1,320**. **(7)** Expenses at branch of ₹ 3,473 will be charged to Branch P/L Account.

Illustration 33

Dara Stores Ltd. with its head office at Delhi, invoiced goods to its branch at Ghaziabad at 20% less than the list price which is cost plus 100%, with instructions that cash sales were to be made at invoice price and credit sales at catalogue price (i.e., list price).

From the following particulars available from the branch, prepare Branch Stock Account, Branch Adjustment Account, Branch Profit and Loss Account and Branch Debtors Account for the year ending 31st December, 2014. (figures in ₹)

Stock on 1st January 2014 (invoice price)			6,000	Cash received from debtors	42,817
Debtors on 1st January 2014			5,000	Expenses at branch	8,683
Goods received from head office (invoice price)			66,000	Debtors on 31st December 2014	12,183
Sales —	Cash	23,000		Stock on 31st December 2014 (invoice price)	8,800
	Credit	50,000	73,000	Remittances to head office	60,000

Solution **In the books of Dara Stores Ltd.**

Dr. **Branch Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance b/d	6,000	2014 Dec. 31	By Bank A/c (Cash sales)	23,000
Dec. 31	To Goods Sent to Branch A/c	66,000		By Branch Debtors A/c	50,000
	To Branch Adjustment A/c (Note 1)	10,000		By Shortage-in- Stock A/c (Note 2)	200
				By Balance c/d	8,800
		82,000			82,000

Dr. **Branch Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec. 31	To Shortage-in-Stock A/c (Note 2)	75	2014 Dec. 31	By Branch Stock A/c (Note 1)	10,000
	To Stock Reserve A/c (Note 5)	3,300		By Stock Reserve A/c (Note 3)	2,250
	To Gross Profit c/d	33,625		By Goods Sent to Branch A/c (Note 4)	24,750
		37,000			37,000

Dr. **Branch Profit & Loss Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Dec.31	To Branch Expenses A/c	8,683	2014 Dec. 31	By Gross Profit b/d	33,625
	To Shortage-in-stock A/c (Cost)	125			
	To General Profit & loss A/c	24,817			
		33,625			33,625

Dr. **Branch Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance b/d	5,000	2014 Dec. 31	By Bank A/c	42,817
Dec. 31	To Branch Stock A/c	50,000		By Balance c/d	12,183
		55,000			55,000

Working Notes:

(1) Let the cost price be ₹ 100. The list price is 100% of cost price. Therefore, ***list price*** = ₹ 100 + ₹ 100 = ₹ 200. The ***invoice price*** is 20% less than list price, i.e., ₹ 200 – 20% of ₹ 200 = ₹ 200 – ₹ 40 = ₹ 160.

Cash sales are made at invoice price, i.e., ₹ 160 whereas credit sales are made at list price, i.e., ₹ 200. Amount charged on credit sales is more than invoice price = ₹ 200 – ₹ 160 = ₹ 40, i.e., 40/200 x 100 = 20% of list price.

Goods sold on credit = ₹ 50,000. Amount charged in excess of invoice price = 20% of list price, i.e., 20% of ₹ 50,000 = ₹ 10,000.

(2) If cost is ₹ 100 then invoice price is ₹ 160. Therefore, loading on invoice price = 60/160 x 100 = 37.5%.

Loading on shortage = 37.5% of ₹ 200 = ₹ 75. Cost = ₹ 200 – ₹ 75 = ₹ 125.

(3) Loading on opening stock = 37.5% of ₹ 6,000 = ₹ 2,250.

(4) Loading on goods sent to branch = 37.5% of ₹ 66,000 = ₹ 24,750.

(5) Loading on closing stock = 37.5% of ₹ 8,800 = ₹ 3,300.

Final Accounts System

The head office may also prepare a Memorandum Branch Trading and Profit and Loss Account to find out the profit or loss of a branch, apart from preparing the Branch Account. Here, the Trading and Profit and Loss Account is prepared in the usual manner, after converting all figures at cost price. The reason for preparing the Memorandum Trading and Profit and Loss Account is to have full information of all transactions which are ignored in ***Debtors System*** (discussed earlier).

The following points are important:

(1) All items of Trading and Profit and Loss Account are to be converted into cost price. (if these are given at invoice price).

(2) Branch Account will be of a Personal Account in nature. It will show only the mutual transactions between head office and branch. The balance of Branch Account is nothing but net assets of the branch at the end of the accounting year.

(3) Branch Trading and Profit and Loss Account is merely a Memorandum Account and, therefore, the entries made therein do not have any double-entry effect. The only object of this account is to disclose profit made or loss incurred by the branch.

Illustration 34

B Co. having its head office at Bombay has a branch at Calcutta. You are given the following particulars relating to the Calcutta Branch for the year ending 31.12.2014: (all figures in ₹)

Stock at branch on 1.1.2014	15,700	Petty cash at branch on 1.1.2014	110
Goods sent to branch during 2014	45,600	Goods returned by branch	3,900
Total sales at branch (including ₹ 19,700 for cash sales)	73,300	Cash sent to branch for expenses:	
Cash received from debtors	52,200	Salary : ₹ 12,800; Petty Cash : ₹ 2,600; Rent : ₹ 3,000	
Branch debtors on 1.1.2014	16,900	Stock at branch on 31.12.2014	18,800
		Petty cash at branch on 31.12.2014	90

Prepare Calcutta Branch Account and Memorandum Branch Trading and Profit and Loss Account in the head office books.

Solution

In the books of B Co.

Dr. Calcutta Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance b/d:		2014 Dec. 31	By Bank A/c (Cash sales)	19,700
	Stock	15,700		By Bank A/c (Cash collected from Debtors)	52,200
	Debtors	16,900		By Goods Sent to Branch A/c	3,900
	Petty cash	110		By Balance c/d:	
Dec. 31	To Goods Sent to Branch A/c	45,600		Stock	18,800
	To Bank A/c (Remittance):			Debtors (Note 1)	18,300
	Salary	12,800		Petty Cash	90
	Petty Cash	2,600			
	Rent	3,000			
	To General Profit & Loss A/c	16,280			
		1,12,990			1,12,990

Dr. Memorandum Branch Trading and Profit & Loss Account Cr.
For the year ended 31st December, 2014

Particulars		₹	Particulars		₹
To Opening stock		15,700	By Sales — Cash		19,700
To Goods Sent to Branch A/c	45,600		Credit		53,600
Less: Returned to H.O.	3,900	41,700	By Closing Stock		18,800
To Gross Profit c/d		34,700			
		92,100			92,100
To Salaries		12,800	By Gross Profit b/d		34,700
To Rent		3,000			
To Branch Expenses (Note 2)		2,620			
To General Profit & Loss A/c		16,280			
		34,700			34,700

Working Notes :

Dr. (1) Branch Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance b/d	16,900	2014 Dec. 31	By Bank A/c (Collection)	52,200
	To Sales A/c (Credit)	53,600		By Balance c/d	18,300
		70,500			70,500

Dr. (2) Petty Cash Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance b/d	110	2014 Dec. 31	By Branch Expenses A/c (Bal. Figure)	2,620
	To Bank A/c (Remittances)	2,600		By Balance c/d	90
		2,710			2,710

Tutorial Note : The students should note that the profit disclosed by the Branch Account and Branch Trading and Profit and Loss Account will be the same.

Ilustration 35

A Calcutta merchant has a branch at Delhi to which he charges out the goods at cost plus 25%. The Delhi branch keeps his own sales ledger and transmits all cash received to the head office every day. All expenses are paid from the head office. The transactions for the Branch were as follows: (all figures in ₹)

Stock on 1.1.2014	22,000	Allowances to customers	500
Debtors on 1.1.2014	200	Returns inward	1,000
Petty cash on 1.1.2014	200	Cheques sent to branch:	
Cash sales	5,300	Rent : ₹ 1,200; Wages : ₹ 400; Salaries : ₹ 1,800	
Goods sent to branch	40,000	Stock on 31.12.2014	26,000
Collections on ledger accounts	42,000	Debtors on 31.12.2014	4,000
Goods returned to head office	600	Petty cash on 31.12.2014 (including miscellanous income	250
Bad debts	600	not remitted ₹ 50)	

Prepare the Branch Account and the Branch Trading and Profit and Loss Account for the year ending 31.12.2014 in the head office books.

Solution

In the books of Head Office

Delhi Branch Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance b/d:		2014 Dec. 31	By Bank A/c (Cash sales)	5,300
	Stock	22,000		By Bank A/c (Collections)	42,000
	Debtors	200		By Goods Sent to Branch A/c (Returns)	600
	Petty cash	200		By Stock Reserve A/c (Note 1)	4,400
Dec. 31	To Goods Sent to Branch A/c	40,000		By Goods Sent to Branch A/c (Note 2)	7,880
	To Bank A/c (Remittances)			By Balance c/d:	
	Rent	1,200		Stock	26,000
	Wages	400		Debtors	4,000
	Salaries	1,800		Petty cash	250
	To Stock Reserve A/c	5,200			
	To General Profit & Loss A/c	19,430			
		90,430			90,430

Delhi Branch Trading and Profit & Loss Account
For the year ended 31st December, 2014

Dr. **Cr.**

Particulars		₹	Particulars		₹
To Opening Stock (₹ 22,000 – ₹ 4,400)		17,600	By Sales:		
To Goods sent to Branch (Cost)	32,000		Cash	5,300	
Less: Returns to H.O. (Cost)	480	31,520	Credit	47,900	
To Wages		400		53,200	
To Gross Profit c/d		23,480	Less: Returns Inward	1,000	52,200
			By Closing Stock ₹ (26,000 – 5,200)		20,800
		73,000			73,000
To Rent		1,200	By Gross Profit b/d		23,480
To Salaries		1,800	By Miscellaneous Income		50
To Bad Debts		600			
To Allowances to Customers		500			
To General Profit & Loss A/c		19,430			
		23,530			23,530

Tutorial Note: At the time of preparing Branch Trading and Profit and Loss Account, all figures should be converted into cost.

Working Notes :

(1) 25 / 125 x ₹ 22,000 = ₹ 4,400.

(2) 25 / 125 x ₹ (40,000 – 600) = ₹ 7,880.

Illustration 36

M/s. Ayaram Gayaram, Cuttack started on April 1, 2014, two branches at Berhampur and Nagpur. All goods sold at the branches are received from the head office invoiced at cost plus 25%. All expenses relating to the branches are paid by the head office. Each branch has its own sales ledger and sends weekly statements. All cash collections are remitted daily to the head office by the branches. The following particulars relating to the half-year ending September 30, 2014 have been extracted from the weekend statements sent by the branches: (all figures in ₹)

	Berhampur	Nagpur		Berhampur	Nagpur
Credit sales	1,25,200	1,10,000	Bad debts	6,000	—
Cash sales	78,600	85,200	Salaries	16,000	18,000
Sales returns	2,300	1,200	General expenses	2,600	1,500
Sundry Debtors	34,500	23,600	Goods received from H.O.	1,50,000	1,25,000
Rent and Taxes	3,200	4,500	Advertisement	7,500	5,200
			Stock on September 30, 2014	45,000	35,000

You are required to prepare the Branch Accounts as they would appear in the books of the head office, showing the profit or loss for the period and the Trading and Profit and Loss Account separately for each branch.

Solution

In the books of Messrs. Ayaram Gayaram

Dr. Branch Account Cr.

Date	Particulars	Berhampur	Nagpur	Date	Particulars	Berhampur	Nagpur
2014 Apr. 1	To Goods Sent to Branch A/c	1,50,000	1,25,000	2014 Sept. 30	By Bank A/c (Cash sales)	78,600	85,200
Sept. 30	To Bank A/c (Remittances):				By Bank A/c (Note 1)	82,400	85,200
	Rent and taxes	3,200	4,500		By Goods Sent to Br. A/c (Note 2)	30,000	25,000
	Salaries	16,000	18,000		By Balance c/d:		
	General expenses	2,600	1,500		Stock	45,000	35,000
	Advertisement	7,500	5,200		Debtors	34,500	23,600
	To Stock Reserve A/c (Note 3)	9,000	7,000				
	To General Profit & Loss A/c	82,200	92,800				
		2,70,500	2,54,000			2,70,500	2,54,000

Dr. Branch Trading and Profit & Loss Account for the 6 months ended 30th September, 2014 Cr.

Particulars	Berhampur	Nagpur	Particulars	Berhampur	Nagpur
To Goods Sent to Br. A/c (Note 4)	1,20,000	1,00,000	By Sales: Cash	78,600	85,200
To Gross Profit c/d	1,17,500	1,22,000	Credit	1,25,200	1,10,000
				2,03,800	1 95,200
			Less: Sales returns	2,300	1,200
				2,01,500	1,94,000
			By Closing Stock (Note 3)	36,000	28,000
	2,37,500	2,22,000		2,37,500	2,22,000
To Rent & taxes	3,200	4,500	By Gross Profit b/d	1,17,500	1,22,000
To Bad debts	6,000	—			
To Salaries	16,000	18,000			
To General expenses	2,600	1,500			
To Advertisement	7,500	5,200			
To General Profit & Loss A/c	82,200	92,800			
	1,17,500	1,22,000		1,17,500	1,22,000

Working Notes :

Dr. (1) Branch Debtors Account Cr.

Date	Particulars	Berhampur	Nagpur	Date	Particulars	Berhampur	Nagpur
2014 Sept. 30	To Sales (credit)	1,25,200	1,10,000	2014 Sept. 30	By Sales returns	2,300	1,200
					By Bad Debts	6,000	—
					By Bank A/c (balancing figure)	82,400	85,200
					By Balance c/d	34,500	23,600
		1,25,200	1,10,000			1,25,200	1,10,000

(2) Goods are sent to branch at cost plus 25%. If the cost price is ₹ 100, then profit is ₹ 25 and invoice price is ₹ 125. Therefore, loading on invoice price 25/125 is 20% of invoice price. Loading for Berhampur = 1/5 of ₹ 1,50,000 = ₹ 30,000 and loading for Nagpur = 1/5 of ₹ 1,25,000 = ₹ 25,000.

(3) Loading on closing stock :
Berhampur = 1/5 of ₹ 45,000 = ₹ 9,000 and
Nagpur = 1/5 of ₹ 35,000 = ₹ 7,000.

(4) Cost of goods sent to Branch :
Berhampur = (₹ 1,50,000 – ₹ 30,000) = ₹ 1,20,000; and
Nagpur = (₹ 1,25,000 – ₹ 25,000) = ₹ 1,00,000.

(5) Cost of closing stock :
Berhampur = (₹ 45,000 – ₹ 9,000) = ₹ 36,000; and
Nagpur = (₹ 35,000 – ₹ 7,000) = ₹ 28,000.

Wholesale and Retail Profit at Branch

Sometimes, the head office (particularly, the manufacturing concern) sells goods to actual consumers through its retail shops. In this case, the head office sends goods to the branches at wholesale prices which is cost plus a percentage of profit. The branch is likely to sell those goods at retail prices which is more than the wholesale prices. The real profit earned by the branch is the difference between the retail price and the wholesale price. For example, the cost price of an article is ₹ 100, the wholesale price, ₹ 160 and the retail price, ₹ 180. If an article is sold by the branch, the actual profit is ₹ 180 – ₹ 100 = ₹ 80 but the branch's real profit is ₹ 180 – 160 = ₹ 20.

This system is followed when ***a branch is treated as a profit centre***. The real cost of the branch is the wholesale price of the goods sent. But, we must remember that wholesale prices are fixed above cost. Therefore, if all the goods that have been sent to branch are sold, no problem is created. The real problem arises when a part of the stock remains unsold, which includes an element of profit made by the head office. To calculate actual profit earned, the value of unsold stock lying with the branch to be reduced from wholesale prices to cost prices. The following Journal Entry is passed at the year-end:

Profit and Loss Account (head office) Dr. [wholesale price — cost]
  To Stock Reserve Account

In the Balance Sheet, branch stock is shown after deducting stock reserve.

At the beginning of the next year, a reverse entry is passed, i.e.,

Stock Reserve Account Dr.
  To Profit and Loss Account [Head office]

The students should note the following important points:

1. Branch Trading Account is debited with the opening stock (if any) at invoice price (wholesale price).
2. Branch Trading Account is also debited with the goods sent to branch (net) at invoice price (wholesale price).
3. Branch Trading Account is credited with the retail price of goods sold.
4. Branch Trading Account is also credited with closing stock at branch at invoice price (wholesale price).
5. The Head Office Trading Account will be debited by opening stock (if any, at cost), goods purchased etc., and will be credited by direct sales (generally at wholesale price) and goods sent to branch (net) at invoice prices (wholesale price). The closing stock (at cost) of head office is also credited to Head Office Trading Account.
6. If there is any closing stock lying at branch, a Stock Reserve Account is opened by debiting Profit and Loss Account (head office) and crediting Stock Reserve Account. The amount of stock reserve is the difference between wholesale price and cost price of head office.
7. If there is any opening stock lying at branch, Stock Reserve Account is debited and head office profit and loss is credited with the loading (i.e., wholesale price of opening *less* cost price of such goods).

Illustration 37

XYZ Ltd operates a number of retail shops. Goods are invoiced at wholesale price which is cost plus 25%. Shops sell the goods at the list price which is cost plus 100%.

From the following particulars, prepare:
(a) Branch Stock Account (at wholesale price); (b) Branch Profit and Loss Account; (c) Stock Reserve Account;
(d) An extract of head office Profit and Loss Account.

Particulars:

Opening stock at shops ₹ 2,000; Goods sent to shops ₹ 8,00,000; Goods returned by shops ₹ 8,000; Goods sold at the shops ₹ 5,20,000; Goods returned by customers at the shop ₹ 20,000; Goods destroyed by fire (retail value) ₹ 6,400; Expenses at the shops ₹ 1,01,500.

Solution

In the books of XYZ Ltd.

Dr. Branch Stock Account (at Wholesale Price) Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	2,000		By Sales	5,20,000
	To Goods Sent to Shops	8,00,000		By Goods Sent to Shops (Returned)	8,000
	To Sales Returns	20,000		By Goods Destroyed by Fire (Note 2)	4,000
	To Gross Profit c/d (Note 1)	1,87,500		By Balance c/d	4,77,500
		10,09,500			10,09,500

Dr. Branch Profit and Loss Account for the year ended . . . Cr.

Particulars	₹	Particulars	₹
To Expenses at the Shops	1,01,500	By Gross Profit b/d	1,87,500
To Goods Destroyed by Fire (Note 2)	4,000		
To Net Profit (Transferred to H. O. Profit & Loss Account)	82,000		
	1,87,500		1,87,500

Dr. Stock Reserve Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Head Office Profit and Loss A/c (Transfer)	400		By Balance b/d (Note 3)	400
	To Balance c/d	95,500		By Head Office Profit and Loss A/c (Reserve required — Note 3)	95,500
		95,900			95,900

Dr. Head Office Profit and Loss Account (Extract) for the year ended . . . Cr.

Particulars	₹	Particulars	₹
To Stock Reserve (Note 3) (Reserve required for closing stock)	95,500	By Branch Profit and Loss A/c	82,000
		By Stock Reserve (Note 3) (Reserve on opening stock)	400

Working Notes:

(1) Calculation of Gross Profit

Particulars		₹
Cost Price		100
Add: Profit @ 25%		25
Wholesale Price	(A)	125
Cost Price		100
Add : Profit @ 100%		100
Retail Price	(B)	200
Gross Profit at the Shops (B – A)		75
Gross Profit = ₹ 5,00,000 x 75/200 = ₹ **1,87,500**.		

(2) Calculation of Wholesale Value of Goods Destroyed by Fire

Particulars
When retail value is ₹ 200 the wholesale value is ₹ 125
When retail value is Re 1 the wholesale value is ₹ 125/200
When retail value is ₹ 6,400 the wholesale value is ₹ 125/200 x ₹ 6,400 = ₹ 4,000

(3) Calculation of Stock Reserve

On opening stock = ₹ 2,000 x 25/125 = ₹ 400

On closing stock = ₹ 4,77,500 x 25/125 = ₹ 95,500

(4) Wholesale retail branch is treated as independent profit center. Therefore, goods destroyed by fire has been charged to wholesale branch profit and loss account

Illustration 38

Rahul Ltd operates a number of retail outlets to which goods are invoiced at wholesale price which is cost plus 25%. These outlets sell the goods at the retail price which is wholesale price plus 20%.

Following is the information regarding one of the outlets for the year ended 31.3.2015 (all figures in ₹) :

Stock at the outlet (1.4.2014)	30,000	Goods lost by fire	?
Goods invoiced to the outlet during the year	3,24,000	Expenses for the outlet for the year	20,000
Gross profit made by the outlet	60,000	Stock at the outlet (31.3.2015)	36,000

You are required to prepare the following accounts in the books of Rahul Ltd for the year ended 31.3.2015:

(a) Outlet Stock Account;

(b) Outlet Profit and Loss Account; (

c) Stock Reserve Account.

Solution

In the books of Rahul Ltd

Dr. Outlet Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d	30,000	?	By Sales (Note 1)	3,60,000
?	To Goods Sent to Outlet	3,24,000	?	By Goods Lost by Fire (Note 2)	18,000
31.3.2015	To Gross Profit c/d	60,000	31.3.2015	By Balance c/d	36,000
		4,14,000			4,14,000

Dr. Outlet Profit and Loss Account for the year ended 31st March, 2015 Cr.

Particulars	₹	Particulars	₹
To Expenses of the Outlet	20,000	By Gross Profit b/d	60,000
To Goods Lost by Fire	18,000		
To Net Profit (Transferred to H. O. Profit & Loss A/c)	22,000		
	60,000		60,000

Dr. Stock Reserve Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Head Office Profit and Loss A/c (Transfer)	6,000	1.4.2014	By Balance b/d (Note 3)	6,000
	To Balance c/d	7,200	31.3.2015	By Head Office Profit and Loss A/c (Reserve required — Note 3)	7,200
		13,200			13,200

Working Notes:

(1) Calculation of Sales

Particulars		₹
Cost Price		100
Add: Profit @ 25%		25
Wholesale Price	(A)	125
Wholesale Price		125
Add : Profit @ 20%		25
Retail Price	(B)	150
Gross Profit at the Outlet (B – A)		25
Retail Sales Value = ₹ 60,000 x 150/25 = ₹ **3,60,000**		

(2) Goods Lost by Fire at Wholesale Value

Particulars	₹
Opening Stock	30,000
Add: Goods Sent to Outlet	3,24,000
Add: Gross Profit	60,000
	4,14,000
Less: Sales	3,60,000
	54,000
Less: Closing Stock	36,000
	18,000

(3) Calculation of Stock Reserve : On opening stock = ₹ 30,000 × 25/125 = ₹ **6,000**.
On closing stock = ₹ 36,000 × 25/125 = ₹ **7,200**.

Illustration 39

White Ltd. has a retail branch at Gurgaon. Goods are sold on 60% profit on cost. The wholesale price is cost plus 40%. Goods are invoiced from Calcutta head office to Gurgaon branch at wholesale price. From the following particulars, ascertain the profit made at head office and branch for the year ended 31.12.2014:

	H.O. (₹)	Branch (₹)		H.O. (₹)	Branch (₹)
Stock on 1.1.2014	1,75,000	—	Expenses (Selling)	56,000	7,000
Purchases	10,50,000	—	Sales	10,71,000	3,50,000
Goods sent (invoice price)	3,78,000	—	Stock on 31.12.2014	4,20,000	63,000

Solution

Dr. Trading and Profit and Loss Account Cr.
For the year ended 31st December, 2014

Particulars	Head Office	Gurgaon	Particulars	Head Office	Gurgaon
To Opening Stock	1,75,000	—	By Sales	10,71,000	3,50,000
To Purchases	10,50,000	—	By Goods Sent to Branch	3,78,000	—
To Goods Sent to Branch	—	3,78,000	By Closing Stock	4,20,000	63,000
To Gross Profit c/d	6,44,000	35,000			
	18,69,000	4,13,000		18,69,000	4,13,000
To Expenses (Selling)	56,000	7,000	By Gross Profit b/d	6,44,000	35,000
To Stock Reserve (Note 1)	18,000	—			
To Net Profit	5,70,000	28,000			
	6,44,000	35,000		6,44,000	35,000

Working Note: **(1)** Goods sent to branch at invoice price should be treated as sale of the head office. Some of the goods are still unsold at the branch. For calculating actual profit of the head office, a stock reserve is to be created by debiting head office Profit and Loss Account. The amount of loading will be 40 / 140 x ₹ 63,000 = ₹ 18,000.

Illustration 40

A head office sends goods to its branch at 20% less than list price, i.e., catalogue price. Goods are sold to consumers at cost plus 100%. From the following particulars, ascertain the profit made at the head office and the branch on the wholesale basis for the year ended 31.12.2014:

	H.O. (₹)	Branch (₹)
Purchases	2,00,000	—
Goods sent to branch (at invoice price)	80,000	—
Sales	1,70,000	80,000

Assume that head office sells goods to customers at catalogue price.

Solution

Trading and Profit and Loss Account
For the year ended 31st December, 2014

Dr. **Cr.**

Particulars	Head Office	Branch	Particulars	Head Office	Branch
To Purchases	2,00,000	—	By Sales	1,70,000	80,000
To Goods Sent to Branch	—	80,000	By Goods Sent to Branch	80,000	—
To Gross Profit c/d	1,15,000	16,000	By Closing Stock (Note 2)	65,000	16,000
	3,15,000	96,000		3,15,000	96,000
To Stock Reserve (Note 3)	6,000	—	By Gross Profit b/d	1,15,000	16,000
To Net Profit	1,09,000	16,000			
	1,15,000	16,000		1,15,000	16,000

Working Notes:

(1) Let cost price be ₹ 100, then catalogue price = Cost + 100%, of Cost, i.e., ₹ 200. Invoice price = catalogue price less 20% of catalogue price = ₹ 200 – ₹ 40 = ₹ 160.

(2) Valuation of Closing Stock at Head Office	₹	(4) Valuation of Closing Stock at Branch	₹
Cost of goods purchased	2,00,000	Goods received from H.O. at invoice price	80,000
Less: Cost of goods sold to customers	85,000	Less: Invoice price of goods sold (160/200 x ₹ 80,000)	64,000
(100/200 x ₹ 1,70,000)		Invoice price of goods unsold	16,000
	1,15,000		
Less: Cost of goods sent to branch (100/160 x ₹ 80,000)	50,000		
Cost of goods unsold	65,000		

(3) Stock reserve for goods unsold at branch = 60/160 x ₹ 16,000 = ₹ 6,000

Illustration 41

A head office invoices goods to its branch at 20% less than the list price (i.e. catalogue price). Goods are sold to customers at cost plus 100%. From the following particulars, ascertain the profit made at the head office and the branch on the wholesale basis for the year ended 31st December 2014.

	H.O. (₹)	Branch (₹)		H.O. (₹)	Branch (₹)
Opening Stock at cost (at I.P. for Branch)	40,000	16,000	Sales	6,00,000	80,000
Purchases	4,00,000	—	Expenses	86,000	4,000
Goods sent to branch at invoice price	96,000	—			

Assume that head office sells goods to customers at catalogue price.

Solution

Trading and Profit and Loss Account
For the year ended 31st December, 2014

Dr. **Cr.**

Particulars	Head Office	Branch	Particulars	Head Office	Branch
To Opening Stock	40,000	16,000	By Sales	6,00,000	80,000
To Purchases	4,00,000	—	By Goods Sent to Branch	96,000	—
To Goods Sent to Branch	—	96,000	By Closing Stock (Note 2)	80,000	48,000
To Gross Profit c/d	3,36,000	16,000			
	7,76,000	1,28,000		7,76,000	1,28,000
To Expenses	86,000	4,000	By Gross Profit b/d	3,36,000	16,000
To Stock Reserve (Note 3)	18,000	—	By Stock Reserve (Note 4)	6,000	—
To Net Profit	2,38,000	12,000			
	3,42,000	16,000		3,42,000	16,000

Working Notes:

(1) Let the cost price be ₹ 100, then ***catalogue price*** = cost plus 100% of cost = ₹ 100 + ₹ 100 = ₹ 200. ***Invoice price*** = catalogue price less 20% of catalogue price = ₹ 200 – ₹ 40 = ₹ 160.

(2) Valuation of Closing Stock at Head Office	₹	(3) Valuation of Closing Stock at Branch	₹
Opening stock at cost	40,000	Opening stock at invoice price	16,000
Add: Purchases	4,00,000	Add: Goods sent to branch	96,000
	4,40,000		1,12,000
Less: Cost of goods sold to customers		Less: Invoice price of goods sold	
(100/200 x ₹ 6,00,000)	3,00,000	(160/200 x ₹ 80,000)	64,000
	1,40,000	Invoice price of goods unsold	48,000
Less: Cost of goods sent to branch			
(100 / 160 x ₹ 96,000)	60,000		
Cost of goods unsold	80,000		

(3) Stock reserve for goods unsold at branch = 60/160 × ₹ 48,000 = ₹ 18,000.

(4) Stock reserve for opening a stock at branch = 60/160 × ₹ 16,000 = ₹ 6,000.

Illustration 42

P K Co Ltd with their head office at Calcutta, invoiced goods to their Bombay Branch at invoice price. The invoice price is 20% less than list price, which is cost plus 100% with instruction that sales are made at list price. From the following particulars, ascertain the profit earned by the head office and branch :(all figures in ₹)

	H.O.	Branch		H.O.	Branch
Opening Stock	40,000	32,000	Goods received from H.O. at invoice price	—	96,000
Purchases	2,00,000	—	Sales	1,70,000	80,000
Goods Sent to Branch at Cost Price	62,500	—	Trade expenses	14,000	8,000

Stocks at head office are valued at cost price but those of branch are valued at invoice price.

Solution

P K Co Ltd

Dr. Trading and Profit and Loss Account for the year ended . . . Cr.

Particulars	Head Office (₹)	Bombay Branch (₹)	Particulars	Head Office (₹)	Bombay Branch (₹)
To Opening Stock	40,000	32,000	By Sales	1,70,000	80,000
To Purchases	2,00,000	—	By Goods Sent to Branch	1,00,000	—
To Goods Sent to Branch	—	1,00,000	By Goods-in-Transit (Note 7)	—	4,000
To Gross Profit c/d	1,22,500	16,000	By Closing Stock (Note 2 & 3)	92,500	64,000
	3,62,500	1,48,000		3,62,500	1,48,000
To Trade Expenses	14,000	8,000	By Gross Profit b/d	1,22,500	16,000
To Stock Reserve (Note 5)	25,500	—	By Stock Reserve (Note 4)	12,000	—
To Net Profit	95,000	8,000			
	1,34,500	16,000		1,34,500	16,000

Working Notes:

(1) Let the cost price be ₹ 100,then list price = Cost *plus* 100% of cost = (₹ 100 + 100) = ₹ **200.**
Invoice price = List price less 20% = ₹ 200 less ₹ 40 = ₹ **160.**

(2) Valuation of Closing Stock at Head Office	₹	(3) Valuation of Closing Stock at Branch	₹
Particulars	₹	Particulars	₹
Opening Stock at cost	40,000	Opening Stock at invoice price	32,000
Add: Purchases	2,00,000	Add: Goods received from Head Office at invoice price	96,000
	2,40,000		1,28,000
Less: Cost of Goods Sold to Customers		Less: Invoice price of goods sold (160/200 x ₹ 80,000)	64,000
(100/200 x ₹ 1,70,000) (Note 6)	85,000	**Invoice Price of Goods Unsold**	64,000
	1,55,000		
Less: Cost of Goods Sent to Branch (Given)	62,.500		
Cost of Goods Unsold	92,500		

(4) Stock reserve for opening stock = 60/160 × ₹ 32,000 ₹ 12,000

(5) Stock reserve for closing stock = 60/160 × ₹ 64,000	₹ 24,000
Stock reserve for stock-in-transit = 60/160 × ₹ 4,000	₹ 1,500
Total	₹ 25,500
(6) It is assumed that head office sells goods to customers at list price.	
(7) Invoice price of goods sent by head office = ₹ 62,500 / 100 × 160	₹ 1,00,000
Invoice price of goods received by branch	₹ 96,000
Goods-in-Transit (at invoice price)	₹ 4,000

Independent Branch

When the size of the branches is very large, their functions become complex. In such a situation, it is desirable or practicable for each branch to establish its own double entry book-keeping system quite separate from those of head office. Under this system of branch accounting, the branches are treated as separate, independent units. These types of branches are known as ***Independent Branches***. An independent branch is given more freedom of action, with the manager acquiring more responsibility. Apart from receiving goods from the head office, these branches are allowed to purchase goods from the open market locally. From the amount received from cash sales or debtors, they can incur expenses and can operate the bank account in their own name. The only link an independent branch has with the head office is that they are owned by the head office, because the latter provides and possesses the premises and other physical assets which a branch needs before it can become operational, and the profit or loss of the branch ultimately belongs to the head office.

The accounting arrangements are quite simple. Each branch maintains a 'Head Office Account' in its Ledger, whilst the head office maintains an account in the name of each branch, just as if individual branches were 'customers' of it. All transactions between the two are passed through these accounts, which, if book-keeping is up to date and accurate, will have equal and opposite balances.

A branch account in the head office books may have the following entries.

In the books of the Head Office

Dr. Delhi Branch Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	40,000	By Bank A/c (cash received from branch)	1,90,000
To Goods Sent to Branch A/c	2,00,000	By Goods Returned from Branch A/c	10,000
To Bank A/c (Expenses paid by head office)	10,000	By Balance c/d	50,000
	2,50,000		2,50,000

In respect of the above account the following points should be noted carefully:

(1) The balance on the ***Delhi Branch Account*** (₹ 50,000) is an asset to the head office and represents the net investment by the head office in Delhi branch.

(2) The balance on the ***Head Office Account*** in the Delhi branch books (₹ 50,000) is a liability of the Delhi branch and represents its capital (i.e., the head office is financing the branch to the extent of ₹ 50,000).

(3) The balances of the two account should be equal and opposite. Where they do not, the discrepancy will be due to cash or goods in-transit.

At the end of each financial or trading period the branch either sends its Trial Balance to the head office for preparation of Trading and Profit and Loss Account and Balance Sheet or prepares its own final accounts (head office being shown as a debtor or a creditor as appropriate). In either case, the net profit made by a branch is credited to head office account; net loss, on the other hand, is debited to that account in the branch books. In this connection, it should be noted that the profit or loss made by each branch is transferred to head office (by passing the above entry), instead of being distributed in the normal way.

After receiving branch Trial Balance by the head office, a consolidated Trading and Profit and Loss Account can be prepared for the entire enterprise, together with a combined Balance Sheet.

The main features of the accounting system of an independent branch are as under:

(1) The branch maintains its entire books of account under double entry system.

(2) The branch in its books opens a Head Office Account to record all the transactions that take place between head office and the branch. This account is personal in nature. It is credited by the amount

of goods received from head office and the allocated head office expenses charged to the branch, and is debited with the amount of cash sent to head office and goods returned.

(3) The head office maintains a Branch Account to record the above transactions. This is a reciprocal account of the Head Office Account maintained by the branch. This account is debited by the amount of goods sent to the branch and the allocated head office expenses charged to the branch, and is credited with the amount of cash received from branch and goods returned.

(4) At the end of the accounting period, the branch prepares its Trial Balance and Trading and Profit and Loss Account, and sends copies of these statements to the head office for incorporation.

(5) After receiving the final statements from the branch, the head office reconciles between the two balances — Branch Account as would appear in the books of head office with the Head Office Account as would appear in the books of the branch. The differences are investigated and required adjusting entries are passed in the head office books to reconcile these two balances.

(6) Lastly, the head office passes necessary Journal Entries to incorporate the branch Trial Balance in its books.

Some Special Items

The following items require some special accounting treatment in case of an independent branch:

(i) Goods-in-transit;
(ii) Cash-in-transit;
(iii) Head office expenses chargeable to branch;
(iv) Depreciation on branch fixed assets; and
(v) Inter-branch transactions.

Goods-in-Transit

It is quite common that the head office and the branch send goods to each other very frequently. The head office is to send goods to the branch at regular intervals as per the requirement of the branch and branch also returns goods to the head office what it cannot sell at a profit. When the head office sends goods to the branch, it immediately debits the Branch Account in its books and credits the Goods Sent to Branch Account. But the branch will pass entry (in respect of this transaction) only when it receives the goods. Similarly, when branch sends or returns some goods to the head office, it immediately debits Head Office Account and credits Goods Returned to Head Office Account. But the head office will pass entry (in respect of this transaction), only when it receives the goods. These goods which are on the way to branch/head office are called '***Goods-in-transit***'.

Some accounting adjustment is required, if there are still some goods in transit at the end of the year. For 'goods-in-transit' the balance in the Head Office Account in the books of the branch will not tally with that of Branch Account in the books of the head office. For reconciling these balances, adjustment entry may be passed either in the books of the head office or in the books of the branch, ***but not in both sets of books***.

(a) When the adjustment entry is passed in the books of the head office:

Goods-in-Transit Account Dr.
To Branch Account

(b) When the adjustment entry is passed in the books of the branch :

Goods-in-Transit Account Dr.
To Head Office Account

The students should remember that the above adjustment entry should be passed only in one set of books, either at head office level or branch level.

On principle, the adjustment entry should be passed in the books of the head office because all in-transit items are detected by the head office after receiving copy of Trial Balance (or copy of Final Accounts) and at this stage, it is not desirable to change the balances in the branch books.

Goods-in-Transit are shown in the Balance Sheet of head office.

Cash-in-Transit

Branch may send cash to head office at regular intervals. At the end of the accounting period, if there is any cash-in-transit it should be adjusted just like goods-in-transit. Here also, adjustment entry may be passed either in the head office books or the branch books. For the reasons explained (in the box) above, the entry should be passed in the head office books only.

The entry will be:

Cash-in-Transit Account Dr.
    To Branch Account

Illustration 43

During March 2015 Bombay head office despatched nine batches of goods to its branch at Calcutta, with each batch costing ₹ 10,000. During the same period Calcutta branch remitted three cheques of ₹ 25,000 each. At the year ended on 31st March 2015 branch had received only eight batches of goods, and the head office had received only two cheques.

The above items will appear in the respective books as follows:

In the books of Calcutta Branch

Dr. Goods from Head Office Account Cr.

Particulars	₹	Particulars	₹
To Head Office A/c (8 batches)	80,000		

Dr. Head Office Account Cr.

Particulars	₹	Particulars	₹
To Bank A/c (3 x ₹ 25,000)	75,000	By Goods from Head Office A/c	80,000
To Balance c/d	5,000		
	80,000		80,000

Dr. Bank Account Cr.

Particulars	₹	Particulars	₹
		By Head Office (3 x ₹ 25,000)	75,000

In the books of the Head Office

Dr. Goods Sent to Branch Account Cr.

Particulars	₹	Particulars	₹
		By Calcutta Branch A/c (9 batches)	90,000

Dr. Calcutta Branch Account Cr.

Particulars	₹	Particulars	₹
To Goods sent to branch A/c	90,000	By Bank A/c (2 x ₹ 25,000)	50,000

Dr. Bank Account Cr.

Particulars	₹	Particulars	₹
To Calcutta Branch A/c (2 cheques @ ₹ 25,000 each)	50,000		

Thus, at the year end balance of Calcutta Branch Account (in the head office books) and balance of Head Office Account (in the branch books) are different. ₹ 40,000 compared with ₹ 5,000 because of the items in-transit. To reconcile the balances the following entry is to be passed in the books of the head office:

Goods-in-Transit Account (1 batch) Dr. ₹ 10,000
Cash-in-Transit Account (1 cheque of ₹ 25,000) Dr. ₹ 25,000
    To Calcutta Branch Account ₹ 35,000

After adjustment, Calcutta Branch Account, Cash-in-Transit Account and Goods-in-Transit Account will appear in the books of the head office as follows:

Dr. Calcutta Branch Account Cr.

Particulars	₹	Particulars	₹
To Goods Sent to Branch A/c	90,000	By Bank A/c (2 x ₹ 25,000)	50,000
		By Goods-in-Transit A/c	10,000
		By Cash-in-Transit A/c	25,000
		By Balance c/d	5,000
	90,000		90,000

Dr. Goods-in-Transit Account Cr.

Particulars	₹	Particulars	₹
To Calcutta Branch A/c	10,000		

Dr. Cash-in-Transit Account Cr.

Particulars	₹	Particulars	₹
To Calcutta Branch A/c	25,000		

Now, both accounts have equal and opposite balances. It should be noted that goods-in-transit and cash-in-transit will appear in the head office Balance Sheet as at 31st March, 2013.

Illustration 44

From the following information, reconcile the Calcutta Head Office Account with Delhi Branch Account:

Particulars	Head Office		Delhi Branch	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
Goods Sent to Delhi Branch	—	13,02,400	—	—
Goods Received by Delhi Branch	—	—	12,80,400	—
Cash Sent by Delhi Branch	—	—	—	1,86,500
Cash Received by Head Office	1,00,000	—	—	—
Delhi Branch Account	4,11,100	—	—	—
Head Office Account	—	—	—	3,02,600

Solution

In the books of the Head Office

Dr. Delhi Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	4,11,100		By Goods-in-Transit A/c (Note 2)	22,000
				By Cash-in-Transit A/c (Note 3)	86,500
				By Balance c/d	3,02,600
		4,11,100			4,11,100

Working Notes:

(1) Net difference = ₹ 4,11,100 – ₹ 3,02,600 = ₹ 1,08,500.
(2) Difference due to goods in transit = ₹ 13,02,400 – ₹ 12,80,400 = ₹ 22,000.
(3) Difference due to cash in transit = ₹ 1,86,500 – ₹ 1,00,000 = ₹ 86,500.
(4) Journal entry in the books of the head office will be:

Goods-in-Transit Account	Dr. ₹ 22,000	
Cash-in-Transit Account	Dr. ₹ 86,500	
To Delhi Branch Account		₹ 1,08,500

Head Office Expenses Chargeable to Branch

The head office may, for acceptable reasons, like to allocate a part of its own expenses among the branches for the centralised services rendered by it. In fact, quite a good amount of time of the head office staff may be devoted in doing the jobs of the branches. Hence, the head office may well decide to charge a part of its expenditure on salaries etc., on the branches. The same may also hold true of certain other items of expenses (e.g., on advertisements). If the head office decides to put down some expenses to the branches, the following entries will be passed:

In the books of the Head Office		**In the books of the Branch**	
Branch Account	Dr.	Head Office Expenses Account	Dr.
To Expenses Account		To Head Office Account	
(Being expenses chargeable to branch)		(Being the share of head office expenses)	

Illustration 45

Journalise the following in the books of the head office as well as branch office:

Head office charges ₹ 5,000 from Calcutta Branch as head office administrative expenses.

Solution

In the books of the Head Office
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Calcutta Branch A/c Dr. To Office Administrative Expenses A/c (Being office administrative expenses chargeable to branch)		5,000	5,000

In the books of Calcutta Branch
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Head Office Administrative Expenses A/c Dr. To Head Office A/c (Being the share of head office administrative expenses provided)		5,000	5,000

Depreciation on Branch Fixed Assets

Branch Assets Account may be maintained at branch or at head office. Accounting entry for depreciation will differ according to situations.

(i) If the accounts of branch fixed assets are maintained at branch :

Depreciation Account Dr.
To Fixed Assets Account
[No entry is to be passed in the head office books]

(ii) If the account of branch fixed assets is maintained at head office :

In this case, all entries regarding purchase or sale of such assets are made in the head office books only. No entry is passed in the books of the branch in this respect. For example, when a branch fixed asset is purchased, the head office debits Branch Fixed Assets Account and credits Bank Account/Branch Account (if paid by branch).

As the assets are used by the branch, the depreciation for such assets is also to be charged to the branch. For depreciation the following entry is passed:

In the books of the Head Office	In the books of the Branch
Branch Account Dr. To Branch Fixed Assets Account (Being the depreciation on branch fixed assets)	Depreciation Account Dr. To Head Office Account (Being the depreciation on fixed assets)

Here, both the head office and the branch pass the required entry for depreciation. The important point to note here is that depreciation is an expense for the branch because the asset is used up by it but the Asset Account is maintained by the head office. The head office debits the branch and credits the particular Asset Account. Likewise, the branch credits the head office and debits the particular expense — Depreciation Account.

Illustration 46

Journalise the following in the books of the head office as well as branch office :

Head office has charged ₹ 10,000 as depreciation on Bangalore Branch Fixed Assets.

Solution

In the books of the Head Office
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Bangalore Branch A/c Dr. To Bangalore Branch Fixed Assets A/c (Being the depreciation charged on branch fixed assets maintained at head office)		10,000	10,000

In the books of Bangalore Branch
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
	Depreciation A/c Dr. To Head Office A/c (Being the depreciation on fixed assets provided)		10,000	10,000

Inter-branch Transfers

It is quite possible that one branch may send goods (or cash) to another branch directly, with of course, the consent of the head office. The usual procedure, in such a case is that the head office, in its books, should debit the receiving branch and credit the sending branch. But in the books of the head office, it regards the transaction as returning the goods to the head office and thereafter sending the goods to another branch. The following entries are passed:

Head Office	Sending Branch	Receiving Branch
Receiving Branch Account Dr. To Sending Branch Account (Being goods transferred to .... branch to .... branch)	Head Office Account Dr. To Goods Sent to H.O. Account (Being goods sent to .... branch as per head office instruction)	Goods from H.O. Account Dr. To Head Office Account (Being goods received from .... branch as per head office instruction)

Illustration 47

Journalise the following in the books of head office as well as branch offices:

Goods worth ₹ 15,000 are supplied by Kanpur Branch to Agra Branch under the instruction of the Delhi Head Office.

Solution **In the books of the Head Office (Delhi)**

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	Agra Branch A/c	Dr.		15,000	
	To Kanpur Branch A/c				15,000
	(Being the goods supplied by Kanpur Branch to Agra Branch)				

In the books of Kanpur Branch

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	Head Office A/c	Dr.		15,000	
	To Goods Sent to Head Office A/c				15,000
	(Being goods sent to Agra Branch as per Head Office instruction)				

In the books of Agra Branch

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
	Goods from Head Office A/c	Dr.		15,000	
	To Head Office A/c				15,000
	(Being goods received from Kanpur Branch as per Head Office instruction)				

Illustration 48

As an accountant of head office how will you record the following items while dealing with the accounts of 'Independent' branches ?

(i) Expenses incurred by head office on behalf of branch.
(ii) Depreciation of branch's fixed assets.
(iii) Goods sent by head office to branch remain in transit up to the last day of the accounting year.
(iv) Inter-branch transfers of goods.

Solution **In the books of the Head Office**

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
(i)	Branch A/c	Dr.		?	
	To Expenses (H.O.) A/c				?
	(Being expenses incurred by the head office on behalf of the branch now adjusted)				
(ii)	Branch A/c (Note 1)	Dr.		?	
	To Branch Fixed Assets A/c				?
	(Being depreciation on branch fixed assets charged to Branch Account)				
(iii)	Goods-in-Transit A/c	Dr.		?	
	To Branch A/c				?
	(Being goods sent by head office not yet received by branch now adjusted)				

(iv)	Receiving Branch A/c Dr. To Sending Branch A/c (Being the necessary adjustment for transfer of goods in between the branches)		?	?

Working Note : (1) It is assumed that the Branch Fixed Assets Account is maintained by the Head Office.

Illustration 49

Give Journal Entries for the following transactions in the books of the head office:

(i) Goods sent by the head office on December 28 worth ₹ 150 to its Kanpur branch not received by the branch up to December 31.

(ii) Goods sent by Bombay branch to Kanpur branch for ₹ 300 are yet to be recorded.

(iii) Kanpur branch paid ₹ 3,000 for a machine purchased by the head office for the latter.

(iv) Provide depreciation at 10% on furniture when Kanpur Branch Furniture Account is maintained in the head office books (Furniture ₹ 25,000).

Solution

In the books of the Head Office
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
(i)	Goods-in-Transit A/c Dr. To Kanpur Branch A/c (Being goods sent to branch by head office on 28th December not yet received by branch)		150	150
(ii)	Kanpur Branch A/c Dr. To Bombay Branch A/c (Being goods transferred by Bombay branch to Kanpur branch)		300	300
(iii)	Machinery A/c Dr. To Kanpur Branch A/c (Being the amount paid by the Kanpur branch for purchase of machine for head office)		3,000	3,000
(iv)	Kanpur Branch A/c Dr. To Branch Furniture A/c (Being depreciation provided on branch furniture @ 10% p.a. on ₹ 25,000)		2,500	2,500

Illustration 50

A Calcutta firm whose accounting year ends on 31st December has two branches — one at Allahabad, and the other at Varanasi. The branches keep a complete set of books. On 31.12.2014, the Allahabad and Varanasi Branch Accounts in the Calcutta books showed balance of ₹ 30,450 and ₹ 45,000 respectively before taking the following information into account:

(i) Goods valued at ₹ 2,000 were transferred from Allahabad branch to Varanasi branch under instruction from the head office.

(ii) Allahabad branch collected ₹ 2,500 from an Allahabad customer of the head office.

(iii) Varanasi branch paid ₹ 5,000 for certain goods purchased by the head office in Varanasi.

(iv) ₹ 5,000 remitted by Allahabad branch to Calcutta on 29th December, 2014 were received on 3rd January following.

(v) For the year 2014, the Allahabad branch showed a net loss of ₹ 1,250 and the Varanasi branch a net profit of ₹ 5,400.

Pass Journal Entries to record the above transactions in the books of the head office and then write-up the two Branch Accounts therein.

Solution

In the books of the Head Office
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2014 (i) Dec. 31	Varanasi Branch A/c Dr. To Allahabad Bank A/c (Being goods transferred from Allahabad branch to Varanasi branch under head office instruction)		2,000	2,000
(ii)	Allahabad Branch A/c Dr. To Sundry Debtors A/c (Being cash collected by Allahabad branch from head office debtors at Allahabad)		2,500	2,500
(iii)	Purchases A/c Dr. To Varanasi Branch A/c (Being the amount paid by Varanasi branch in respect of purchases of head office)		5,000	5,000
(iv)	Cash-in-Transit A/c Dr. To Allahabad Branch A/c (Being cash remitted by Allahabad branch on 29th December 2014 received by the head office on 3rd January 2013)		5,000	5,000

(v)	Profit & Loss A/c Dr. To Allahabad Branch A/c (Being the loss suffered by the Branch during 2014)		1,250	1,250
(vi)	Varanasi Branch A/c Dr. To Profit & Loss A/c (Being the profit earned by the branch during 2014)		5,400	5,400

Dr. Allahabad Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Balance b/d	30,450	31.12.2014	By Varanasi Branch A/c	2,000
	To Sundry Debtors A/c	2,500		By Cash-in-Transit A/c	5,000
				By Profit & Loss A/c	1,250
				By Balance c/d	24,700
		32,950			32,950

Dr. Varanasi Branch Account Cr

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Balance b/d	45,000	31.12.2014	By Purchases A/c	5,000
	To Allahabad Branch A/c	2,000		By Balance c/d	47,400
	To Profit & Loss A/c	5,400			
		52,400			52,400

Illustration 51

Give Journal Entries in the books of Branch A to rectify or adjust the following :

(i) Head office expenses ₹ 3,500 allocated to the Branch, but not recorded in the Branch books.

(ii) Depreciation of branch assets, whose accounts are kept by the Head Office not provided earlier for ₹ 1,500.

(iii) Branch paid ₹ 2,000 as salary to a H.O. Inspector, but the amount paid has been debited by the Branch to Salaries Account.

(iv) H.O. collected ₹ 10,000 directly from a customer on behalf of the Branch, but no intimation to this effect has been received by the Branch.

(v) A remittance of ₹ 15,000 sent by the Branch has not yet been received by the Head office.

(vi) Branch A incurred advertisement expenses of ₹ 3,000 on behalf of Branch B.

Solution

In the books of the Branch A

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
(i)	Expenses A/c Dr. To Head Office A/c (Being the allocated expenses of the H.O. not recorded in the books of the Branch)		3,500	3,500
(ii)	Depreciation A/c Dr. To Head Office A/c (Being the depreciation on branch assets provided)		1,500	1,500
(iii)	Head Office A/c Dr. To Salaries A/c (Being salary of H.O. staff wrongly debited to Branch Salaries Account, now rectified)		2,000	2,000
(iv)	Head Office A/c Dr. To Debtors A/c (Being money collected from branch debtors by H.O. has not been recorded in the books of the branch, now rectified)		10,000	10,000
(v)	Already it is recorded in the branch books. Therefore, no entry is required			
(vi)	Head Office A/c Dr. To Cash A/c (Being advertisement expenses paid on behalf of branch B, now adjusted)		3,000	3,000

Illustration 52

A Calcutta head office passes one entry at the end of each month to adjust the position arising out of inter-branch transactions during the month. From the following inter-branch transactions in April, 2015, make the entries in the books of Calcutta head office.

(a) ***Delhi branch***:

(i) Received goods from Nagpur branch ₹ 9,000 and Ahmedabad branch ₹ 6,000.
(ii) Sent goods to Ahmedabad branch ₹ 15,000 and Nagpur branch ₹ 12,000.
(iii) Received bills receivable from Ahmedabad branch ₹ 9,000.
(iv) Sent acceptances to Nagpur branch ₹ 6,000 and Ahmedabad branch ₹ 3,000.

(b) ***Kanpur branch*** [apart from (a) above]:

(i) Received goods from Nagpur branch ₹ 15,000 and Delhi branch ₹ 6,000.
(ii) Cash sent to Nagpur branch ₹ 3,000 and Delhi branch ₹ 6,000.

(c) ***Nagpur branch*** [apart from (a) and (b) above]:

(i) Sent goods to Ahmedabad branch ₹ 9,000.
(ii) Received bills receivable from Ahmedabad branch ₹ 9,000.
(iii) Received cash from Ahmedabad branch ₹ 5,000

Solution **In the books of the Head Office**

Journal **Dr.** **Cr.**

Date	Particulars		L.F.	₹	₹
2015	Kanpur Branch A/c	Dr.		12,000	
April 30	Nagpur Branch A/c	Dr.		2,000	
	To Delhi Branch A/c				12,000
	To Ahmedabad Branch A/c				2,000
	(Being the adjustment for branch transactions)				

Workings **Statement Showing Inter-Branch Transactions**

Branches	Delhi		Kanpur		Nagpur		Ahmedabad	
	Dr. ₹	Cr. ₹	Dr. ₹	Cr. ₹	Dr. ₹	Cr. ₹	Dr. ₹	Cr. ₹
Delhi								
Goods received	15,000	—	—	—	—	9,000	—	6,000
Goods sent	—	27,000	—	—	12,000	—	15,000	—
Bills Receivable received	9,000	—	—	—	—	—	—	9,000
Bills Payable accepted	—	9,000	—	—	6,000	—	3,000	—
Kanpur								
Goods received	—	6,000	21,000	—	—	15,000	—	—
Cash sent	6,000	—	—	9,000	3,000	—	—	—
Nagpur								
Goods sent	—	—	—	—	—	9,000	9,000	—
Bills Receivable received	—	—	—	—	9,000	—	—	9,000
Cash received	—	—	—	—	5,000	—	—	5,000
TOTAL	30,000	42,000	21,000	9,000	35,000	33,000	27,000	29,000
Balance	12,000	—	—	12,000	—	2,000	2,000	—
	42,000	42,000	21,000	21,000	35,000	35,000	29,000	29,000

Incorporation of Branch Trial Balance in the Head Office Books

It has already been stated that an independent branch prepares its own Trial Balance and Final Accounts and remits the copies of these statements to the head office.

After receiving Branch Trial Balance, head office proceeds to incorporate it in its own books. This is absolutely necessary because the branch belongs to the head office, and if the branch Trial Balance is not incorporated in the head office books, the latter will not show correct position.

The incorporation of Branch Trial Balance can be divided into two parts:

(a) Incorporation of Branch Profit and Loss; and
(b) Incorporation of Branch Assets and Liabilities.

Incorporation of Branch Profit and Loss

For the purpose of incorporation of branch profit and loss, the head office may follow any of the following two methods:

(i) Detailed Incorporation
(ii) Abridged Incorporation

Detailed Incorporation

Under this method, incorporation is done with a view to prepare Branch Trading and Profit and Loss Account in the books of the head office. Head office opens a separate Branch Trading and Profit and Loss Account to incorporate all revenue transactions of the branch. This account is temporary in nature and is prepared to ascertain the real profit or loss of the branch after making all adjustments.

In this connection, we must remember that head office maintains only the ***Branch Account*** and the statements received from the branch do not form a part of the double entry system. Therefore, all the Journal Entries should be passed through the Branch Account maintained in the head office. The required Journal Entries are as follows:

Journal Entries

1. For items on the debit side of the Branch Trading Account

Branch Trading Account Dr.
To Branch Account

The above entry is passed for the total amount of items like opening stock, purchases, carriage inwards, wages, processing cost, goods received from head office, sales returns, etc.

2. For items on the credit side of the Branch Trading Account

Branch Account Dr.
To Branch Trading Account

The above entry is passed for the total amount of items like sales, goods sent to head office, closing stock, purchases returns, abnormal loss of stock, etc.

3. For Gross Profit of the Branch

Branch Trading Account Dr.
To Branch Profit and Loss Account

4. For Gross Loss of the Branch

Branch Profit and Loss Account Dr.
To Branch Trading Account

5. For items on the debit side of the Branch Profit and Loss Account

Branch Profit and Loss Account Dr.
To Branch Account

The above entry is passed for the total amount of items like salaries, rent, depreciation, bad debts, repairs, discount allowed, etc.

6. For items on the credit side of the Branch Profit and Loss Account

Branch Account Dr.
To Branch Profit and Loss Account

The above entry is passed for the total amount of items like discount received, miscellaneous income, etc.

7. For net profit of the Branch

Branch Profit and Loss Account Dr.
To General Profit and Loss Account

8. For net loss of the Branch

General Profit and Loss Account Dr.
To Branch Profit and Loss Account

Abridged Incorporation

Under this method, a Memorandum Trading and Profit and Loss Account is prepared for ascertaining branch profit. Only one entry is passed (in place of 8 above) for incorporating branch net profit/loss.

Branch Account Dr.
To General Profit and Loss Account
(In case of loss the above entry shall be reversed).

Incorporation of Branch Assets and Liabilities

This part of the incorporation is done with a view to include branch assets and liabilities in the annual Balance Sheet of the whole business. At the beginning of the new financial year, assets and liabilities are sent back to the books of the branch by means of reverse entries. The following entries are passed for incorporation :

Journal Entries

1. For branch assets

Branch Assets Account(s) Dr. [Individually]
To Branch Account

2. For branch liabilities

Branch Account Dr. [Individually]
To Branch Liabilities Account

Illustration 53

The following is the Trial Balance of Meerut Branch as on 31st December, 2014:

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Delhi head office		5,000	Debtors	3,700	
Stock 1st January 2014	6,000		Creditors		1,850
Purchases	1,06,040		Rent	1,960	
Goods received from head office	19,000		Sundry office expenses	1,470	
Sales		1,38,000	Cash at bank	1,780	
Goods supplied to head office		6,000	Furniture	6,000	
Salaries	4,500		Depreciation on furniture	400	
			TOTAL	1,50,850	1,50,850

Stock at branch on 31st December, 2014 was valued at ₹ 7,700.

Meerut Branch Account in the head office books on 31st December, 2014 stood at ₹ 8,700 (debit balance). On 28th December, 2014 the head office forwarded goods of the value of ₹ 3,700 to the branch where they were received on 3rd January, 2015.

(i) Prepare Trading and Profit and Loss Account of Meerut branch for the year ended 31st December, 2014 and its Balance Sheet as on that date.
(ii) Pass Journal Entries in the books of the head office to incorporate the above-mentioned trial balance, and
(iii) Show Meerut Branch Account as it would be closed in the head office's ledger.

Solution

(i) In this problem, Meerut Branch Trading and Profit and Loss Account as well as Balance Sheet are to be prepared in the usual manner as if it is a separate business. The balance of Head Office Account (₹ 5,000) should be treated as Capital.

Dr. Meerut Branch Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Opening stock	6,000	By Sales	1,38,000
To Purchases	1,06,040	By Goods supplied to H.O. (Note 4)	6,000
To Goods received from H.O.	19,000	By Closing stock	7,700
To Gross Profit c/d	20,660		
	1,51,700		1,51,700
To Salaries	4,500	By Gross Profit b/d	20,660
To Rent	1,960		
To Sundry office expenses	1,470		
To Depreciation on furniture	400		
To Net Profit	12,330		
	20,660		20,660

Meerut Branch Balance Sheet as at 31st December, 2014

Liabilities		₹	Assets	₹
Delhi head office:			Furniture	6,000
Opening balance	5,000		Debtors	3,700
Add: Profit	12,330	17,330	Closing stock	7,700
Creditors		1,850	Cash at bank	1,780
		19,180		19,180

(ii) For incorporation of Branch Trial Balance, the following entries are to be passed:

In the books of the Head Office

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2014 Dec. 31	Meerut Branch Trading A/c	Dr.		1,31,040	
	To Meerut Branch A/c (Note 1)				1,31,040
	(Being the incorporation of opening stock purchases and goods received from head office)				
	Meerut Branch A/c	Dr.		1,51,700	
	To Meerut Branch Trading A/c (Note 2)				1,51,700
	(Being the incorporation of sales, goods supplied to head office and closing stock)				
	Meerut Branch Trading A/c	Dr.		20,660	
	To Meerut Branch Profit & Loss A/c				20,660
	(Being the gross profit transferred to Branch Profit & Loss Account)				
	Meerut Branch Profit & Loss A/c	Dr.		8,330	
	To Meerut Branch A/c (Note 3)				8,330
	(Being the incorporation of branch expenses i.e. salaries, rent etc.)				
	Meerut Branch Profit & Loss A/c	Dr.		12,330	
	To General Profit & Loss A/c				12,330
	(Being the incorporation of branch net profit)				
	Goods-in-Transit A/c	Dr.		3,700	
	To Meerut Branch A/c				3,700
	(Being the goods sent to branch on 28th December 2014 received on 3rd Jan., 2014)				
	Meerut Branch Furniture A/c	Dr.		6,000	
	Meerut Branch Debtors A/c	Dr.		3,700	
	Meerut Branch Stock A/c	Dr.		7,700	
	Meerut Branch Cash A/c	Dr.		1,780	
	To Meerut Branch A/c				19,180
	(Being the incorporation of branch assets)				
	Meerut Branch A/c	Dr.		1,850	
	To Meerut Branch Creditors A/c				1,850
	(Being the incorporation of branch liability)				

Dr. (iii) In the books of the Head Office Meerut Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Balance b/d	8,700	31.12.2014	By Meerut Branch Trading A/c (Note 1)	1,31,040
	To Meerut Branch Trading A/c (Note 2)	1,51,700		By Meerut Branch Profit & Loss A/c	8,330
	To Meerut Branch Creditors A/c	1,850		By Goods-in-Transit A/c	3,700
				By Meerut Branch Assets A/c	19,180
		1,62,250			1,62,250

Tutorial Notes:

(1) In Branch Trial Balance, Delhi Head Office Account shows a ***credit*** balance of ₹ 5,000. It means that in the head office book, Meerut Branch Account should show a ***debit*** balance of ₹ 5,000. But in the head office book, it shows a ***debit*** balance of ₹8,700. The difference of ₹ 3,700 is due to goods in transit.

(2) After incorporation of Branch Trial balance, the Branch Account in the head office book will not show any balance.

Working Notes:

(1) Opening stock ₹ 6,000 + Purchases ₹ 1,06,040 + Goods received from H.O. ₹ 19,000 = ₹ 1,31,040.

(2) Sales ₹ 1,38,000 + Goods supplied to H.O. ₹ 6,000 + Closing stock ₹ 7,700 = ₹ 1,51,700.

(3) Salaries ₹ 4,500 + Rent ₹ 1,960 + Office expenses ₹ 1,470 + Depreciation ₹ 400 = ₹ 8,330.

(4) Goods supplied to head office should not be treated as goods returned to head office. They have been treated as goods sold to head office.

Abridged Incorporation

Illustration 54

From information given in ***Illustration 61***, prepare Memorandum Branch Trading and Profit and Loss Account and pass necessary Journal Entries to incorporate Meerut branch balances and prepare Meerut Branch Account in the head office books.

Solution — Memorandum Meerut Branch Trading and Profit and Loss Account

Dr. For the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Opening stock	6,000	By Sales	1,38,000
To Purchases	1,06,040	By Goods supplied to H.O.	6,000
To Goods received from H.O.	19,000	By Closing stock	7,700
To Gross Profit c/d	20,660		
	1,51,700		1,51,700
To Salaries	4,500	By Gross Profit b/d	20,660
To Rent	1,960		
To Sundry office expenses	1,470		
To Depreciation on furniture	400		
To Net Profit	12,330		
	20,660		20,660

In the books of the Head Office

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2014	Meerut Branch A/c	Dr.		12,330	
Dec. 31	To General Profit & Loss A/c				12,330
	(Being the incorporation of branch net profit)				
	Goods-in-Transit A/c	Dr.		3,700	
	To Meerut Branch A/c				3,700
	(Being goods sent to branch on 28th December received on 3rd January 2013)				
	Meerut Branch Furniture A/c	Dr.		6,000	
	Meerut Branch Debtors A/c	Dr.		3,700	
	Meerut Branch Stock A/c	Dr.		7,700	
	Meerut Branch Cash A/c	Dr.		1,780	
	To Meerut Branch A/c				19,180
	(Being the incorporation of branch assets)				

	Particulars		L.F.	₹	₹
	Meerut Branch A/c	Dr.		1,850	
	To Meerut Branch Creditors A/c				1,850
	(Being the incorporation of branch liability)				

In the books of the Head Office

Meerut Branch Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Balance b/d	8,700	31.12.2014	By Goods-in-Transit A/c	3,700
	To Meerut Branch Creditors A/c	1,850		By Meerut Branch Assets A/c	19,180
	To General Profit & Loss A/c	12,330			
		22,880			22,880

Tutorial Notes:

(1) The students should note that, under this method, individual items of Trading and Profit and Loss Account are not incorporated in the books of the head office. Only the net profit of the branch is incorporated. Branch profit is calculated with the help of a Memorandum Trading and Profit and Loss Account.

(2) Branch assets and liabilities are incorporated in the same manner in the case of detailed incorporation method.

Illustration 55

C. Co. Ltd. of Calcutta had a branch in Bombay which maintained its accounts independently. Accounts relating to fixed assets in the Bombay branch were, however, kept in the books of accounts of the head office. On 31st December, 2014 the Bombay branch extracted the following Trial Balance from its own books of accounts and forwarded the same to the head office.

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Stock-in-Trade (1.1.2014)	20,000		Cash in hand and at bank	2,500	
Purchases	50,000		Sales		75,900
Carriage and freight inward	2,500		Sundry creditors		5,000
Goods received from head office	15,000		Miscellaneous receipts		500
Transit Insurance ch. on goods received	1,000		Purchases returns		800
Salaries	10,000		Sales returns	500	
Rents rates and taxes	3,800		Bills receivable	1,500	
General office expenses	9,000		Discount allowed	200	
Sundry debtors	7,200		Head office account		41,000
			TOTAL	1,23,200	1,23,200

The Closing stock (as at 31.12.2014) at Bombay branch was ₹ 16,000. Depreciation was to be allowed @ 15% p.a. on Branch Plant and Machinery of ₹ 25,000 and @ 20% p.a. on Branch Furniture and Fittings of ₹ 6,000. Outstanding rent in respect of the year 2014 amounted to ₹ 500. Bombay Branch account, in the head office books, showed a debit balance of ₹ 46,000 and it was revealed that the difference in the balances shown by Head Office Account and Bombay Branch Account was on account of cash-in-transit.

You are to show Journal Entries required to incorporate the above Trial Balance and other particulars in the books of the head office and also the Bombay Branch Account.

Solution

In the books of C. Co. Ltd. (H.O.)

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2014 Dec. 31	Bombay Branch Trading A/c	Dr.		89,000	
	To Bombay Branch A/c (Note 1)				89,000
	(Being the incorporation of opening stock, purchases, carriage and freight inward, goods received from head office, transit insurance, sales returns etc.)				
	Bombay Branch A/c	Dr.		92,700	
	To Bombay Branch Trading A/c (Note 2)				92,700
	(Being the incorporation of closing stock, sales, and purchase returns)				
	Bombay Branch Trading A/c	Dr.		3,700	
	To Bombay Branch Profit & Loss A/c				3,700
	(Being the gross profit transferred to Branch Profit & Loss Account)				
	Bombay Branch Profit & Loss A/c	Dr.		28,450	
	To Bombay Branch A/c (Note 3)				28,450
	(Being the incorporation of branch expenses)				

Bombay Branch A/c Dr. To Bombay Branch Profit & Loss A/c (Being the incorporation of branch miscellaneous income)		500	500
General Profit & Loss A/c Dr. To Bombay Branch Profit & Loss A/c (Being the incorporation of branch net loss)		24,250	24,250
Cash-in-Transit A/c Dr. To Bombay Branch A/c (Being cash remitted by Bombay branch not yet received by the head office)		5,000	5,000
Bombay Branch A/c Dr. To Branch Plant & Machinery A/c To Branch Furniture & Fittings A/c (Being the depreciation charged on branch assets)		4,950	 3,750 1,200
Bombay Branch Closing Stock A/c Dr. Bombay Branch Debtors A/c Dr. Bombay Branch Bills Receivable A/c Dr. Bombay Branch Cash in hand A/c Dr. To Bombay Branch A/c (Being the incorporation of branch assets)		16,000 7,200 1,500 2,500	 27,200
Bombay Branch A/c Dr. To Bombay Branch Creditors A/c To Outstanding Rent A/c (Being the incorporation of branch liabilities)		5,500	 5,000 500

In the books of the C. Co. Ltd. (H. O.)

Dr. Bombay Branch Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Balance b/d	46,000	31.12.2014	By Bombay Branch Trading A/c (Note 1)	89,000
	To Bombay Branch Trading A/c (Note 2)	92,700		By Bombay Branch Profit & Loss A/c	28,450
	To Bombay Branch Trading A/c	500		By Cash-in-Transit A/c	5,000
	To Branch Plant & Machinery A/c	3,750		By Bombay Branch Assets A/c	27,200
	To Branch Furniture & Fittings A/c	1,200			
	To Bombay Branch Creditors A/c	5,000			
	To Outstanding Rent A/c	500			
		1,49,650			1,49,650

Working Notes:

(1) Opening stock ₹ 20,000 + Purchases ₹ 50,000 + Carriage and freight ₹ 2,500 + Goods from head office ₹ 15,000 + Transit insurance ₹ 1,000 + Sales return ₹ 500 = ₹ 89,000.

(2) Sales ₹ 75,900 + Closing stock ₹ 16,000 + Purchase returns ₹ 800 = ₹ 92,700.

(3) Salaries ₹ 10,000 + Rent, rates (including outstanding) ₹ 4,300 + General office expenses ₹ 9,000 + Discount allowed ₹ 200 + Depreciation on Plant and Machinery ₹ 3,750 + Depreciation on Furniture and Fittings ₹ 1,200 = ₹ 28,450.

Illustration 56

A limited company with its Head Office in Bombay whose Branch Office in Delhi, which obtain goods partly from head office and partly from outsiders. The branch keeps a separate set of books. The following balances were extracted on 31.12.2014 :

Particulars	Bombay		Delhi	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
Share Capital Account	—	4,00,000	—	—
Plant and Machinery	2,80,000	—	—	—
Furniture and Fixture	50,000	—	25,000	—
Loose Tools	40,000	—	18,000	—
Profit and Loss Account on 1.1.2014	—	35,000	—	—
Debtors and Creditors	2,30,000	55,000	10,000	25,000
Cash in Hand	5,000	—	2,800	—
Cash at Bank	5,000	—	6,000	—
Purchases and Sales	6,00,000	8,10,000	1,12,000	2,45,000
Salaries and Wages	30,000	—	16,000	—

Rent	15,000	—	8,500	—
General Expenses	5,000	—	7,500	—
Goods from Head Office to Branch		90,000	80,000	—
Current Accounts	70,000	—	—	55,800
Opening Stock (1.1.2014)	50,000	—	40,000	—
	13,90,000	13,90,000	3,25,800	3,25,800

The difference between the balances of the Head Office Current Account and Branch Current Account is due to goods and cheque in transit as at the date of the preparation of the Trial Balance. Rent of branch office remains unpaid ₹ 150. Plant, Furniture and Loose Tools are to be depreciated at 10% p.a., 15% p.a., and 20% p.a. respectively. Stock-in-trade valued at 31.12.2014 were as follows: Head office ₹ 65,000; Branch ₹ 35,000.

Prepare a combined Trading and Profit and Loss Account for the year ended 31.12.2014 and a Balance Sheet as at the date.

Solution

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	Head Office (₹)	Delhi Branch (₹)	Particulars	Head Office (₹)	Delhi Branch (₹)
To Opening Stock	50,000	40,000	By Sales	8,10,000	2,45,000
To Purchases	6,00,000	1,12,000	By Goods Sent to Branch	90,000	—
To Goods from Head Office	—	80,000	By Closing Stock	65,000	35,000
To Gross Profit c/d	3,15,000	48,000			
	9,65,000	2,80,000		9,65,000	2,80,000
To Salaries and Wages	30,000	16,000	By Gross Profit b/d	3,15,000	48,000
To Rent	15,000	8,500			
To Outstanding Rent	—	150			
To General Expenses	5,000	7,500			
To Depreciation on :					
Plant and Machinery @ 10%	28,000	—			
Furniture @ 15%	7,500	3,750			
Loose Tools @ 20%	8,000	3,600			
To Net Profit c/d	2,21,500	8,500			
	3,15,000	48,000		3,15,000	48,000

Dr. Profit and Loss Appropriation Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Balance c/d	2,65,000	By Balance b/d	35,000
		By Net Profit b/d: Head Office	2,21,500
		Branch	8,500
	2,65,000		2,65,000

Balance Sheet of . . . as at 31st December, 2014

Liabilities	₹	₹	Assets	₹	₹
Share Capital			**Fixed Assets**		
Authorised :			Plant and Machinery (H.O.)	2,80,000	
. . . Equity Shares of . . . each		***	less: Depreciation	28,000	2,52,000
Issued and Subscribed :			Furniture and Fixtures :		
. . . Equity shares of . . . each		4,00,000	Head Office	50,000	
Reserve and Surplus			Branch	25,000	
Profit and Loss Account		2,65,000		75,000	
Secured Loan		Nil	Less: Depreciation (₹ 7,500 + ₹ 3,750)	11,250	63,750
Unsecured Loan		Nil	Loose Tools :		
Current Liabilities and Provisions			Head Office	40,000	
Creditors :			Branch	18,000	
Head Office	55,000			58,000	
Branch	25,000	80,000	Less: Depreciation (₹ 8,000 + ₹ 3,600)	11,600	46,400
Outstanding Rent (Branch)		150	**Investments**		Nil
			Current Assets, Loans and Advances		
			Debtors :		
			Head Office	2,30,000	
			Branch	10,000	2,40,000

			Stock-in-Trade :		
			Head Office	65,000	
			Branch	35,000	1,00,000
			Goods-in-Transit		10,000
			Cash at Bank :		
			Head Office	15,000	
			Branch	6,000	21,000
			Cheque-in-Transit		4,200
			Cash in Hand :		
			Head Office	5,000	
			Branch	2,800	7,800
		7,45,150			7,45,150

Working Note : (1) In the books of the Head Office, Branch Current Account balance is ₹ 70,000 but in the books of the Delhi Branch, Head Office Current Account balance is ₹ 55,800. Total difference is ₹ 70,000 – ₹ 55,800 = ₹ 14,200. Difference due to Goods-in-Transit' is ₹ 10,000 (₹ 90,000 – ₹ 80,000) and the balance ₹ 4,200 is due to cheque-in-transit. The Branch Current Account will appear as follows:

Dr. Delhi Branch Current Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d	70,000		By Goods-in-Transit*	10,000
				By Cash-in-Transit	4,200
				By Balance c/d	55,800
		70,000			70,000

*Goods sent by head office = ₹ 90,000 but goods received by the branch ₹ 80,000. Therefore, goods of ₹ 10,000 still in transit.

Illustration 57

Imphal Branch of a business having head office in Calcutta prepares its accounts independently. The position as on 31.12.2014 is depicted below :

Particulars	Calcutta Head Office		Imphal Branch	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
Bills Receivable / Bills Payable	—	11,800	6,000	—
Debtors / Creditors	78,500	39,600	58,400	29,200
Stock	1,42,000	—	72,000	—
Cash and Bank	1,07,400	—	44,200	—
Fixed Assets	4,53,500	—	1,59,400	—
Profit and Loss Account	—	1,46,600	—	30,600
Capital	—	8,82,000	—	—
Branch Account	2,98,600	—	—	—
Head Office Account	—	—	—	2,80,200
TOTAL	10,80,000	10,80,000	3,40,000	3,40,000

It is revealed that the above accounts for the year ended 31.12.2014 were prepared without considering the following facts:

(a) Goods worth ₹ 4,400 had been despatched by the head office to Imphal on 27.12.2014 but the goods did not reach there till 2.1.2015.

(b) As per convention, the branch should be charged with ₹ 3,000 for administrative services rendered by the head office.

(c) The branch had sent a bank draft to the head office on 30.12.2014 for ₹ 10,000. But the draft reached head office after 31.12.2014.

(d) Stock stolen in transit ₹ 4,000 (uninsured). The stock was invoiced by the head office to the branch and charged to the Branch Account. But the branch manager refused to consider it in the branch books.

(e) Depreciation on some branch assets (of which accounts are maintained in head office books) not provided for ₹ 2,500.

(f) The balance of branch profit should be transferred to the head office books.

Show the necessary adjustment entries in the books of the head office and the branch and prepare the Balance Sheet of the business as on 31.12.2014.

Solution **In the books of Head Office (Calcutta)**

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2014 (a) Dec. 31	Goods-in-Transit A/c Dr.		4,400	
	To Imphal Branch A/c			4,400
	(Being goods sent to Imphal Branch on 27.12.2014 but the goods have not been received by branch, now adjusted)			
(b)	Imphal Branch A/c Dr.		3,000	
	To Profit and Loss A/c			3,000
	(Being amount charged to Imphal Branch for admisinistrative services rendered by H.O.)			
(c)	Cash-in-Transit A/c Dr.		10,000	
	To Imphal Branch A/c			10,000
	(Being bank draft sent by branch on 30.12.2014 but received by H.O. after 31.12.2014, now adjusted)			
(d)	Profit and Loss A/c Dr.		4,000	
	To Imphal Branch A/c			4,000
	(Being goods stolen in transit and charged to Branch but the branch manager refused to accept it, now adjusted in the H.O. Profit and Loss Account)			
	Tutorial Note : It should be noted that after passing (a), (c) and (d) entries above, the Branch A/c balance in H.O. book will be (₹ 2,98,600 – ₹ 4,400 – ₹ 10,000 – ₹ 4,000) = ₹ 2,80,200. Now it is matching with the balance of Head Office Account (in the branch's books).			
(e)	Imphal Branch A/c Dr.		2,500	
	To Imphal Branch Fixed Assets A/c			2,500
	(Being depreciation on fixed assets of Imphal Branch adjusted)			
(f)	Imphal Branch A/c Dr.		25,100	
	To Profit and Loss A/c (Note 1)			25,100
	(Being the incorporation of branch profit)			
	Profit and Loss A/c (Note 3) Dr.		1,70,700	
	To Capital Account			1,70,700
	(Being total profit transferred to Capital Account)			
	Branch Bills Receivable A/c Dr.		6,000	
	Branch Debtors A/c Dr.		58,400	
	Branch Stock A/c Dr.		72,000	
	Branch Cash and Bank A/c Dr.		44,200	
	Branch Fixed Assets A/c Dr.		1,59,400	
	To Imphal Branch A/c			3,40,000
	(Being the incorporation of branch assets in the H.O. book)			
	Imphal Branch A/c Dr.			
	To Branch Creditors A/c		29,200	
	(Being the incorporation of branch liability in the H.O. book)			29,200
	Tutorial Note : Last four entries have not been asked in the question. Yet, these entries are required to be passed to close the Imphal Branch Account in the H.O., book (See Working Note 4 for details).			

In the books of Imphal Branch

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2014 Dec. 31	Profit and Loss A/c Dr.		3,000	
	To Head Office A/c			3,000
	(Being the amount charged by H.O. for administrative services)			
	Profit and Loss A/c Dr.		2,500	
	To Head Office A/c			2,500
	(Being depreciation on Branch Fixed Assets maintained at H.O. adjusted)			
	Profit and Loss A/c (Note 1) Dr.		25,100	
	To Head Office A/c			25,100
	(Being adjusted branch profit transferred to Head Office Account)			

Tutorial Note: No entry is to be passed for Goods-in-Transit and Cash-in-Transit because these have already been adjusted in Head Office books.

Balance Sheet of . . . as at 31st December, 2014

Liabilities	₹	₹	Assets	₹	₹
Capital :			Fixed Assets :		
Opening balance	8,82,000		Head Office	4,53,500	
Add: Profit	1,70,700	10,52,700	Branch	1,59,400	
Creditors :				6,12,900	
Head Office	39,600		Less: Depreciation	2,500	6,10,400
Branch	29,200	68,800	Stock :		
Bills Payable :			Head Office	1,42,000	
Head Office		11,800	Branch	72,000	2,14,000
			Debtors :		
			Head Office	78,500	
			Branch	58,400	1,36,900
			Goods-in-Transit		4,400
			Bills Receivable :		
			Branch		6,000
			Cash and Bank :		
			Head Office	1,07,400	
			Branch	44,200	1,51,600
			Cash-in-Transit		10,000
		11,33,300			11,33,300

Working Notes:

(1) Revised Net Profit of Branch

Particulars	₹
Profit as per Trial Balance	30,600
Less : Charge for Administrative Services	3,000
	27,600
Less: Depreciation of Branch Fixed Assets	2,500
	25,100

(2) Revised Net Profit on Head Office

Particulars	₹
Profit as per Trial Balance	1,46,600
Add : Charge for Administrative Services	3,000
	1,49,600
Less: Goods Stolen in Transit	4,000
	1,45,600

(3) Total profit transferred to Capital Account =₹ 1,45,600 + ₹ 25,100 = ₹1,70,700.

Dr. (4) Imphal Branch Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	2,98,600	By Goods-in-Transit	4,400
To Profit and Loss A/c	3,000	By Cash-in-Transit	10,000
To Imphal Branch Fixed Assets A/c	2,500	By Profit and Loss A/c	4,000
To Profit and Loss A/c	25,100	By Branch Bills Receivable A/c	6,000
To Branch Creditors A/c	29,200	By Branch Debtors A/c	58,400
		By Branch Stock A/c	72,000
		By Branch Cash and Bank A/c	44,200
		By Branch Fixed Assets A/c	1,59,400
	3,58,400		3,58,400

Closing the Books of Account of the Branch

At the end of the accounting period, the books of accounts of the branch are also closed.

For the purpose of closing the books of accounts, any of the following two methods can be adopted by the branch:

Method 1

Under this method all items of Trial Balance are closed through the ***Head Office Account***. Usual entries are passed in the branch books for depreciation on fixed assets, outstanding salaries etc. The following entries are passed to close the books of the branch:

1. For revenue items on the debit side of the Branch Trading and Profit and Loss Account

Head Office Account Dr.

To Opening Stock Account

To Purchases Account
To Goods received from Head Office Account
To Wages Account
To Rent Account
To Salaries Account
To Depreciation etc. Account

2. For revenue items on the credit side of the Branch Trading and Profit and Loss Account

Sales Account Dr.
Purchases Returns Account Dr.
Closing Stock Account Dr.
Discount Received Account Dr.
To Head Office Account

3. For branch assets

Head Office Account Dr.
To Debtors Account
To Cash at Bank Account
To Cash-in-Transit Account
To Closing Stock Account

4. For branch liabilities

Outstanding Expenses Account Dr.
Creditors Account Dr.
To Head Office Account

[After passing the above entries, the Head Office Account will not show any balance]

Illustration 58

A Madras Head Office has an independent branch at Ahmedabad. From the following particulars, give Journal Entries to close the books of the Ahmedabad branch. Show also the Madras Head Office Account in the branch books.

Trial Balance of Ahmedabad Branch as at 31st December, 2014

Particulars	₹.	Particulars	₹.
Stock on 1st January	8,200	Creditors	2,700
Purchases	12,800	Sales	34,950
Wages	6,550	Head office	14,000
Manufacturing expenses	3,400	Discount	150
Rent	1,700	Purchase returns	300
Salaries	5,500		
Debtors	4,000		
General expenses	2,000		
Goods received from Head Office	7,200		
Cash at bank	750		
	52,100		52,100

(a) Closing stock at branch was ₹ 14,350.
(b) The branch fixed assets maintained at H.O. books were: Machinery ₹ 25,000, Furniture ₹ 1,000. Depreciation was to be allowed at 10 per cent on Machinery and 15 per cent on Furniture.
(c) Rent due was ₹ 150.
(d) A remittance of ₹ 4,000 made by the branch on 28th December, 2014 was received by the Head Office on 4th January, 2015.

Solution

In the books of the Ahmedabad Branch
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2014 Dec. 31	Depreciation A/c Dr. To Head Office A/c (Being the depreciation on fixed assets accounts maintained by the Head Office)		2,650	2,650

Cash-in-Transit A/c	Dr.		4,000	
To Head Office A/c				4,000
(Being the amount remitted on 28th December 2014 to Head Office but credited by it on 4th January 2015)				
Rent A/c	Dr.		150	
To Outstanding Rent A/c				150
(Being the outstanding rent paid)				
Head Office A/c	Dr.		50,150	
To Opening Stock A/c				8,200
To Purchases A/c				12,800
To Wages A/c				6,550
To Manufacturing Expenses A/c				3,400
To Rent A/c				1,850
To Salaries A/c				5,500
To General Expenses A/c				2,000
To Goods received from H.O. A/c				7,200
To Depreciation A/c				2,650
(Being the transfer of different revenue items to Head Office Account)				
Sales A/c	Dr.		34,950	
Purchase Returns A/c	Dr.		300	
Closing Stock A/c	Dr.		14,350	
Discount A/c	Dr.		150	
To Head Office A/c				49,750
(Being the transfer of different revenue items to Head Office Account)				
Head Office A/c	Dr.		23,100	
To Debtors A/c				4,000
To Cash at Bank A/c				750
To Cash-in-transit A/c				4,000
To Closing Stock A/c				14,350
(Being the assets account balances transferred)				
Creditors A/c	Dr.		2,700	
Outstanding Rent A/c	Dr.		150	
To Head Office A/c				2,850
(Being the liabilities account balances transferred)				

In the books of Ahmedabad Branch

Dr. **Head Office Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Sundry Expenses	50,150	31.12.2014	By Balance b/d	14,000
	To Sundry Assets	23,100		By Cash-in-transit	4,000
				By Sundry Revenue	49,750
				By Depreciation	2,650
				By Sundry Liabilities	2,850
		73,250			73,250

Illustration 59

Vivek & Co of Bombay have a branch in Goa. Goods sold at Goa are supplied from Bombay but no charge is made in the books as between the branch and the head office. Cash remittances are made by the branch to the head office from time to time. On September 30, 2014, the branch Balance Sheet after closing the book was as follows:

Liabilities	₹	Assets	₹
Creditors	60,000	Debtors	3,00,000
Head Office Account	2,52,000	Cash at bank	12,000
		Building extension A/c transferred to H.O. A/c	Nil
	3,12,000		3,12,000

For the six months ending 31st March, 2015, the following transactions took place at Goa Branch (all figures in ₹):

Sales	3,60,000	Discount allowed	12,000
Purchases	72,000	Discount earned	1,800
Wages paid	30,000	Cash paid to creditors	90,000
Salaries (including ₹ 3,000 paid in advance)	6,000	Cash sent to bank	1,20,000

Fire Insurance premium paid for one year	4,800	Building A/c (further payments to contractors)	6,000
Manager's salary for 9 months	10,800	Cash in hand	2,400
Cash collection from Debtors	2,40,000	Cash at bank	42,000

Prepare the Head Office Account in the books of Goa branch as on 31st March 2015 to show entries after the books are closed and also the branch Balance Sheet on the same date, assuming that it is to be made on the same lines as on 30th September 2014.

Solution **In the books of Goa Branch of Vivek & Co**

Journal **Dr.** **Cr.**

Date	Particulars	L.F.	₹	₹
2015 March 31	Salaries Paid in Advance A/c Dr.		6,600	
	To Salaries A/c			3,000
	To Manager's Salary A/c			3,600
	(Being the adjustment for salaries paid in advance)			
"	Prepaid Insurance A/c Dr.		2,400	
	To Fire Insurance Premium A/c			2,400
	(Being adjustment for insurance paid in advance)			
"	Head Office A/c Dr.		1,26,600	
	To Purchases A/c			72,000
	To Wages A/c			30,000
	To Salaries A/c (₹ 6,000 – ₹ 3,000)			3,000
	To Fire Insurance A/c (₹ 4,800 – ₹ 2,400)			2,400
	To Managers' Salary A/c (₹ 10,800 – ₹ 3,600)			7,200
	To Discount Allowed A/c			12,000
	(Being the transfer of different revenue items to Head Office Account after making adjustment for advance salary and prepaid insurance premium)			
	Sales A/c Dr.		3,60,000	
	Discount Earned A/c Dr.		1,800	
	To Head Office A/c			3,61,800
	(Being the transfer of different revenue items to Head Office Account)			
	Head Office A/c Dr.		6,000	
	To Building A/c			6,000
	(Being the Asset Account balance transferred to Head Office Account)			

Dr. **Head Office Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015			2014		
March 31	To Purchases	72,000	Oct. 1	By Balance b/f	2,52,000
	To Wages	30,000	2015	By Sales	3,60,000
	To Salaries	3,000	March 31	By Discount Earned	1,800
	To Fire Insurance	2,400			
	To Discount Allowed	12,000			
	To Manager's Salary	7,200			
	To Building	6,000			
	To Cash and Bank (Note 1)	60,000			
	To Balance c/d	4,21,200			
		6,13,800			6,13,800

Balance Sheet of Goa Branch as at 31st March, 2015

Liabilities	₹	₹	Assets	₹	₹
Head Office Account		4,21,200	Sundry Debtors (Note 2)		4,08,000
Sundry Creditors (Note 3)		40,200	Prepaid Insurance		2,400
			Salaries Paid in Advance :		
			Manager	3,600	
			Others	3,000	6,600
			Cash at Bank		42,000
			Cash in Hand		2,400
		4,61,400			4,61,400

Working Notes :

Dr. **(1) Cash and Bank Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014			2015		
Oct. 1	To Balance b/f	12,000	March 31	By Wages	30,000
2015				By Salaries	6,000
March 31	To Sundry Debtors (Cash collected)	2,40,000		By Fire Insurance Premium	4,800
	To Cash "C"	1,20,000		By Salary to Manager	10,800
				By Sundry Creditors (Payment)	90,000
				By Bank "C"	1,20,000
				By Building	6,000
				By H.O. Remittance (Balancing figure)	60,000
				By Balance c/d:	
				Cash	2,400
				Bank	42,000
		3,72,000			3,72,000

Dr. **(2) Sundry Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2014					
Oct. 1	To Balance b/f	3,00,000	?	By Cash and Bank	2,40,000
	To Sales	3,60,000	2015	By Discount Allowed	12,000
			March 31	By Balance c/d	4,08,000
		6,60,000			6,60,000

Dr. **(3) Sundry Creditors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2015			2014		
March 31	To Cash and Bank	90,000	Oct. 1	By Balance b/f	60,000
	To Discount Earned	1,800		By Purchases	72,000
	To Balance c/d	40,200			
		1,32,000			1,32,000

Method 2

Under this method, branch will pass usual closing entries for transforming all revenue items to its Trading and Profit and Loss Account. The net profit or loss is transferred to Head Office Account. Different assets and liabilities are closed through Head office Account in the usual manner. The following Journal Entries are passed:

1. For net profit

Profit and Loss Account Dr.
To Head Office Account

2. For net loss

Head Office Account Dr.
To Profit and Loss Account

After transferring branch profit/loss to Head Office Account, the balance of the Head Office Account in the branch books will be equal to net assets (Assets – Liabilities). Now the branch can prepare its Balance Sheet, taking net assets as capital of the branch.

However, the branch may also close the Assets and Liabilities Account by passing the following entries.

1. For closing Assets Account

Head Office Account Dr.
To Assets Accounts [Individually]

2. For closing Liabilities Account

Liabilities Accounts Dr. [Individually]
To Head Office Account

[After passing above entries, the Head Office Account will not show any balance].

Illustration 60

From the information given in ***Illustration 58***, pass Journal Entries in the books of Ahmedabad branch to close the books and prepare its Head Office Account.

Solution

In the books of the Head Office
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2014 Dec. 31	Depreciation A/c	Dr.		2,650	
	To Head Office Account				2,650
	(Being the depreciation on fixed assets accounts maintained by the Head Office)				
	Cash-in-Transit A/c	Dr.		4,000	
	To Head Office A/c				4,000
	(Being the amount remitted on 28th Dec., 2014 to Head Office but credited by it on 4th Jan., 2013)				
	Rent A/c	Dr.		150	
	To Outstanding Rent A/c				150
	(Being the outstanding rent paid)				
	Head Office A/c	Dr.		400	
	To Profit & Loss A/c				400
	(Being the transfer of loss)				
	Head Office A/c	Dr.		23,100	
	To Debtors A/c				4,000
	To Cash at Bank A/c				750
	To Cash-in-Transit A/c				4,000
	To Closing Stock A/c				14,350
	(Being the assets account balances transferred)				
	Creditors A/c	Dr.		2,700	
	Outstanding Rent A/c	Dr.		150	
	To Head Office A/c				2,850
	(Being liabilities account balances transferred)				

In the books of Ahmedabad Branch
Head Office Account

Dr. | **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Profit & Loss A/c	400	31.12.2014	By Balance b/d	14,000
	To Sundry Assets A/c	23,100		By Cash-in-Transit A/c	4,000
				By Depreciation A/c	2,650
				By Sundry Liabilities A/c	2,850
		23,500			23,500

Working Notes:

Trading and Profit and Loss Account for the year ended 31st December, 2014

Dr. | **Cr.**

Particulars		₹	Particulars	₹
To Opening Stock		8,200	By Sales	34,950
To Purchases	12,800		By Closing Stock	14,350
Less: Returns	300	12,500		
To Wages		6,550		
To Manufacturing Expenses		3,400		
To Goods received from H.O.		7,200		
To Gross Profit c/d		11,450		
		49,300		49,300
To Rent	1,700		By Gross Profit b/d	11,450
Add: Outstanding	150	1,850	By Discount	150
To Salaries		5,500	By Net Loss	400
To General expenses		2,000		
To Depreciation:				
On Machinery	2,500			
On Furniture	150	2,650		
		12,000		12,000

Foreign Branches

When a branch is established abroad, it is called a ***Foreign Branch***. The accounting arrangements for a foreign branch are exactly the same as for any independent branch, up to the Trial Balance. But in this case accounts are maintained in foreign currency to correspond with the local conditions. The main problem which the Head Office has to face is the restatement of accounts of one currency into another. In order to incorporate the Trial Balance of a foreign branch in the books of the Head Office, it must be translated into the currency of the Head Office as per the provision of AS-11 — "***The Effects of Changes in Foreign Exchange Rates***".

The conversion rate will depend upon the classification of foreign operations.

Classification of Foreign Operations

Foreign operations are classified as :

(i) Integral foreign operations; and (ii) Non-integral foreign operations.

An ***integral*** foreign operation is a dependent foreign operation or an extension of the activities of the reporting enterprise.

For example, Tata Motors Ltd. has a branch office at Dhaka, Bangladesh. This branch is exclusively selling Tata commercial vehicles and passenger cars and remits the cash immediately to Tata Motors Ltd.
This is an integral foreign operation.

A ***non-integral*** foreign operation tends to act as a ***stand-alone*** unit, accumulates cash and other monetary items, incurs expenses, generate incomes and perhaps arranges borrowings, all substantially in its local currency.

The following are indications that a foreign operation is a non-integral foreign operation rather than an integral foreign operation:

(a) while the reporting enterprise may ***control the foreign operation***, the activities of the foreign operation are carried out with a ***significant degree of autonomy*** from those of the reporting enterprise;
(b) transactions with the reporting enterprise are not a high proportion of the foreign operation's activities;
(c) the activities of the foreign operation are financed mainly from its own operations or local borrowings rather than from the reporting enterprise;
(d) costs of labour, material and other components of the foreign operation's products or services are primarily paid or settled in the local currency rather than in the reporting currency;
(e) the foreign operation's sales are mainly in currencies other than the reporting currency;
(f) cash flows of the reporting enterprise are insulated from the day-to-day activities of the foreign operation rather than being directly affected by the activities of the foreign operation;
(g) sales prices for the foreign operation's products are not primarily responsive on a short-term basis to changes in exchange rates but are determined more by local competition or local government regulation; and
(h) there is an active local sales market for the foreign operation's products, although there also might be significant amounts of exports.

The appropriate classification for each operation can, in principle, be established from factual information related to the indicators listed above. In some cases, the classification of a foreign operation as either a non-integral foreign operation or an integral foreign operation of the reporting enterprise may not be clear, and judgement is necessary to determine the appropriate classification.

Translation of Foreign Integral Operations

The financial statements of an integral foreign operation should be translated as if the transactions of the foreign operation had been those of the reporting enterprise itself.

The cost and depreciation of tangible fixed assets is translated using the exchange rate at the date of purchase of the asset or, if the asset is carried at fair value or other similar valuation, using the rate that existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when those costs were incurred. The recoverable amount or realisable value of an asset is translated using the exchange rate at the date as at which the net realisable value is determined. The rate used is therefore usually the closing rate.

Illustration 61

On 31st March, 2014, the following ledger balances have been extracted from the books of Washington Branch Office :

Ledger Accounts	
Building	180
Stock as on 1.4.2013	26
Cash and Bank Balances	57
Purchases	96
Sales	110
Commission Receipts	28
Debtors	46
Creditors	65

You are required to convert above ledger balances into Indian Rupees.
Use the following rates of exchange :
(a) Opening rate : ₹ 46 per $
(b) Closing rate : ₹ 50 per $
(c) Average rate : ₹ 48 per $
(d) For fixed assets : ₹ 42 per $.
[Assumed that the branch is an integral foreign operation of the Indian company.]

Solution **Conversion of Ledger Balances (in Dollars) into Rupees**

Ledger Balances	Dollar		Rate of Exchange	Rupees	
	Dr.	Cr.	Per $	Dr.	Cr.
1. Building	180	–	42	7,560	–
2. Stock as on 1.4.2013	26	–	46	1,196	–
3. Cash and Bank Balances	57	–	50	2,850	–
4. Purchases	96	–	48	4,608	–
5. Sales	–	110	48	–	5,280
6. Commission Receipts	–	28	48	–	1,344
7. Debtors	46	–	50	2,300	–
8. Creditors	–	65	50	–	3,250

Points to Remember

Sl. No.	Items	Conversion Rules
1.	Fixed assets and depreciation thereon	Rate applicable on the date of purchase
2.	Fixed liabilities	Rate applicable when incurred
3.	Current assets/liabilities	Rate prevailing at the year-end
4.	Opening stock	Rate prevailing at the beginning of the year
5.	Revenue items	Average rate of the period
6.	Closing stock	Rate prevailing at the year-end
7.	Remittances	Actual rates at which these were made
8.	H.O. Current Account	At the actual figures shown for the Branch Account in the books of the H.O.

Illustration 62

DM Ltd., Delhi has a branch in London. London branch is an integral foreign operation of DM Ltd. At the end of the year 31st March, 2015, the branch furnishes the following Trial Balance in UK Pound.

Particulars	Dr.	Cr.
Fixed Assets (acquired on 1st April, 2011)	24,000	—
Stock as on 1st April, 2014	11,200	—
Goods from Head Office	64,000	—
Expenses	4,800	—
Debtors	4,800	—

Creditors	—	3,200
Cash at Bank	1,200	—
Head Office Account	—	22,800
Purchases	12,000	—
Sales	—	96,000
	1,22,000	1,22,000

In head office books, the Branch Account stood as shown below :

London Branch Account

Particulars	₹	Particulars	₹
To Balance b/d	20,10,000	By Bank A/c	52,16,000
To Goods Sent to Branch	49,26,000	By Balance c/d	17,20,000
	69,36,000		69,36,000

The following further information are given :

(a) Fixed assets are to be depreciated @ 10% p.a. on straight line basis.

(b) On 31st March, 2015 :
Expenses outstanding £ 400
Prepaid expenses £ 200
Closing stock £ 8,000

(c) Rate of Exchange :
1st April, 2011 ₹ 70 to £ 1
1st April, 2014 ₹ 76 to £ 1
31st March, 2015 ₹ 77 to £ 1
Average ₹ 75 to £ 1

You are required to prepare :

(i) Trial Balance incorporating adjustments of outstanding and prepaid expenses, converting UK Pound into Indian Rupees.

(ii) Trading and Profit and Loss Account for the year ended 31st March, 2015 and the Balance Sheet as on that date of London branch as would appear in the books of Delhi head office of DM Ltd.

Solution

DM Ltd.

London Branch Converted Trial Balance as at 31st March, 2015

Sl.No.	Heads of Account	UK Pound (£)		Exchange Rate	Indian Rupee (₹)	
		Dr.	Cr.		Dr.	Cr.
1.	Fixed Assets	24,000	–	70	16,80,000	–
2.	Stock as on 1st April, 2008	11,200	–	76	8,51,200	–
3.	Goods from H.O.	64,000	–	Actual	49,26,000	–
4.	Expenses (₹ 4,800 + 400 – 200)	5,000	–	75	3,75,000	–
5.	Debtors	4,800	–	77	3,69,600	–
6.	Creditors	–	3,200	77	–	2,46,400
7.	Cash at Bank	1,200	–	77	92,400	–
8.	Head Office Account	–	22,800	Actual	–	17,20,000
9.	Purchases	12,000	–	75	9,00,000	–
10.	Sales	–	96,000	75	–	72,00,000
11.	Prepaid Expenses	200	–	77	15,400	–
12.	Outstanding Expenses	–	400	77	–	30,800
	Difference on Exchange	–	–	–	–	12,400
		1,22,400	1,22,400		92,09,600	92,09,600

Closing Stock at ₹ 77 per pound = 8,000 × ₹ 77 = ₹ **6,16,000**.

DM Ltd.

Dr. Trading, Profit and Loss Account for the year ended March, 2015 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	8,51,200	By Sales	72,00,000
To Purchases	9,00,000	By Closing Stock	6,16,000

To Goods from H.O.	49,26,000		
To Gross Profit c/d	11,38,800		
	78,16,000		78,16,000
To Expenses	3,75,000	By Gross Profit b/d	11,38,800
To Depreciation (10% of ₹ 16,80,000)	1,68,000	By Difference on Exchange (See Note below)	12,400
To Net Profit	6,08,200		
	11,51,200		11,51,200

Tutorial Note : AS-11 (revised) states that in case a foreign operation is determined as an integral operation, financial statements should be translated using the same principle, as if the foreign operation had been those of the reporting entity itself. The resulting exchange gain or loss should be recognised in the Statement of Profit and Loss.

DM Ltd.
Balance Sheet of as at 31st March, 2015

Liabilities	₹	₹	Assets	₹	₹
Head Office Balance	17,20,000		Fixed Assets	16,80,000	
Add: Profit	6,08,200	23,28,200	Less: Depreciation	1,68,000	15,12,000
Outstanding Expenses		30,800	Debtors		3,69,600
Creditors		2,46,400	Prepaid Expenses		15,400
			Closing Stock		6,16,000
			Cash at Bank		92,400
		26,05,400			26,05,400

Translation of Foreign Non-integral Operations

In translating the financial statements of a non-integral foreign operation for incorporation in its financial statements, the reporting enterprise should use the following procedures:

(a) the assets and liabilities, both monetary and non-monetary, of the non-integral foreign operation should be translated at the ***closing rate***;

(b) income and expense items of the non-integral foreign operation should be translated at exchange rates at the ***dates of the transactions***; and

(c) all resulting exchange differences should be accumulated in a foreign currency translation reserve until the disposal of the net investment.

For practical reasons, a rate that approximates the actual exchange rates, for example an average rate for the period, is often used to translate income and expense items of a foreign operation.

Illustration 63

An Indian company, Moon Star Limited has a branch at Vergina (USA). The branch is a non-integral foreign operation of the Indian company. The Trial Balance of the branch as at 31st March, 2014 is as follows :

Particulars	US $	
	Dr.	Cr.
Office equipments	48,000	—
Furniture and fixtures	32,000	—
Stock (April 1, 2013)	22,400	—
Purchases	96,000	—
Sales	—	1,66,400
Goods Sent from H.O.	32,000	—
Salaries	3,200	—
Carriage Inward	400	—
Rent, Rates and Taxes	800	—
Insurance	400	—
Trade Expenses	400	—

Head Office Account	—	45,600
Sundry Debtors	9,600	—
Sundry Creditors	—	6,800
Cash at Bank	2,000	—
Cash in Hand	400	—
TOTAL	2,18,800	2,18,800

The following further information is given :

(1) Salaries outstanding $ 400.

(2) Depreciate office equipment and furniture and fixtures @ 10% p.a. at written-down value.

(3) The head office sent goods to branch for ₹ 15,80,000.

(4) The head office shows an account of ₹ 20,50,000 due from Branch.

(5) Stock on 31st March, 2014 – $ 21,500.

(6) There were no transit items either at the start or at the end of the year.

(7) On April 1, 2014 when the fixed assets were purchased the rate of exchange was ₹ 43 to one $. On April 1, 2013, the rate was ₹ 47 per $. On March 31, 2014 the rate was ₹ 50 per $. Average rate during the year was ₹ 45 to one $.

Prepare :

(a) Trial Balance incorporating adjustments given converting dollars into rupees.

(b) Trading, Profit and Loss Account for the year ended 31st March, 2014, and Balance Sheet as on date depicting the profitability and net position of the branch as would appear in the books of Indian company for the purpose of incorporating in the main Balance Sheet.

Solution

Moon Star Limited

Virginia (USA) Branch Converted Trial Balance as at 31st March, 2014

Heads of Account	US Dollar ($)		Rate of Exchange	Indian Rupee (₹)	
	Dr.	Cr.		Dr.	Cr.
Office Equipments	43,200		50	21,60,000	
Furniture and Fixtures	2,880		50	1,44,000	
Stock (1st April, 2013)	22,400		47	10,52,800	
Purchases	96,000		45	43,20,000	
Sales		1,66,400	45		74,88,000
Goods Sent from H.O.	32,000		Actual	15,80,000	
Salaries (₹ 3,200 + 400)	3,600		45	1,62,000	
Carriage Inward	400		45	18,000	
Rent, Rates and Taxes	800		45	36,000	
Insurance	400		45	18,000	
Trade Expenses	400		45	18,000	
Head Office Account		45,600	Actual		20,50,000
Sundry Debtors	9,600		50	4,80,000	
Sundry Creditors		6,800	50		3,40,000
Cash at Bank	2,000		50	1,00,000	
Cash in Hand	400		50	20,000	
Depreciation on :					
Office Equipments	4,800		50	2,40,000	
Furniture and Fixture	320		50	16,000	
Outstanding Salaries		400	50		20,000
Exchange Difference					4,66,800
	2,19,200	2,19,200		1,03,64,800	1,03,64,800

Closing Stock = 21,500 × 50 = ₹ **10,75,000**.

Dr. Trading, Profit and Loss Account of Virginia Branch (USA) for the year ended March, 2014 Cr.

Particulars	₹	Particulars	₹
To Opening Stock	10,52,800	By Sales	74,88,000
To Purchases	43,20,000	By Closing Stock	10,75,000
To Goods from H.O.	15,80,000		

	₹		₹
To Carriage Inward	18,000		
To Gross Profit c/d	15,92,200		
	85,63,000		85,63,000
To Salaries	1,62,000	By Gross Profit b/d	15,92,200
To Rent, Rates and Taxes	36,000		
To Insurance	18,000		
To Trade Expenses	18,000		
To Depreciation :			
Office Equipment	2,40,000		
Furniture and Fixtures	16,000		
To Net Profit c/d	11,02,000		
	15,92,200		15,92,200

Balance Sheet of Virginia Branch (USA) as at 31st March, 2014

Liabilities	₹	Assets	₹
Head Office Account	20,50,000	Office Equipment	21,60,000
Add: Net Profit	11,02,200	Furniture and Fixtures	1,44,000
	31,52,200	Closing Stock	10,75,000
Foreign Currency Transaction Reserve (See Note)	4,66,800	Sundry Debtors	4,80,000
Sundry Creditors	3,40,000	Cash at Bank	1,00,000
Outstanding Salaries	20,000	Cash in Hand	20,000
	39,79,000		39,79,000

Tutorial Note : AS-11 (revised) states that in case a foreign operation is determined as a non-integral operation, all exchange differences should be accumulated in a foreign currency transaction reserve.

Illustration 64

S & M Ltd., Mumbai, have a branch in Sydney, Australia. The Sydney branch is an integral foreign operation of S & M Ltd. At the end of 31st March, 2015, the following ledger balances have been extracted from the books of the Mumbai Office and the Sydney Office :

Particulars	Mumbai (₹ '000)		Sydney (Austr $ '000)	
	Dr.	Cr.	Dr.	Cr.
Share Capital	—	2,000	—	—
Reserve and Surplus	—	1,000	—	—
Land	500	—	—	—
Buildings (cost)	1,000	—	—	—
Building Depreciation Reserve	—	200	—	—
Plant and Machinery (cost)	2,500	—	200	—
Plant and Machinery Depreciation Reserve	—	600	—	130
Debtors / Creditors	280	200	60	30
Stock (1.4.2014)	100	—	20	—
Branch Stock Reserve	—	4	—	—
Cash and Bank Balances	10	—	10	—
Purchases / Sales	240	520	20	123
Goods Sent to Branch	—	100	5	—
Managing Director's Salary	30	—	—	—
Wages and Salaries	75	—	45	—
Rent	—	—	12	—
Office Expenses	25	—	18	—
Commission Receipts	—	256	—	100
Branch / H.O. Current A/c	120	—	—	7
TOTAL	4,880	4,880	390	390

The following information is also available :

(1) Stock as at 31.3.2015 — Mumbai ₹ 1,50,000; Sydney A $ 3,125.

(2) Head office always sent goods to the branch at cost plus 25%.
(3) Provision is to be made for doubtful debts at 5%.
(4) Depreciation is to be provided on buildings at 10% and on plant and machinery at 20% on written-down values.
(5) The Managing Director is entitled to 2% commission on net profits.
(6) Income tax is to be provided at 47.5%.

You are required to:

(a) Convert the Branch Trial Balance into Rupees; (use the following rates of exchange)
Opening rate A$ = ₹ 20; Closing rate A$ = ₹ 24; Average rate A$ = ₹ 22; For Fixed Assets A$ = ₹ 18.

(b) Prepare the Trading and Profit and Loss Account for the year ended 31st March, 2015 showing to the extent possible H.O. results and Branch results separately. (Balance Sheet not required).

Solution (a)

S.M. Ltd

Sydny Branch Converted Trial Balance as at 31st March. 2015

Heads of Account	Australian Dollar		Rate of Exchange (₹)	Rupees	
	Dr. ('000)	Cr. ('000)		Dr. ('000)	Cr. ('000)
Plant and Machinery (cost)	2,00	—	18	36,00	—
Plant and Machinery Depreciation Reserve	—	1,30	18	—	23,40
Debtors	60	—	24	14,40	—
Creditors	—	30	24	—	7,20
Stock (1.4.2014)	20	—	20	4,00	—
Cash and Bank Balances	10	—	24	2,40	—
Purchases	20	—	22	4,40	—
Sales	—	1,23	22	—	27,06
Goods from H.O.	5	—	Actual	1,00	—
Wages and Salaries	45	—	22	9,90	—
Rent	12	—	22	2,64	—
Office Expenses	18	—	22	3,96	—
Commission Receipts	—	1,00	22	—	22,00
H.O. Current Account	—	7	Actual	—	1,20
Difference on Exchange	—	—	—	2,16	—
	3,90	3,90		80,86	80,86

Solution (b)

S & M Ltd

Dr. Trading and Profit and Loss Account for the year ended on 31st March, 2015 (₹'000) Cr.

Particulars	Head Office	Branch	Total	Particulars	Head Office	Branch	Total
To Opening Stock	1,00	4,00	5,00	By Sales	5,20	27,06	32,26
To Purchases	2,40	4,40	6,80	By Goods Sent to Branch	1,00	—	1,00
To Goods from H.O.	—	1,00	1,00	By Closing Stock	1,50	75	2,25
To Gross Profit c/d	4,30	18,41	22,71				
	7,70	27,81	35,51		7,70	27,81	35,51
To Wages and Salaries	75	9,90	10,65	By Gross Profit b/d	4,30	18,41	22,71
To Rent	—	2,64	2,64	By Commission Receipts	2,56	22,00	24,56
To Office Expenses	25	3,96	4,21				
To Prov. for Doubtful Debts @ 5%	14	72	86				
To Depreciation (Note 1)	4,60	2,52	7,12				
To Difference on Exchange	—	2,16	2,16				
To Branch Stock Reserve (Note 2)	11	—	11				
To Balance c/d	1,01	18,51	19,92				
	6,86	40,41	47,27		6,86	40,41	47,27
To Managing Directors Remuneration :				By Balance b/d			19,52
Salary			30				
Commission (Note 3)			41				
To Provision for Income Tax (Note 4)			8,93				
To Balance c/d			9,88				
			19,52				19,52

Working Notes :

(1) Calculation of Depreciation (₹'000)

Particulars	H.O.	Branch
Building (at cost)	10,00	—
Less : Depreciation Reserve	2,00	—
	8,00	—
(A) Depreciation @ 10%	80	—
Plant and Machinery (at cost)	25,00	36,00
Less: Depreciation Reserve	6,00	23,40
	19,00	12,60
(B) Depreciation @ 20%	3,80	2,52
Total Depreciation (A + B)	4,60	2,52

(2) Calculation of Stock Reserve (₹'000)

Particulars	₹
Closing Stock	75
Stock Reserve reqd. on Closing Stock (1/5 of 75)	15
Less: Stock Reserve on 1.4.1995	4
Additional Stock Reserve required	11

(3) Calculation of Managing Director's Commission (000)

Particulars	
Profit before Commission	19,52
Add: Provision for Doubtful Debts	86
Profit u/s 349*	20,38
Commission @ 2%	41 (aprox.)

* For calculating profit u/s 349 of the Companies Act, 1956, depreciation should be deducted based on rates given in Schedule XIV to the Companies Act, 1956. In the Question, rates as per Schedule XIV are not given. Therefore, adjustment for depreciation is ignored.

(4) Calculation of Provision for Income Tax **('000)**

Particulars		
Profit before commission)		19,52
Less: Managing Director's Remuneration		71
		18,81

Provision for income tax@47.5% on ₹18,81,000 =₹ 8,93,000.

KEY POINTS

- From an accounting point of view, the branches can be divided into the following main classes:
  - ¤ Home Branches
    (a) Dependent branches (where the head office maintains all the accounts)
    (b) Independent branches (where the branch keeps its own accounts)
  - ¤ Foreign Branches
    They almost invariably trade independently and record their transactions in foreign currency.
- There are three main methods of accounting for branch transactions, viz.
  - ¤ Debtors System
  - ¤ Stock and Debtors System
  - ¤ Final Accounts System
- Under 'Debtors System', a Branch Account is opened for each branch in the head office ledger. all transactions relating to that branch are recorded in this account. the Branch Account exhibits the profit or loss for an accounting period as well as net assets laying with the branch.
- Stock and Debtors system is generally used when the goods are sent to the branch at an invoice price and the size of the branch is large. Under this system, the branch maintains a few central accounts to exercise greater control over the branch stock and other related expenses. These accounts usually are: (i) Branch Stock Account; (ii) Branch Debtors Account; (iii) Goods Sent to Branch Account; (iv) Branch Adjustment Account; (v) Branch Cash Account; (vi) Branch Expenses Account; (vii) Branch Profit and Loss Account; and (viii) Branch Fixed Assets Account.
- Sometimes, a separate Branch Profit and Loss Account is not opened. In that situation, the Branch Adjustment Account will show net profit/loss of the branch. In this case, branch expenses, pilferage (cost + loading), theft (cost + loading), and shortage in stock (cost + loading) are charged to Branch Adjustment Account. Similarly, surplus in stock (cost + loading) is credited to Branch Adjustment Account.
- **Treatment of Some Typical Items**
  - ¤ ***Normal loss*** : No treatment is required even if it is given specifically in the examination problem. However, for calculating Branch Closing Stock (when it is not given) normal loss is credited to Branch Stock Account at invoice price. Normal Loss Account is closed by debiting to Branch Adjustment Account.
  - ¤ ***Pilferage/Theft*** : In retail trade, pilferage or shoplifting is very common and this has come to be regarded as a normal business loss. The loading of such goods is charged to Branch Adjustment Account and cost is charged to Branch Profit and Loss Account.

KEY POINTS (Contd.)

- ¤ ***Shortage in stock*** : Shortage in stock may be due to spoilage, leakage, sales in small quantity, etc. Loading on shortage in stock should be charged to Branch Adjustment Account and cost of such goods should be charged to Branch Profit and Loss Account.
- ¤ ***Surplus in stock*** : Loading on surplus in stock is credited to Branch Adjustment Account and cost of such goods is credited to Branch Profit and Loss Account.
- ¤ ***Loss by fire/loss-in-transit*** : Loading on goods lost by fire/in-transit should be charged to Branch Adjustment Account and the cost of such goods should be charged to **General Profit and Loss Account**.

- When the size of the branches is very large, their functions become complex. In such a situation, it is desirable or practicable for each branch to establish its own double entry book-keeping system quite separate from those of head office. Under this system of branch accounting, the branches are treated as separate, independent units. These types of branches are known as ***Independent Branches***.
- On principle, the adjustment entry should be passed in the books of the head office because all in-transit items are detected by the head office after receiving copy of Trial Balance (or copy of Final Accounts) and at this stage, it is not desirable to change the balances in the branch books.
  Goods-in-Transit are shown in the Balance Sheet of head office.

THEORETICAL QUESTIONS

1. Explain the distinguishing features between branch accounts and departmental accounts.
2. What are the main classes of branch accounts ?
3. State the objectives of keeping branch accounts.
4. What do you understand by the expression 'Branch Adjustment Account'? Explain clearly.
5. What do you understand by an 'independent branch'?
   Differentiate between a 'dependent branch' and an 'independent branch'.
   Explain briefly the system of accounting that you will adopt in each case.
6. Write a note on stock and debtors system.
7. Give Journal Entries for incorporating the branch Trial Balance in the books of head office.
8. What is a foreign branch ? Explain the methods of converting figures of Trial Balance of a foreign branch into the home currency of head office.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below :

1. Stock and debtors system is generally used when the goods are sent to the branch at
   A cost price
   B an invoice price
   C none of these.
2. Branch stock account is a practical means of controlling stock at
   A branch
   B head office
   C none of these.
3. Wholesale prices are fixed above
   A cost
   B invoice price
   C none of these.
4. Goods-in-transit are shown in the balance sheet of
   A branch
   B head office
   C none of these.

5. Up to the trial balance, the accounting arrangements for a foreign branch are exactly the same as for any
   A dependent branch
   B independent branch;
   C none of these.

PRACTICAL QUESTIONS

Debtors System [Cost Price]

1. Shetty Solvents Co. Bangalore opened a branch at Hyderabad on January 1, 2014. The following information is available in respect of the branch for the year 2014:

Particulars	₹	Particulars	₹
Goods sent to the branch	75,000	Cash remittance to branch towards petty cash	6,000
Cash sales at the branch	50,000	Petty cash at branch on 31.12.2014	500
Credit sales at the branch	60,000	Debtors of branch as on 31.12.2014	5,000
Salaries of the branch staff paid by the H.O.	15,000	Stock at the branch on 31.12.2014	27,000
Office expenses of the branch paid by the H.O.	12,000		

Prepare Branch Account to show the profit/loss from the branch for the year 2014.

2. X operates a branch at Delhi. All purchases are made by the Head Office at Madras; goods being charged out to the branch at cost price. All cash received by the branch is remitted to Madras Branch. Petty expenses are paid out of an imprest which is reimbursed by the Head Office from time to time.
   From the following particulars relating to Delhi branch, you are required to prepare Branch Account (for calculating profit) in the books of the Head Office.

Particulars	₹	Particulars	₹
Balances on 1.1.2014:		Petty expenses paid by branch out of imprest	700
Stock : ₹ 8,000; Petty cash : ₹ 800; Plant : ₹ 10,000		Cash sales during the year	70,000
Balances on 31.12.2014:		Sale of plant on 1.7.2014	800
Stock	7,000	(Book value on the date of sale ₹ 900)	
Goods sent to branch	50,000	Expenses paid by Head Office	5,000

It is required to write-off Plant @ 20% p.a.

3. The following information and particulars relate to New Delhi branch for the year 2014-15:
   31.3.2014 : Stock ₹ 50,000; Debtors ₹ 70,000; Petty cash ₹ 250.
   31.3.2015 : Stock ₹ 75,000; Debtors ₹ 95,000; Petty cash ₹ 120.
   Goods costing ₹ 5,50,000 was sold by the branch @ 25% on cost. Cash sales amounted to ₹ 1,50,000 and the rest credit sales.
   Branch receives all goods from Head Office. Branch spent ₹ 30,000 for salaries, ₹ 12,000 for rent and ₹ 8,000 for petty expenses (all expenses remitted by Head Office).
   You are required to prepare New Delhi Branch Account in the books of the Head Office for the year 2014-15.

4. From the following particulars relating to the Kanya-Kumari branch for the year ended 31st December, 2014, prepare Branch Account in the books of Head Office:

Particulars	₹	Particulars	₹
Goods sent to branch	28,400	Petty cash at branch on 1st January 2014	500
Cash sales	18,800	Petty cash at branch on 31st December 2014	300
Credit sales	41,200	Goods returned by the branch	1,000
Cash received from Debtors	38,000	Opening stock at branch	9,600
Cash sent to branch for expenses:		Debtors on 31st December 2014	9,000
Rent	2,000	Discount allowed to Debtors	1,000
Salaries	8,000	Bad debts written-off by the branch	2,000
Petty cash	2,000	Stock at branch on 31st December 2014	10,500

5. The Rajani Stores Ltd at Madras has a branch at Trichy. Goods are invoiced to the branch at selling price being cost plus 25%. The branch keeps its own sales ledger and deposits all cash received daily to the credit of Head Office Account opened at the State Bank of India, Trichy. All the expenses are paid by cheque from Madras. From the following details, prepare a Branch Account in the Head Office books and make the necessary adjustments therein to arrive at the actual branch profit or loss during the year 2014

Particulars	₹
Stock on 1st January, 2014	7,500
Stock on 31st December, 2014	9,000
Sundry Debtors on 1st January, 2014	4,200
Sundry Debtors on 31st December, 2014	5,400
Goods invoiced from Head Office	54,600
Rent, rates and taxes	2,400
Sundry Expenses	480
Cash Sales for the year	32,400
Credit Sales	21,000
Wages paid	2,040
Wages owing	200

Debtors System [Invoice Price]

6. Jaico Ltd. invoices goods to its Kanpur branch at cost plus 25% thereon, both cash and credit sales are effected by the branch. The branch expenses are paid direct from the Head Office. The details of transactions available for the year ended 31.3.2014 are:

Particulars	₹	Particulars	₹
Goods received from Head Office at invoice price	40,000	Discounts allowed to customers	300
Returns to Head Office at invoice price	800	Bad debts	500
Stock at Kanpur on 1.4.2013 at invoice price	8,000	Returns from customers	700
Credit sales for the year	30,000	Rent and rates	60
Cash sales for the year	18,700	Wages and salaries	1,200
Debtors as on 1.4.2013	5,200	Sundry expenses	300
Debtors as on 31.3.2014	4,200	Stock on 31.3.2014 at invoice price	6,000

Record the above transactions in the Head Office ledger and close the accounts as on 31.3.2014 and show how the relevant items will appear in the Head Office's Balance Sheet on that date.

7. X of Calcutta started on 1.4.2014, two branches at Madras and Nagpur. All goods sold at the branches are received from the Head Office invoiced at 125% of cost. All expenses relating to the branch are paid by the Head Office. Each branch has its own Sales Ledger and sends weekly statements. All cash collections are remitted daily to the Head Office by the branches. The following particulars relating to the half-year ended 30.9.2014 have been extracted from the weekly statements sent by the branches: (all figures in ₹)

Particulars	Madras	Nagpur	Particulars	Madras	Nagpur
Credit sales	1,25,200	1,10,000	Salaries	16,000	18,000
Cash sales	78,600	85,200	General expenses	2,600	1,500
Sales returns	2,300	1,200	Goods received from H.O.	1,50,000	1,25,000
Sundry debtors	34,500	23,600	Advertisement	7,500	5,200
Rent and rates	3,200	4,500	Stock on 30.9.2014	45,000	35,000
Bad debts	6,000	—			

You are required to prepare the Branch Account as they would appear in the books of the Head Office, showing the profit or loss for the period.

8. X opened a branch at Calcutta on 1.7.2014. Goods are sent from the Head Office at cost plus $33^1/_3$%. The branch is adviced to deposit cash everyday in the bank in the Head Office. From the following particulars, prepare Branch Account in the books of Head Office for the period ending 31.12.2014. Petty cash at branch is maintained on imprest system.

Particulars	₹	Particulars	₹
Cash sent to branch for expenses	500	Received from Debtors	16,000
Furniture purchased for the branch	10,000	Discount allowed	300
Goods sent to branch at invoice price	1,00,000	Bad debts	100
Expenses paid by the Head Office:		Returned by Debtors (invoice price)	800
Rent : ₹ 1,000; Salaries : ₹ 2,000; Expenses ₹ 1,000; Insurance : ₹ 600 (up to 30.6.2013)	4,600	Petty expenses paid by branch	600
		Stock at cost on 31.12.2014 (excluding stock received from Debtors)	18,000
Cash sales by branch	70,000		
Credit sales by branch	25,000	Depreciation on furniture @ 10% p.a.	

Stock and Debtors System

9. A Calcutta Head Office has a branch at Nagpur. Goods are invoiced by the head office to the branch at cost plus 25%. From the following particulars, prepare the (1) Branch Stock Account, (2) Goods Sent to Branch Account, (3) Branch Stock Adjustment Account, (4) Branch Debtors Account, and (5) Branch Profit and Loss Account:

Particulars			₹
Stock on 1st January, 2014 (invoice price)			30,000
Goods invoiced to branch during the year (invoice price)			1,38,000
Branch debtors on 1st January, 2014			24,000
Goods returned by branch (invoice price)			2,000
Branch Sales :	Cash	64,000	
	Credit	72,800	1,36,800
Bad debts written off			700
Discounts allowed to Debtors			500
Branch Expenses			14,500

10. Messrs. Eastern Traders, Delhi have opened a branch at Jaipur on 1.7.2014. The goods were sent by the Head Office to the branch and invoiced at selling price which was 125%, of the cost price of the Head Office.
The following are the particulars relating to the transactions of Jaipur branch:

Particulars	₹	Particulars	₹
Goods sent to branch (at cost to Head Office)	2,80,800	Cash sent to branch for:	
Sales: Cash	1,25,000	Wages	3,000
Credit	1,75,000	Freight	11,000
Cash collected from Debtors	1,56,000	Other expenses including godown rent	6,000
Discount allowed	4,000	Spoiled cloth in bales written-off at invoice price	500
Stock on June 30, 2015 at invoice price	55,500		

Prepare Branch Debtors, Branch Stock, Branch Adjustment and Branch Profit and Loss Accounts in Head Office books.

11. B Ltd. opened a branch in Hyderabad in late 2013, and forwarded goods for resale from the Head Office at Calcutta, invoiced them at selling price; the mark-up was 1/3 of selling price.
The Head Office maintained a Branch Stock Account, Goods Sent to Branch Account, Branch Debtors Account and the Branch Adjustment Account. These were written-up from weekly branch returns of cash sales, credit sales, cash received from debtors and other credits allowed to debtors.
During the year to 31st December, 2014, the following transactions took place at Hyderabad:

Particulars	₹	Particulars	₹
Goods received from Calcutta	1,80,000	Cash discount given	1,808
Goods returned to Calcutta	1,680	Cash sales	1,00,800
Bad debts	596	Credit sales	72,000
Cash received from Debtors	68,624		

The following additional information is also available in respect of the branch:
Stock on hand at selling price : 1.1.2014 : ₹ 16,080; 31.12.2014 : ₹ 21,000 and Debtors : 1.1.2014 : ₹ 6,608; and 31.12.2014 : ₹ 7,580.
You are required:
(a) to present the Ledger Accounts in the Head Office recording the above transactions; and
(b) to compute the gross profit of the branch for the period.

12. Gulshan Stores Ltd with its head office in Calcutta invoiced goods to its branch at Patna at 20% less than the list price which is cost plus 100% with instructions that cash sales were to be made at the invoice price and credit sales at the catalogue price (i.e., list price).
From the following particulars available from the branch, prepare Branch Stock Account, Branch Adjustment Account, Branch Profit and Loss Account and Branch Debtors Account for the year ending 31.12.2015.

Particulars		₹
Stock on 1.1.2015 (invoice price)		6,000
Debtors on 1.1.2015		5,000
Goods received from head office (invoice price)		66,000
Sales : Cash	23,000	
Credit	50,000	73,000
Cash from debtors		42,817

Expenses at branch	8,683
Remittance to head office	60,000
Debtors on 31.12.2015	12,183
Stock on 31.12.2015 (invoice price)	8,800

13. Sunny Traders of Mumbai opened a branch shop on 1.1.2015 in Kolkata. All goods for sale at the shop are purchased by the head office and charged to the branch at retail selling price, which is cost plus $33^1/_3$%. The branch backs its takings, without deduction, for the credit of head office. Although it is a cash business, the branch manager is allowed to give credit in a few special cases.
The following information is relevant for the first three months to 31 March :

Particulars	₹
Purchases	27,130
Sales at head office	9,100
Goods sent by head office to the branch at selling price	28,000
Cash sales at branch	18,000
Credit sales by branch	2,000
Goods returned to head office at selling price	1,000
Cash collected from branch debtors	1,730
Branch expenses	1,000
Head office expenses	1,200
Closing stock at head office	2,650
Opening stock at head office	2,900
Authorised reduction in branch selling prices	820

From the above particulars, prepare :
(i) Branch Stock Account;
(ii) Branch Adjustment Account;
(iii) Branch Profit and Loss Account; and
(iv) Goods Sent to Branch Account.

14. X Ltd. has its Head Office at Bombay with branches at Calcutta and Madras. The Head Office alone makes purchases and goods sent to the branches are invoiced at cost plus 25%. Sales are made only at the branches, which remit all cash received to Bombay. From the following particulars for the year ended 30.9.2014, prepare the Branch Stock Account, Branch Adjustment Account and Goods Sent to Branch Account for the year, as they would appear in the Bombay books: (all figures in ₹)

Particulars	Calcutta	Madras	Particulars	Calcutta	Madras
Goods sent (invoice price)	30,000	25,500	Credit sales	13,000	9,250
Returns to H.O. (invoice price)	500	425	Stock on 1.10.2013 (invoice price)	5,500	7,500
Cash sales	18,500	17,125	Stock on 30.9.2014 (invoice price)	4,875	6,750

15. The P.T. Co. Ltd. invoices goods to its Kanpur branch at cost plus 25%. Both cash and credit sales are effected by the branch at these prices. Branch expenses are paid direct from the Head Office, all cash received by the branch being remitted to Head Office.
The following are the details of the transactions for the year ended 31.12.2014:

Particulars	₹	Particulars	₹
Goods received from H.O. at invoice price	2,00,000	Discounts allowed to customers	1,600
Returns to H.O. at invoice price	5,000	Bad debts written-off	3,000
Stock at branch as on 1.1.2014	50,000	Returns from customers	2,000
Credit sales	1,10,000	Rent, rates and taxes	2,400
Cash sales	1,08,000	Salaries and wages	8,000
Debtors as on 1.1.2014	38,000	Sundry expenses	1,200
Cash received from Debtors	1,16,000		

Prepare :
(i) Branch Stock, (ii) Branch Debtors, (iii) Branch Adjustment Account, and (iv) Branch Profit and Loss Accounts in the books of the Head Office.

16. Linken Ltd. with a Head Office in Calcutta opened a branch on January 1, 2014, at Kanpur where all sales were to be made on credit basis.
All goods required by the branch were supplied by the company from Calcutta and invoiced to the branch at 20 per cent above cost. During the year ended 31st December, 2014 the following transactions took place:

Particulars	₹	Particulars	₹
Goods sent to Kanpur branch (at cost to H.O.)	22,000	Returns to Calcutta office (at cost to H.O.)	840
Sales as shown by Kanpur branch report	19,670	Cash received from debtors and remitted to Calcutta	15,190
Debtors balance at branch written-off as bad	640		

Loss of goods at branch through pilferage is estimated at 1 per cent of goods received. The stock of goods held by the branch on 31st December, 2014 amounted to ₹ 5,820 at invoiced price. You are required to record the entries in the appropriate accounts in the Head Office Ledger showing the balances as on 31st December, 2014 and the branch gross and net profits, for the year ended on that date. Assume that there are no other charges.

17. X Ltd. operates a retail branch at Bombay. All purchases are made by the Head Office in Calcutta, goods being charged out to the branch at selling price which is cost plus 25%. All the expenses of branch are paid through Head Office cheques. Cash collected from customers as also the ready money sales are daily banked to the credit of the Head Office. From the following particulars of the branch write-up necessary accounts to arrive at the branch profit or loss in the Head Office books by using stock and debtors system.

Particulars	₹	Particulars	₹
Debtors at start	10,000	Invoiced inventory at the end	15,000
Debtors at end	12,000	Salaries	6,000
Ready money sales during the year	70,000	Rent	5,000
Cash received on ledger account	65,000	Bad debts	2,000
Returns to H.O. at invoice price	5,000	Discount and allowance	3,000
Invoiced inventory at the beginning	16,000	Normal leakage and spoilage	4,000

18. Bombay Traders Ltd. sends goods to its Madras branch at cost plus 25%. The following particulars are available in respect of the branch for the year ended 31st March 2014:

Particulars	₹	Particulars	₹
Opening stock at branch at invoice price to branch	80,000	Sales	12,19,000
Goods sent to branch at invoice price	12,00,000	Expenses	60,000
Loss in transit at invoice price	15,000	Closing stock at branch at invoice price to branch	40,000
Pilferage at invoice price	6,000	Recovered from insurance co. against loss-in-transit	10,000

Show Ledger Accounts in the Head Office books for: (a) Branch Stock Account; (b) Goods Sent to Branch Account; (c) Branch Adjustment Account; and (d) Branch Profit and Loss Account.

19. HP and Co. is a retail organisation with a number of branches. All accounts are kept at the Head Office and goods sent to branches are recorded at cost plus the expected mark-up of $33^1/_3$%. The accounting system is designed to give the Head Office as much control as possible over the branch stocks.

At the Madras branch at 1st January, 2014, goods costing ₹ 24,000 were in stock, but some of these, costing ₹ 3,000, had been reduced in selling price to ₹ 3,200. The balances of the Madras Branch Debtors Accounts totalled ₹ 18,400 on the same date.

The following information relates to the Madras branch for the year to 31st December, 2014 or at the end of that year:

Particulars	₹	Particulars	₹
Goods sent to branch (cost)	3,72,000	Goods returned by Br. debtors direct to H.O. (selling price)	1,600
Cash sales (including all goods marked down at the beginning of the year and others costing ₹ 36,000 sold for half of the normal selling price)	3,21,200	Bad debts written-off	600
		Closing stock of goods at selling price	48,000
		Closing total of debtors' balances	16,600
Cash received from debtors	1,25,600		

You are required to prepare: (a) Branch Stock Account; (b) Goods Sent to Branch Account; (c) Branch Adjustment Account; (d) Branch Debtors Account; and (e) Branch Profit and Loss Account.

20. B.B. Co. Ltd. with their Head Office at Calcutta, invoiced goods to their Bangalore branch at 20% less than list price, which is cost plus 100% with instruction that cash sales are to be made at invoice price and a credit sales at list price. From the following particulars, prepare Branch Stock Account, Branch Adjustment Account, Branch Profit and Loss Account, and Branch Debtors Account for the year ended 31.12.2014.

Particulars	₹	Particulars	₹
Stock on 1.1.2014 (at invoice price)	24,000	Cash received from debtors	1,71,268
Debtors on 1.1.2014	20,000	Expenses at Branch	34,732
Goods received from H.O. (at invoice price)	2,64,000	Remittance to H.O.	2,40,000

Goods returned to H.O. (at invoice price)	2,000	Debtors on 31.12.2014	48,732
Sales : Cash	92,000	Stock on 31.12.2014 (at invoice price)	85,200
Credit	2,00,000		

Final Accounts System

21. A Head Office in Calcutta has a branch in Burdwan. All purchases are made by the Head Office and goods sent to the branch are invoiced at cost plus 25 per cent. All cash received by the branch is deposited to the Head Office Account in the Burdwan branch of the Head Office bank.

    The branch maintains a Sales Ledger and the other necessary subsidiary books but all other branch transactions are recorded in the Head Office books.

    The following information pertaining to the branch has been collected for the year ended December, 31, 2014:

Particulars	₹	Particulars	₹
Stock at branch on Jan. 1 (invoice price)	30,000	Stock at branch on Dec. 31 (invoice price)	25,000
Goods received from H.O. less returns (invoice price)	96,000	Cash sales	54,000
Credit sales less returns	43,000	Cash received from customers	41,000
Discount allowed to customers	1,000	Bad debts written-off	500
Branch expenses paid	5,700		

    In the Head Office books prepare the Branch Stock Account, Branch Total Debtors Account and Branch Profit and Loss Account.

22. A Head Office in Calcutta has a branch at Haldia. All purchases are made by Head Office and goods sent to the branch are invoiced at cost plus 25%. All cash received by branch is deposited to the Head Office Account in the branch of the Head Office's bank.

    The branch maintains a Sales Ledger and other necessary subsidiary books; but all other branch transactions are recorded in the Head Office books.

    The following information pertaining to the branch has been collected for the year ended December 31, 2014:

Particulars	₹	Particulars	₹
Stock at branch (1.1.2014 - cost price)	96,000	Stock at Branch (31.12.2014 - cost price)	80,000
Goods received from Head Office (invoice price)	3,80,000	Cash sales	2,16,000
Credit sales	1,72,000	Discount allowed to customers	4,000
Bad debts written-off	2,000	Branch expenses paid	22,800
Cash received from customers	1,64,000		

    In the Head Office books, prepare the Branch Stock Account, Branch Debtors Account and Branch Profit and Loss Account.

23. B.S. Ltd. operates a retail branch at Ranchi. All purchases are made by the Head Office in Calcutta. Goods for the branch being delivered to it direct and charge out at selling price, which is cost price plus 50 per cent. All cash received by the branch is remitted to Calcutta. Branch expenses are paid by the branch out of an imprest account which is reimbursed by Calcutta monthly.

    The branch keeps a Sales Ledger and certain essential subsidiary books; but otherwise all branch transactions are recorded in the books of the Calcutta office.

    On January 1, 2014, Stock-in-trade at the branch at selling price, amounted to ₹ 48,660 and Debtors to ₹ 6,440.

    During the year ended December 31,2014, the following transactions took place at the branch:

Particulars	₹	Particulars	₹
Goods received by the branch at selling price	1,21,800	Cash sales	64,150
Credit sales	51,280	Goods returned to Calcutta at selling price	1,560
Reductions in selling price authorised by Head Office	970	Cash received from debtors	42,660
Debtors written-off as irrecoverable	650	Cash discounts allowed	1,120

    A consignment of goods despatched to the branch in December, 2014, at a selling price of ₹ 1,200 was not received by the branch until January 6, 2015 and had not been included in its stock figure. The expenses relating to the branch for the year ended December 31, 2014 amounted to ₹ 17,290.

    On December 31, 2014, Physical stock at the branch, at selling price amounted to ₹ 52,200. You are required to write-up the Branch Stock Account and the Branch Total Debtors Account maintained in Calcutta books, and to prepare the Trading and Profit and Loss Account of the branch for the year ended December 31, 2014.

24. A business has three branches at Coimbatore, Trivandrum and Bangalore. The Head Office at Madras purchases goods and sends them to branches, to be sold at a uniform percentage of profit on cost.
The following particulars are made available to you to enable you to prepare a combined Trading Account for the year ended 31st March, 2014.

Particulars	Madras (₹)	Coimbatore (₹)	Trivandrum (₹)	Bangalore (₹)
Stock on 1st April 2013	54,000	16,000	12,500	10,000
Purchases in the year	2,74,000	—	—	—
Sales	—	1,80,000	1,20,000	1,00,000
Stock on 31st March 2014	28,000	6,000	5,000	2,500
Branch Accounts on 1st April 2013:				
Coimbatore	15,000			
Trivandrum	32,000			
Bangalore	4,000			
Remittances from branches	3,20,000	1,50,000	1,60,000	70,000

Madras office invoices goods to the branches at fixed sales prices but maintains branch accounts in its Ledgers at cost price. Show Branch Accounts in Madras Head Office books.

25. The branches of a multiple shop company are supplied from the Head Office with goods at cost. The branches pay wages and minor items of petty cash, but otherwise all expenses are paid by the Head Office.
From the weekly returns of the branches, the following summaries are prepared:

Dr. Cash Account (Branches) Year 2014 Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance	1,200	2014 Dec. 31	By Cash Purchases	4,360
Dec. 31	To Cash Sales	4,13,680		By Wages	1,12,500
	To Cash on Ledger A/cs	12,350		By Expenses	2,320
				By Amount banked	3,06,550
				By Balance	1,500
		4,27,230			4,27,230
2015 Jan. 1	To Balance	1,500			

Dr. Debtors' Account (Branches) Year 2014 Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 Jan. 1	To Balance	890	2014 Dec. 31	By Cash	12,350
Dec. 31	To Sales	14,350		By Allowance	480
				By Balance	2,410
		15,240			15,240
2015 Jan. 1	To Balance	2,410			

Branches Current Account (in Head Office books) appears in summarised form as follows:

Particulars		₹	Particulars	₹
2014 Jan. 1 To Balance:			2014 Jan. 1 By Balance:	
Cash	1,200		Rent & Rates	4,340
Debtors	890		Dec. 31 By Bank	3,06,550
Stocks	16,380		Dec. 31 By Balance	60
Fittings	10,000	28,470		
Dec. 31 To Goods		2,26,500		
To Cash :				
Rent & Rates		20,200		
Salaries		32,300		
Sundry expenses		2,480		
Fittings		1,000		
		3,10,950		3,10,950
Jan. 1 To Balance		60		

You are required to prepare a Memorandum Trading and Profit and Loss Account of the branches and also show the Branch Account as it would appear in the Head Office books at the end of the year.

26. X Ltd. Bombay started on 1st January, 2014 has two branches in Kanpur and Lucknow. All goods sold at the branches are received from the Head Office invoiced at cost plus 25 percent. All expenses relating to branches are paid by the Head Office. Each branch has its own Sales Ledger and sends weekly statements. All cash collections are remitted daily to Head Office by the branches. The following particulars relating to the year ended 31st December, 2014 have been extracted from the weekly statement sent by the branches: (all figures in ₹)

Particulars	Kanpur	Lucknow	Particulars	Kanpur	Lucknow
Credit sales	1,25,200	1,10,000	Salaries	16,000	18,000
Cash sales	78,600	85,000	General expenses	2,600	1,500
Sales returns	2,300	1,200	Goods received from H.O.	1,50,000	1,25,000
Sundry debtors	34,500	23,600	Advertisement	7,500	5,200
Rent and rates	3,200	4,500	Stock on 31st December 2014	45,000	35,000
Bad debts	6,000	—			

You are required to prepare the Branch Accounts as they would appear in the books of the Head Office, showing the profit and loss for the period and the Trading and Profit and Loss Account separately for each branch.

27. All purchases are made by the Head Office, all goods sold by the branches are received from the Head Office and the branches sell, maintain accounts of the debtors, collect from them and send daily collections to the Head Office. Branch expenses are met from remittances specially sent from Head Office which keeps no stock.

Particulars	Madras (₹)	Delhi (₹)	Calcutta (₹)
Bad debts	1,200	1,000	500
Debtors at commencement	23,100	19,460	21,020
Debtors at end	29,460	18,900	22,000
Sales (credit)	61,210	31,000	49,109
Return inwards	600	—	300
Allowances to Debtors	1,100	900	1,300
Sales (cash)	11,000	19,000	18,000
Goods bought and sent	40,000	30,000	29,000
General charges	500	300	200
Salaries	1,600	2,000	1,000
Opening stock	19,000	18,000	21,000
Closing stock	5,000	4,800	3,600

The expenses at the Head Office which is in Bombay amounted to ₹ 8,000 and general charges to ₹ 1,000.
Prepare the Branch Accounts as they should appear in the Head Office books and Profit and Loss Accounts showing the net results of each branch as also of the Head Office in Bombay.

Wholesale Price

28. G.K. Sports of Calcutta has a retail branch at Kanpur. Goods are sold to customers at cost plus 100%. The wholesale price is cost plus 80%. Goods are invoiced to Kanpur at wholesale price.
From the following particulars, find out the value of closing stock on 31st December, 2014 and profit made at head office and Kanpur for the year 2014.

Particulars	Head Office (₹)	Kanpur Branch (₹)
Stock on January 1, 2014	25,000	
Purchases	1,50,000	
Goods sent to Kanpur Branch (at invoice price)	54,000	
Sales	1,53,000	50,000

Sales at head office are made only on wholesale basis and that at branch only on retail basis .

29. Kanpur Trading Co. Ltd. operates a number of retail branches of its own as well as supplies goods to other stockists. The wholesale price is cost plus 20% and retail branches sell the goods at 10% above the wholesale price. Goods are sent to retail branches at wholesale price. The following figures relate to the Lucknow Branch for the year 2014.

Particulars	₹
Opening stock	1,12,500
Goods sent to Lucknow branch (at cost to Head Office)	4,50,000
Sales at Lucknow Branch	5,77,500
Expenses incurred at Lucknow Branch	15,000
Shortage of goods (at selling price)	2,475

You are required to ascertain profit made by the Lucknow Branch.

30. White Ltd has a retail branch at Margaon. Goods are sold at 60% profit on cost. The wholesale price is cost plus 40%. Goods are invoiced from Calcutta Head Office to Branch at Margaon at wholesale price. From the following particulars ascertain the profit made at head office and branch for the year ended December 31, 2014.

Particulars	Head Office (₹)	Margaon (₹)
Stock on 1st January, 2014	1,75,000	
Purchases	10,50,000	
Goods sent to branch (at invoice price)	3,78,000	
Sales	10,71,000	3,50,000
Stock on December 31, 2014	4,20,000	63,000

Sales at head office are made only on wholesale basis and that at branch only to customers. Stock at head office is valued at invoice price.

31. ABC Ltd operates a number of retail shops to which goods are invoiced at wholesale price which is cost plus 20%. Shops sell the goods at the list price which is wholesale price plus 10%.
From the following particulars for Shop No. 6, prepare :
(a) Branch Stock Account; (b) Goods Sent to Branch Account; (c) Branch Profit and Loss Account; (d) Stock Reserve Account; and (e) an extract of Head Office Profit and Loss Account.:

Particulars	₹
Stock at shop on 1.1.2014	15,000
Goods invoiced to shop during 2014	1,40,000
Sales at shop during 2014	1,54,770
Goods destroyed by fire (retail value)	660
Expenses at the shop	7,200

Independent Branch

32. Journalise the following transactions in the Delhi Branch Office and Head Office books :
    (i) Head office has charged ₹ 5,000 as depreciation on Delhi Branch assets.
    (ii) Goods worth ₹ 25,000 have been supplied by Delhi Branch to Bombay Branch under the advice of Head Office.
    (iii) Delhi Branch has received ₹ 15,000 from a customer of the Head Office.
33. Journalise the following transactions in the books of Head Office as well as Branch offices :
    (i) Goods worth ₹ 5,000 are supplied by Delhi Branch to Agra Branch under the instructions of Head Office.
    (ii) Delhi Branch draws a bill receivable for ₹ 5,000 on Agra Branch which sends its acceptance.
    (iii) Head Office charges ₹ 4,000 from Delhi Branch as Head Office administrative expenses.
34. Head Office passes adjustment entry at the end of each month to adjust the position arising out of inter-branch transactions during the month. From the following inter-branch transactions in January, 1996, make the entry in the books of head office :
    (a) Bombay Branch :
        (i) Received goods: ₹ 6,000 from Calcutta Branch, ₹ 4,000 from Patna Branch.
        (ii) Sent goods to: ₹ 10,000 to Patna, ₹ 8,000 to Calcutta.
        (iii) Received Bills Receivable: ₹ 6,000 from Patna.
        (iv) Sent acceptance: ₹ 4,000 to Calcutta, ₹ 2,000 to Patna.
    (b) Madras Branch (apart from the above)
        (v) Received goods: ₹ 10,000 from Calcutta, ₹ 4,000 from Bombay.
        (vi) Cash sent: ₹ 2,000 to Calcutta, ₹ 6,000 to Bombay.
    (c) Calcutta Branch (apart from the above)
        (vii) Sent goods to Patna: ₹ 6,000.
        (viii) Paid Bills Payable: ₹ 4,000 to Patna, ₹ 4,000 cash to Patna.
35. A Head Office at Bangalore has branches at Hassan and Mysore. What adjustment entries are required to be passed in the books of Head Office in regard to the following. The company closes its accounts on December 31 each year.
    (a) A remittance of ₹ 8,500 made by Hassan to the Head Office on December 28 was received by the latter on January 4.
    (b) Depreciation at 10% p.a. is to be provided on machinery at Mysore costing ₹ 75,000 the account of which is in the Head Office books.
    (c) Goods worth ₹ 20,000 sent by the Head Office to Mysore branch on December 24 were received by the latter on January 8.
    (d) The Hassan branch paid ₹ 100 dividend to a local shareholder on behalf of the Head Office.
    (e) A sum of ₹ 300 being arrears of call money was received by the Mysore office from a shareholder in November but was not communicated to the Head Office till January 3.

36. The following is the Trial Balance of Calcutta Branch as at 31st March, 2015 :

Particulars	Dr. (₹)	Cr. (₹)
Bombay Head Office	32,400	
Stock — 1st April, 2014	60,000	
Purchases	1,78,000	
Goods Received from Head Office	90,000	
Sales		3,80,000
Goods Supplied to Head Office		60,000
Salaries	15,000	
Debtors	37,000	
Creditors		18,500
Rent	9,600	
Office Expenses	4,700	
Cash in Hand and at Bank	17,800	
Furniture	14,000	
	4,58,500	4,58,500

Closing stock was valued at ₹ 27,000. The Branch Account in the books of head office stood at ₹ 4,600 (Dr.) on 31st March, 2015. On 28th March, 2015 the head office forwarded goods to the value of ₹ 25,000 to the branch where they were received on 3rd April, 2015.

Required : (a) Branch Trading and Profit and Loss Account

(b) Journal entries necessary to incorporate the above figures.

(c) Calcutta Branch Account in the books of the head office.

37. XY Company of Calcutta has a branch at Delhi. Goods sold at Delhi are supplied from Calcutta but no charge is made in the books as between the branch and the Head Office. On 31st March, 2014, the branch Balance Sheet after closing the books was as follows:

Liabilities	₹	Assets	₹
Creditors balances	40,000	Debtors balances	2,00,000
Head office	1,68,000	Building extension account closed by H.O. A/c	—
		Cash at bank	8,000
	2,08,000		2,08,000

For the six months ending with September, 2014 the following transactions took place at branch:

Particulars	₹	Particulars	₹
Sales	2,40,000	Purchases	48,000
Wages paid	20,000	Salaries (inclusive of advance of ₹ 2,000)	4,000
General expenses	1,600	Life insurance premium paid for 1 year	3,200
Manager's salary for 9 months	7,200	Cash collections from Debtors	1,60,000
Discounts allowed	8,000	Discounts earned	1,200
Cash paid to Creditors	60,000	Cash sent to bank	80,000
Building Account (further payment to contractors)	4,000	Cash in hand	1,600
Cash at bank	28,000		

Set out the Head Office account in the Delhi books as on 30th September, 2014 to show the entries after the books are closed and also the branch Balance Sheet on that same date assuming to be made up on the same lines as on 31st March, 2014.

38. Messrs. Dhyanchand & Co., Kanpur, have a branch in Delhi. The Delhi branch deals not only in the goods from the head office but buys some auxiliary goods and deals in them. They, however, do not prepare any Profit and Loss Account but close all the accounts to the head office at the end of the year and open them afresh on the basis of advice from their head office. The Fixed Assets Accounts are also maintained at the head office. The goods from the head office are invoiced at selling prices to give a profit of 20% on the sale price. The goods sent from the branch to the head office are at cost. From the following, prepare the Branch Account, Branch Trading and Profit and Loss Accounts and Branch Assets Account in the head office books:

Trial Balance of Delhi Branch as on 31.3.2015

Particulars	Dr. (₹)	Cr. (₹)
Head Office Opening Balance, 1.4.2014	15,000	
Goods from Head Office	50,000	
Purchases	20,000	
Sales		1,00,000

Opening Stock (Head Office Goods at invoice price)	4,000	
Opening Stock of other goods	500	
Goods to Head Office		3,000
Salaries	7,000	
Rent	3,000	
Office Expenditure	2,000	
Cash in Hand	500	
Cash at Bank	4,000	
Head Office Current Account		15,000
Sundry Debtors	15,000	
Sundry Creditors		3,000
	1,21,000	1,21,000

The branch balances on 1 April 2014 were as under :

Furniture ₹ 5,000; Sundry debtors ₹ 9,500; Cash ₹ 1,000; Creditors ₹ 30,000; Stock (head office goods at invoice price) ₹ 4,000; Other goods ₹ 500. The closing stock at branch of the head office goods at invoice price is ₹ 3,000 and that of purchased goods at cost is ₹ 1,000. Depreciation is to be provided at 10% on branch assets.

39. You are required to prepare the Trading and Profit and Loss Accounts and consolidated Balance Sheet of Eve Ltd. in Calcutta and its branch at Delhi. Give Journal Entries for incorporation of Delhi Branch Accounts in the head office and show the Branch Account in head office books after incorporating therein the assets and liabilities.

The trial balances as on 31st December, 2014 are as under:

Particulars	H.O. Dr. (₹)	Branch Dr. (₹)	H.O. Cr. (₹)	Branch Cr. (₹)
Manufacturing expenses	30,000	10,000	—	—
Salaries	30,000	10,000	—	—
Wages	1,00,000	40,000	—	—
Cash in hand	10,000	2,000	—	—
Purchases	1,50,000	80,000	—	—
Capital	—	—	2,00,000	—
Goods received from H.O.	—	15,000	—	—
Rent	8,000	4,000	—	—
General expenses	20,000	5,000	—	—
Sales	—	—	4,50,000	1,50,000
Goods sent to branch	—	—	15,000	—
Purchases returns	—	—	5,000	1,000
Opening stock	50,000	30,000	—	—
Discounts earned	—	—	2,000	1,000
Machinery at H.O.	1,50,000	—	—	—
Machinery at Branch	50,000	—	—	—
Furniture at H.O.	7,000	—	—	—
Furniture at branch	3,000	—	—	—
Debtors	40,000	15,000	—	—
Creditors	—	—	30,000	5,000
H.O. account	—	—	—	54,000
Branch account	54,000	—	—	—
TOTAL	7,02,000	2,11,000	7,02,000	2,11,000

Closing stock at head office was ₹ 40,000 and at branch ₹ 30,000. Depreciation is to be provided on machinery @ 20 per cent and on furniture @ 15 per cent. Rent outstanding is ₹ 500 (for branch).

Foreign Branch

40. On 31st December, 2014 the following balances appeared in the books of the Calcutta branch of an English firm having its Head Office in London:

	Dr. (₹)	Cr. (₹)
Stock on 1.1.2014	12,600	
Purchase and Sales	75,000	1,12,500
Debtors and Creditors	39,000	26,000

Bills of Exchange	10,400	9,100
Wages and Salaries	4,800	
Rent rates and taxes	3,600	
Sundry charges	1,500	
Furniture and fixtures	4,910	
Bank balance	28,990	
London office		33,200
	1,80,800	1,80,800

Stock on 31.12.2014 was ₹ 32,500. Calculate Branch Account in the books of London office showed a debit balance of £ 760 on 31.12.2014. Fixtures and furniture were acquired from a remittance received from London of £ 117 which exactly covered the cost of such fixtures, etc. The rates of exchange may be taken at: 31.12.2013 ₹ 42 per £; 31.12.2014 ₹ 39 per £ The average rate for the year 2014 may be taken at ₹ 36 per £.

Prepare the Trading and Profit and Loss Account and Balance Sheet relating to Calcutta branch in the London books. [*It is assumed that the branch is an integral foreign operation of the English firm.*]

41. An Indian company has a branch at Washington. The branch is an integral foreign operation of the Indian company. Its Trial Balance as at 30th September, 2014 is as follows:

Heads of Account	Dr. (US $)	Cr. (US $)
Plant and Machinery	1,20,000	
Furniture and Fixtures	8,000	
Stock, October 1, 2013	56,000	
Purchases	2,40,000	
Sales		4,16,000
Goods from Indian Co. (H.O.)	80,000	
Wages	2,000	
Carriage Inward	1,000	
Salaries	6,000	
Rent, Rates and Taxes	2,000	
Insurance	1,000	
Trade Expenses	1,000	
Head Office A/c		1,14,000
Trade Debtors	24,000	
Trade Creditors		17,000
Cash at Bank	5,000	
Cash in Hand	1,000	
TOTAL	5,47,000	5,47,000

The following further information is given :

(1) Wages outstanding $ 1,000.
(2) Depreciate Plant and Machinery and Furniture and Fixtures @ 10% p.a.
(3) The head office sends goods to branch for ₹ 39,40,000.
(4) The head office shows an amount of ₹ 43,00,000 due from branch.
(5) Stock on 30th September, 2014: $ 52,000.
(6) There were no in-transit items either at the start or at the end of the year.
(7) On September 1, 2014, when the fixed assets were purchased, the rate of exchange was ₹ 38 to one $.
On October 1, 2013, the rate was ₹ 39 to one $.
On September 30, 2014, the rate was ₹ 41 to one $.
Average rate during the year was ₹ 40 to one $.

You are asked to prepare :

(a) Trial Balance incorporating adjustments given under 1 to 4 above, converting dollars into rupees.
(b) Trading and Profit and Loss Account for the year ended 30th September, 2014 and Balance Sheet as on that date depicting the profitability and net position of the branch as would appear in India for the purpose of incorporating in the main Balance Sheet.

Guide to Answers

Multiple Choice

1. B; 2. A; 3. A; 4. B; 5. A.

Practical Questions

1. **Branch Profit — ₹ 29,500.**
2. **Branch Profit — ₹ 11,300; Depreciation ₹ 1,800.**
3. **Branch Profit — ₹ 87,500; Credit Dates — ₹ 5,37,500; Goods sent to branch — ₹ 5,75,000.**
4. **Branch Profit — ₹ 18,900; Opening balance of Debtors — ₹ 8,200.**
5. **Branch Profit — ₹ 5,800.**
6. **Branch Profit — ₹ 12,680; Cash received from Debtors — ₹ 29,500.**
7. **Branch Profit : Madras — ₹ 82,200; Nagpur — ₹ 92,800.**
8. **Branch Profit — ₹ 32,000.**
9. **Branch Profit — ₹ 10,280.**
10. **Branch Profit — ₹ 34,600. Difference in Branch Stock Account ₹ 5,000 has been treated as returns from debtors.**
11. **Gross Profit — ₹ 57,650 (after charging loading ₹ 150 for deficiency of stock). Deficiency of stock at invoice price ₹ 600.**
12. **Branch Profit — ₹ 24,817.**
13. **Branch Profit — ₹ 3,385.**
14. **Profit : Calcutta — ₹ 7,400; Madras — ₹ 5,715.**
15. **Gross Profit — ₹ 43,200; Branch Profit — ₹ 27,000.**
16. **Gross Profit — ₹ 3,580; Branch Profit — ₹ 2,720.**
17. **Branch Profit — ₹ 9,200; Credit Sales — ₹ 72,000; Supplies from H.O. — ₹ 1,50,000.**
18. **Branch Profit — ₹ 1,77,000; Gross Profit — ₹ 2,43,800.**
19. **Gross Profit — ₹ 92,800; Branch Profit — ₹ 86,200.**
20. **Net Profit — ₹ 1,00,518.**
21. **Branch Profit — ₹ 9,000.**
22. **Branch Profit — ₹ 39,200; Gross Profit — ₹ 68,000.**
23. **Branch Profit — ₹ 18,570; Gross Profit — ₹ 37,830.**
24. **Goods sent to branch at cost — ₹ 3,00,000; Goods sent to branch at invoice price — ₹ 3,75,000.**
    Closing Stock : Madras — ₹ 28,000; Coimbatore — ₹ 4,800; Trivandrum — ₹ 4,000; Bangalore — ₹ 2,000.
    Gross Profit : Coimbatore — ₹ 36,000; Trivandrum — ₹ 24,000; Bangalore — ₹ 20,000.
25. **Net Profit — ₹ 26,830; Gross Profit — ₹ 88,690.**
26. **Net Profit : Kanpur — ₹ 61,200; Lucknow — ₹ 74,800; Gross Profit : Kanpur — ₹ 96,500; Lucknow — ₹ 1,04,000.**
27. **Net Profit : Madras — ₹ 13,210; Delhi — ₹ 2,600; Calcutta — ₹ 17,409.**
28. **(i) Value of Closing Stock : H.O. — ₹ 60,000; Branch — ₹ 9,000.**
    (ii) Profit : H.O. — ₹ 88,000; Branch — ₹ 5,000; Stock reserve — ₹ 4,000.
29. **Gross Profit — ₹ 52,500; Net Profit — ₹ 35,625; Stock — ₹ 1,25,250.**
30. **Net Profit : H.O. — ₹ 5,65,000; Branch — ₹ 35,000.**
31. **Branch Profit — ₹ 6,270; Stock Reserve — ₹ 2,283.**
32. **Only journal entries.**
33. **Only journal entries.**
34. **Madras Branch Account Dr. ₹ 6,000**
    Patna Branch Account Dr. ₹ 16,000
    To Bombay Branch Account ₹ 6,000
    To Calcutta Branch Account ₹ 16,000
35. **Only journal entries.**
36. **Branch Profit — ₹ 1,09,700; Cash in transit — ₹ 12,000.**
37. **Remittance to Head Office — ₹ 40,000; Balance Sheet total — ₹ 3,07,600; For lack of information Branch Trading and Profit and Loss Account cannot be prepared.**
38. **Branch Profit — ₹ 30,200; Stock Reserve — ₹ 600.**
39. **Head Office Profit : ₹ 92,950; Branch Loss : ₹ 22,950; Balance Sheet Total : ₹ 3,05,500.**
40. **Net Profit : £ 1,300; Balance Sheet total : £ 2,960.**
41. **Exchange difference : ₹ 7,00,000; Net Profit : ₹ 27,01,600; Balance Sheet total : ₹ 77,39,600.**

35

Hire Purchase Accounts

Introduction

With an increasing demand for better life, the consumption of goods has been on the expanding scale. But, this has not been backed up by adequate purchasing power, transforming it into effectual demand, i.e, actual sale at set or settled prices. This has created the market for what is called ***hire purchase***.

When a person is unable to acquire an asset against immediate cash payment, or is not sure to make payment within a stipulated period of time he may make some arrangements with the seller to stagger the payment. This enables the purchaser to use the asset while paying for it by instalments over an agreed period of time. This type of a business deal is known as ***hire purchase transaction***. Here, the customer pays the entire amount either in monthly or quarterly or yearly instalments, while the asset — the durable (television, fridge, etc.,) remains the property of the seller until the buyer squares up his entire liability. For the seller the contracted instalments include his interest on the credit to the purchaser. Therefore, when the total amount is paid in instalments over a period of time, the total amount paid is certainly higher than the cash down price of the article because of the counterveiling interest charges.

Obviously, both the parties gain in the bargain. By virtue of this process, the purchaser has the immediate use of the asset without making down right payment from his own, he gets both credit and product from the same seller. From the point of view of the seller, the benefit rests in the enhancement of his sale while he recovers his own cost of credit — the credit he had from the financier — from the hire purchaser.

Thus, it is not surprising that in consumer durables, in particular, the hire purchase system has increased its share of the total market. It is to be noted that the process is being extended to the production firms where the producers obtain costly machinery and implements under this system as in a single-window operation — credit and asset from the same business entity.

Nature of Hire Purchase Agreement

Under the Hire Purchase System the customer (called the Hire Purchaser) obtains possession of the goods at the outset and can use it, while paying for it by instalments over an agreed period of time. However, the ownership of the goods remains with the seller (called the Hire Vendor) until the hire purchaser has made all the payments. Each instalment paid by the hire purchaser is treated as hire charges for using the asset. In case he fails to pay any of the instalments (even the last one) the hire vendor will take back his goods without compensating the buyer, i.e., the hire vendor is not going to pay back a part or whole of the amount received through instalments from the buyer.

The special features of the hire purchase agreement are:

(1) The hire vendor transfers only possession of the goods to the hire purchaser immediately after the contract for hire purchase is made.

(2) The goods should be delivered by the hire vendor on the condition that a hire purchaser should pay the agreed amount in periodical instalments.

(3) The hire purchaser generally makes a down payment (initial payment) on signing the agreement and the balance of the amount alongwith interest is paid in instalments at regular intervals for a specified period.

(4) Each instalment including down-payment (if any) is treated as hire charges by the seller.

(5) Each instalment consists partly of a finance charge (interest) and partly of a capital payment.

(6) The hire purchaser should be given power to exercise the option to purchase the hired goods.

(7) The property in goods is to pass to the hire purchaser on the payment of the last instalment and exercising the option conferred upon him under the agreement.

(8) The hire purchaser has the right to terminate the agreement at any time before the property so passes.

(9) In case of default in respect of payment of even the last instalment, the hire vendor has the right to take the goods back without making any compensation.

Legal Position

"Hire Purchase" and "Hire Purchase Agreements" have been defined in the Hire Purchase Act, 1972. Though the Act was passed by the Parliament and had got the assent of the President, the date of coming into effect of the Act, was rescinded.

Section 2: Definition — In this Act, unless the context otherwise requires, — "hire purchase agreement" means an agreement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement and includes an agreement under which —

(i) possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical instalments, and

(ii) the property in the goods is to pass to such person on the payment of the last of such instalments, and

(iii) such person has a right to terminate the agreement at any time before the property so passes.

Accounting Arrangements of Hire Purchase Transaction

In connection with the accounting for goods sold on the hire purchase system, we should know the meaning of the following terms:

1. **Hire Vendor** : The seller in a hire purchase agreement.
2. **Hire Purchaser** : The buyer in a hire purchase agreement.
3. **Cash Price** : The amount to be paid on outright purchase in cash.
4. **Down Payment** : Initial payment made at the time of signing the hire purchase agreement.
5. **Hire Purchase Price** : The amount to be paid if the goods are purchased under the hire purchase system. It includes the cash price and interest of the future instalments.

Under a hire purchase agreement, the hire purchaser obtains possession of the goods at the outset, but the ownership is not transferred until the last instalment is paid. Therefore, on a strict legal interpretation of the facts of the transaction, the hire vendor should not take any profit out of the hire purchase transaction until the final payment is made. Similarly, the hire purchaser should not include the goods as fixed assets (as most hire purchase items are of asset type) in his Balance Sheet until the final instalment is paid.

In this connection, the following points are very important :

1. AS—19 (Accounting Standard for Leases) is applicable to Hire Purchase agreement. ***Para 4*** states that "The definition of a lease includes agreements for the hire of an asset which contain a provision

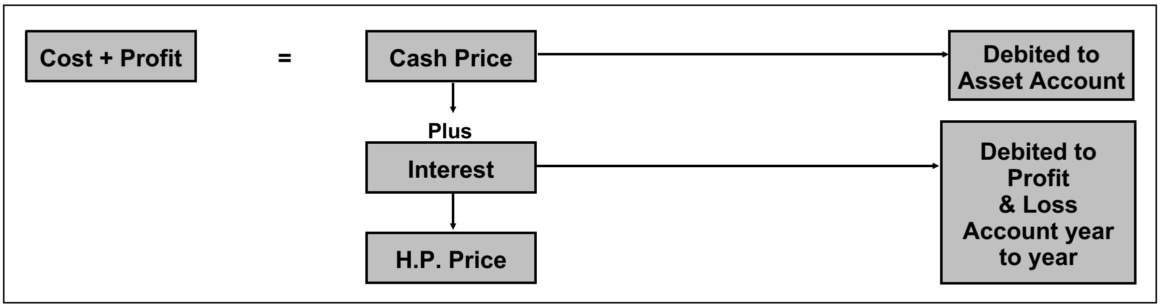
giving the hirer an option to acquire title to the asset upon the fulfillment of agreed conditions. These agreements are commonly known as hire purchase agreements. Hire purchase agreements include agreements under which the property in the asset is to pass to the hirer on the payment of the last instalment and the hirer has a right to terminate the agreement at any time before the property so passes.

2. At the inception of the hire purchase agreement, the hire purchaser should record the asset acquired on hire purchase as an ***asset***. Assets cannot be recorded on piecemeal basis with the payment of instalments.
3. Hire purchaser should recognise the ***liability*** at the inception of the hire purchase agreement.

Books of the Hire Purchaser

To have proper accounting record, some information is required in regard to the hire purchase transactions. They are as : (1) Date of purchase of the asset; (2) Cash price of the asset; (3) Hire purchase price of the asset; (4) The amount of down payment; (5) Number and amount of each instalment; (6) Rate of interest; (7) Method and rate of depreciation; and (8) Date of closing the books of account.

Before passing journal entries the students should consider the make-up of the hire purchase price:



Recording of Asset

Method 1

Under this method, the full ***cash price*** of the asset is debited to the Asset Account and credited to the Hire Vendor Account. At the time of payment of instalment, Interest Account is debited and Hire Vendor Account is credited (with the interest on outstanding balance). When instalment is paid, the Hire Vendor Account is debited and Bank Account is credited. At the time of preparation of Final Accounts, interest is transferred to Profit and Loss Account and asset is shown in the Balance Sheet at cost less depreciation. The balance due to hire vendor is shown in the Balance Sheet as a liability (alternatively it can be shown as a deduction from Asset Account). [***See Illustration 5***]

Depreciation on asset acquired on hire purchase must be charged from the date of acquisition of possession (not from the date of legal ownership) and it is to be calculated on cash price.

Journal Entries

1. When the asset is acquired on hire purchase

Asset Account	Dr. [Full cash price]
To Hire Vendor Account	

2. When down payment is made

Hire Vendor Account	Dr. [Down payment]
To Bank Account	

3. When an instalment becomes due

Interest Account	Dr. [Interest on outstanding balance]
To Hire Vendor Account	

4. When an instalment is paid

Hire Vendor Account Dr. [Amount of instalment]
To Bank Account

5. When depreciation is charged on the asset

Depreciation Account Dr. [Calculated on cash price]
To Asset Account

6. For closing interest and depreciation account

Profit and Loss Account Dr.
To Interest Account
To Depreciation Account

Illustration 1

On January 1, 2012 Gopinath and Co. acquired a pick-up Van on hire purchase from French Motor Co. Ltd. The terms of the contract were as follows:

(a) The cash price of the van was ₹ 1,00,000.
(b) ₹ 40,000 were to be paid on signing of the contract.
(c) The balance was to be paid in annual instalments of ₹ 20,000 plus interest.
(d) Interest chargeable on the outstanding balance was 6% p.a.
(e) Depreciation at 10% p.a. is to be written-off using the straight-line method.

You are required to:

(i) Give Journal Entries and show the relevant accounts in the books of Gopinath and Co. from January 1, 2012 to December 31, 2014; and
(ii) Show the relevant items in the Balance Sheet of the purchaser as on December 31, 2012 to 2014.

Solution

In the books of Gopinath & Co.
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2012 Jan. 1	Pick-up Van A/c	Dr.		1,00,000	
	To French Motor Co. Ltd. A/c				1,00,000
	(Being the purchase of a pick-up van on hire purchase from French Motor Co. Ltd.)				
"	French Motor Co. Ltd. A/c	Dr.		40,000	
	To Bank A/c				40,000
	(Being the amount paid on signing the H.P. contract)				
Dec. 31	Interest A/c	Dr.		3,600	
	To French Motor Co. Ltd. A/c				3,600
	(Being the interest payable @ 6% on ₹ 60,000)				
"	French Motor Co. Ltd. A/c (₹ 20,000 + ₹ 3,600)	Dr.		23,600	
	To Bank A/c				23,600
	(Being the payment of 1st instalment along with interest)				
"	Depreciation A/c	Dr.		10,000	
	To Pick-up Van A/c				10,000
	(Being the depreciation charged @ 10% p.a. on ₹ 1,00,000)				
"	Profit & Loss A/c	Dr.		13,600	
	To Depreciation A/c				10,000
	To Interest A/c				3,600
	(Being the depreciation and interest transferred to Profit and Loss Account)				
2013 Dec. 31	Interest A/c	Dr.		2,400	
	To French Motor Co. Ltd. A/c				2,400
	(Being the interest payable @ 6% on ₹ 40,000)				
	French Motor Co. Ltd. A/c (₹ 20,000 + ₹ 2,400)	Dr.		22,400	
	To Bank A/c				22,400
	(Being the payment of 2nd instalment along with interest)				
	Depreciation A/c	Dr.		10,000	
	To Pick-up Van A/c				10,000
	(Being the depreciation charged @ 10% p.a.)				
	Profit & Loss A/c	Dr.		12,400	
	To Depreciation A/c				10,000
	To Interest A/c				2,400
	(Being the depreciation and interest charged to Profit and Loss Account)				

2014 Dec. 31	Interest A/c Dr. To French Motor Co. Ltd. A/c (Being the interest payable @ 6% on ₹ 20,000)		1,200	1,200
	French Motor Co. Ltd. A/c (₹ 20,000 + ₹ 1,200) Dr. To Bank A/c (Being the payment of final instalment along with interest)		21,200	21,200
	Depreciation A/c Dr. To Pick-up Van A/c (Being the depreciation charged @ 10% p.a. on ₹ 1,00,000)		10,000	10,000
	Profit & Loss A/c Dr. To Depreciation A/c To Interest A/c (Being the interest and depreciation charged to Profit and Loss Account)		11,200	10,000 1,200

Ledger of Gopinath and Co.

Dr. **Pick-up Van Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To French Motor Co. Ltd. A/c	1,00,000	31.12.2012	By Depreciation A/c	10,000
			31.12.2012	By Balance c/d	90,000
		1,00,000			1,00,000
1.1.2013	To Balance b/d	90,000	31.12.2013	By Depreciation A/c	10,000
			31.12.2013	By Balance c/d	80,000
		90,000			90,000
1.1.2014	To Balance b/d	80,000	31.12.2014	By Depreciation A/c	10,000
			31.12.2014	By Balance c/d	70,000
		80,000			80,000

Dr. **French Motor Co. Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Bank A/c	40,000	1.1.2012	By Pick-up Van A/c	1,00,000
31.12.2012	To Bank A/c	23,600	31.12.2012	By Interest A/c	3,600
31.12.2012	To Balance c/d	40,000			
		1,03,600			1,03,600
31.12.2013	To Bank A/c	22,400	1.1.92013	By Balance b/d	40,000
31.12.2013	To Balance c/d	20,000	31.12.2013	By Interest A/c	2,400
		42,400			42,400
31.12.2014	To Bank A/c	21,200	1.1.2014	By Balance b/d	20,000
			31.12.2014	By Interest A/c	1,200
		21,200			21,200

Dr. **Depreciation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Pick-up Van A/c	10,000	31.12.2012	By Profit & Loss A/c	10,000
31.12.2013	To Pick-up Van A/c	10,000	31.12.2013	By Profit & Loss A/c	10,000
31.12.2014	To Pick-up Van A/c	10,000	31.12.2014	By Profit & Loss A/c	10,000

Dr. **Interest Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To French Motor Co. Ltd. A/c	3,600	31.12.2012	By Profit & Loss A/c	3,600
31.12.2013	To French Motor Co. Ltd. A/c	2,400	31.12.2013	By Profit & Loss A/c	2,400
31.12.2014	To French Motor Co. Ltd. A/c	1,200	31.12.2014	By Profit & Loss A/c	1,200

Balance Sheet of Gopinath & Co. as at 31st December, 2012

Liabilities	₹	Assets	₹
French Motor Co. Ltd.	40,000	Pick-up Van	90,000

Balance Sheet of Gopinath & Co. as at 31st December, 2013

Liabilities	₹	Assets	₹
French Motor Co. Ltd.	20,000	Pick-up Van	80,000

Balance Sheet of Gopinath & Co. as at 31st December, 2014

Liabilities	₹	Assets	₹
		Pick-up Van	70,000

Method 2

This method is almost similar to Method 1, excepting the accounting for interest. Under this method, like method 1, the full cash price of the asset is debited to Asset Account and credited to the Hire Vendor Account. At the same time the entire amount of interest payable (for all instalments) is debited to the H.P. Interest Suspense Account and credited to the Hire Vendor Account. At the time of payment of each instalment, the Hire Vendor Account is debited and the Bank Account is credited. At the same time an appropriate amount of interest is removed from the H.P. Interest Suspense Account and debited to the Interest Account. At the time of preparation of Final Accounts, the interest is transferred to the Profit and Loss Account and the balance of the H.P. Interest Suspense Account is shown in the Balance Sheet as a deduction from the Hire Vendor Account. All other entries are similar to method 1.

Journal Entries

1. When the asset is acquired on hire purchase

Asset Account	Dr. [Full cash price]
To Hire Vendor Account	

2. For total interest payable

H.P. Interest Suspense Account	Dr. [Total interest]
To Hire Vendor Account	

3. When down payment is made

Hire Vendor Account	Dr.
To Bank Account	

4. For interest of the relevant period

Interest Account	Dr. [Interest of the relevant period]
To H.P. Interest Suspense Account	

5. When an instalment is paid

Hire Vendor Account	Dr.
To Bank Account	

6. When depreciation is charged on the asset

Depreciation Account	Dr. [Calculated on cash price]
To Asset Account	

7. For closing interest and depreciation account

Profit and Loss Account	Dr.
To Interest Account	
To Depreciation Account	

If we apply this method to the figures from ***Illustration 1***, the H.P. Interest Suspense Account, Interest Account and French Motor Co. Ltd. Accounts and Balance Sheets will appear as follows:

Dr. H.P. Interest Suspense Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To French Motor Co. Ltd. A/c (Note 1)	7,200	31.12.2012	By Interest A/c	3,600
			31.12.2012	By Balance c/d	3,600
		7,200			7,200

1.1.2013	To Balance b/d	3,600	31.12.2013	By Interest A/c	2,400
			31.12.2013	By Balance c/d	1,200
		3,600			3,600
1.1.2014	To Balance b/d	1,200	31.12.2014	By Interest A/c	1,200

Dr. **Interest Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To H.P. Interest Suspense A/c	3,600	31.12.2012	By Profit & Loss A/c	3,600
31.12.2013	To H.P. Interest Suspense A/c	2,400	31.12.2013	By Profit & Loss A/c	2,400
31.12.2014	To H.P. Interest Suspense A/c	1,200	31.12.2014	By Profit & Loss A/c	1,200

Dr. **French Motor Co. Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Bank A/c	40,000	1.1.2012	By Pick-up Van A/c	1,00,000
31.12.2012	To Bank A/c	23,600	1.1.2012	By H.P. Interest Suspense A/c	7,200
31.12.2012	To Balance c/d	43,600			
		1,07,200			1,07,200
31.12.2013	To Bank A/c	22,400	1.1.2013	By Balance b/d	43,600
31.12.2013	To Balance c/d	21,200			
		43,600			43,600
31.12.2014	To Bank A/c	21,200	1.1.2014	By Balance b/d	21,200

Balance Sheet of Gopinath & Co. as at 31st December, 2012

Liabilities		₹	Assets		₹
French Motor Co. Ltd.	43,600		Pick-up Van	1,00,000	
Less: H.P. Interest Suspense	3,600	40,000	*Less*: Depreciation	10,000	90,000

Balance Sheet of Gopinath & Co. as at 31st December, 2013

Liabilities		₹	Assets		₹
French Motor Co. Ltd.	21,200		Pick-up Van	90,000	
Less: H.P. Interest Suspense	1,200	20,000	*Less*: Depreciation	10,000	80,000

Balance Sheet of Gopinath & Co. as at 31st December, 2014

Liabilities	₹	Assets		₹
		Pick-up Van	80,000	
		Less: Depreciation	10,000	70,000

Working Notes : (1) Total interest = ₹ 3,600 + ₹ 2,400 + ₹ 1,200 = ₹ 7,200.

Illustration 2

A. Co. Ltd. purchased machinery from B. Co. Ltd. on hire purchase terms. The cash price of the machinery was ₹ 1,19,145. ₹ 32,000 was to be paid on 1.1.2012 and balance in 3 instalments of ₹ 32,000 each on 31st December every year subject to interest @ 5% p.a. Depreciation is to be provided @ 15% p.a. on the diminishing balances.

Show Machinery Account and B.Co. Ltd. Account in the books of A. Co. Ltd. for 3 years upto 2014.

Solution

In the books of A. Co. Ltd.

Dr. **Machinery Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To B. Co. Ltd. A/c	1,19,145	31.12.2012	By Depreciation A/c	17,872
			31.12.2012	By Balance c/d	1,01,273
		1,19,145			1,19,145
1.1.2013	To Balance b/d	1,01,273	31.12.2013	By Depreciation A/c	15,191
			31.12.2013	By Balance c/d	86,082
		1,01,273			1,01,273

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d	86,082	31.12.2014	By Depreciation A/c	12,912
			31.12.2014	By Balance c/d	73,170
		86,082			86,082

Dr. **B. Co. Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Bank A/c (Down payment)	32,000	1.1.2012	By Machinery A/c	1,19,145
31.12.2012	To Bank A/c (Instalment)	32,000	31.12.2012	By Interest A/c	4,357
31.12.2012	To Balance c/d	59,502			
		1,23,502			1,23,502
31.12.2013	To Bank A/c	32,000	1.1.2013	By Balance b/d	59,502
31.12.2013	To Balance c/d	30,477	31.12.2013	By Interest A/c	2,975
		62,477			62,477
31.12.2014	To Bank A/c	32,000	1.1.2014	By Balance b/d	30,477
			31.12.2014	By Interest A/c	1,523
		32,000			32,000

Working Note : (1) Calculation of Interest

2012	₹	2013	₹	2014	₹
Cash price	1,19,145	Balance b/f	59,502	Balance b/f	30,477
Less: Down payment	32,000	*Add*: Interest @ 5%	2,975	*Add*: Interest @ 5%	1,523
	87,145		62,477		32,000
Add: Interest @ 5%	4,357	*Less*: Instalment	32,000	*Less*: Instalment	32,000
	91,502	Balance c/f	30,477		nil
Less: Instalment	32,000				
Balance c/f	59,502				

Illustration 3

On 1st January, 2012, Globe Press purchased a printing machine on the hire purchase system from Modern Machinery Co. The payment was to be made at ₹ 30,000 down and the balance in three equal annual instalments of ₹ 20,000 each payable on 31st December. The vendor company charged interest @ 8% p.a. Globe Press provided depreciation @ 10% p.a. on the diminishing balances and paid all the instalments. It closed its books on 31st December every year. The cash down value of machine was ₹ 81,543.

Show the (a) Modern Machinery Co.'s Account; and (b) Printing Machine Account in the books of Globe Press for 3 years upto 31st December, 2014.

Solution

In the books of Globe Press

Dr. **Printing Machine Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Modern Machinery Co. A/c	81,543	31.12.2012	By Depreciation A/c	8,154
			31.12.2012	By Balance c/d	73,389
		81,543			81,543
1.1.2013	To Balance b/d	73,389	31.12.2013	By Depreciation A/c	7,339
			31.12.2013	By Balance c/d	66,050
		73,389			73,389
1.1.2014	To Balance b/d	66,050	31.12.2014	By Depreciation A/c	6,605
			31.12.2014	By Balance c/d	59,445
		66,050			66,050
1.1.2015	To Balance b/d	59,445			

Dr. **Modern Machinery Co. Account** **Cr**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Bank A/c	30,000	1.1.2012	By Printing Machine A/c	81,543
31.12.2012	To Bank A/c (Instalment)	20,000	31.12.2012	By Interest A/c	4,123
31.12.2012	To Balance c/d	35,666			
		85,666			85,666

31.12.2013	To Bank A/c (Instalment)	20,000	1.1.2013	By Balance b/d	35,666
31.12.2013	To Balance c/d	18,519	31.12.2013	By Interest A/c	2,853
		38,519			38,519
31.12.2014	To Bank A/c	20,000	1.1.2014	By Balance b/d	18,519
			31.12.2014	By Interest A/c	1,481
		20,000			20,000

Working Note : (1) Calculation of Interest

2012	₹	2013	₹	2014	₹
Cash price	81,543	Balance b/f	35,666	Balance b/f	18,519
Less: Down payment	30,000	*Add*: Interest @ 8%	2,853	*Add:* Interest @ 8%	1,481
	51,543		38,519		20,000
Add: Interest @ 8%	4,123	*Less*: Instalment	20,000	*Less*: Instalment	20,000
	55,666	Balance c/f	18,519		nil
Less: Instalment	20,000				
Balance c/f	35,666				

Illustration 4

Sri S. Nandi purchased a machine on 30.6.2011 from A. Ltd. on Hire Purchase System. The cash price of the machine was ₹ 34,000. The agreement provided that he would pay ₹ 8,000 on delivery of the machine and the balance in 6 half-yearly instalments of ₹ 4,800 each. A. Ltd. charged interest at 6% per annum of half-yearly balances. The buyer closed his books of accounts on 31st December every year. Assuming that he decided to write-off depreciation on the machine at 10% p.a. under the diminishing balance method. Show the necessary Ledger Accounts in the books of Sri S. Nandi.

Solution **In the books of Sri S. Nandi**

Dr. **Machine Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
30.6.2011	To A. Ltd. A/c	34,000	31.12.2011	By Depreciation A/c (1/2 year)	1,700
			31.12.2011	By Balance c/d	32,300
		34,000			34,000
1.1.2012	To Balance b/d	32,300	31.12.2012	By Depreciation A/c	3,230
			31.12.2012	By Balance c/d	29,070
		32,300			32,300
1.1.2013	To Balance b/d	29,070	31.12.2013	By Depreciation A/c	2,907
			31.12.2013	By Balance c/d	26,163
		29,070			29,070
1.1.2014	To Balance b/d	26,163	31.12.2014	By Depreciation A/c	2,616
			31.12.2014	By Balance c/d	23,547
		26,163			26,163
1.1.2015	To Balance b/d	23,547			

Dr. **A. Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
30.6.2011	To Bank A/c (Down payment)	8,000	30.6.2011	By Machinery A/c	34,000
31.12.2011	To Bank A/c	4,800	31.12.2011	By Interest A/c (6 months)	780
31.12.2011	To Balance c/d	21,980			
		34,780			34,780
30.6.2012	To Bank A/c	4,800	1.1.2012	By Balance b/d	21,980
31.12.2012	To Bank A/c	4,800	30.6.2012	By Interest A/c (6 months)	659
31.12.2012	To Balance c/d	13,574	31.12.2012	By Interest A/c (6 months)	535
		23,174			23,174
30.6.2013	To Bank A/c	4,800	1.1.2013	By Balance b/d	13,574
31.12.2013	To Bank A/c	4,800	30.6.2013	By Interest A/c	407
31.12.2013	To Balance c/d	4,656	31.12.2013	By Interest A/c	275
		14,256			14,256

30.6.2014	To Bank A/c	4,800	1.1.2014 30.6.2014	By Balance b/d By Interest A/c	4,656 144
		4,800			4,800

Dr. **Interest Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2011	To A. Ltd. A/c	780	31.12.2011	By Profit & Loss A/c	780
30.6.2012 31.12.2012	To A. Ltd. A/c To A. Ltd. A/c	659 535	31.12.2012	By Profit & Loss A/c	1,194
		1,194			1,194
30.6.2013 31.12.2013	To A. Ltd. A/c To A. Ltd. A/c	407 275	31.12.2013	By Profit & Loss A/c	682
		682			682
30.6.2014	To A. Ltd. A/c	144	31.12.2014	By Profit & Loss A/c	144

Dr. **Depreciation Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2011	To Machinery A/c	1,700	31.12.2011	By Profit & Loss A/c	1,700
31.12.2012	To Machinery A/c	3,230	31.12.2012	By Profit & Loss A/c	3,230
31.12.2013	To Machinery A/c	2,907	31.12.2013	By Profit & Loss A/c	2,907
31.12.2014	To Machinery A/c	2,616	31.12.2014	By Profit & Loss A/c	2,616

Working Note:
(1) Calculation of Interest

2011	₹	2012	₹	2013	₹	2014	₹
Cash price	34,000	Balance b/f	21,980	Balance b/f	13,574	Balance b/f	4,656
Less: Down payment	8,000	*Add*: Interest (1/2 year)	659	*Add*: Interest (1/2 year)	407	*Add*: Interest*	144
	26,000		22,639		13,981		4,800
Add: Interest (1/2 year)	780	*Less*: Instalment	4,800	*Less*: Instalment	4,800	*Less*: Instalment	4,800
	26,780		17,839		9,181		nil
Less: Instalment	4,800	*Add*: Interest (1/2 year)	535	*Add*: Interest (1/2 year)	275		
Balance c/f	21,980		18,374		9,456		
		Less: Instalment	4,800	*Less*: Instalment	4,800		
		Balance c/f	13,574	Balance c/f	4,656		

* Actual interest comes to ₹ 139.69 but has been put at ₹ 144 for balancing purposes.

Illustration 5

M H Ltd bought a motor vehicle on 1.1.2014, for ₹ 4,34,180 under a hire-purchase agreement. The cash price was ₹ 3,60,000. The vehicle was financed by Tata Finance Ltd. The agreement required an initial deposit of ₹ 1,20,000 on acquisition, followed by two equal instalments of ₹ 1,57,090 on 31.12.2014 and 31.12.2015, hire purchase interest being calculated @ 20% p.a. on the balance at 31 December each year.

On 31.12.2013, the balance on the Motor Vehicle Account was ₹ 16,00,000 and on the provision for depreciation (motor vehicles) ₹ 7,60,000. Depreciation is calculated @ 25% p.a. on a straight line basis, assuming no residual value. No other acquisitions or disposals took place.

Prepare necessary ledger accounts for the two years ended 31.12.2014 and 31.12.2015 and also show the relevant items in the Balance Sheet of M H Ltd as at 31st December, 2014.

Solution **In the books of M H Ltd**

Dr. **Motor Vehicles Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2014 1.1.2014	To Balance b/d To Tata Finance Ltd A/c	16,00,000 3,60,000	31.12.2014	By Balance c/d	19,60,000
		19,60,000			19,60,000
1.1.2015	To Balance b/d	19,60,000	31.12.2015	By Balance c/d	19,60,000
1.1.2015	To Balance b/d	19,60,000			

Dr. Provision for Depreciation (Motor Vehicles) Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Balance b/d	12,50,000	1.1.2014	By Balance b/d	7,60,000
			31.12.2014	By Depreciation A/c (25% of ₹ 19,60,000)	4,90,000
		12,50,000			12,50,000
31.12.2015	To Balance c/d	17,40,000	1.1.2015	By Balance b/d	12,50,000
				By Depreciation A/c	4,90,000
		17,40,000			17,40,000
			1.1.2016	By Balance b/d	17,40,000

Dr. Tata Finance Ltd Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Bank A/c (Deposit)	1,20,000	1.1.2014	By Motor Vehicles A/c	3,60,000
31.12.2014	To Bank A/c (1st Instalment)	1,57,090	31.12.2014	By Interest A/c	48,000
31.12.2014	To Balance c/d	1,30,910		[20% x (₹ 3,60,000 – ₹ 1,20,000)]	
		4,08,000			4,08,000
31.12.2015	To Bank A/c (2nd Instalment)	1,57,090	1.1.2015	By Balance b/d	1,30,910
			31.12.2015	By Interest A/c (Note 1)	26,180
		1,57,090			1,57,090

Dr. Interest Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Tata Finance Ltd A/c	48,000	31.12.2014	By Profit and Loss A/c	4,800
31.12.2015	To Tata Finance Ltd A/c	26,180	31.12.2015	By Profit and Loss A/c	26,180

Balance Sheet of M H Ltd as on 31st December, 2014 (includes)

Liabilities	₹	Assets	₹
		Motor Vehicles (at cost)	19,60,000
		Less: Provision for Depreciation	12,50,000
			7,10,000
		Less: Amount Payable to Tata Finance Ltd (not yet due)	1,30,910
			5,79,090

Working Note : (1) Actual interest comes to ₹ 26,182 but has been put at ₹ 26,180 for balancing purposes.

Illustration 6

Buyers Ltd. purchased a truck on January 1, 2012 on hire purchase basis from Vendors Ltd. The cash down price was ₹ 30,000. The terms of purchase were as under:

(a) ₹ 12,000 is payable as deposit.

(b) Balance being payable by 12 quarterly instalments of ₹ 1,920, falling due from April 1, 2012.

The financial year of the company (Buyers Ltd.) ends on June 30.

On September 30, 2013 the truck was sold for ₹ 20,000 and the hire purchase balances were settled for ₹ 10,200.

Buyers Ltd. brings the Asset Account at cash price and spreads interest equally over the period of hire purchase payments. Depreciation at 20% p.a. on cost was provided up to the date of sale.

Show the Truck Account, Vendors Ltd. Account and the Interest Suspense Account in the books of Buyers Ltd.

Solution

In the books of Buyers Ltd.

Dr. Truck Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Vendors Ltd. A/c	30,000	30.6.2012	By Depreciation A/c (Note 1)	3,000
			30.6.2012	By Balance c/d	27,000
		30,000			30,000

Date	Particulars	₹	Date	Particulars	₹
1.7.2012	To Balance b/d	27,000	30.6.2013	By Depreciation A/c	6,000
			30.6.2013	By Balance c/d	21,000
		27,000			27,000
1.7.2013	To Balance b/d	21,000	30.9.2013	By Depreciation A/c (Note 2)	1,500
30.6.2014	To Profit & Loss A/c (Profit on sale)	500	30.9.2013	By Bank A/c (Sale proceeds)	20,000
		21,500			21,500

Dr. Vendors Ltd. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Bank A/c	12,000	1.1.2012	By Truck A/c	30,000
1.4.2012	To Bank A/c	1,920	1.1.2012	By Interest Suspense A/c (Note 3)	5,040
30.6.2012	To Balance c/d	21,120			
		35,040			35,040
1.7.2012	To Bank A/c	1,920	1.7.2012	By Balance b/d	21,120
1.10.2012	To Bank A/c	1,920			
1.1.2013	To Bank A/c	1,920			
1.4.2013	To Bank A/c	1,920			
30.6.2013	To Balance c/d	13,440			
		21,120			21,120
1.7.2013	To Bank A/c	1,920	1.7.2013	By Balance b/d	13,440
1.10.2013	To Bank A/c	10,200			
30.6.2014	To Interest Suspense A/c	1,320			
		13,440			13,440

Dr. Interest Suspense Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Vendors Ltd. A/c (Note 3)	5,040	30.6.2012	By Profit & Loss A/c (Note 4)	840
			30.6.2012	By Balance c/d	4,200
		5,040			5,040
1.7.2012	To Balance b/d	4,200	30.6.2013	By Profit & Loss A/c (Note 5)	1,680
			30.6.2013	By Balance c/d	2,520
		4,200			4,200
1.7.2013	To Balance b/d	2,520	30.9.2013	By Vendors Ltd. A/c	1,320
				By Profit & Loss A/c (Balancing figure)	1,200
		2,520			2,520

Working Notes :

(1) Depreciation @ 20% on ₹ 30,000 for 6 months = ₹ 3,000

(2) Depreciation @ 20% on ₹ 30,000 for 3 months = ₹ 1,500

(4) Interest for 2011-12 = 2/12 x ₹ 5,040 = ₹ 840. Interest has been allocated on the basis of number of instalments due in each accounting period.

(5) Interest for 2012-13 = 4/12 x ₹ 5,040 = ₹ 1,680.

(3) Calculation of total interest:

Instalments ₹ 1,920 x 12	₹ 23,040
Down payment	₹ 12,000
Hire Purchase price	₹ 35,040
Less: Cash price	₹ 30,000
Total interest	₹ 5,040

Illustration 7

Mahalaxmi Traders has bought three computers since 2013. All are subject to hire purchase agreements with the vendor, XYZ Ltd. Data relating to the computers are as follows :

Particulars	Computer A	Computer B	Computer C
Date of purchase	30.6.2013	31.3.2014	31.3.2013
Cash price	₹ 80,000	₹ 60,000	₹ 60,000
Deposit	₹ 10,400	₹ 7,200	₹ 7,200
Total interest	₹ 19,200	₹ 13,200	₹ 8,000
Number of quarterly instalments	12	12	8

The hire purchase agreements state that the first quarterly instalment is due three months after the date of purchase.

It is the firm's policy to assume that hire purchase interest accrues evenly over the life of the agreement and to credit the total hire purchase price to the vendor at the date of purchase. A Hire Purchase Interest Suspense Account is maintained.

The accounting year of the firm ends on 31st December. Depreciation on computers is at 20% p.a. on the written down value. A full year's depreciation is charged against profit in the year of purchase.

Prepare the following ledger accounts for the years ended 31.12.2013, 31.12.2014 and 31.12.2015 : (a) Computers; (b) Provision for Depreciation on Computers; (c) XYZ Limited; (d) Hire Purchase Interest Suspense.

Solution

In the books of Mahalaxmi Traders

Dr. (a) Computers Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013			2013		
Jun 30	To XYZ Ltd A/c	80,000	Dec. 31	By Balance c/d	80,000
2014			2014		
Jan 1	To Balance b/d	80,000	Dec. 31	By Balance c/d	1,40,000
Mar 31	To XYZ Ltd A/c	60,000			
		1,40,000			1,40,000
2015			2015		
Jan 1	To Balance b/d	1,40,000	Dec. 31	By Balance c/d	2,00,000
Mar 31	To XYZ Ltd A/c	60,000			
		2,00,000			2,00,000

Dr. (b) Provision for Depreciation on Computers Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013			2013		
Dec 31	To Balance c/d	16,000	Dec 31	By Depreciation A/c (20% on ₹ 80,000)	16,000
2014			2014		
Dec 31	To Balance c/d	40,800	Jan 1	By Balance b/d	16,000
			Dec 31	By Depreciation A/c [20% on ₹ (1,40,000 – 16,000)]	24,800
		40,800			40,800
2015			2015		
Dec 31	To Balance c/d	72,640	Jan 1	By Balance b/d	40,800
			Dec 31	By Depreciation A/c [20% on ₹ (2,00,000 – 40,800)]	31,840
		72,640			72,640

(c) The amount of the instalments is as under :

$$\frac{\text{Cash Price + Total Interest − Deposit Paid}}{\text{Number of Instalments}} = \text{Quarterly Instalment}$$

Computer A — $\frac{(80{,}000 + 19{,}200 - 10{,}400)}{12} =$ ₹ 7,400 ;

Computer B — $\frac{(60{,}000 + 13{,}200 - 7{,}200)}{12} =$ ₹ 5,500

Computer C — $\frac{(60{,}000 + 8{,}000 - 7{,}200)}{8} =$ ₹ 7,600

Number of instalments in each accounting year is as under :

	2013	2014	2015
Computer A	2	4	4
Computer B	—	3	4
Computer C	—	—	3

Dr. XYZ Limited Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013			2013		
Jun 30	To Bank A/c (Deposit A)	10,400	Jun 30	By Computers A/c	80,000
Sep 30	To Bank A/c (Instalment A)	7,400	"	By H P Interest Suspense A/c	19,200
Dec 31	To Bank A/c (Instalment A)	7,400			
"	To Balance c/d	74,000			
		99,200			99,200
2014			2014		
Mar 31	To Bank A/c (Instalment A)	7,400	Jan 1	By Balance b/d	74,000
"	To Bank A/c (Deposit B)	7,200	Mar 31	By Computers A/c	60,000
Jun 30	To Bank A/c (Instalments A & B)	12,900	"	By H P Interest Suspense A/c	13,200
Sep 30	To Bank A/c (Instalments A & B)	12,900			
Dec 31	To Bank A/c (Instalments A & B)	12,900			
"	To Balance c/d	93,900			
		1,47,200			1,47,200
2015			2015		
Mar 31	To Bank A/c (Instalment A & B)	12,900	Jan 1	By Balance b/d	93,900
"	To Bank A/c (Deposit C)	7,200	Mar 31	By Computers A/c	60,000
Jun 30	To Bank A/c (Instalments A, B & C)	20,500	"	By H P Interest Suspense A/c	8,000
Sep 30	To Bank A/c (Instalments A, B & C)	20,500			
Dec 31	To Bank A/c (Instalments A, B & C)	20,500			
"	To Balance c/d	80,300			
		1,61,900			1,61,900

Dr. (d) Hire Purchase Interest Suspense Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013			2013		
Jun 30	To XYZ Ltd A/c	19,200	Dec 31	By Profit and Loss A/c (Note 1)	3,200
			"	By Balance c/d	16,000
		19,200			19,200
2014			2014		
Jan 1	To Balance b/d	16,000	Dec 31	By Profit and Loss A/c (Note 2)	9,700
Mar 31	To XYZ Ltd A/c	13,200	"	By Balance c/d	19,500
		29,200			29,200
2015			2015		
Jan 1	To Balance b/d	19,500	Dec 31	By Profit and Loss A/c (Note 3)	13,800
Mar 31	To XYZ Ltd A/c	8,000	"	By Balance c/d	13,700
		27,500			27,500

Working Notes :	₹
(1) 2013 — Computer A : ₹ 19,200 x 2/12	3,200
(2) 2014 — Computer A : ₹ 19,200 x 4/12	6,400
Computer B : ₹ 13,200 x 3/12	3,300
	9,700
(3) 2015 — Computer A : ₹ 19,200 x 4/12	6,400
Computer B : ₹ 13,200 x 4/12	4,400
Computer C : ₹ 8,000 x 3/8	3,000
	13,800

Books of the Hire Vendor

There are different methods of recording hire purchase transactions in the books of the hire vendor. It is selected according to the type and value of goods sold, volume of transactions, the length of the period of purchase, etc. The different methods are discussed below:

Sales Method

A business that sells a few relatively large items on hire purchase may adopt this method. Under this method, hire purchase sale is treated as a credit sale. The only exception is that the vendor agrees to accept payments in instalments and for that he charges interest. Generally, a special Sales Day Book is maintained for recording all sales under hire purchase agreement. The hire vendor debits the hire purchaser with the ***cash price*** of the goods and the credit is given to the H.P. Sales Account. When an instalment falls due, the hire purchaser is debited with the interest on the amount owing and credit is given to the Interest Account. When the instalment is received, the Bank Account is debited and Hire Purchaser Account is credited. The amount due from the hire purchaser at the end of the year is shown in the Balance Sheet on the assets side as Hire Purchase Debtors.

Journal Entries

1. When goods are sold and delivered under hire purchase
Hire Purchaser Account Dr. [Full cash price]
To H.P. Sales Account

2. When the down payment is received
Bank Account Dr.
To Hire Purchaser Account

3. When an instalment becomes due
Hire Purchaser Account Dr.
To Interest Account

4. When the amount of instalment is received
Bank Account Dr.
To Hire Purchaser Account

5. For closing Interest Account
Interest Account Dr.
To Profit and Loss Account

6. For closing Hire Purchase Sales Account
H.P. Sales Account Dr.
To Trading Account

Illustration 8

On 1st January 2012, X & Co. purchased a motor car from Hindustan Auto Limited on the hire purchase system. The agreed cash selling price was ₹ 1,20,000. At the time of agreement a sum of ₹ 30,000 was paid out of the cash price of the car and the balance was payable in 3 equal annual instalments together with interest @ 10% p.a.

You are required to pass necessary Journal Entries and show important accounts in the books of Hindustan Auto Limited for the year 2012 to 2014 (Date of closing the books of account is 31st December).

Solution **In the books of Hindustan Auto Ltd.**

Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2012 Jan. 1	X & Co. A/c Dr. To H.P. Sales A/c (Being the goods sold on hire purchase)		1,20,000	1,20,000
Jan. 1	Bank A/c Dr. To X & Co. A/c (Being the amount received against hire purchase sale at the time of signing the agreement)		30,000	30,000
Dec. 31	X & Co. A/c Dr. To Interest A/c (Being the interest charged @ 10% p.a. on ₹ 90,000)		9,000	9,000
Dec. 31	Bank A/c Dr. To X & Co. A/c (Being the 1st instalment received in respect of hire purchase sale)		39,000	39,000

Dec. 31	Interest A/c Dr. To Profit & Loss A/c (Being the interest received from X & Co. transferred to Profit & Loss Account)		9,000	9,000
Dec. 31	H.P. Sales A/c Dr. To Trading A/c (Being the transfer of H.P. Sales Account to Trading Account)		1,20,000	1,20,000
2013 Dec. 31	X & Co. A/c Dr. To Interest A/c (Being the interest charged @ 10% p.a. on ₹ 60,000)		6,000	6,000
Dec. 31	Bank A/c Dr. To X & Co. A/c (Being the 2nd instalment received in respect of hire purchase sale)		36,000	36,000
Dec. 31	Interest A/c Dr. To Profit & Loss A/c (Being the interest received from X & Co. transferred to Profit & Loss Account)		6,000	6,000
2014 Dec. 31	X & Co. A/c Dr. To Interest A/c (Being the interest charged @ 10% p.a. on ₹ 30,000)		3,000	3,000
Dec. 31	Bank A/c Dr. To X & Co. A/c (Being the final instalment received from X & Co.)		33,000	33,000
Dec. 31	Interest A/c Dr. To Profit & Loss A/c (Being the interest received from X & Co. transferred to Profit & Loss Account)		3,000	3,000

Ledger of Hindustan Auto Limited

Dr. **X & Co. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To H.P. Sales A/c	1,20,000	1.1.2012	By Bank A/c	30,000
31.12.2012	To Interest A/c	9,000	31.12.2012	By Bank A/c	39,000
			31.12.2012	By Balance c/d	60,000
		1,29,000			1,29,000
1.1.2013	To Balance b/d	60,000	31.12.2013	By Bank A/c	36,000
31.12.2013	To Interest A/c	6,000	31.12.2013	By Balance c/d	30,000
		66,000			66,000
1.1.2014	To Balance b/d	30,000	31.12.2014	By Bank A/c	33,000
31.12.2014	To Interest A/c	3,000			
		33,000			33,000

Dr. **Interest Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Profit & Loss A/c	9,000	31.12.2012	By X & Co. A/c	9,000
31.12.2013	To Profit & Loss A/c	6,000	31.12.2013	By X & Co. A/c	6,000
31.12.2014	To Profit & Loss A/c	3,000	31.12.2014	By X & Co. A/c	3,000

Dr. **H.P. Sales Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Trading A/c	1,20,000	1.1.2012	By X & Co. A/c	1,20,000

In this connection, the students should note the following:

(i) The entire profit on sale under hire purchase agreement is credited to the Profit and Loss Account of the year in which the sale has taken place.

(ii) Interest pertaining to each accounting period is credited to the Profit and Loss Account of that year.

Interest Suspense Method

This method is almost similar to the sales method, excepting the accounting for interest. Under this method, the hire purchaser is debited with full cash price and interest (total) included in the hire selling price. Credit is given to the H.P. Sales Account and Interest Suspense Account. When the instalment is received, the Bank Account is debited and the Hire Purchaser Account is credited. At the same time an appropriate amount of interest (i.e., interest for the relevant accounting period) is removed from the Interest Suspense Account and credited to the Interest Account. At the time of preparation of Final Accounts, interest is transferred to the credit of the Profit and Loss Account. The balance of the Interest Suspense Account is shown in the Balance Sheet as a deduction from Hire Purchase Debtors.

Journal Entries

1. When goods are sold and delivered under hire purchase

Hire Purchaser Account	Dr.	[Full cash price + total interest]
To H.P. Sales Account		[Full cash price]
To Interest Suspense Account		[Total interest]

2. When down payment / instalment is received

Bank Account	Dr.
To Hire Purchaser Account	

3. For interest of the relevant accounting period

Interest Suspense Account	Dr.
To Interest Account	

4. For closing Interest Account

Interest Account	Dr.
To Profit and Loss Account	

5. For closing Hire Purchase Sales Account

H.P. Sales Account	Dr.
To Trading Account	

Illustration 9

Assuming the same facts as in **Illustration 8**, with an agreed cash selling price of ₹ 1,20,000 and a total addition for interest of ₹ 18,000, pass necessary Journal Entries and show X & Co. Account, Interest Suspense Account, Interest Account and H.P. Sales Account.

Solution

In the books of Hindustan Auto Ltd.
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2012 Jan. 1	X & Co. A/c	Dr.		1,38,000	
	To H.P. Sales A/c				1,20,000
	To Interest Suspense A/c				18,000
	(Being the goods sold on hire purchase)				
Jan. 1	Bank A/c	Dr.		30,000	
	To X & Co. A/c				30,000
	(Being the amount received against hire purchase sale at the time of signing the agreement)				
Dec. 31	Interest Suspense A/c	Dr.		9,000	
	To Interest A/c				9,000
	(Being the interest pertaining to 2014 transferred to Interest Account)				
Dec. 31	Bank A/c	Dr.		39,000	
	To X & Co. A/c				39,000
	(Being the 1st instalment received in respect of hire purchase sale)				
Dec. 31	Interest A/c	Dr.		9,000	
	To Profit & Loss A/c				9,000
	(Being the interest received from X & Co. transferred to Profit and Loss Account)				
Dec. 31	H.P. Sales A/c	Dr.		1,20,000	
	To Trading A/c				1,20,000
	(Being the transfer of H.P. Sales Account to Trading Account)				

2013 Dec. 31	Bank A/c To X & Co. A/c (Being the 2nd instalment received in respect of hire purchase sale)	Dr.		36,000	36,000
	Interest Suspense A/c To Interest A/c (Being the interest pertaining to 2013 transferred to Interest Account)	Dr.		6,000	6,000
Dec. 31	Interest A/c To Profit & Loss A/c (Being the interest received from X & Co. transferred to Profit and Loss Account)	Dr.		6,000	6,000
2014 Dec. 31	Bank A/c To X & Co. A/c (Being the final instalment received from X & Co.)	Dr.		33,000	33,000
Dec. 31	Interest Suspense A/c To Interest A/c (Being the interest pertaining to 2013 transferred to Interest Account)	Dr.		3,000	3,000
Dec. 31	Interest A/c To Profit & Loss A/c (Being the interest received from X & Co. transferred to Profit and Loss Account)	Dr.		3,000	3,000

Ledger of Hindustan Auto Limited

Dr. **X & Co. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To H.P. Sales A/c	1,20,000	1.1.2012	By Bank A/c	30,000
1.1.2012	To Interest Suspense A/c	18,000	31.12.2012	By Bank A/c	39,000
			31.12.2012	By Balance c/d	69,000
		1,38,000			1,38,000
1.1.2013	To Balance b/d	69,000	31.12.2013	By Bank A/c	36,000
			31.12.2013	By Balance c/d	33,000
		69,000			69,000
1.1.2014	To Balance b/d	33,000	31.12.2014	By Bank A/c	33,000

Dr. **Interest Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Interest A/c	9,000	1.1.2012	By X & Co. A/c	18,000
31.12.2012	To Balance c/d	9,000			
		18,000			18,000
31.12.2013	To Interest A/c	6,000	1.1.2013	By Balance b/d	9,000
31.12.2013	To Balance c/d	3,000			
		9,000			9,000
31.12.2014	To Interest A/c	3,000	1.1.2014	By Balance b/d	3,000

Dr. **Interest Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Profit & Loss A/c	9,000	31.12.2012	By Interest Suspense A/c	9,000
31.12.2013	To Profit & Loss A/c	6,000	31.12.2013	By Interest Suspense A/c	6,000
31.12.2014	To Profit & Loss A/c	3,000	31.12.2014	By Interest Suspense A/c	3,000

Dr. **H.P. Sales Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Trading A/c	1,20,000	1.1.2012	By X & Co. A/c	1,20,000

The balances on the Hire Purchaser's Account and Interest Suspense Account will appear in the Balance Sheet as on 31st December, 2012 as follows:

Balance Sheet of Hindustan Auto Limited as at 31st December, 2012

Liabilities	₹	Assets	₹
		X & Co. (H.P. Debtors)	69,000
		Less: Interest Suspense A/c	9,000
			60,000

Ascertainment of Total Cash Price

We know that the basis for accounting in the books of the hire purchaser is the ***total cash price***. Sometimes, (particularly in examination problems) the total cash price may not be given. For the purpose of ascertaining the total cash price we can use any of the following methods according to the need.

(1) Calculation of total cash price when no annuity table is given.

(2) Calculation of total cash price when annuity table is given.

Calculation of Total Cash Price when the Annuity Table is not Given

In this method, the interest included in the last instalment is to be calculated first with the help of the appropriate formula (explained below).

For example in a hire purchase transaction, apart from down payment, four other instalments are payable. The interest will be calculated first on the 4th instalment, then on the 3rd instalment, then on the 2nd instalment and lastly on the 1st instalment. Interest on down payment will be nil.

In this connection, it should be noted that the amount of interest will go on increasing from the 4th instalment to the 3rd instalment, from the 3rd instalment to the 2nd instalment and from the 2nd instalment to the 1st instalment.

We know that interest is to be calculated on the outstanding balance of cash price.

In this case, we will have to calculate the interest with the help of the total amount due on hire purchase price since the cash price is not known. For the purpose of calculating the interest, the following steps should be followed:

Step 1 : Calculate the ratio between interest and the amount due with the help of the following formula:

$$\text{Ratio of interest and amount due} = \frac{\text{Rate of interest}}{100 + \text{Rate of interest}}$$

Step 2 : Calculate the interest included in the last instalment by applying the following formula:
Interest = Total amount due at the time of instalment x Ratio of interest and amount due (as calculated in Step 1).

Step 3 : Subtract the interest (as calculated in Step 2) from this instalment to get the amount of outstanding ***cash price*** at the time of last instalment.

Step 4 : Add the cash price calculated in Step 3 to the amount of instalment due at the end of the third year.

Step 5 : Calculate the interest on the entire sum (cash price included in the 4th instalment + amount of 3rd instalment). Deduct this interest from the total amount due at the end of 3rd year to get the outstanding cash price at the time of 3rd instalment.

Step 6 : Add the cash price calculated in Step 5 to the amount of instalment due at the end of 2nd year.

Step 7 : Calculate the interest on the entire sum so obtained in Step 6.
Deduct this interest from the total amount due at the end of 2nd year to get the outstanding cash price at the time of 2nd instalment.

Step 8 : Add the cash price calculated in Step 7 to the amount of instalment due at the end of 1st year.

Step 9 : Calculate the interest on the entire sum so obtained in Step 8. Deduct this interest from the total amount due at the end of 1st year to get the outstanding cash price at the time of 1st instalment.

Step 10 : Add the cash price calculated in Step 9 to the amount of down payment, if any. The sum so obtained will be the ***total cash price***.

Illustration 10

A & Co. purchased a truck on hire purchase system. As per terms he is required to pay ₹ 70,000 down. ₹ 53,000 at the end of first year, ₹ 49,000 at the end of second year and ₹ 55,000 at the end of third year. Interest is charged @ 10% p.a.

You are required to calculate the total cash price of the truck and the interest paid with each instalment.

Solution

(1) Ratio of interest and amount due $= \frac{\text{Rate of interest}}{100 + \text{Rate of interest}} = \frac{10}{110} = 1/11$

(2) Calculation of Interest and Cash Price

No. of instalments [1]	Amount due at the time of instalment [2]	Interest [3]	Cash price [2 – 3]
3rd	55,000	1/11 of ₹ 55,000 = ₹ 5,000	50,000
2nd	*99,000	1/11 of ₹ 99,000 = ₹ 9,000	90,000
1st	**1,43,000	1/11 of ₹ 1,43,000 = ₹ 13,000	1,30,000

Total cash price = ₹ 1,30,000 + 70,000 (down payment) = ₹ 2,00,000
*₹ 50,000 + 2nd instalment of ₹ 49,000 = ₹ 99,000 ** ₹ 90,000 + 1st instalment of ₹ 53,000 = ₹ 1,43,000.

Illustration 11

On 1st January, 2012, Ray & Co. purchased a motor car from Automobile Co. on the hire purchase system. At the time of agreement a sum of ₹ 24,000 was paid out of the cash down price of the car and the balance was payable in 3 equal annual instalments together with interest @ 5% p.a. The amount of the last instalment including interest was ₹ 33,600. Depreciation was to be provided at 10% p.a. on the reducing balances.

Prepare (i) Motor Car Account and (ii) Automobile Company Account in the books of Ray & Co for the year ended on 31st December 2012 to 2014.

Solution

In the books of Ray & Co.

Dr. Motor Car Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Automobile Co. A/c (Note 2)	1,15,500	31.12.2012	By Depreciation A/c	11,550
			31.12.2012	By Balance c/d	1,03,950
		1,15,500			1,15,500
1.1.2013	To Balance b/d	1,03,950	31.12.2013	By Depreciation A/c	10,395
			31.12.2013	By Balance c/d	93,555
		1,03,950			1,03,950
1.1.2014	To Balance b/d	93,555	31.12.2014	By Depreciation A/c	9,355
			31.12.2014	By Balance c/d	84,200
		93,555			93,555

Dr. Automobile Co. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Bank A/c	24,000	1.1.2012	By Motor Car A/c (Note 2)	1,15,500
31.12.2012	To Bank A/c	33,600	31.12.2012	By Interest A/c (@ 5%)	4,576
31.12.2012	To Balance c/d	62,476			
		1,20,076			1,20,076
31.12.2013	To Bank A/c	33,600	1.1.2013	By Balance b/d	62,476
31.12.2013	To Balance c/d	32,000	31.12.2013	By Interest A/c (@ 5%)	3,124
		65,600			65,600
31.12.2014	To Bank A/c	33,600	1.1.2014	By Balance b/d	32,000
			31.12.2014	By Interest A/c	1,600
		33,600			33,600

Working Notes:

(1) Ratio of interest and amount due =

$$\frac{5}{100 + 5} = \frac{5}{105} = \frac{1}{21}$$

(2) Calculation of Interest and Cash Price

No. of instalments [1]	Amount due at the time of instalment [2]	Interest [3]	Cash price [2 – 3]
3rd	33,600	1/21 of ₹ 33,600 = ₹ 1,600	₹ 32,000
2nd	*65,600	1/21 of ₹ 65,600 = ₹ 3,124	₹ 62,476
1st	**96,076	1/21 of ₹ 96,076 = ***₹ 4,576	₹ 91,500

Total Cash Price = ₹ 91,500 + ₹ 24,000 = ₹ 1,15,500. *₹ 32,000 + ₹ 33,600 = ₹ 65,600; ** ₹ 62,476 + ₹ 33,600 = ₹ 96,076.
*** Interest for 1st year actually comes to ₹ 4,575. For balancing purposes it has been taken as ₹ 4,576.

Illustration 12

Dobsons Ltd. purchased a machine on the hire purchase system from Hind Machinery Ltd. The terms were that they would pay ₹ 20,000 down on 1.1.2010 and 5 annual instalments of ₹ 11,000 each commencing from 1.1.2011.

They charged depreciation on the machine at the rate of 15 per cent per annum under the diminishing balance system. Hind Machinery Ltd. had charged interest at the rate of 10 per cent per annum.

Show the Machinery Account and Hind Machinery Ltd. Account to record the above transactions in the books of Dobsons Ltd. till the instalments are paid off.

Dobsons' accounting year ends on 31st December in each year.

Solution

In the books of Dobsons Ltd.

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2010	To Hind Machinery Ltd. A/c (Note 1)	61,700	31.12.2010	By Depreciation A/c	9,255
			31.12.2010	By Balance c/d	52,445
		61,700			61,700
1.1.2011	To Balance b/d	52,445	31.12.2011	By Depreciation A/c	7,867
			31.12.2011	By Balance c/d	44,578
		52,445			52,445
1.1.2012	To Balance b/d	44,578	31.12.2012	By Depreciation A/c	6,687
			31.12.2012	By Balance c/d	37,891
		44,578			44,578
1.1.2013	To Balance b/d	37,891	31.12.2013	By Depreciation A/c	5,684
			31.12.2013	By Balance c/d	32,207
		37,891			37,891
1.1.2014	To Balance b/d	32,207	31.12.2014	By Depreciation A/c	4,831
			31.12.2014	By Balance c/d	27,376
		32,207			32,207

Dr. Hind Machinery Ltd. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2010	To Bank A/c	20,000	1.1.2010	By Machinery A/c	61,700
31.12.2010	To Balance c/d	45,868	31.12.2010	By Interest A/c	*4,168
		65,868			65,868
1.1.2011	To Bank A/c	11,000	1.1.2011	By Balance b/d	45,868
31.12.2011	To Balance c/d	38,355	31.12.2011	By Interest A/c	3,487
		49,355			49,355
1.1.2012	To Bank A/c	11,000	1.1.2012	By Balance b/d	38,355
31.12.2012	To Balance c/d	30,091	31.12.2012	By Interest A/c	2,736
		41,091			41,091
1.1.2013	To Bank A/c	11,000	1.1.2013	By Balance b/d	30,091
31.12.2013	To Balance c/d	21,000	31.12.2013	By Interest A/c	1,909
		32,000			32,000
1.1.2014	To Bank A/c	11,000	1.1.2014	By Balance b/d	21,000
31.12.2014	To Balance c/d	11,000	31.12.2014	By Interest A/c	1,000
		22,000			22,000
1.1.2015	To Bank A/c	11,000	1.1.2015	By Balance b/d	11,000

* Interest for the 1st year actually comes to ₹ 4,130 but has been put at ₹ 4,168 for balancing purposes.

Working Note:

(1) Ratio of interest and amount due =

$$\frac{10}{100 + 10} = \frac{10}{110} = \frac{1}{11}$$

(2) Calculation of Interest and Cash Price

No. of instalments [1]	Amount due at the time of instalment [2]	Interest [3]	Cash price [2 – 3]
5th	₹ 11,000	1/11 of ₹ 11,000 = ₹ 1,000	₹ 10,000
4th	(₹ 10,000 + 11,000) = ₹ 21,000	1/11 of ₹ 21,000 = ₹ 1,909	₹ 19,091
3rd	(₹ 19,091 + 11,000) = ₹ 30,091	1/11 of ₹ 30,091 = ₹ 2,736	₹ 27,355
2nd	(₹ 27,355 + 11,000) = ₹ 38,355	1/11 of ₹ 38,355 = ₹ 3,487	₹ 34,868
1st	(₹ 34,868 + 11,000) = ₹ 45,868	1/11 of ₹ 45,868 = *₹ 4,168	₹ 41,700
Total Cash Price = ₹ 41,700 + ₹ 20,000 = ₹ 61,700			

* Interest for the 1st year actually comes to ₹ 4,170. For balancing purposes, it has been taken as ₹ 4,168.

Illustration 13

On July 1, 2013, Eastern Printers purchased a printing machine from HMT Ltd. on hire purchase basis, payments to be made ₹ 10,000 on the said date and the balance in three half yearly instalments of ₹ 8,200, ₹ 7,440 and ₹ 6,300 commencing from December, 2013. The vendor charged interest at 10% p.a. calculated on half yearly basis.

Eastern Printers close their books annually on December 31 and provide depreciation at 10% per annum on diminishing balances in each year.

Determine the cash price of the machine and show the necessary Ledger Accounts in the books of Eastern Printers.

Solution

In the books of Eastern Printers

Dr. Machine Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.7.2013	To HMT Ltd. A/c (Note 1)	30,000	31.12.2013	By Depreciation A/c (1/2 year)	1,500
			31.12.2013	By Balance c/d	28,500
		30,000			30,000
1.1.2014	To Balance b/d	28,500	31.12.2014	By Depreciation A/c	2,850
			31.12.2014	By Balance c/d	25,650
		28,500			28,500
1.1.2015	To Balance b/d	25,650			

Dr. HMT Ltd. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.7.2013	To Bank A/c	10,000	1.7.2013	By Machine A/c	30,000
31.12.2013	To Bank A/c	8,200	31.12.2013	By Interest A/c	1,000
31.12.2013	To Balance c/d	12,800			
		31,000			31,000
1.7.2014	To Bank A/c	7,440	1.1.2014	By Balance b/d	12,800
31.12.2014	To Bank A/c	6,300	1.7.2014	By Interest A/c	640
			31.12.2014	By Interest A/c	300
		13,740			13,740

Working Notes : (1) Interest is payable @ 10% p.a. but it is to be calculated at 1/2 yearly rest. The effective rate = 5% half yearly.

(1) Ratio of interest and amount due = $\frac{5}{100 + 5} = \frac{5}{105} = \frac{1}{21}$

(2) Calculation of Interest and Cash Price

No. of instalments [1]	Amount due at the time of instalment [2]	Interest [3]	Cash price [2 – 3]
3rd	₹ 6,300	1/21 of ₹ 6,300 = ₹ 300	₹ 6,000
2nd	(₹ 6,000 + 7,440) = ₹ 13,440	1/21 of ₹ 13,440 = ₹ 640	₹ 12,800
1st	(₹ 12,800 + 8,200) = ₹ 21,000	1/21 of ₹ 21,000 = ₹ 1,000	₹ 20,000
Total Cash Price = ₹ 20,000 + ₹ 10,000 = ₹ 30,000.			

Calculation of Total Cash Price when the Annuity Table is Given

The ascertainment of interest included in each instalment is relatively simple with the help of an annuity table. Under this method, the interest in each instalment is calculated from the annuity table. In an ordinary annuity table, the present values of one rupee (known as factor) are given for different interest rates and different years. To get the present value of each instalment, the amount of each instalment is multiplied by these factors. The sum of these present values are added to the down payment (if any) to arrive at the total cash price of a hire purchase transaction. The different steps are summarised below:

Step 1 : Ascertain the factors (from annuity table) applicable to different years from a given rate of interest.

Step 2 : Multiply the factors with the respective instalments to arrive at the present values of different instalments.

Step 3 : Take the total of all the present values.

Step 4 : Add down payment (if any) with the total of present values (step 3) to arrive at the cash price.

An annuity table is given below:

PRESENT VALUE FACTORS

Present value of Re 1 to be received in one payment at the end of a given number of years $(1 + r)^{-n}$

Future years	Percentage rate of Discount														
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909	0.901	0.893	0.885	0.877	0.870
2	0.980	0.961	0.943	0.925	0.907	0.890	0.873	0.857	0.842	0.826	0.812	0.797	0.783	0.769	0.756
3	0.971	0.942	0.915	0.889	0.864	0.840	0.816	0.794	0.772	0.751	0.731	0.712	0.693	0.675	0.658
4	0.961	0.924	0.888	0.855	0.823	0.792	0.763	0.735	0.708	0.683	0.659	0.636	0.613	0.592	0.572
5	0.951	0.906	0.863	0.822	0.784	0.747	0.713	0.681	0.650	0.621	0.593	0.567	0.543	0.519	0.497
6	0.942	0.888	0.837	0.790	0.746	0.705	0.666	0.630	0.596	0.564	0.535	0.507	0.480	0.456	0.432
7	0.933	0.871	0.813	0.760	0.711	0.665	0.623	0.583	0.547	0.513	0.482	0.452	0.425	0.400	0.376
8	0.923	0.853	0.789	0.731	0.677	0.627	0.582	0.540	0.502	0.467	0.434	0.404	0.376	0.351	0.327
9	0.914	0.837	0.766	0.703	0.645	0.592	0.544	0.500	0.460	0.424	0.391	0.361	0.333	0.308	0.284
10	0.905	0.820	0.744	0.676	0.614	0.558	0.508	0.463	0.422	0.386	0.352	0.322	0.295	0.270	0.247

Illustration 14

On 1.1.2012 Sharma purchased a plant from Ahuja on the hire purchase system. The hire purchase rate was settled at ₹ 60,000 payable as to ₹ 15,000 on 1.1.2012 and ₹ 15,000 at the end of three successive years. Interest was charged at the rate of 5% p.a. The asset was to be depreciated in the books of the purchaser at 10% p.a. on the reducing instalment method.

The annuity table shows that the present value of Re 1 for one, two and three years are .9524; .9070; and .8639 respectively. Calculate the total cash price of the plant.

Solution **Calculation of Cash Price**

No. of instalments	Amount of instalment [1]	Present Value of Re 1 [2]	Present Value of the Instalment [1 x 2]
1st	₹ 15,000	.952	14,280
2nd	₹ 15,000	.907	13,605
3rd	₹ 15,000	.864	12,960
		2.723	40,845
Add: Down Payment			15,000
Total Cash Price			55,845

Tutorial Note : When the amount of each instalment is equal, we can get the present value of all instalments at a time by multiplying sum of the present value factors with the amount of instalment. For example : ₹ 15,000 x 2.7230 = ₹ 40,845.

Ascertainment of Interest

We know that the hire purchase price consists of two things : (i) cash price; and (ii) interest. Cash price is the capital expenditure incurred for the acquisition of an asset and (ii) interest is the revenue expense for the delay in making the full payment. Ascertainment of any of these two gives the answer for the other, e.g., if we ascertain the total amount of interest, it becomes very simple to ascertain the cash price just by deducting the interest from the hire purchase price.

Interest is charged on the amount outstanding. Therefore, if the hire purchaser makes a down payment on signing the contract, it will not include any amount of interest. It should be noted that though the instalments of a hire purchase agreement may be equal, the interest element in each instalment is not the same.

At the time of calculating interest, students may face the following two situations:

(a) When the cash price, rate of interest and the amount of different instalements are given; and

(b) When the cash price and the amount of different instalments are given, but the rate of interest is not given.

Now, let us consider the above two situations.

When the cash price, rate of interest and the amount of different instalments are given

In this situation, the total amount of interest is to be ascertained first. It is the difference between the hire purchase price (down payment + total instalments) and the cash price. To calculate the amount of interest involved in each instalment the following steps are followed:

Step 1 : Deduct down payment from the cash price. Calculate the interest at the given rate on the remaining balance. This represents the amount of interest included in the first instalment.

Step 2 : Deduct the interest of Step 1 from the amount of first instalment. The resultant figure is the cash price included in the first instalment.

Step 3 : Deduct the cash price of the 1st instalment (Step 2) from the balance due after down payment. It represents the amount outstanding after the 1st instalment is paid.

Step 4 : Calculate the interest at the given rate on the balance outstanding after the 1st instalment. Deduct this interest from the amount of the 2nd instalment to get the cash price included in the 2nd instalment.

Step 5 : Deduct the cash price of the 2nd instalment (Step 4) from the balance due after the 1st instalment. It represents the amount outstanding after the 2nd instalment is paid.

Repeat the above steps till the last instalment is paid.

Illustration 15

X Ltd. purchased a machine on hire purchase basis from Ideal Machinery Co. Ltd. on the following terms:

(a) cash price ₹ 40,000; (b) down payment at the time of signing the agreement on 1.1.2014 ₹ 10,811; (c) 5 annual instalments of ₹ 7,700, the first to commence at the end of twelve months from the date of down payment and (d) Rate of interest is 10% p.a.

You are required to calculate the total interest and interest included in cash instalment.

Solution **Calculation of Interest**

	Total [₹]	Interest in each instalment [1]	Cash Price in each instalment [2]
Cash Price	40,000		
Less: Down Payment	10,811	Nil	₹ 10,811
Balance due after down payment	29,189		
Interest/Cash Price of 1st instalment	—	₹ 29,189 x 10/100 = ₹ 2,919	₹ 7,700 – ₹ 2,919 = ₹ 4,781
Less: Cash price of 1st instalment	4,781		
Balance due after 1st instalment	24,408		
Interest/Cash price of 2nd instalment	—	₹ 24,408 x 10/100 = ₹ 2,441	₹ 7,700 – ₹ 2,441 = ₹ 5,259
Less: Cash price of 2nd instalment	5,259		
Balance due after 2nd instalment	19,149		
Interest/Cash price of 3rd instalment	—	₹ 19,149 x 10/100 = ₹ 1,915	₹ 7,700 – ₹ 1,915 = ₹ 5,785
Less: Cash price of 3rd instalment	5,785		
Balance due after 3rd instalment	13,364		
Interest/Cash price of 4th instalment	—	₹ 13,364 x 10/100 = ₹ 1,336	₹ 7,700 – ₹ 1,336 = ₹ 6,364
Less: Cash price of 4th instalment	6,364		

Balance due after 4th instalment Interest/Cash price of 5th instalment Less: Cash price of 5th instalment	7,000 — 7,000	₹ 7,000 x 10/100 = ₹ 700	₹ 7,700 – ₹ 700 = ₹ 7,000
Total	Nil	₹ 9,311	₹ 40,000

Total interest can also be calculated as follows:
(Down payment + instalments) – Cash price = ₹ (10,811 + 7,700 x 5) – ₹ 40,000 = ₹ 9,311.

When the cash price and the amount of different instalments are given, but the rate of interest is not given

When the rate of interest is not given, but the cash price and the amount of instalments are given, the following steps are followed to calculate the interest:

Step 1 : Calculate the total interest by deducting the cash price from the hire purchase price (i.e., down payment + amount of instalment x number of instalments).
Step 2 : Deduct down payment from the hire purchase price.
Step 3 : Calculate the amount of outstanding balance of the hire purchase price at the beginning of each year.
Step 4 : Calculate the ratio of outstanding balance of Step 3.
Step 5 : Calculate the amount of interest of each instalment on the basis of the ratio of Step 4.

Illustration 16

P. Ltd. purchases a plant on hire purchase basis for ₹ 50,000 and makes the payment in the following order: Down payment ₹ 10,000; the 1st instalment after one year ₹ 20,000; the 2nd instalment after two years ₹ 10,000; and the last instalment after three years. The cash price of the plant is ₹ 43,000.

You are required to calculate : (i) the total interest and (ii) the interest included in each instalment.

Solution
(i) Total interest = Hire Purchase Price – Cash Price = ₹ 50,000 – ₹ 43,000 = ₹ 7,000.
(ii) Hire Purchase Price outstanding at the beginning of each year

	₹
Hire Purchase price	50,000
Less: Down payment	10,000
(a) Hire Purchase Price outstanding at the beginning of the 1st year	40,000
Less: 1st instalment	20,000
(b) Hire Purchase Price outstanding at the beginning of the 2nd year	20,000
Less: 2nd instalment	10,000
(c) Hire Purchase Price outstanding at the beginning of the 3rd year	10,000
Less: 3rd instalment	10,000
	Nil
Ratio of (a) : (b) : (c) = 40 : 20 : 10 or 4 : 2 : 1 Interest of 1st instalment = 4/7 x ₹ 7,000 = ₹ 4,000; Interest of 2nd instalment = 2/7 x ₹ 7,000 = ₹2,000; and Interest of 3rd instalment = 1/7 x ₹ 7,000 = ₹ 1,000.	

The students should note that if the amount of each instalment is equal, the total interest can be allocated to different instalments by the sum of the years digits method (without following the steps 2 to 5). Under this method, the interest in each instalment is calculated by multiplying the total interest by a fraction based on the sum of the number of instalments. The following illustration will explain the concept.

Illustration 17

Taking the relevant data from **Illustration 15** excluding point no. (d), calculate the interest included in each instalments.

Solution

(i) Sum of the number of instalments = (5 + 4 + 3 + 2 + 1) = 15.
(ii) Total interest = ₹ (10,811 + 7,700 x 5) – ₹ 40,000 = ₹ 9,311.
(iii) Interest of 1st instalment = 5/15 x ₹ 9,311 = ₹ 3,104
Interest of 2nd instalment = 4/15 x ₹ 9,311 = ₹ 2,483
Interest of 3rd instalment = 3/15 x ₹ 9,311 = ₹ 1,862
Interest of 4th instalment = 2/15 x ₹ 9,311 = ₹ 1,241
Interest of 5th instalment = 1/15 x ₹ 9,311 = ₹ 621

It should be noted that the amount of interest for each instalment calculated under this method will marginally vary with a given rate of interest.

Illustration 18

M/s. India Motors Ltd. sells scooters under the hire purchase system. Their payment for the sale of scooter is ₹ 1,000 on delivery, ₹ 1,040 at the end of the first year, ₹ 960 at the end of the second year, and ₹ 880 at the end of the third year, inclusive of finance charges.

Calculate the interest.

Solution

In this problem, neither the cash price nor the rate of interest is given. It may be assumed that the cash price included in each instalment (excluding down payment) is equal and the difference in the various instalments (excluding down payment) is due to the interest. It is also assumed that the rate of interest is equal althrough.

On the basis of the above assumption, we have the following equations:

Let, x = cash price included in each instalment and i = interest included in each instalment.

$x + i = ₹\ 880$ .. (i)

$x + 2i = ₹\ 960$ .. (ii)

$x + 3i = ₹\ 1{,}040$ .. (iii)

By adding equations (i) and (ii), we get $2x + 3i = ₹\ 1{,}840$ .. (iv)

By subtracting (iii) from (iv) we get

$$\begin{array}{rcl} 2x + 3i & = & ₹\ 1{,}840 \\ -x - 3i & = & -₹\ 1{,}040 \\ \hline x & = & ₹\ 800 \end{array}$$

Therefore, the cash price included in each instalment = ₹ **800**.

Details of each instalment is given in the following table: (in ₹)

	Instalment [1]	Cash Price included in each instalment [2]	Interest [1 – 2]
Down payment	1,000	1,000	Nil
1st instalment	1,040	800	240
2nd instalment	960	800	160
3rd instalment	880	800	80
Total	3,880	3,400	480

Repossession

In a hire purchase agreement the hire purchaser has an obligation to pay up to the last instalment so that the ownership of goods passes to him. If the hire purchaser fails to pay any of the instalments, the hire vendor has the right to take the asset back in its actual form without any compensation to the hire purchaser. The amounts received from the hire purchaser through down payment and instalments are treated as the hire charges by the hire vendor. This act of recovery of possession of the asset is termed as ***repossession***.

Repossessed assets are ultimately sold to other customers after repairing or reconditioning (if necessary). Accounting figures relating to repossessed assets are segregated from those which continue under hire purchase contracts in the usual way. Repossessions are then accounted for in a separate account of that name — "Goods Repossessed Account".

So far as the repossession of assets are concerned, the hire vendor can take back the whole of the asset or a part thereof depending on the agreement between the parties. The former is called "Complete Repossession" and the latter "Partial Repossession".

Complete Repossession

In the case of a complete repossession, the hire vendor closes the Hire Purchaser's Account in his books by transferring the balance of the Hire Purchaser Account to the Goods Repossessed Account. Likewise, the hire purchaser closes the Hire Vendor's Account in his books by transferring the balance of the Hire Purchase Assets Account to the Hire Vendor Account.

Entries in the Books of the Hire Vendor

1. All the entries (except the entry for payment) are passed in the usual manner upto the date of default.

2. When the goods are repossessed and the account of the hire purchaser is closed.

Goods Repossessed Account Dr.
 To Hire Purchaser Account

3. When repairing and reconditioning expenses are paid

Goods Repossessed Account Dr.
 To Bank/Cash Account

4. When repossessed goods are sold

Bank/Cash Account Dr.
 To Goods Repossessed Account

When all the above entries are incorporated in the Goods Repossessed Account, it may show a balance. If it is a debit balance, it shows a loss. Conversely, if it is a credit balance, it indicates a profit. The balance is ultimately transferred to the Profit and Loss Account.

5. For closing goods repossessed account

(i) Profit and Loss Account Dr. [***In case of Loss***]
 To Goods Repossessed Account
 OR
(ii) Goods Repossessed Account Dr. [***In case of Profit***]
 To Profit and Loss Account

Entries in the Books of the Hire Purchaser

The hire purchaser keeps two accounts — Asset Account and the Hire Vendor Account. At the time of complete repossession, both the accounts are to be closed. The following are the important Journal Entries :

1. All entries (except the entry for payment) are passed in the usual manner up to the date of default.

2. Usual entry for depreciation is also passed.

3. When the asset is taken back and the account of the hire vendor is closed

Hire Vendor Account Dr.
 To Assets Account

4. When the asset account is closed

Profit and Loss Account Dr.
 To Asset Account

Generally, an asset is repossessed at a price less than the book value. Therefore, it is a loss to the hire purchaser. In case of profit, the above entry will be reversed.

Illustration 19

Modern Transporter purchased a truck on hire purchase from Hindustan Motors for ₹ 56,000. The truck was purchased on 1st January, 2013. Payment to be made ₹ 15,000 down cash and 3 instalments of ₹ 15,000 each at the end of each year. Rate of interest charged is 5% p.a. Buyer depreciates assets at 10% p.a. on written down value method. Because of financial difficulties, Modern Transporter after having paid the down cash and the first instalment at the end of the first year could not pay the second instalment and Hindustan Motors took possession of the truck.

Prepare (a) the Truck Account; and (b) the Sellers' Account in the books of the buyer assuming that the year ends on 31st December.

Solution

In the books of Modern Transporter

Dr. **Truck Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
2013 Jan 1	To Hindustan Motors A/c	56,000	2013 Dec 31	By Depreciation A/c	5,600
				By Balance c/d	50,400
		56,000			56,000

2011 Jan 1	To Balance b/d	50,400	2011 Dec 31	By Depreciation A/c	5,040
				By Hindustan Motors A/c	29,452
				By Profit and Loss A/c (Note 3)	15,908
		50,400			50,400

Dr. Hindustan Motors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2010 Jan 1	To Bank A/c (down payment)	15,000	2010 Jan 1	By Truck A/c	56,000
Dec 31	To Bank A/c (1st instalment)	15,000	Dec 31	By Interest A/c (Note 1)	2,050
Dec 31	To Balance c/d	28,050			
		58,050			58,050
2011 Dec 31	To Truck A/c (Note 2)	29,452	2011 Jan 1	By Balance b/d	28,050
				By Interest A/c	1,402
		29,452			29,452

Working Notes :

(1) Calculation of Interest

Interest to be paid on ₹ (56,000 – 15,000) = ₹ 41,000 @ 5% p.a. Therefore, interest will be 5% of ₹ 41,000 = ₹ 2,050.

(2) The balance in Hindustan Motors Account will be closed by transferring the amount to Truck Account. After surrender, there will be no balance in the Hindustan Motors Account.

(3) After adjusting the balance of Hindustan Motors Account, if there is any balance in the Truck Account it should be treated as loss on surrender of asset. It is to be charged to Profit and Loss Account of the year of surrender.

Illustration 20

On 1st January 2013, C.S.T.C. purchased a bus on hire purchase from French Motor Co. Ltd. for ₹ 5,60,000. Payment to be made, ₹ 1,50,000 down payment and three instalments of ₹ 1,50,000 each at the end of each year. Rate of interest is charged at 5% p.a. C.S.T.C. depreciates the bus at 10% p.a. on written-down value method. Because of financial difficulties C.S.T.C. after having paid the down payment and 1st instalment at the end of the first year could not pay the 2nd instalment and French Motor Co. Ltd. took possession of the bus on 31.12.2014 and sold it for ₹ 3,01,100 on the same date. You are required to prepare : (a) C.S.T.C. Account and Goods Repossessed Account in the books of the French Motor Co. Ltd.; and (b) Bus Account and French Motor Co. Ltd. Account in the books of C.S.T.C.

Solution

In the books of French Motor Co. Ltd.

Dr. C.S.T.C. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2013	To H.P. Sales A/c	5,60,000	1.1.2013	By Bank A/c	1,50,000
31.12.2013	To Interest A/c	20,500	31.12.2013	By Bank A/c	1,50,000
			31.12.2013	By Balance c/d	2,80,500
		5,80,500			5,80,500
1.1.2014	To Balance b/d	2,80,500	31.12.2014	By Goods Repossessed A/c	2,94,525
31.12.2014	To Interest A/c	14,025			
		2,94,525			2,94,525

Dr. Goods Repossessed Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To C.S.T.C. A/c	2,94,525	31.12.2014	By Bank A/c (Sale of repossessed bus)	3,01,100
31.12.2014	To Profit & Loss A/c	6,575			
		3,01,100			3,01,100

In the books of C.S.T.C.

Dr. Bus Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2013	To French Motor Co. Ltd. A/c	5,60,000	31.12.2013	By Depreciation A/c	56,000
			31.12.2013	By Balance c/d	5,04,000
		5,60,000			5,60,000
1.1.2014	To Balance b/d	5,04,000	31.12.2014	By Depreciation A/c	50,400
			31.12.2014	By French Motor Co. Ltd. A/c	2,94,525
			31.12.2014	By Profit & Loss A/c (Loss)	1,59,075
		5,04,000			5,04,000

Dr. **French Motor Co. Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2013	To Bank A/c	1,50,000	1.1.2013	By Bus A/c	5,60,000
31.12.2013	To Bank A/c	1,50,000	31.12.2013	By Interest A/c	20,500
31.12.2013	To Balance c/d	2,80,500			
		5,80,500			5,80,500
31.12.2014	To Bus A/c	2,94,525	1.1.2014	By Balance b/d	2,80,500
			31.12.2014	By Interest A/c	14,025
		2,94,525			2,94,525

Illustration 21

Auto Distributors Ltd. sold a motor car to Sita Travel Agency on hire purchase on terms as to payment requiring four annual instalments of ₹ 28,200 at the end of each year commencing from the date of agreement on 1st January, 2012. The rate of interest was taken at 5% p.a. and the interest is included in the annual payment of ₹ 28,200.

Show Ledger Accounts in the books of Sita Travel Agency who defaulted in the payment of the third yearly instalment whereupon the vendor re-possessed the car. Sita Travel Agency was to provide depreciation on the motor car @ 10% p.a. on the straight line method.

Solution **In the books of the Sita Travel Agency**

Dr. **Motor Car Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Auto Distributors Ltd. A/c (Note 2)	1,00,000	31.12.2012	By Depreciation A/c	10,000
			31.12.2012	By Balance c/d	90,000
		1,00,000			1,00,000
1.1.2013	To Balance b/d	90,000	31.12.2013	By Depreciation A/c	10,000
			31.12.2013	By Balance c/d	80,000
		90,000			90,000
1.1.2014	To Balance b/d	80,000	31.12.2014	By Depreciation A/c	10,000
			31.12.2014	By Auto Distributors Ltd. A/c	55,057
				By Profit & Loss A/c (Loss)	14,943
		80,000			80,000

Dr. **Auto Distributors Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Bank A/c	28,200	1.1.2012	By Motor Car A/c	1,00,000
31.12.2012	To Balance c/d	76,795	31.12.2012	By Interest A/c (Note 2)	4,995
		1,04,995			1,04,995
31.12.2013	To Bank A/c	28,200	1.1.2013	By Balance b/d	76,795
31.12.2013	To Balance c/d	52,435	31.12.2013	By Interest A/c (Note 2)	3,840
		80,635			80,635
31.12.2014	To Motor Car A/c	55,057	1.1.2014	By Balance b/d	52,435
			31.12.2014	By Interest A/c	2,622
		55,057			55,057

Working Note: (1) Interest is payable @ 5% p.a. Therefore, the ratio of interest and amount due = $^{5}/_{105}$ = $^{1}/_{21}$.

(2) Calculation of Interest and Cash Price

No. of instalments [1]	Amount due at the time of instalment [2]	Interest [3]	Cash price [2 – 3]
4th	28,200	1/21 of ₹ 28,200 = ₹ 1,343	26,857
3rd	(26,857 + 28,200) 55,057	1/21 of ₹ 55,057 = ₹ 2,622	52,435
2nd	(52,435 + 28,200) 80,635	1/21 of ₹ 80,635 = ₹ 3,840	76,795
1st	(76,795 + 28,200)1,04,995	1/21 of ₹ 1,04,995 = *₹ 4,995	1,00,000

Total cash price = ₹ 1,00,000. *Interest for 1st year actually comes to ₹ 5,000. For balancing purposes, it has been taken as ₹ 4,995.

Illustration 22

On 1st January, 2014 Ashok acquired furniture on the hire purchase system from Real Aids Ltd., agreeing to pay four semi- annual instalments of ₹ 800 each, commencing on 30th June 2014. The cash price of the items was ₹ 3,010 and an interest of 5% p.a. was chargeable.

On 30th September, 2014 Ashok expressed his inability to continue and Real Aids seized the property. It was agreed that Ashok would pay the due proportion of the instalment upto the date of seizure and also a further sum of ₹ 200 towards depreciation. At the time of repossession, Real Aids valued the furniture at ₹ 1,500.

The company after incurring ₹ 200 towards repairs of the furniture sold the items for ₹ 1,800 on 15th October, 2014.

Show the Ledger Accounts as they would appear in the books of Real Aids Ltd., working out the profit or loss on the transaction, assuming that the company passes hire purchase transactions through its books as sales.

Solution

In the books of Real Aids Ltd.

Dr. Hire Purchase Sales Account Cr.

Date	Particulars	₹	Date	Particulars	₹
			1.1.2014	By Ashok A/c	3,010

Dr. Ashok Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Hire Purchase Sales A/c	3,010	30.6.2014	By Bank A/c	800
30.6.2014	To Interest A/c (5/100 x 3,010 x 6/12)	75	30.9.2014	By Bank A/c (Note 1)	600
30.9.2014	To Interest A/c (5/100 x 2,285 x 3/12)	29	30.9.2014	By Goods Repossessed A/c	1,714
		3,114			3,114

Dr. Goods Repossessed Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.9.2014	To Ashok A/c (Note 2)	1,714	15.10.2014	By Sales A/c	1,800
30.9.2014	To Cash A/c (Expenses)	200	31.12.2014	By Profit & Loss A/c	114
		1,914			1,914

Dr. Profit & Loss Account for the year ended 31.12.2014 [Extract] Cr.

Particulars	₹	Particulars	₹
To Goods Repossessed A/c	114	By Interest A/c ₹ (75 + 29)	104
		By Net Loss (Balancing figure)	10
	114		114

Working Notes:

(1) Amount of instalment for 6 months is ₹ 800. Therefore, amount of instalment for 3 months will be ₹ 400. Ashok paid ₹ 400 + ₹ 200 (for depreciation) = ₹ 600.

(2) Alternatively, Goods Repossessed Account can be debited at ₹ 1,500 and ₹ 214 will be charged to Profit and Loss Account. However, net loss will be the same.

Illustration 23

GH Limited acquired three excavators from MN Limited under hire purchase agreements which provided for a deposit of 10% with the balance to be paid in three annual instalments, the first of which was due one year after the signing of the agreement and the payment of the deposit. The date of purchase, capital cost and annual repayments are as under :

Excavator	Date of acquisition	Capital cost (₹)	Annual repayment (₹)
A	31st December 2011	15,000	5,428
B	31st December 2012	15,000	5,428
C	31st December 2013	25,000	8,042

All instalments were paid on the due dates except that when the excavator C was purchased, the vendor agreed to take back excavator A on the basis that GH Limited was to be credited with ₹ 5,000 in lieu of a deposit on excavator C and that no further payment was to be made in respect of excavator A after the instalment paid on 31st December, 2013.

The practice of GH Limited was to capitalise the cash value of each excavator immediately on purchase, crediting it to the vendor. Each yearly instalment included interest at the rate of 10% per annum calculated on the outstanding balance at the beginning of the year. GH Limited makes up its accounts to 31st December of each year and provides depreciation on excavators at the rate of 20% on reducing balance.

You are required to : write-up in the books of GH Limited in columnar form for the three years ended 31st December, 2014 :

(i) Asset Account for each Excavator; (ii) Vendors Account for Excavators; (iii) Assets Disposal Account; and (iv) Depreciation Provision Account for each Excavator.

Solution **In the books of G. H. Limited**

Dr. **Excavators Account** **Cr.**

Date	Particulars	A ₹	B ₹	C ₹	Date	Particulars	A ₹	B ₹	C ₹
1.1.2012	To Balance b/d	15,000	15,000	—	31.12.2012	By Balance c/d	15,000	15,000	—
1.1.2013	To Balance b/d	15,000	15,000	—	31.12.2013	By Asset Disposal A/c	15,000	—	—
31.12.2013	To M N Limited A/c	—	—	25,000	31.12.2013	By Balance c/d	—	15,000	25,000
		15,000	15,000	25,000			15,000	15,000	25,000
1.1.2014	To Balance b/d	—	15,000	25,000	31.12.2014	By Balance c/d	—	15,000	25,000

Dr. **Provision for Depreciation Account** **Cr.**

Date	Particulars	A ₹	B ₹	C ₹	Date	Particulars	A ₹	B ₹	C ₹
31.12.2012	To Balance c/d	3,000	3,000	—	31.12.2012	By Profit & Loss A/c	3,000	3,000	—
31.12.2013	To Asset Disposal A/c	5,400	—	—	1.1.2013	By Balance b/d	3,000	3,000	—
31.12.2013	To Balance c/d	—	5,400	—	31.12.2013	By Profit & Loss A/c (Note 1)	2,400	2,400	—
		5,400	5,400	—			5,400	5,400	—
31.12.2014	To Balance c/d	—	7,320	5,000	1.1.2014	By Balance b/d	—	5,400	—
					31.12.2014	By Profit & Loss A/c (Note 2)	—	1,920	5,000
		—	7,320	5,000			—	7,320	5,000

Dr. **M. N. Limited Account** **Cr.**

Date	Particulars	A ₹	B ₹	C ₹	Date	Particulars	A ₹	B ₹	C ₹
31.12.2012	To Bank A/c (1st inst.)	5,428	5,428	—	1.1.2012	By Balance b/d**	13,500	13,500	—
31.12.2012	To Balance c/d	9,422	9,422	—	31.12.2012	By Interest A/c	1,350	1,350	—
		14,850	14,850	—			14,850	14,850	—
31.12.2013	To Bank A/c (2nd inst.)	5,428	5,428	—	1.1.2013	By Balance b/d	9,422	9,422	—
31.12.2013	To Asset Disposal A/c	4,936	—	5,000	31.12.2013	By Interest A/c	942	942	—
31.12.2013	To Balance c/d	—	4,936	20,000	31.12.2013	By Excavators A/c	—	—	25,000
		10,364	10,364	25,000			10,364	10,364	25,000
31.12.2014	To Bank A/c (3rd inst.)	—	5,428	8,042	1.1.2014	By Balance b/d	—	4,936	20,000
31.12.2014	To Balance c/d	—	—	13,958	31.12.2014	By Interest A/c	—	*492	2,000
		—	5,428	22,000			—	5,428	22,000

* Actual interest comes to ₹ 493.60 but for balancing purposes it has been taken as ₹ 492. ** (₹ 15,000 – ₹ 1,500)

Dr. **Asset Disposal Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2013	To Excavators A/c	15,000	31.12.2013	By Provision for Depreciation A/c	5,400
31.12.2013	To Profit & Loss A/c	336	31.12.2013	By M.N. ltd. A/c	9,936
		15,336			15,336

Working Note :

(1) Depreciation for 2013 = 20% of ₹ (15,000 – 3,000) = ₹ 2,400.

(2) Depreciation for 2014 = 20% of ₹ (15,000 – 5,400) = ₹ 1,920 (B).

Partial Repossession

In case of a partial repossession, only a part of the asset is taken back by the hire vendor and other part is left with the hire purchaser. The Journal Entries are as usual upto the date of default (excepting entry for payment) in the books of both the parties. As a portion of the asset is still left with the hire purchaser, neither party closes the account of the other in their respective books.

Assets are repossessed at a mutually agreed value (based on agreed rate of depreciation which is an enhanced rate). The hire vendor debits the Goods Repossessed Account and credit the Hire Purchaser Account with the value as agreed upon on the repossession. Similarly, the hire purchaser debits the Hire Vendor Account and credits the Assets Account with the same amount. If the repossessed value is less than the book value of the asset, the difference is charged to the Profit and Loss Account of the hire purchaser as '***loss on surrender***'.

For the remaining portion of the asset lying with the hire purchaser, he (Hire Purchaser) applies the usual rate of depreciation and shows the Asset Account at its usual written-down value.

Illustration 24

On 1.1.2013, X acquires on hire purchase from Y, machinery valued at ₹ 60,000 payable in three yearly instalments of ₹ 20,000, plus interest at 6% per annum. X paid the first instalment but could not pay the second. Y took back the machinery which cost ₹ 40,000, allowing ₹ 22,500 therefore. X paid all the interest due to that date on the full amount owing.

X had written off depreciation at 10% per annum on diminishing balance. Show Machinery Account and Y Account in the books of X.

Solution

In the books of X

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 Jan 1	To Y A/c	60,000	2013 Dec 31	By Depreciation A/c	6,000
				By Balance c/d (Note 5)	54,000
		60,000			60,000
2014 Jan 1	To Balance b/d	54,000	2014 Dec 31	By Depreciation A/c (10% of ₹ 54,000)	5,400
				By Y A/c (Note 1)	22,500
				By Profit and Loss A/c (Note 1)	9,900
				By Balance b/d	16,200
		54,000			54,000
2015 Jan 1	To Balance b/d	16,200			

Dr. Y Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2013 Dec 1	To Bank A/c (20,000 + 3,600)	23,600	2013 Jan 1	By Machinery A/c	60,000
	To Balance c/d	40,000		By Interest A/c	3,600
		63,600			63,600
2014 Dec 1	To Machinery A/c (Note 1)	22,500	2014 Jan 1	By Balance b/d	40,000
	To Balance c/d	19,900		By Interest A/c	2,400
		42,400			42,400
			2015 Jan 1	By Balance b/d	19,900

Working Notes :

(1) Machinery costing ₹ 40,000 was taken over by Y at an agreed value of ₹ 22,500. Machinery costing ₹ 20,000 (60,000 – 40,000) is still with X.For calculating loss on surrender of machinery, the written down value as on the date of surrender is to be calculated. The calculation has been done in the following manner :

Calculation of Loss on Surrender of Machinery Costing ₹ 40,000	₹
Cost of machinery on 1.1.2013	40,000
Less: Depreciation for 2013 @ 10% on ₹ 40,000	4,000
Written down value on 1.1.2014	36,000
Less: Depreciation for 2014 (10% of ₹ 36,000)	3,600
Written down value on 31.12.2014	32,400
Less: Agreed value for surrender of machinery	22,500
Loss on surrender	9,900

Illustration 25

From the following particulars, calculate :

(i) Value of plant taken back by the vendor.
(ii) Value of plant left with the purchaser.
(iii) Profit or loss on plants taken back.
(iv) Profit or loss on plant repossessed when sold by vendor.

Particulars :

(i) X purchased 3 plants from Y costing ₹ 1,00,000 each.

(ii) Purchaser charged depreciation @ 20% p.a. on diminishing balance method.

(iii) 2 plants were seized by the vendor when second instalment was not paid at the end of the second year and vendor valued the plants at cost less 30% depreciation annually charged at diminishing balance method.

(iv) The vendor spent ₹ 40,000 on overhauling the plants and sold for ₹ 1,60,000.

Solution

	₹	₹
(i) Value of Two Plants Taken Back by the Vendor		
Cost of 2 plants seized by the vendor = ₹ 1,00,000 x 2		2,00,000
Less: Depreciation for two years @ 30% p.a. on Diminishing Balance Method —		
1st year (30% of ₹ 2,00,000)	60,000	
2nd year (30% of ₹ 1,40,000)	42,000	1,02,000
		98,000
(ii) Value of One Plant left with the Purchaser		
Cost of 1 plant		1,00,000
Less: Depreciation for two years @ 20% p.a. on Diminishing Balance Method —		
1st year (20% of ₹ 1,00,000)	20,000	
2nd year (20% of ₹ 80,000)	16,000	36,000
		64,000
(iii) Profit or Loss on Plants Taken Back		
Book value of two plants (₹ 64,000 x 2) [See (ii) above]		1,28,000
Agreed value of two plants taken over [See (i) above]		98,000
Loss on plant taken back		30,000
(iv) Profit or Loss on Plants Repossessed		
Value of 2 plants taken over by the Vendor [See (ii) above]		98,000
Add: Cost of overhauling		40,000
Total Cost		1,38,000
Sale Price		1,60,000
Profit on Sale of Repossessed Plants		22,000

Illustration 26

Rajesh purchased seven trucks on hire purchase on 1st July, 2014. The cash purchase price of each truck was ₹ 50,000. He was to pay 20% of the cash purchase price at the time of delivery and the balance in five half-yearly instalments starting from 31st December, 2014 with interest at 5% p.a.

On Rajesh's failure to pay the instalment due on 30th June 2015, it was agreed that Rajesh would return 3 trucks to the vendor and remaining four would be retained by him. The returning price of 3 trucks was ₹ 40,500. Rajesh charged depreciation @ 20% p.a. Vendor after spending ₹ 1,000 on repairs, sold away all three trucks for ₹ 40,000.

Show Trucks Account and Vendor's Account in the books of Rajesh and Rajesh Account and Goods Repossessed Account in the books of the vendor, assuming that their books are closed on 30th June every year.

Solution

In the books of Rajesh

Trucks Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.7.2014	To Vendor A/c (₹ 50,000 x 7) (Cost of Trucks)	3,50,000	30.6.2015	By Depreciation A/c (20% of ₹ 3,50,000)	70,000
			30.6.2015	By Vendor A/c (Agreed value of trucks retruned)	40,500
			30.6.2015	By Profit & Loss A/c (Note 4)	79,500
			30.6.2015	By Balance c/d (Note 5)	1,60,000
		3,50,000			3,50,000
1.7.2015	To Balance b/d	1,60,000			

Dr. Vendor Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.7.2014	To Bank A/c (Down payment)	70,000	1.7.2014	By Trucks A/c (₹ 70,000 x 5)	3,50,000
31.12.2014	To Bank A/c (Note 3)	63,000	31.12.2014	By Interest A/c (Note 1)	7,000
30.6.2015	To Trucks A/c	40,500	30.6.2015	By Interest A/c (Note 2)	5,600
30.6.2015	To Balance c/d	1,89,100			
		3,62,600			3,62,600

Working Notes :

(1) Interest is to be calculated @ 5% on ₹ (3,50,000 – 70,000) for 6 months = 5/100 x 1/2 x ₹ 2,80,000 = ₹ 7,000.

(2) Interest is to be calculated @ 5% on ₹ (3,50,000 – 70,000 + 7,000 – 63,000) for 6 months = ₹ 5,600.

(3) Amount of 1st instalment = 1/5 ₹ (3,50,000 – 70,000) + ₹ 7,000 (interest) = ₹ 56,000 + ₹ 7,000 = ₹ 63,000.

(4) Book value of three trucks returned

Cash price of 7 trucks = ₹ 50,000 x 7	= ₹ 3,50,000
Less: Depreciation for 2014-13 @ 20%	= ₹ 70,000
Book value of 7 trucks on 30.6.2013	= ₹ 2,80,000

Therefore, book value of 3 trucks = ₹ 2,80,000 / 7 x 3 = ₹ 1,20,000. Agreed value of 3 trucks = ₹ 40,500. Loss on surrender = ₹ 1,20,000 – ₹ 40,500 = ₹ 79,500.

(5) Book value of 4 trucks = ₹ 2,80,000 / 7 x 4 = ₹ 1,60,000.

In the books of Vendor

Dr. Rajesh Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.7.2014	To H.P. Sales A/c	3,50,000	1.7.2014	By Bank A/c	70,000
31.12.2014	To Interest A/c	7,000	31.12.2014	By Bank A/c (₹ 56,00 + ₹ 7,000)	63,000
30.6.2015	To Interest A/c	5,600	30.6.2015	By Goods Repossessed A/c	40,500
			30.6.2015	By Balance c/d	1,89,100
		3,62,600			3,62,600

Dr. Goods Repossessed Account Cr.

Date	Particulars	₹	Date	Particulars	₹
30.6.2015	To Rajesh A/c	40,500	30.6.2015	By Bank A/c	40,000
30.6.2015	To Bank A/c	1,000	30.6.2015	By Profit & Loss A/c (Loss)	1,500
		41,500			41,500

Illustration 27

Arunagshu Transport Agency purchased 2 motor vans costing ₹ 80,000 each from Debika Auto Company on 1st January 2012, on the hire purchase system. The terms of payment were as follows:

Payment of ₹ 20,000 each for motor van on delivery. Remainder in three equal instalments together with interest 10% p.a. to be paid at the end of each year.

Arunagshu Transport Agency write-off 20% depreciation each year on the diminishing balance method. The hire purchaser paid two instalments due on 31st December 2012 and 2013 but could not pay the final instalment.

Debika Auto Company re-possessed one motor van adjusting its value against the amount due. The re-possession was done on the basis of 25% depreciation on the Fixed Instalment Method.

Write-up the Ledger Accounts in the books of Arunagshu Transport Agency.

Solution

In the books of Arunagshu Agency

Dr. Motor Van Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Debika Auto Co. A/c	1,60,000	31.12.2012	By Depreciation A/c	32,000
			31.12.2012	By Balance c/d	1,28,000
		1,60,000			1,60,000
1.1.2013	To Balance b/d	1,28,000	31.12.2013	By Depreciation A/c	25,600
			31.12.2013	By Balance c/d	1,02,400
		1,28,000			1,28,000

1.1.2014	To Balance b/d	1,02,400	31.12.2014	By Depreciation A/c	20,480
			?	By Debika Auto Co A/c (Agreed value of van returned)	20,000
			?	By Profit & Loss A/c (Note 2)	20,960
			?	By Balance c/d (W. D. V. of one Motor Van still in possession)	40,960
		1,02,400			1,02,400

Dr. **Debika Auto Company Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Bank A/c (Down payment)	40,000	1.1.2012	By Motor Van A/c	1,60,000
31.12.2012	To Bank A/c ₹ (40,000 + 12,000)	52,000	31.12.2012	By Interest A/c	12,000
31.12.2012	To Balance c/d	80,000			
		1,72,000			1,72,000
31.12.2013	To Bank A/c ₹ (40,000 + 8,000)	48,000	1.1.2013	By Balance b/d	80,000
31.12.2013	To Balance c/d	40,000	31.12.2013	By Interest A/c	8,000
		88,000			88,000
31.12.2014	To Motor Van A/c	20,000	1.1.2014	By Balance b/d	40,000
31.12.2014	To Balance c/d	24,000	31.12.2014	By Interest A/c	4,000
		44,000			44,000

Working Notes:

(1) Book Value of Motor Van repossessed	₹	**(2) Loss on Repossession of one Van**	₹
Cost of the Van on 1.1.2012	80,000	Cost of the Van on 1.1.2012	80,000
Less: Depreciation of 2012 @ 20%	16,000	Less: Depreciation for 2012, 2013 & 2014 @ 25% on the fixed instalment method	60,000
W.D.V. on 1.1.2013	64,000	Agreed value	20,000
Less: Depreciation of 2013 @ 20%	12,800	Book value	40,960
W.D.V. on 1.1.2014	51,200	Less: Agreed value (as above)	20,000
Less: Depreciation of 2014 @ 20%	10,240	**Loss on repossession**	20,960
Book value on 31.12.2014	40,960		

Illustration 28

Seema Agency purchased three trucks from Vishal Automobiles Ltd on 1.1.2012, under hire purchase agreement. The cash price of each truck is ₹ 1,50,000. According to the terms and conditions of Vishal Automobiles Ltd 10% of cash price is to be paid on delivery and balance cash price in three equal yearly instalments payable at the end of each year together with interest @ 10% p.a.

Seema Agency writes off 20% depreciation on straight line method. Seema Agency paid the first and second instalment in due time but failed to pay the last instalment due on 31.12.2014.

Vishal Automobiles Ltd agreed to leave two trucks with Seema Agency and take back the third one, adjusting the value against amount due. The returned truck being valued @ 30% depreciation on diminishing balance method.

Vishal Automobiles Ltd sold the re-possessed truck for ₹ 45,000 in cash on 7.1.2015 after incurring repairing expenses of ₹ 8,000.

Show Trucks Account and Vishal Automobiles Ltd Account in the books of Seema Agency and Re-possessed Truck Account in the books of Vishal Automobiles Ltd to give effect to the above transactions.

Solution **In the books of Seema Agency**

Dr. **Truck Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Vishal Automobiles Ltd A/c	4,50,000	31.12.2012	By Depreciation A/c	90,000
			31.12.2012	By Balance c/d	3,60,000
		4,50,000			4,50,000
1.1.2013	To Balance b/d	3,60,000	31.12.2013	By Depreciation A/c	90,000
			31.12.2013	By Balance c/d	2,70,000
		3,60,000			3,60,000

1.1.2014	To Balance b/d	2,70,000	31.12.2014	By Depreciation A/c	90,000
			31.12.2014	By Vishal Automobiles Ltd A/c	51,450
			31.12.2014	By Profit and Loss A/c (Note 2)	8,550
			31.12.2014	By Balance c/d (W.D.V. of Trucks still in possession)	1,20,000
		2,70,000			2,70,000

Dr. **Vishal Automobiles Ltd Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Bank A/c (Down payment)	45,000	1.1.2012	By Truck A/c	4,50,000
31.12.2012	To Bank A/c (₹ 1,35,000 + ₹ 40,500)	1,75,500	31.12.2012	By Interest A/c (10% of ₹ 4,05,000)	40,500
31.12.2012	To Balance c/d	2,70,000			
		4,90,500			4,90,500
31.12.2013	To Bank A/c (₹ 1,35,000 + ₹ 27,000)	1,62,000	1.1.2013	By Balance b/d	2,70,000
31.12.2013	To Balance c/d	1,35,000	31.12.2013	By Interest A/c (10% of ₹ 2,70,000)	27,000
		2,97,000			2,97,000
31.12.2014	To Truck A/c	51,450	1.1.2014	By Balance b/d	1,35,000
31.12.2014	To Balance c/d	97,050	31.12.2014	By Interest A/c	13,500
		1,48,500			1,48,500

In the books of Vishal Automobiles Ltd

Dr. **Re-possessed Truck Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Seema Agency A/c (Note 1)	51,450	31.12.2014	By Balance c/d	51,450
1.1.2015	To Balance b/d	51,450	7.1.2015	By Bank A/c	45,000
?	To Bank A/c (Repairing expenses)	8,000	?	By Profit and Loss A/c	14,450
		59,450			59,450

Working Notes :

(1) Book Value of Truck Repossessed

Particulars	₹
Cost of the Truck	1,50,000
Less: Depreciation @ 20% p.a. for three years on straight line basis	90,000
	60,000

(2) Loss on Repossession of the Truck

Particulars	₹
Cost of the Truck	1,50,000
Less: Depreciation @ 30% for the year 2012	45,000
	1,05,000
Less: Depreciation @ 30% on ₹ 1,05,000 for 2013	31,500
	73,500
Less: Depreciation @ 30% on ₹ 73,500	22,050
Agreed Value of Repossessed Truck	51,450
Book Value	60,000
Less: Agreed Value	51,450
	8,550

Illustration 29

Bombay Roadways Ltd. purchased three trucks costing ₹ 1,00,000 each from Hindusthan Auto Ltd. on 1st January, 2012 on the Hire Purchase System. The terms were : on delivery payment of ₹ 25,000 for each truck and balance of the principal amount in 3 equal instalments plus interest at 15% per annum to be paid at the end of each year.

Bombay Roadways Ltd. writes-off 25% depreciation each year on the Diminishing Balance Method. Bombay Roadways Ltd. paid the instalments due on 31st December, 2012 and 31st December, 2013 but could not pay the final instalment.

Hindusthan Auto Ltd. repossessed two trucks adjusting values against the amount due. The repossession was done on 1st January, 2015 on the basis of 40% depreciation on the Diminishing Balance Method.

You are required to: (a) Write-up the ledger accounts in the books of Bombay Roadways Ltd. showing the above transactions upto 1.1.2015, and (b) Show the disclosure of the balances arising from the above transactions in the Balance Sheet of Bombay Roadways Ltd. as on 31st December, 2014.

Solution **In the books of Bombay Roadways Ltd.**

Dr. **Trucks Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Hindustan Auto Ltd A/c	3,00,000	31.12.2012	By Depreciation A/c	75,000
			31.12.2012	By Balance c/d	2,25,000
		3,00,000			3,00,000
1.1.2013	To Balance b/d	2,25,000	31.12.2013	By Depreciation A/c	56,250
			31.12.2013	By Balance c/d	1,68,750
		2,25,000			2,25,000
1.1.2014	To Balance b/d	1,68,750	31.12.2014	By Depreciation A/c	42,188
			31.12.2014	By Balance c/d	1,26,562
		1,68,750			1,68,750
1.1.2015	To Balance b/d	1,26,562	1.1.2015	By Hindustan Auto Ltd A/c (Note 1)	43,200
			1.1.2015	By Prov. for Loss on Repossession A/c	41.175

Dr. **Provision for Loss on Repossession Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Balance c/d	41,175	31.12.2014	By Profit & Loss A/c	41,175
1.1.2015	To Trucks A/c	41,175	1.1.2015	By Balance b/d	41,175

Tutorial Note : Since the company is aware of the default and since the payment was due on 31st December, 2014 the resulting loss must be provided in the accounts of 2014. It should be adjusted at the time of actual repossession.

Dr. **Hindustan Auto Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Bank A/c	75,000	1.1.2012	By Trucks A/c	3,00,000
31.12.2012	To Bank A/c (75,000 + 33,750)	1,08,750	31.12.2012	By Interest A/c (15% 0n ₹ 2,25,000)	33,750
31.12.2012	To Balance c/d	1,50,000			
		3,33,750			3,33,750
31.12.2013	To Bank A/c (75,000 + 22,500)	97,500	1.1.2013	By Balance b/d	1,50,000
31.12.2013	To Balance c/d	75,000	31.12.2013	By Interest A/c (15% on ₹ 1,50,000)	22,500
		1,72,500			1,72,500
31.12.2014	To Balance c/d	86,250	1.1.2014	By Balance b/d	75,000
			31.12.2014	By Interest A/c (15% 0n ₹ 75,000)	11,250
		86,250			86,250
1.1.2015	To Trucks A/c	43,200	1.1.2015	By Balance b/d	86,250

Working Notes:

(1) Value of two Trucks Repossessed	**₹**	**(2) Loss on repossession of two Trucks**	**₹**
Cost of two Trucks on 1.1.2012	2,00,000	Cost of two trucks on 1.1.2012	2,00,000
Less: Depreciation of 2012	80,000	*Less:* Depreciation @ 25%	50,000
	1,20,000	Book value on 1.1.2013	1,50,000
Less: Depreciation of 2013	48,000	*Less*: Depreciation of @ 25%	37,500
	72,000	Book value on 1.1.2014	1,12,500
Less: Depreciation of 2014	28,800	*Less*: Depreciation @ 25%	28,125
	43,200	Book value on 1.1.2015	84,375
		Agreed value of two repossessed trucks	43,200
		Loss on repossession — Prov. to be created in 2014 accounts	41,175

Hire Purchase Agreements for Goods of Small Value

The discussion so far was limited to the hire purchase transactions for goods of substantial sales value — invariably the fixed assets and the transactions were between ***two business units***. Now, the discussion will focus on the transactions between a retailer and the consumers and the hire purchase items i.e., consumer durables like T.V., fridge, etc. It should be noted that a large volume of the transactions of goods of these nature are being contracted every day and the accounting is important only from the point of view of ***the seller*** and not the buyer.

Since the sale of items of this nature are numerous and of small value, it becomes practically inconvenient for a particular retailer to maintain separate accounts for each transaction. In this case, the retailer is not interested to know the profit earned or losses incurred on each transaction — rather he is interested in knowing the overall profit or loss arising from all the transactions in a particular accounting period. It should be noted that profit and hire purchase interest are combined into one figure and it is apportioned over the hire purchase period.

When the hire purchase transactions are numerous and value of the items are small, it is preferable to open separate ***memorandum*** hire purchase books. A Hire Purchase Sales Register is kept, to disclose both the hire purchase price and the cost price of the goods. This register should also show the number of instalments payable, amount of down payment and the number of hire purchase agreement. In addition to Hire Purchase Sales Register, a Memorandum Hire Purchase Ledger is also maintained in which accounts of the customers are kept. The sale price is debited to the individual customers' accounts and these accounts being credited with all instalments paid. The total of the "sale price" column is credited to a Control Account, which is debited with the total instalments received.

It must be noted that above entries are of a memorandum nature only, and do not form a part of the double entry system. In practice, such accounts are vital and useful only for reference; but from the point of view of double entry, they are entirely useless and unnecessary.

In the general ledger, personal aspect is ignored, the entries being recorded in total only.

A specimen of the Hire Purchase Sales Register is given below:

Hire Purchase Sales Register

S.N.	Date of Agree-ment	Name of Custo-mer	Name of Article	Cost Price	H.P. Price	Down Pay-ment	No. of Instal-ments	Instalments Due				Total Instal-ments Recd.	Instal-ments due but not recd.	Instal-ment not yet due
								1	2	3	4			

The book keeper should be very careful in recording the different items in the register and casting (totalling) of the individual column, because these are the basis for the ascertainment of the profit or loss from hire purchase business. The totals of the columns of the register are very relevant for posting to the respective Control Accounts at regular intervals.

Relevant Expressions in Regard to Hire Purchase Sales of Small Items

Before studying the different accounting methods for ascertaining profit or loss on hire purchase transactions, we should be conversant to some relevant expressions which are used frequently. These are:

(1) Cost price of goods sold on hire purchase; (2) Value of goods sold on hire purchase; (3) Cash received; (4) Hire purchase debtors; (5) Hire purchase stock; and (6) Stock at shop.

(1) Cost price of goods sold on hire purchase The hire vendor buys goods either from the manufacturers directly or from the wholesellers. He sells them either against cash or under the hire purchase system. When he sells goods against cash, he does so at a profit — at a price more than the cost price. But when he sells the goods under hire purchase, he sells them at a price which is higher than the price of cash purchase. The extra charge is just to cover the loss of interest on these transactions. However, ***the interest in these transactions are not calculated separately, applying the concept of materiality***. Profit, in this case, is calculated on the

basis of the difference between cost price and hire purchase price. This difference is generally known as 'loading'. Loading can be expressed as a percentage of cost (***known as 'mark-up'***) or as a percentage of sales value or hire purchase price (***known as 'margin'***). For example, if the cost price of an item is ₹ 1,000 and the hire purchase price is ₹ 1,250, the profit is ₹ 250. If the profit is expressed as a percentage of cost, mark-up becomes 25%. Likewise, if it is expressed as a percentage of the hire purchase price, the margin becomes 20%.

(2) Value of goods sold on hire purchase It is the total of the hire purchase price of all goods sold during the accounting period under the hire purchase system. Generally, the value of goods sold on hire purchase is given in the examination problem. If, however, it is not given, it can be worked out as follows:

(i) Applying loading rate to the cost of goods sold under hire purchase system.

(ii) [Down payment + (Number of instalments x amount of each instalment] x Number of items sold.

(3) Cash received It represents the total amount received during the accounting period in respect to hire purchase sales. It includes down payment, instalments received in respect to previous year(s) as well as of the current year.

(4) Hire purchase debtors Commonly, a debtor is a person to whom goods are sold on credit. There is some difference between an ordinary debtor and a hire purchase debtor. A hire purchase customer is required to pay different instalments on different due dates. In the case of hire purchase debtors it is the total amount of such instalments which have ***fallen due during a particular accounting period but have not yet been paid by the hire purchase customers***. (see example of next item). Hire purchase debtors is also known as (i) Instalments due but not yet paid; or (ii) Instalment due, customers paying, etc.

(5) Stock on hire purchase It is also known as instalments not yet due or goods with hire purchase customers. Under a hire purchase agreement, some instalments fall due during the current accounting period while others fall due on the subsequent accounting year(s). The total amount of instalments which ***have not yet become due during the current accounting period is called stock on hire purchase***. It should be noted that it does not represent any ***physical stock***. For example, if the cash price of an item is ₹ 1,000 and the hire purchase price is ₹ 1,200. The payment is to be made in twenty four monthly equal instalments, i.e., ₹ 50 p.m. Out of 24 instalments, 10 instalments are due for payment during the current accounting period 2013-12 and the balance 14 instalments are due for payment in the subsequent years. In this case, the hire purchase stock will be ₹ 50 (24 – 10) = ₹ 700. In this example, let us assume that out of the 10 instalments due during 2013-12, the hire purchase customers paid only 6 instalment during the year. Therefore, the hire purchase debtors for 2013-12 will be ₹ 50 (10 – 6) = ₹ 200.

(6) Stock at shop It is the physical stock of unsold goods lying in the godown of the retailer. The cost of unsold stock in the shop has nothing to do with the ascertainment of profit or loss arising out of the hire purchase transactions. However, this figure is relevant towards the ascertainment of cost of goods sold on hire purchase, which can be ascertained by deducting the stock in the shop from the total purchases. When the cost of goods sold is given, it becomes very simple to ascertain the value of goods sold on hire purchase by simply adding the percentage of mark-up.

Ascertainment of Profit/Loss

There are two common methods of ascertaining profit / loss of goods of small value sold on hire purchase. These are:

(1) the Hire Purchase Trading Account Method; and (2) the Stock and Debtors Method

Hire Purchase Trading Account Method

Under this method, a Hire Purchase Trading Account is prepared as follows, following the method of preparation of a Consignment Account.

(a) Debit the Hire Purchase Trading Account with:

(i) Opening balance of H.P. Stock (Instalments not yet due) brought forward from the previous year. Generally, it is shown at hire purchase price. If it is given at cost, convert that into Hire Purchase price by adding loading.

(ii) Opening balance of H.P. Debtors (Instalment due but not yet paid) brought forward from the previous year.
(iii) Value of goods sold on Hire Purchase during the accounting period.
(iv) Expenses incurred during the accounting period.
(v) Loss on repossession of goods.

(b) Credit the Hire Purchase Trading Account with:

(i) Cash received from hire purchase customers during the accounting period. It includes down payment, hire purchase instalments of the previous year as well as of the current year collected during the accounting period.
(ii) Instalments due but not paid on goods repossessed.
(iii) Closing balance of H.P. Stock (Instalment not yet due) at hire purchase price carried forward to the next period. If it is not given in the problem, it can be calculated by preparing Memorandum Goods with H.P. Customers Account.
(iv) The closing balance of H.P. Debtors (Instalments due but not yet paid) is carried forward to next period. If the closing balance of H.P. Debtors is not given in the problem, it can be calculated by preparing Memorandum H.P. Debtors Account.

Pass adjustment entries for the following:

(i) For loading on opening balance of Hire Purchase Stock (Instalments not yet due / Goods with H.P. Customers)
Stock Reserve Account Dr.
To Hire Purchase Trading Account

(ii) For loading on goods sold on Hire Purchase during the year
Goods sold on Hire Purchase Account Dr.
To Hire Purchase Trading Account

(iii) For loading on closing balance of Hire Purchase Stock (Instalments not yet due / Goods with H.P. customers)
Hire Purchase Trading Account Dr.
To Stock Reserve Account

The proforma of a Hire Purchase Trading Account is given below:

Dr. Hire Purchase Trading Account Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d : Hire Purchase Stock (at H.P. price) Hire Purchase Debtors To Goods Sold on H.P. A/c (H.P. price) To Loss on Goods Repossessed A/c To Expenses A/c To Stock Reserve A/c (Loading on closing H.P. stock) To Profit & Loss A/c			By Cash A/c A/c By Goods Repossessed A/c (Instalments due but not paid) By Stock Reserve A/c (Loading on opening H.P. stock) By Goods sold on H.P. A/c (Loading on goods sold) By Balance c/d: H.P. Stock (at H.P. price) H.P. Debtors	

Illustration 30

Ram sells goods on hire purchase basis at a profit of 50% on cost. Following particulars are given relating to the business during 2014:

Particulars	₹	Particulars	₹
Hire Purchase Stock (at selling price) as on 1.1.2014	9,000	Hire Purchase Stock (at selling price) as on 31.12.2014	30,000
H.P. Debtors on 1.1.2014	5,000	H.P. Debtors on 31.12.2014	9,000
Goods sold on hire purchase during the year (at H.P. price)	87,000	Cash received from hire purchase customers during 2014	62,000

Prepare Hire Purchase Trading Account showing the profit earned for 2014.

Solution

In the books of Ram

Dr. Hire Purchase Trading Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d :		31.12.2014	By Stock Reserve A/c (Note 1)	3,000
	Hire Purchase Stock	9,000	31.12.2014	By Goods Sold on H.P. A/c (Note 2)	29,000
	Hire Purchase Debtors	5,000	31.12.2014	By Cash A/c	62,000
31.12.2014	To Goods Sold on H.P. A/c	87,000	31.12.2014	By Balance c/d :	
31.12.2014	To Stock Reserve A/c (Note 3)	10,000		Hire Purchase Stock	30,000
31.12.2014	To Profit & Loss A/c	22,000		Hire Purchase Debtors	9,000
		1,33,000			1,33,000

Working Notes:

(1) Loading on opening balance of Hire Purchase Stock = 50/150 x ₹ 9,000 = ₹ 3,000.

(2) Loading on Goods sold on Hire Purchase = 50/150 x ₹ 87,000 = ₹ 29,000.

(3) Loading on closing balance of hire purchase stock = 50/150 x ₹ 30,000 = ₹ 10,000.

Tutorial Note: The closing balance of Instalments Due Account (H.P. Debtors Account) can be verified by preparing the following accounts:

Dr. Memorandum Hire Purchase Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d (given)	5,000	By Cash A/c (given)	62,000
To Hire Purchase Stock A/c (Note 4)	66,000	By Balance c/d	9,000
	71,000		71,000

Dr. (4) Memorandum Hire Purchase Stock Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d (given)	9,000	By Hire Purchase Debtors A/c (Balancing figure)	66,000
To Goods sold on H.P. A/c (given)	87,000	By Balance c/d (given)	30,000
	96,000		96,000

Illustration 31

A trader sells goods of small value on the hire purchase system at 60% profit on cost.

From the following information, prepare Hire Purchase Trading Account:

		₹
1.1.2014	Stock with hire purchase customers at hire purchase price	6,480
31.12.2014	Goods sold on hire purchase basis during the year	26,136
	Cash received from hire purchase customers during the year	8,400
	Hire purchase debtors	1,520
	Stock with hire purchase customers at hire purchase price	22,696

Solution

Dr. Hire Purchase Trading Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d :		31.12.2014	By Stock Reserve A/c (Note 1)	2,430
	Hire Purchase Stock	6,480	31.12.2014	By Goods Sold on H P A/c (Note 2)	9,801
31.12.2014	To Goods Sold on H P A/c	26,136	31.12.2014	By Cash A/c	8,400
31.12.2014	To Stock Reserve A/c (Note 3)	8,511	31.12.2014	By Balance c/d :	
31.12.2014	To Profit and Loss A/c	3,720		Hire Purchase Stock	22,696
				Hire Purchase Debtors	1,520
		44,847			44,847

Working Notes :

(1) Loading on opening balance of hire purchase stock = 60/160 × ₹ 6,480 = ₹ 2,430.

(2) Loading on goods sold on hire purchase = 60/160 × ₹ 26,136 = ₹ 9,801.

(3) Loading on closing balance of hire purchase stock = 60/160 × ₹ 22,696 = ₹ 8,511.

Illustration 32

Domestic Appliances started trading on 1.1.2015 selling goods on hire purchase. Hire purchase terms require a deposit of 30% of the hire purchase selling price at the time of sale, followed by 10 equal monthly instalments, the first of which is payable on month after payment of the deposit.

A summary of the first six months' hire purchase transactions showed :

Month	January	February	March	April	May	June
Cost Price (₹)	2,400	13,200	1,500	6,000	3,900	3,600
H P Selling Price (₹)	4,000	22,000	3,000	11,000	7,000	6,000

All instalments were paid promptly on the due dates. You are requested to prepare Hire Purchase Trading Account.

Solution

Workings **Calculation of Amount of Deposits and Instalments**

Month of Sale ₹	Cost of Sale ₹	HP Selling Price ₹	Deposits and Instalments Received							Instalments Not Yet Due
			Jan ₹	Feb ₹	Mar ₹	Apr ₹	May ₹	Jun ₹	Total ₹	
Jan	2,400	4,000	1,200	280	280	280	280	280	2,600	1,400
Feb	13,200	22,000	—	6,600	1,540	1,540	1,540	1,540	12,760	9,240
Mar	1,500	3,000	—	—	900	210	210	210	1,530	1,470
Apr	6,000	11,000	—	—	—	3,300	770	770	4,840	6,160
May	3,900	7,000	—	—	—	—	2,100	490	2,590	4,410
Jun	3,600	6,000	—	—	—	—	—	1,800	1,800	4,200
Total	30,600	53,000	1,200	6,880	2,720	5,330	4,900	5,090	26,120	26,880

In the books of Domestic Appliances

Dr **Hire Purchase Trading Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
30.6.2015	To Goods Sold on H P A/c	53,000	30.6.2015	By Goods Sold on H P A/c (Loading — ₹ 53,000 – 30,600)	22,400
30.6.2015	To Stock Reserve A/c (Note 1)	11,360			
30.6.2015	To Profit and Loss A/c	11,040	30.6.2015	By Cash A/c (Deposits and instalments received)	26,120
			30.6.2015	By Balance c/d : H P Stock	26,880
		75,400			75,400

Working Note : (1) Loading on closing balance of hire purchase stock : ₹ 22,400 / ₹ 53,000 × ₹ 26,880 = ₹ 11,360.

Calculation of Missing Figures

Sometimes in the examination, some figures required to calculate profit/loss are not given. These may be: (i) Hire Purchase Stock; (ii) Hire Purchase Debtors; (iii) Purchases; or, (iv) Cash received, etc.

Before preparing the Hire Purchase Trading Account, the missing item(s) should be calculated first. The following steps are followed:

Step 1 : Draw up the following Memorandum Accounts.
(a) Memorandum Stock at Shop Account
(b) Memorandum H.P. Stock Account / Stock with H.P. Customers Account
(c) Memorandum H.P. Debtors Account / Instalments Due Account.

Step 2 : Place the available figures in the respective accounts.

Step 3 : Balance the account having maximum figures available. It will be helpful in finding out the missing figure of that account.

Step 4 : Place the figures so calculated in Step 3 to the relevant account.

Step 5 : Continue the process of transfer until all the figures are available.

The proforma of these accounts are given below:

Dr. **Memorandum Stock at Shop Account** **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d (at cost)		By Goods sold on Hire Purchase A/c (at cost)	
To Purchases		By Balance c/d	

Dr. Memorandum Hire Purchase Stock Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d (at H.P. price)		By Hire Purchase Debtors A/c	
To Goods sold on H.P. (at H.P. price)		By Goods Repossessed A/c (instalments not yet due)	
		By Balance c/d	

Dr. Memorandum Hire Purchase Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d (at H.P. price)		By Cash A/c	
To H.P. Stock A/c (total instalments due)		By Goods Repossessed A/c (instal. due but not yet recd.)	
		By Balance c/d	

It should be noted here that the Memorandum Stock at Shop Account shows all figures at cost, but the Memorandum H.P. Stock Account and the Memorandum H.P. Debtors Account show all figures at hire purchase price. Therefore, any figure transferred from the Memorandum Stock at Shop Account to any other account should be converted at hire purchase price. Similarly, any figure transferred to the Memorandum Stock at Shop Account from other account should be converted at cost price.

Illustration 33

ESS Ltd. has a hire purchase department. Goods are sold on hire purchase at a profit of 25% on sales price. From the following particulars, prepare Hire Purchase Trading Account in the books of ESS Ltd. for the year to 31st March, 2015:

Particulars	₹	Particulars	₹
1.4.2014		**During the year ended 31.3.2015**	
Stock in the shop	10,000	Goods sold on H.P. at H.P. price	1,76,000
Instalments due	6,000	Purchases	1,36,000
Stock out with customers at H.P. price	80,000	Cash A/c	1,60,000
		31.3.2015	
		Stock in the shop	14,000
		Stock out with customers at H.P. price	92,000

Solution

In the books of ESS Ltd.

Dr. Hire Purchase Trading Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d :		31.3.2015	By Cash A/c	1,60,000
	Stock out with Customers	80,000	31.3.2015	By Stock Reserve A/c (Note 1)	20,000
	H.P. Debtors	6,000	31.3.2015	By Goods Sold on H.P. A/c (Note 2)	44,000
31.3.2015	To Goods Sold on H.P. A/c	1,76,000	31.3.2015	By Balance c/d :	
31.3.2015	To Stock Reserve A/c (Note 3)	23,000		Stock out with Customers	92,000
31.3.2015	To Profit & Loss A/c	41,000		H.P.Debtors (Note 4)	10,000
		3,26,000			3,26,000

Working Notes:

(1) Loading on opening balance of stock with customers = 25/100 x ₹ 80,000 = ₹ 20,000.

(2) Loading on goods sold on H.P. = 25/100 x ₹ 1,76,000 = ₹ 44,000.

(3) Loading on closing balance of stock with customers = 25/100 x ₹ 92,000 = ₹ 23,000.

(4) Closing balance of instalments due (H.P., Debtors) at the end is calculated as follows:

Dr. Memorandum Hire Purchase Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	6,000	By Cash A/c	1,60,000
To Stock out with Customers A/c (Note 5)	1,64,000	By Balance c/d	10,000
	1,70,000		1,70,000

Dr. (5) Memorandum Stock out with Customers Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d (given)	80,000	By H.P. Debtors A/c (Balancing figure)	1,64,000
To Goods sold on H.P. A/c (given)	1,76,000	By Balance c/d (given)	92,000
	2,56,000		2,56,000

Dr. Memorandum Stock at Shop Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	10,000	By Goods sold on H.P. A/c (at cost) (3/4 x ₹ 1,76,000)	1,32,000
To Purchases	1,36,000	By Balance c/d	14,000
	1,46,000		1,46,000

Turotial Note: Stock in the shop (opening and closing balance) and purchases will not be considered in the Hire Purchase Trading Account. The Memorandum Stock at Shop Account has been prepared for reconciliation purposes only.

Illustration 34

Fortunate Limited commenced business on 1st April, 2014 and gives you the following information for the year ended 31st March, 2015: Total purchases for the year amounted to ₹ 90,000. General sales totalled ₹ 85,000, stock at close amounted to ₹ 15,000. Two items were sold on hire purchase terms of which the details are given below:

	Cost	Down payment per unit	Number of further instalments per unit	Total instalment falling due in 2014-13 (excluding down payments)
Item No. 1	30 x ₹ 150	₹ 30	6 of ₹ 30	50
Item No. 2	20 x ₹ 400	₹ 80	8 of ₹ 80	30

Instalments due in 2014-13 were all received. Prepare the Hire Purchase Trading Account and General Trading Account for the year ended 31st March, 2013.

Solution

In the books of Fortunate Limited

Dr. Hire Purchase Trading Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.3.2015	To Goods Sold on H.P. A/c (Note 1)	20,700	31.3.2015	By Goods Sold on H.P. A/c (Note 4)	8,200
31.3.2015	To Stock Reserve A/c (Note 7)	5,736	31.3.2015	By Cash A/c (Note 5)	6,400
31.3.2015	To Profit & Loss A/c	2,464	31.3.2015	By Balance c/d :	
				Hire Purchase Stock (Note 6)	14,300
		28,900			28,900

Dr. General Trading Account for the year ended on 31st March, 2015 Cr.

Particulars	₹	Particulars	₹
To Purchases A/c	90,000	By Sales A/c	85,000
To Gross Profit c/d	22,500	By Goods Sold on H.P. A/c (Note 8)	12,500
		By Closing Stock A/c	15,000
	1,12,500		1,12,500

Working Notes: **(1) Details of sales 2014-15**

Item No. 1 : (6 x 30 + ₹ 30) x 30 = ₹ 6,300

Item No. 2 : (8 x 80 + ₹ 80) x 20 = ₹ 14,400

= ₹ 20,700

(2) Profit on item no. 1 : (₹ 6,300 – 30 x ₹ 150) = ₹ 1,800. Therefore, profit included in sales = ₹ 1,800 / ₹ 6,300 = 2/7.

(3) Profit on item no. 2 : (₹ 14,400 – 20 x ₹ 400) = ₹ 6,400. Therefore, profit included in sales ₹ 6,400/14,400 = 4/9.

(4) Total profit = ₹ 1,800 + ₹ 6,400 = ₹ 8,200.

(5) Cash Received		₹
Item No. 1 : Cash down (30 x ₹ 30)	900	
Instalments (50 x ₹ 30)	1,500	2,400
Item No. 2 : Cash down (20 x ₹ 80)	1,600	
Instalments (30 x ₹ 80)	2,400	4,000
		6,400

(6) Instalments not yet due		₹
Item No. 1 : (30 x 6 – 50) x ₹ 30	3,900	
Item No. 2 : (20 x 8 – 30) x ₹ 80	10,400	14,300

(7) Stock Reserve		₹
Item No. 1 : 2/7 of ₹ 3,900	1,114	
Item No. 2 : 4/9 of ₹ 10,400	4,622	5,736

Dr. (8) Goods Sold on H.P. Account Cr.

Particulars	₹	Particulars	₹
To Hire Purchase Trading A/c (Note 4)	8,200	By Hire Purchase Trading A/c	20,700
To General Trading A/c (Balancing figure)	12,500		
	20,700		20,700

Illustration 35

Ravi Tandon commenced business as a hire purchase trader on 1.1.2014, with a capital of ₹ 1,00,000. He decided to sell vacuum cleaners (VC) and electric polishers (EP) and his terms were that payment should be made in eight equal instalments, the first payable on the date of sale and the remainder at quarterly intervals thereafter.

The following information is extracted from his books at the end of 2014 :

Items	Numbers Purchased	Numbers Sold	Cost per Unit (₹)	HP Selling Price per Unit (₹)
VCs	300	250	960	1,680
EPs	250	200	1,440	2,520

The following is the summary of the Bank Account for 2014 :

Receipts	₹	Payments	₹
Capital introduced	1,00,000	Payment in respect of purchases :	
Receipts in respect of sales :		VCs — 250 @ ₹ 960 each	2,40,000
VCs — 250 @ ₹ 840 each	2,10,000	EPs — 250 @ ₹ 1,440 each	3,60,000
EPs — 200 @ ₹ 630 each	1,26,000	Expenses	19,800
Overdraft at 31.12.2014	2,29,660	Drawings	35,000
		Bank Interest	10,860
	6,65,660		6,65,660

All instalments due from customers were received on due date. Credit for profit on sales is taken in respect of instalments received.On 31.12.2014, outstanding expenses were ₹ 4,600.

Prepare Hire Purchase Trading Account and Profit and Loss Account for the year ended 31.12.2014 and a Balance Sheet as on that date.

Solution

In the books of Ravi Tandan

Dr. Hire Purchase Trading Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Goods Sold on H.P. A/c (Note 1)	9,24,000	31.12.2014	By Goods Sold on H.P. A/c	
31.12.2014	To Stock Reserve A/c (Note 4)	2,52,000		(Loading — Note 2)	3,96,000
31.12.2014	To Profit and Loss A/c	1,44,000	31.12.2014	By Bank A/c (Note 3)	3,36,000
			31.12.2014	By Balance c/d :	
				Hire Purchase Stock (Note 5)	5,88,000
		13,20,000			13,20,000

Dr. Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars		₹	Particulars	₹
To Expenses	19,800		By HP Trading A/c	1,44,000
Add: Outstanding	4,600	24,400		
To Bank Interest		10,860		
To Net Profit		1,08,740		
		1,44,000		1,44,000

Balance Sheet of Ravi Tandan as at 31st December, 2014

Liabilities		₹	Assets		₹
Capital :			Closing Stock :		
Introduced	1,00,000		VCs — 50 @ ₹ 960 each		48,000
Add: Net Profit	1,08,740		EPs — 50 @ ₹ 1,440 each		72,000
	2,08,740		HP Stock :		
Less: Drawings	35,000	1,73,740	VCs	2,10,000	
Creditors (VCs — 50 @ ₹ 960 each)		48,000	Less: Stock Reserve	90,000	1,20,000
Outstanding Expenses		4,600	EPs	3,78,000	
Bank Overdraft		2,29,660	Less: Stock Reserve	1,62,000	2,16,000
		4,56,000			4,56,000

Working Notes :

(1) Goods Sold on Hire Purchase	₹
250 Vacuum Cleaners @ ₹ 1,680 each	4,20,000
200 Electric Polishers @ ₹ 2,520 each	5,04,00
	9,24,000
(2) Loading on Goods Sold	
250 Vacuum Cleaner × (₹ 1,680 – ₹ 960)	1,80,000
200 Electric Polishers × (₹ 2,520 – ₹ 1,440)	2,16,000
	3,96,000
(3) Instalment Received	
250 Vacuum Cleaners @ ₹ 840 each	2,10,000
200 Electric Polishers @ ₹ 630 each	1,26,000
	3,36,000
(4) Loading on Closing Balances of H P Stock	
On Vacuum Cleaner = ₹ 1,80,000 / ₹ 4,20,000 × ₹ 2,10,000	90,000
On Electric Polisher = ₹ 2,16,000 / ₹ 5,04,000 × ₹ 3,78,000	1,62,000
	2,52,000
(5) Hire Purchase Stock = H.P. Sales – Instalments Received	
Vacuum Cleaner = ₹ 4,20,000 – ₹ 2,10,000	2,10,000
Electric Polisher = ₹ 5,04,000 – ₹ 1,26,000	3,78,000
	5,88,000

Repossession

When goods are repossessed for default in payment, the number of instalments due but not yet received on the goods are not recoverable. The amounts of these instalments in respect to the repossessed goods are transferred from the Memorandum Hire Purchase Debtors Account to the Goods Repossessed Account by debiting the latter and crediting the former in the Memorandum Hire Purchase Ledger.

In the General Ledger, Goods Repossessed Account is debited and Hire Purchase Trading Account is credited with the instalments due but not yet received. If the selling price / market price of the goods repossessed is less than the instalments due but not paid, it represents a loss on repossession and is transferred to the Hire Purchase Trading Account by debiting the Hire Purchase Trading Account and crediting the Goods Repossessed Account. Likewise, if the selling price / market price of the goods repossessed is more than the instalments due but not paid, it represents a profit and it is credited to the Hire Purchase Trading Account.

The following are the Journal Entries for repossession :

(1) When the goods are repossessed

Goods Repossessed Account Dr. [Instalments due but not yet paid]
To Hire Purchase Trading Account

(2) When there is a loss on repossession

[Selling price / market price is ***less*** than Instalments due but not yet paid]
Hire Purchase Trading Account Dr.
To Loss on Repossession Account

(3) When there is a profit on repossession

[Selling price / market price is ***greater*** than Instalments due but not yet paid]
Profit on Repossession Account Dr.
To Hire Purchase Trading Account

Illustration 36

Amar & Co. has a hire purchase department and goods are sold on hire purchase at cost plus 60%. From the following information, prepare the Hire Purchase Trading Account to ascertain the profit or loss made in the hire purchase department. Show your workings clearly.

Particulars	₹	Particulars	₹
Jan.1, 2013		Cash received during the year	56,000
Hire Purchase Stock (at H.P. price)	16,000	Goods received back from customers (instalment due ₹ 2,000) valued at	300
Dec. 31, 2013		Goods with H.P. customers at H.P. price	36,000
Goods sold on H.P. during the year	80,000	Instalments due but not yet received	2,000

Solution

In the books of Amar & Co.

Dr. Hire Purchase Trading Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2013	To Balance b/d :		31.12.2013	By Cash A/c	56,000
	Hire Purchase Stock	16,000	31.12.2013	By Stock Reserve A/c (Note 1)	6,000
31.12.2013	To Goods Sold on H.P. A/c	80,000		By Goods Sold on H.P. A/c (Note 2)	30,000
31.12.2013	To Loss on Goods Repossessed A/c (Note 6)	1,700		By Goods Repossessed A/c (Note 6)	2,000
31.12.2013	To Stock Reserve A/c (Note 3)	13,500		By Hire Purchase Stock (Note 3)	36,000
31.12.2013	To Profit & Loss A/c	20,800		By Hire Purchase Debtors (Note 4)	2,000
		1,32,000			1,32,000

Working Notes:

(1) Loading on opening balance of goods with customers = 60/160 x ₹ 16,000 = ₹ 6,000.

(2) Loading on goods sold on hire purchase = 60/160 x ₹ 80,000 = ₹ 30,000.

(3) Loading on closing balance of goods with customers = 60/160 x ₹ 36,000 = ₹ 13,500.

(4) Closing balance of instalment due (H.P. Debtors) can be verified by preparing the following accounts:

Dr. Memorandum Hire Purchase Debtors Account Cr.

Particulars	₹	Particulars	₹
To Hire Purchase Stock A/c (Note 5)	60,000	By Cash A/c	56,000
		By Goods Repossessed A/c	2,000
		By Balance c/d	2,000
	60,000		60,000

Dr. (5) Memorandum Hire Purchase Stock Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d (given)	16,000	By Hire Purchase Debtors A/c (Balancing figure)	60,000
To Goods sold on H.P. A/c (given)	80,000	By Balance c/d (given)	36,000
	96,000		96,000

(6) Instalment due on repossessed goods is ₹ 2,000. It has been valued at ₹ 300. Therefore, loss on repossession = ₹ 2,000 – ₹ 300 = ₹ 1,700. Alternatively, only ₹ 300 (realisable value of goods repossessed can be credited to H.P. Trading Account).

Illustration 37

Mr X is a hire purchase trader and sells goods on hire purchase basis at cost plus 50%.

From the following information, prepare Hire Purchase Trading Account to determine profit for the year ending 31.3.2015:

April 1, 2014	₹	March 31, 2015	₹
Stock with Customers (at HP price)	90,000	Stock at Shop (excluding returned goods)	2,00,000
Stock at Shop (at cost)	1,80,000	Instalments due but not received	90,000
Instalments due (good)	50,000	Stock with customers (at HP price)	3,00,000
Goods repossessed (against instalments due ₹ 20,000)	5,000		
Cash received from customers	6,00,000		

Solution

In the books of X

Dr. Hire Purchase Trading Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.4.2014	To Balance b/d :		31.3.2015	By Cash A/c	6,00,000
	Stock with Customers (at HP price)	90,000	"	By Stock Reserve A/c (Note 4)	30,000
	Instalments due (good)	50,000	"	By Goods Repossessed A/c	20,000

31.3.2015	To Goods Sold on HP A/c (Note 2)	8,70,000	"	By Goods Sold on HP A/c (Loading)	2,90,000
"	To Loss on Goods Repossessed A/c (6)	15,000	"	By Balance c/d :	
"	To Stock Reserve A/c (Note 5)	1,00,000		Stock with Customers	3,00,000
"	To Profit and Loss A/c	2,05,000		Instalments Due	90,000
		13,30,000			13,30,000

Working Notes :

Dr. (1) Memorandum Stock at Shop Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d (at cost)	1,80,000	By Goods Sold on HP (cost price)	5,80,000
To Purchases	6,00,000	By Balance c/d	2,00,000
	7,80,000		7,80,000

Dr. (2) Memorandum Hire Purchase Stock Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	90,000	By HP Debtors A/c (Note 3)	6,60,000
To Goods Sold on HP A/c (Balancing figure)	8,70,000	By Balance c/d	3,00,000
	9,60,000		9,60,000

Dr. (3) Memorandum Hire Purchase Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d (given)	50,000	By Cash (given)	6,00,000
To HP Stock A/c (Instalments falling due during the year)	6,60,000	By Goods Repossessed A/c (given)	20,000
		By Balance c/d (given)	90,000
	7,10,000		7,10,000

(4) Loading on Opening Stock with Customers : It is given that loading is 50% of cost. It means, loading is 1/3 of the hire purchase price. Total loading = 1/3 of ₹ 90,000 = ₹ 30,000.

(5) Loading on Closing Stock with Customers : 1/3 of ₹ 3,00,000 = ₹ 1,00,000.

(6) Instalments due on repossessed goods is ₹ 20,000. It has been valued at ₹ 5,000. Therefore, loss on repossession is ₹ 15,000.

Illustration 38

Following are the particulars from the books of a trader who sells goods of small value on the hire purchase system at 50% profit on cost. Prepare the Hire Purchase Trading Account for the year ending December 31, 2014:

Particulars	₹	Particulars	₹
January 1 :		Goods repossessed (instalment due ₹ 8,000) valued at	
Stock with the customers	27,000	₹ 1,500 which has been included in the stock at the end	
Stock in the shop	54,000	at ₹ 1,500	
Instalments due	15,000	Cash received from customers	1,80,000
December 31 :		Goods purchased during the year	1,80,000
Stock in the shop	61,500		
Instalments due	27,000		

Solution

In the books of a Trader

Dr. Hire Purchase Trading Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d :		31.12.2014	By Cash A/c	1,80,000
	Stock with customers	27,000	31.12.2014	By Stock Reserve A/c (Note 4)	9,000
	Instalments due	15,000	31.12.2014	By Goods Repossessed A/c (Note 6)	8,000
31.12.2014	To Goods sold on H.P. A/c (Note 2)	2,61,000	31.12.2014	By Goods Sold on H.P. A/c (Loading)	87,000
	To Loss on Goods Repossessed A/c (Note 6)	6,500	31.12.2014	By Balance c/d :	
31.12.2014	To Stock Reserve A/c (Note 5)	29,333		Stock with Customers (Note 2)	88,000
31.12.2014	To Profit & Loss A/c	60,167		Instalments due	27,000
		3,99,000			3,99,000

Working Notes :

Dr. (1) Memorandum Stock at Shop Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d (cost)	54,000	By Goods sold on H.P. A/c (at cost) (Balancing figure)	1,74,000
To Purchases A/c	1,80,000	By Balance c/d (₹ 61,500 – ₹ 1,500)	60,000
	2,34,000		2,34,000

Dr. (2) Memorandum H.P. Stock Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	27,000	By Hire Purchase Debtors A/c	2,00,000
To Goods sold on H.P. (at H.P. price) (₹ 1,74,000 x 150/100)	2,61,000	By Balance c/d	88,000
	2,88,000		2,88,000

Dr. (3) Memorandum H.P. Debtors Account Cr.

Particulars	₹	Particulars	₹
To Balance b/d	15,000	By Cash A/c	1,80,000
To H.P. Stock A/c (Balancing figure)	2,00,000	By Goods Repossessed A/c	8,000
		By Balance c/d	27,000
	2,15,000		2,15,000

(4) Loading on opening stock with customers. It is given that loading is 50% of cost. It means, loading is 1/3 of hire purchase price. Total loading = 1/3 of ₹ 27,000 = ₹ 9,000.

(5) Loading on closing stock with customers. 1/3 of ₹ 88,000 = ₹ 29,333.

(6) Instalments due on repossessed goods is ₹ 8,000. It has been valued at ₹ 1,500. Therefore, loss on repossession is ₹ 8,000 – ₹ 1,500 = ₹ 6,500.

Stock and Debtors System

The Stock and Debtors System (similar to the system followed in case of Branch Accounts) can also be applied for the ascertainment of profit or loss on goods of small value sold on hire purchase basis. Under this system, the following accounts are opened : (i) Hire Purchase Stock Account; (ii) Hire Purchase Debtors Account; (iii) Goods Sold on Hire Purchase Account; (iv) Goods Repossessed Account; and (v) Hire Purchase Adjustment Account.

Journal Entries in the books of the Hire Vendors

(1) For goods sold on hire purchase
Hire Purchase Stock Account Dr. [H.P. Price]
To Goods Sold on Hire Purchase Account

(2) For total instalment due during the accounting period
Hire Purchase Debtors Account Dr.
To Hire Purchase Stock Account

(3) For money received from debtors
Bank / Cash Account Dr.
To Hire Purchase Debtors Account

(4) For goods repossessed
Goods Repossessed Account Dr. [Unpaid instalments]
To Hire Purchase Stock Account

(5) For loading on goods sold on hire purchase
Goods Sold on Hire Purchase Account Dr.
To Hire Purchase Adjustment Account

(6) For loading on opening hire purchase stock
Stock Reserve Account Dr.
To Hire Purchase Adjustment Account

(7) For loading on closing hire purchase stock
Hire Purchase Adjustment Account Dr.
To Stock Reserve Account

(8) For loss on goods repossessed

Hire Purchase Adjustment Account Dr. [Difference between instalments unpaid and
To Goods Repossessed Account market value of goods repossessed or loading only.]

(The above entry will be reversed when there is a profit.)

(9) For expenses incurred on hire purchase business

Hire Purchase Adjustment Account Dr.
To Bank /Cash Account

(10) When profit on hire purchase is transferred to Profit and Loss Account

Hire Purchase Adjustment Account Dr.
To Profit and Loss Account

(The above entry will be reversed, when there is a loss)

(11) When goods sold on hire purchase account is closed

Goods Sold on Hire Purchase Account Dr.
To General Trading Account
or
To Stock at Shop Account

Illustration 39

Sambhu Bros. sells its product under the hire purchase method. The following information was available as on the dates noted below :

Particulars	1.1.2013 (₹)	31.12.2013 (₹)
Stock out on hire purchase price	90,000	1,03,000
Shop stock balance	11,250	15,750
Instalments due (customers still paying)	6,750	11,250

It is ascertained that cash of ₹ 1,80,000 has been received during the year and gross profit is reckoned at 25% of the selling price.

Prepare : (i) H.P. Trading Account; and (ii) The accounts under Stock and Debtors Method.

Solution (i) **In the books of Sambhu Bros.**

Dr. **Hire Purchase Trading Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2013	To Balance b/d:		31.12.2013	By Cash A/c	1,80,000
	Hire Purchase Stock	90,000	31.12.2013	By Stock Reserve A/c (Note 1)	22,500
	Hire Purchase Debtors	6,750	31.12.2013	By Goods Sold on H. Pur. A/c (Note 2)	49,375
	To Goods Sold on Hire Purchase A/c	1,97,500		By Balance c/d:	
31.12.2013	To Stock Reserve A/c (Note 3)	25,750		Hire Purchase Stock	1,03,000
31.12.2013	To Profit & Loss A/c	46,125		Hire Purchase Debtors	11,250
		3,66,125			3,66,125

Tutorial Note : Students should prepare different accounts of the "Stock and Debtors System" as given below for finding out the relevant figures appearing in the above Hire Purchase Trading Account.

Solution (ii)

Dr. **Hire Purchase Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2013	To Balance b/d	90,000	?	By Hire Purchase Debtors A/c	1,84,500
?	To Goods Sold on Hire Purchase A/c	1,97,500	31.12.2013	By Balance c/d	1,03,000
		2,87,500			2,87,500

Dr. **Hire Purchase Debtors Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2013	To Balance b/d	6,750	?	By Cash	1,80,000
?	To Hire Purchase Stock A/c (Bal. figure)	1,84,500	31.12.2013	By Balance c/d	11,250
		1,91,250			1,91,250

Dr. **Hire Purchase Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2013	To Stock Reserve A/c (Note 3)	25,750	1.1.2013	By Stock Reserve A/c (Note 1)	22,500
31.12.2013	To Profit & Loss A/c	46,125	31.12.2013	By Goods Sold on Hire Purchase A/c (Note 2)	49,375
		71,875			71,875

Dr. **Shop Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2013	To Balance b/d	11,250	?	By Goods Sold on Hire Purchase A/c (at cost) (3/4 of ₹ 1,97,500)	1,48,125
?	To Purchase A/c (Balancing figure)	1,52,625	31.12.2013	By Balance c/d	15,750
		1,63,875			1,63,875

Working Notes:

(1) Goods are sold at a profit of 25% on selling price. So, loading is 1/4 of the selling price. Therefore, loading on opening balance of hire purchase stock = 1/4 of ₹ 90,000 = ₹ 22,500

(2) Loading on goods sold on hire purchase = 1/4 of ₹ 1,97,500 = ₹ 49,375.

(3) Loading on closing balance of hire purchase stock = 1/4 of ₹ 1,03,000 = ₹ 25,750.

Illustration 40

Decor Ltd. supply goods on hire purchase system at a profit of 50% over the cost. the following are the transactions for the year ending December 31, 2014 :

Stock out on hire purchase at Cost on	₹
01.01.2014	60,000
31.12.2014	48,000
Instalments due (customers are still paying) on	
01.01.2014	5,400
31.12.2014	9,000
Goods re-possessed during the year (for instalments unpaid ₹ 900) valued at	450
Instalments realised during the year	1,17,000

Prepare the Hire Purchase Stock Account, Hire Purchase Debtors' Account and the Hire Purchase Adjustment Account.

Solution

In the books of Decor Ltd.

Dr. **Hire Purchase Stock Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d (Note 1)	90,000	31.12.2014	By Hire Purchase Debtors a/c	1,21,500
31.12.2014	To Goods Sold on Hire Purchase A/c (Balancing figure)	1,03,500	31.12.2014	By Balance c/d (Note 2)	72,000
		1,93,500			1,93,500

Dr. **Hire Purchase Debtors' Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d	5,400		By Bank A/c	1,17,000
	To Hire Purchase Stock A/c (Balancing figure)	1,21,500		By Goods Repossessed A/c (Instalment unpaid)	900
			31.12.2014	By Balance c/d	9,000
		1,26,900			1,26,900

Dr. **Hire Purchase Adjustment Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Goods Repossessed (Note 4) (Loss on repossession)	450	1.1.2014	By Stock Reserve A/c	30,000
	To Profit and Loss A/c (Balancing figure)	40,050		By Goods Sold on Hire Purchase A/c (Note 3)	34,500
	To Stock Reserve a/c	24,000			
		64,500			64,500

Working Notes :

(1) Hire purchase price = Cost + 50%. Stock out on hire purchase on 1.1.2014 at hire purchase price = ₹ 60,000 + 50% of ₹ 60,000 = ₹ 60,000 + ₹ 30,000 = ₹ 90,000.
(2) Stock out on hire purchase on 31.12.2014 at hire purchase price = ₹ 48,000 + 50% of ₹ 48,000 = ₹ 48,000 + ₹ 24,000 = ₹ 72,000.
(3) Loading on goods sold on hire purchase = 1/3 of ₹ 1,03,500 = ₹ 34,500.
(4) Goods repossessed at ₹ 900 but it has been valued at ₹ 450. Therefore, loss on repossession is ₹ 450.

Illustration 41

Varun sells goods on hire purchase basis also. He fixes the hire purchase price by adding 50% to the cost of the goods with him. The following are the figures relating to his hire purchase business for the year, 2014 :

Particulars	₹	Particulars	₹
Balance of Hire Purchase Stock Account as on 1.1.2014	12,000	Selling price of goods sold on hire purchase basis during the year	90,600
Balance of Hire Purchase Debtors Account as on 1.1.2014	300	Total amount of instalments that fell due during the year	92,700
Cash received from customers during the year	92,400		

A customer to whom goods for ₹ 1,200 had been sold paid only 5 instalments of ₹ 100 each. On his failure to pay the monthly instalment of ₹ 100 due on 4.12.2014, the goods were reprossessed on 27.12.2014 after due legal notice.

Prepare ledger accounts on the Stock-Debtors System for the year ended 31.12.2014.

Solution

In the books of Varun

Dr. Hire Purchase Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d	12,000	?	By Hire Purchase Debtors A/c	92,700
?	To Goods Sold on Hire Purchase A/c	90,600	27.12.2014	By Goods Repossessed A/c (Instalments not yet due)	600
			31.12.2014	By Balance c/d	9,300
		1,02,600			1,02,600

Dr. Hire Purchase Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d	300	?	By Cash A/c	92,400
?	To Hire Purchase Stock A/c	92,700	27.12.2014	By Goods Repossessed A/c (Instalment due but not paid)	100
			31.12.2014	By Balance c/d	500
		93,000			93,000

Dr. Hire Purchase Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Stock Reserve A/c (Note 3)	3,100	1.1.2014	By Stock Reserve A/c (Note 1)	4,000
31.12.2014	To Profit & Loss A/c	31,200	32.12.2014	By Goods sold on Hire Purchase A/c (Note 2)	30,200
			31.12.2014	By Goods Repossessed A/c (Profit)	100
		34,300			34,300

Dr. Goods Repossessed Account Cr.

Date	Particulars	₹	Date	Particulars	₹
27.12.2014	To Hire Purchase Stock A/c	600	31.12.2014	By Balance c/d (Note 4)	800
27.12.2014	To Hire Purchase Debtors A/c	100			
31.12.2014	To Hire Purchase Adjustment A/c	100			
		800			800

Working Notes:

(1) If cost is ₹ 100, profit is ₹ 50 and hire purchase price is ₹ 100 + ₹ 50 = ₹ 150. Profit on hire purchase price = 50/150 = 1/3. Therefore, loading on opening stock = 1/3 of ₹ 12,000 = ₹ 4,000.
(2) Loading on goods sold on hire purchase = 1/3 of ₹ 90,600 = ₹ 30,200.
(3) Loading on closing balance of hire purchase stock = 1/3 of ₹ 9,300 = ₹ 3,100.
(4) It is assumed that the repossessed goods have been valued at cost i.e., 2/3 of ₹ 1,200 = ₹ 800.

Illustration 42

Furnishers Ltd. supply furnishing on hire-purchase terms at a profit of 50% over the cost. The following are the transactions for the year ending December 31, 2014 :

Particulars	₹	Particulars	₹
Jan. 1 Stock out on hire purchase at cost	20,000	Instalments realised during the year	39,000
Jan. 1 Instalments due (customers still paying)	1,800	Dec. 31 Stock out on hire purchase at cost	16,000
Goods re-possessed during the year (for instalments unpaid ₹ 300) evaluated at	150	Instalments due (customers still paying)	3,000

Prepare the Hire-Purchase Stock Account, Hire-Purchase Debtors' account and the Hire-Purchase Adjustment Account.

Solution

In the books of Furnishers Ltd.

Hire Purchase Stock Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d (At H.P. price)	30,000	?	By Hire Purchase Debtors A/c	40,500
?	To goods Sold on Hire Purchase A/c	34,500	31.12.2014	By Balance c/d (at H.P. Price)	24,000
		64,500			64,500

Hire Purchase Debtors Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d	1800	?	By Bank A/c	39,000
?	To Hire Purchase Stock A/c	40,500		By Goods Reposs. A/c (Instalment unpaid)	300
			31.12.2014	By Balance c/d	3,000
		42,300			42,300

Hire Purchase Adjustment Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Goods Repossessed A/c	150	1.1.2014	By Stock Reserve A/c (Note 1)	10,000
31.12.2014	To Stock Reserve A/c (Note 3)	8,000	?	By Goods Sold on Hire Purchase A/c (Note 2)	11,500
31.12.2014	To Profit & Loss A/c	13,350			
		21,500			21,500

Working Notes:

(1) Goods are sold at a profit of 50% on cost. It means, if cost is ₹ 100 then profit = ₹ 50 and hire purchase price = ₹ 100 + ₹ 50 = ₹ 150. Therefore loading on hire purchase price = 50/150 = 1/3. Loading on opening balance of hire purchase stock = 1/3 of ₹ 30,000 = ₹ 10,000.

(2) Loading on goods sold on hire purchase = 1/3 of ₹ 34,500 = ₹ 11,500.

(3) Loading on closing balance of hire purchase stock = 1/3 of ₹ 24,000 = ₹ 8,000.

Illustration 43

Y Ltd. sells products on hire purchase terms, the price being cost plus $33^{1}/_{3}$%. From the following particulars for 2014, prepare the Hire Purchase Stock Account, the Shop Stock Account, the Hire purchase Debtors Account, the Stock Reserve Account and the Hire Purchase Adjustment account (for profit):

Particulars	₹	Particulars	₹
2014, January, 1		**2014, December, 31**	
Stock out on hire at hire purchase price	1,20,000	Stock out on hire at hire purchase price	1,38,000
Stock in hand, at shop	15,000	Stock in hand at shop	21,000
Instalments due (Customers still paying)	9,000	Instalments due (Customers still paying)	15,000
		Cash received during the year	2,40,000

Solution

In the books of Y Ltd.

Hire Purchase Stock Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d (At H.P. price)	1,20,000	?	By Hire Purchase Debtors A/c	2,46,000
31.12. .2014	To Goods Sold on Hire Purchase A/c	2,64,000	31.12.2014	By Balance c/d	1,38,000
		3,84,000			3,84,000

Dr. Shop Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d	15,000	?	By Hire Purchase Stock A/c (3/4 of ₹ 2,64,000)	1,98,000
?	To Purchases A/c	2,04,000	31.12.2014	By Balance c/d	21,000
		2,19,000			2,19,000

Dr. Hire Purchase Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Balance b/d	9,000	?	By Cash A/c	2,40,000
31.12.2014	To Hire Purchase Stock A/c	2,46,000	31.12.2014	By Balance c/d	15,000
		2,55,000			2,55,000

Dr. Stock Reserve Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2014	To Hire Purchase Adjustment A/c	30,000	1.1.2014	By Balance b/d	30,000
31.12.2014	To Balance c/d	34,500	31.12.2014	By Hire Purchase Adjustment A/c	34,500
		64,500			64,500

Dr. Hire Purchase Adjustment Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2014	To Stock Reserve A/c (Note 3)	34,500	1.1.2014	By Stock Reserve A/c (Note 1)	30,000
31.12.2014	To Profit & Loss A/c	61,500	31.12.2014	By Goods Sold on Hire Purchase A/c (Note 2)	66,000
		96,000			96,000

Working Notes:

(1) Goods are sold at a profit of $33^{1}/_{3}$% on cost. It means, if the cost is ₹ 100, then profit is ₹ 33.33 and hire purchase price = ₹ 100 + ₹ 33.33 = ₹ 133.33. Therefore, loading on hire purchase price = 33.33/133.33 = 1/4. Loading on opening balance of hire purchase stock = 1/4 of ₹ 1,20,000 = ₹ 30,000.

(2) Loading on goods sold on hire purchase = 1/4 of ₹ 2,64,000 = ₹ 66,000.

(3) Loading on closing balance of hire purchase stock = 1/4 of ₹ 1,38,000 = ₹ 34,500.

Instalment Payment System

An instalment sale is a credit sale in which payments are made in instalments over a period of time. Under this system the buyer is given the possession and also ownership of the goods right at the time of signing the agreement. If the buyer defaults, the seller cannot repossess the goods but he can sue the buyer for the amount due.

The following are the features of an Instalment Payment System :

(a) It is an outright credit sale of goods.

(b) The buyer has the facility to pay the price in instalments over a period of time.

(c) The buyer gets immediate possession as well as ownership of the goods.

(d) In the event of default by the buyer in the payment of any instalment, the seller cannot repossess the goods (because the ownership has already been transferred).

(e) In case of default, the total amount of instalments paid by the buyer are not forfeited. The seller can only bring a suit against the buyer for the unpaid instalments.

The difference between the hire purchase system and the instalment payment system is as follows:

	Hire Purchase System	Instalment Payment System
(i) Nature of Contract	It is an agreement of hiring of goods.	It is an agreement of sale of goods.
(ii) Passing of Title	The title of the goods is passed on to the buyer after the payment of the final instalment or as agreed by the parties.	The title of the goods is passed on to the buyer at the time of signing the agreement.

(iii) Rights of Seller	If the buyer fails to pay any of the instalments, the goods can be repossessed by the seller.	The seller cannot repossess the goods. He can sue the buyer for the amount due.
(iv) Rights of Disposal	The buyer cannot hire out, sell, transfer, destroy, pledge the goods.	The buyer can hire out, sell, transfer, destroy, pledge the goods and the bona fide purchaser can get good title.
(v) Return of Goods	The buyer may return goods without further payment, except for the instalments already due.	Except seller's default, goods cannot be returned. Buyer is liable to pay the amount due.
(vi) Forfeiture of Amount Received	In case of default, the total amount of instalments paid is forfeited and treated as hire charges.	In case of default, the total amount of instalments paid by the buyer cannot be forfeited.

Accounting Arrangements

Under the instalment payment system, the property in the goods passes to the buyer at the time of signing the contract. When accounting entries are to be passed in the books of the buyer and seller, this fact should be taken into account. The seller will treat the transaction as a credit sale. Likewise, the buyer treats it as an outright credit purchase (but the payment should be made in instalments). The buyer credits the seller with the total amount payable to him (including interest) and debits the Asset Account with cash price and Interest Suspense Account (with total interest).

The seller debits the buyer with full amount and credits sales account with cash price and the Interest Suspense Account with total interest. A proportionate part of the Interest Suspense Account is transferred each year to the credit of the Profit and Loss Account. The buyer maintains the Assets Account in a manner similar to that of the Hire Purchase System. The depreciated value of the asset is shown in the asset side of the Balance Sheet. The amount due to seller is shown in the Balance Sheet as a liability. The seller shows the balance due from the buyer as debtors (not as stock as in the case of Hire Purchase System) in the Balance Sheet.

The Books of the Buyer

The following journal entries are passed in the books of the buyer.

1. When the asset is acquired on instalment payment system.

Asset Account	Dr. [Full cash price]
Interest Suspense Account	Dr. [Total interest]
To Vendor Account	[Instalment price]

2. When down payment is made

Vendor Account	Dr.
To Bank Account	

3. For interest of the relevant period

Interest Account	Dr.
To Interest Suspense Account	

4. For payment of instalment

Vendor Account	Dr.
To Bank Account	

5. When depreciation is charged on the asset

Depreciation Account	Dr.
To Asset Account	

6. For closing interest and depreciation account.

Profit and Loss Account	Dr.
To Interest Account	
To Depreciation Account	

The Books of the Seller/Vendor

The following Journal Entries are passed in the books of the seller.

1. When goods are sold and delivered under the instalment payment system.

Purchaser Account	Dr.	[Full cash price + total interest]
To Sales Account		[Cash price]
To Interest Suspense Account		[Total interest]

2. When down payment is received

Bank Account Dr.
To Purchaser Account

3. For interest of the relevant period

Interest Suspense Account Dr.
To Interest Account

4. For receipt of the amount of instalment

Bank Account Dr.
To Purchaser Account

5. For closing interest account

Interest Account Dr.
To Profit and loss Account

6. For closing sales account

Sales Account Dr.
To Trading Account

Illustration 44

Eastern Collieries Ltd. purchased wagons from Texmaco Ltd. under the Instalment Payment System on 1st January 2013. It was agreed that ₹ 15,000 was to be paid on signing the agreement and a sum of ₹ 15,000 was to be paid annually for 3 years. The cash price of the wagons was ₹ 52,300 and the rate of interest was 10%. Depreciation is charged @ 20% on the straight line method.

You are required to give Journal entries recording the above transactions in the books of both the parties.

Solution

In the books of Eastern Collieries Ltd.

Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2013 Jan. 1	Wagon A/c	Dr.		52,300	
	Interest Suspense A/c (Note 2)	Dr.		7,700	
	To Texmaco Ltd. A/c				60,000
	(Being the purchase of wagons from Texmaco Ltd. on instalment system)				
	Texmaco Ltd.	Dr.		15,000	
	To Bank A/c				15,000
	(being the amount paid on signing the agreement)				
Dec. 31	Interest A/c	Dr.		3,730	
	To Interest Suspense A/c				3,730
	(Being interest of 2013 on ₹ 37,300 @ 10% p.a.)				
	Texmaco Ltd. A/c	Dr.		15,000	
	To Bank A/c				15,000
	(Being the payment of 1st instalment)				
	Depreciation A/c	Dr.		10,460	
	To Wagon A/c				10,460
	(Being the depreciation charged @ 20% p.a. on ₹ 52,300)				
	Profit & Loss A/c	Dr.		14,190	
	To Interest A/c				3,730
	To Depreciation A/c				10,460
	(Being the interest and depreciation transferred to Profit & Loss Account)				

2014 Dec. 31	Interest A/c Dr. To Interest Suspense A/c (Being interest of 2014 on ₹ 26,030 @ 10% p.a.)		2,603	 2,603
	Texmaco Ltd. A/c Dr. To Bank A/c (Being the payment of 2nd instalment)		15,000	 15,000
	Depreciation A/c Dr. To Wagon A/c (Being the depreciation charged @ 20% p.a. on ₹ 52,300)		10,460	 10,460
	Profit & Loss A/c Dr. To Interest A/c To Depreciation A/c (Being the interest and depreciation transferred to Profit and Loss Account)		13,063	 2,603 10,460
2015 Dec. 31	Interest A/c (Note 1) Dr. To Interest Suspense A/c (Being interest of 2014 on ₹ 13,633 @ 10% p.a.)		1,367	 1,367
	Texmaco Ltd. A/c Dr. To Bank A/c (Being the payment of final instalment)		15,000	 15,000
	Depreciation A/c Dr. To Wagon A/c (Being the depreciation charged @ 20% on ₹ 52,300)		10,460	 10,460
	Profit & Loss A/c Dr. To Interest A/c To Depreciation A/c (Being the interest and depreciation transferred to Profit & Loss Account)		11,827	 1,367 10,460

In the books of Texmaco Ltd.

Journal **Dr.** **Cr.**

Date	Particulars	L.F.	₹	₹
2013 Jan. 1	Eastern Collieries Ltd. A/c Dr. To Sales A/c To Interest Suspense A/c (Being sale of wagons on instalment payment system)		60,000	 52,300 7,700
	Bank A/c Dr. To Eastern Collieries Ltd. A/c (Being the amount received as down payment)		15,000	 15,000
Dec. 31	Interest Suspense A/c Dr. To Interest A/c (Being interest of 2013 credited to Interest Account)		3,730	 3,730
	Bank A/c Dr. To Eatern Collieries Ltd. A/c (Being the 1st instalment received)		15,000	 15,000
	Sales A/c Dr. To Trading A/c (Being the transfer of Sales Account to Trading Account)		52,300	 52,300
	Interest A/c Dr. To Profit & Loss A/c (Being the interest credited to Profit and Loss Account)		3,730	 3,730
2014 Dec. 31	Interest Suspense A/c Dr. To Interest A/c (Being interest of 2014 credited to Interest Account)		2,603	 2,603
	Bank A/c Dr. To Eastern Colleries Ltd.A/c (Being the 2nd instalment received)		15,000	 15,000
	Interest A/c Dr. To Profit & Loss A/c (Being the interest credited to Profit & Loss Account)		2,603	 2,603

2015 Dec. 31	Interest Suspense A/c To Interest A/c (Being interest of 2014 credited to Interest Account)	Dr.	1,367	1,367
	Bank A/c To Eastern Collieries Ltd. A/c (Being the 3rd instalment received)	Dr.	15,000	15,000
	Interest A/c To Profit & Loss A/c (Being the interest credited to Profit & Loss Account)	Dr.	1,367	1,367

Working Notes: **(1) Calculation of Interest**

2013	₹	2014	₹	2015	₹
Cash Price	52,300	Balance b/d	26,030	Balance b/d	13,633
Less : Down Payment	15,000	Add : Interest @ 10%	2,603	Add : Interest @ 10%	*1,367
	37,300		28,633		15,000
Add : Interest @ 10%	3,730	Less : Instalment	15,000	Less : instalment	15,000
	41,030	Balance c/f	13,633		Nil
Less : Instalment	15,000			*Actual Interest comes to ₹ 1,363 but has been put at ₹ 1,367 for balancing purposes.	
Balance c/f	26,030				

(2) Total interest = ₹ 3,730 + ₹ 2,603 + ₹ 1,367 = ₹ 7,700.

Illustration 45

Burdwan Motor Service co. buys a motor car on instalment payment system from Hind Motors Ltd. on 1.1.2012 under which payment is to be made on December 31 for 4 years @ ₹ 50,000 per annum, interest being calculated at 5% p.a. The cash down price of the car is ₹ 1,77,300. Depreciate the car at 10% p.a. on the Diminishing Balance Method. Write-up the Motor Car Account, Vendor Account and the Interest Suspense Account in the Buyer's books over the first four years.

Solution **In the books of Burdwan Motor Service Co.**

Dr. **Motor Car Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Hind Motor Ltd. A/c	1,77,300	31.12.2012	By Depreciation A/c	17,730
			31.12.2012	By Balance c/d	1,59,570
		1,77,300			1,77,300
1.1.2013	To Balance b/d	1,59,570	31.12.2013	By Depreciation A/c	15,957
			31.12.2013	By Balance c/d	1,43,613
		1,59,570			1,59,570
1.1.2014	To Balance b/d	1,43,613	31.12.2014	By Depreciation A/c	14,361
			31.12.2014	By Balance c/d	1,29,252
		1,43,613			1,43,613
1.1.2015	To Balance b/d	1,29,252	31.12.2015	By Depreciation A/c	12,925
				By Balance c/d	1,16,327
		1,29,252			1,29,252

Dr. **Interest Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Hind Motor Ltd. A/c	22,700	31.12.2012	By Interest A/c	8,865
			31.12.2012	By Balance c/d	13,835
		22,700			22,700
1.1.2013	To Balance b/d	13,835	31.12.2013	By Interest A/c	6,808
			31.12.2013	By Balance c/d	7,027
		13,835			13,835
1.1.2014	To Balance b/d	7,027	31.12.2014	By Interest A/c	4,649
			31.12.2014	By Balance c/d	2,378
		7,027			7,027
1.1.2015	To Balance b/d	2,378	31.12.2015	By Interest A/c	2,378

Dr. Hind Motors Ltd. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Bank A/c	50,000	1.1.2012	By Motor Car A/c	1,77,300
31.12.2012	To Balance c/d	1,50,000		By Interest Suspense A/c	22,700
		2,00,000			2,00,000
31.12.2013	To Bank A/c	50,000	1.1.2013	By Balance b/d	1,50,000
31.12.2013	To Balance c/d	1,00,000			
		1,50,000			1,50,000
31.12.2014	To Bank A/c	50,000	1.1.2014	By Balance b/d	1,00,000
31.12.2014	To Balance c/d	50,000			
		1,00,000			1,00,000
31.12.2015	To Bank A/c	50,000	1.1.2013	By Balance b/d	50,000

Working Notes : (1) Calculation of Interest

2012	₹	2013	₹	2014	₹	2015	₹
Cash price	1,77,300	Balance b/f	1,36,165	Balance c/f	92,973	Balance c/f	47,622
Add: Interest @ 5%	8,865	Add: Interest @ 5%	6,808	Add: Interest @ 5%	4,649	Add: Interest @ 5%	*2,378
	1,86,165		1,42,973		97,622		50,000
Less: Instalment	50,000	Less: Instalment	50,000	Less: Instalment	50,000	Less: Instalment	50,000
Balance c/f	1,36,165	Balance c/f	92,973	Balance c/f	47,622	* Actual interest comes to ₹ 2,381, but has been put at ₹ 2,378 for balancing purposes.	

Illustration 46

Coconut Growers purchase a machinery on instalment basis from Y Machinery Co. Ltd., on the following terms :-

(a) Cash down payment at the time of signing the agreement on 1.1.2011 is ₹ 10,811.

(b) Five annual instalments of ₹ 7,700, the first to commence at the end of twelve months from the date of cash down payment.

(c) Interest at 10% p.a. is charged by the seller.

(d) Depreciation at 20% p.a. on WDV basis is written off on the machinery.

(e) Machinery is sold for ₹ 15,000 on the completion of payments of instalments.

(f) Accounting year ended on 31st December in each year.

Show the Machinery Account for the entire period.

Solution

In the books of Coconut Growers

Dr. Machinery Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1.1.2011	To Y Machinery Co. Ltd. A/c (Note 1)	40,000	31.12.2011	By Depreciation A/c	8,000
			31.12.2011	By Balance c/d	32,000
		40,000			40,000
1.1.2012	To Balance b/d	32,000	31.12.2012	By Depreciation A/c	6,400
			31.12.2012	By Balance c/d	25,600
		32,000			32,000
1.1.2013	To Balance b/d	25,600	31.12.2013	By Depreciation A/c	5,120
			31.12.2013	By Balance c/d	20,480
		25,600			25,600
1.1.2014	To Balance b/d	20,480	31.12.2014	By Depreciation A/c	4,026
			31.12.2014	By Balance c/d	16,384
		20,480			20,480
1.1.2015	To Balance b/d	16,384	31.12.2015	By Depreciation A/c	3,277
31.12.2015	To Profit & Loss A/c (Profit on Sale)	1,893	31.12.2015	By Bank A/c	15,000
		18,277			18,277

Working Notes: **(1) Calculation of Cash Price**

No. of instalments	Amount of instalment	Interest	Principal
5th	7,700	* 1/11 of ₹ 7,700 = ₹ 700	7,000 (7,700 – 700)
4th	7,700	1/11 of ₹ 14,700 = ₹ 1,336	6,364 (7,700 – 1,336)
3rd	7,700	1/11 of ₹ 21,064 = ₹ 1,915	5,785 (7,700 – 1,915)
2nd	7,700	1/11 of ₹ 26,849 = ₹ 2,441	5,259 (7,700 – 2,441)
1st	7,700	1/11 of ₹ 32,108 = ₹ 2,919	4,781 (7,700 – 2,919)
	₹ 38,500	₹ 9,311	29,189
		Add : Cash Down Payment	10,811
		Cash price	40,000

* Let the amount due at the beginning of the 5th year be ₹ 100. Interest is 10%, i.e., ₹ 10. Amount payable at the end of the 5th year is ₹ 100 + 10 = ₹ 110. Therefore, the ratio between interest and the amount due = 10/110 = 1/11. (See also Note 2).

(2) Calculation of the amount due at the year-end

5th year :	₹ 7,700
4th year : ₹ (7,000 + 7,700)	₹ 14,700
3rd year : ₹ (6,364 + 7,000 + 7,700)	₹ 21,064
2nd year : ₹ (5,785 + 6,364 + 7,000 + 7,700)	₹ 26,849
1st year : ₹ (5,259 + 5,785 + 6,364 + 7,000 + 7,700)	₹ 32,108

Illustration 47

On 1st January 2012 A sells a truck to B, on the instalment payment system, on the following condition :

(1) The purchase price of the truck is ₹ 1,00,000.

(2) This amount is payable to A in four equal annual instalments along with 12% interest per annum on the outstanding balance, the first instalment being payable on the date of sale.

B, in turn, hires out the truck to A for a monthly sum of ₹ 3,000 per month from 1st January 2012. The hire charges are to be adjusted at the end of each year against the amount due to A on account of principal and interest, any difference being settled in cash. B charges 20% depreciation (on the Written Down Value method) on the truck.

All payments are made as per the agreement. On 1st January 2014, the truck is sold by B to A for ₹ 15,000 in cash.

Show in B's books, the Truck Account, the Interest Suspense Account, the Hire Charges Account; the Interest Account and A's account.

Solution

In the books of B

Truck Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To A A/c	1,00,000	31.12.2012	By Depreciation A/c	20,000
			31.12.2012	By Balance c/d	80,000
		1,00,000			1,00,000
1.1.2013	To Balance b/d	80,000	31.12.2013	By Depreciation A/c	16,000
			31.12.2013	By Balance c/d	64,000
		80,000			80,000
1.1.2014	To Balance b/d	64,000	31.12.2014	By Depreciation A/c	12,800
			31.12.2014	By Balance c/d	51,200
		64,000			64,000
1.1.2015	To Balance b/d	51,200	1.1.2015	By Cash A/c	15,000
			1.1.2015	By Loss on Sale of Truck A/c	36,200
		51,200			51,200

Dr. **Interest Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To A A/c (Note 1)	18,000	31.12.2012	By Interest A/c	9,000
			31.12.2012	By balance c/d	9,000
		18,000			18,000
1.1.2013	To Balance b/d	9,000	31.12.2013	By Interest A/c	6,000
			31.12.2013	By Balance c/d	3,000
		9,000			9,000
1.1.2014	To Balance b/d	3,000	31.12.2014	By Interest A/c	3,000

Dr. **Hire Charges Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Profit & Loss A/c	36,000	31.12.2012	By A A/c	36,000
31.12.2013	To Profit & Loss A/c	36,000	31.12.2013	By A A/c	36,000
31.12.2014	To Profit & Loss A/c	36,000	31.12.2014	By A A/c	36,000

Dr. **Interest Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Interest Suspense A/c	9,000	31.12.2012	By Profit & Loss A/c	9,000
31.12.2013	To Interest Suspense A/c	6,000	31.12.2013	By Profit & Loss A/c	6,000
31.12.2014	To Interest Suspense A/c	3,000	31.12.2014	By Profit & Loss A/c	3,000

Dr. **A Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
1.1.2012	To Cash A/c	25,000	1.1.2012	By Truck A/c	1,00,000
31.12.2012	To Hire Charges A/c	36,000	1.1.2012	By Interest Suspense A/c (Note 1)	18,000
31.12.2012	To Balance c/d	57,000			
		1,18,000			1,18,000
31.12.2013	To Hire Charges A/c	36,000	1.1.2013	By Balance b/d	57,000
31.12.2013	To Balance c/d	23,000	1.1.2013	By Cash A/c (Note2)	2,000
		59,000			59,000
31.12.2014	To Hire Charges A/c	36,000	1.1.2014	By Balance b/d	23,000
			31.12.2014	By Cash A/c (Note 2)	5,000
			31.12.2014	By Balance c/d	8,000
		36,000			36,000
1.1.2015	To Balance b/d	8,000	1.1.2015	By Cash A/c	8,000

Working Notes :

(1) Calculation of interest : For 2012 on ₹ 75,000 @ 12% = ₹ 9,000; For 2013 on ₹ 50,000 @ 12% = ₹ 6,000; For 2014 on ₹ 25,000 @ 12% = ₹ 3,000. Total ₹ 18,000.

(2) Cash settlement

Date	Principal + Interest Due	Hire Charges	Cash received
1.1.2013	₹ 25,000 + ₹ 9,000 = ₹ 34,000	₹ 36,000	₹ 2,000
1.1.2014	₹ 25,000 + ₹ 6,000 = ₹ 31,000	₹ 36,000	₹ 5,000
1.1.2015	₹ 25,000 + ₹ 3,000 = ₹ 28,000	₹ 36,000	₹ 8,000

Key Points

- Under the Hire Purchase System the customer (called the Hire Purchaser) obtains possession of the goods at the outset and can use it, while paying for it by instalments over an agreed period of time.
- **Hire Vendor** : The seller in a hire purchase agreement.
- **Hire Purchaser** : The buyer in a hire purchase agreement.
- **Cash Price** : The amount to be paid on outright purchase in cash.
- **Down Payment** : Initial payment made at the time of signing the hire purchase agreement.
- **Hire Purchase Price** : The amount to be paid if the goods are purchased under the hire purchase system. It includes the cash price and interest of the future instalments.
- The entire profit on sale under hire purchase agreement is credited to the Profit and Loss Account of the year in which the sale has taken place. Interest pertaining to each accounting period is credited to the Profit and Loss Account of that year.
- **Hire Purchase Price** consists of two things : (i) cash price; and (ii) interest. Cash price is the capital expenditure incurred for the acquisition of an asset and (ii) interest is the revenue expense for the delay in making the full payment. Ascertainment of any of these two gives the answer for the other, e.g., if we ascertain the total amount of interest, it becomes very simple to ascertain the cash price just by deducting the interest from the hire purchase price

THEORETICAL QUESTIONS

1. What are the accouting procedures to be adopted in respect of the Hire Purchase System ?
2. What is meant by Hire Purchase System and how does it differ from the Instalment Payment System ?
3. State the nature of hire purchase agreement.
4. State para 4 of AS–19 in respect of hire purchase accounting.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below :

1. Each instalment including down payment (if any) is treated as hire charges by the
   A buyer
   B seller
   C none of these.
2. The hire purchaser can record the asset at its
   A hire purchase price
   B cash down price
   C none of these.
3. Interest is charged on the amount
   A outstanding
   B paid
   C none of these.
4. Assets are generally repossessed at a mutually agreed
   A value
   B current price
   C none of these.
5. Under instalment payment system, the seller treats the transaction as a
   A cash sale
   B credit sale
   C none of these.
6. Minimum lease payments are :
   (i) payments over the lease term, the lessee is to make
   (ii) contingent rent
   (iii) any residual value guaranteed by the lessee.
   Which of the following is correct ?
   A (i), (ii) and (iii)
   B (i) and (iii)
   C (i) and (ii)
7. Gross investment in the lease is the aggregate of the
   A minimum lease payments under finance lease from the stand point of the lessor
   B minimum lease payments under finance lease from the stand point of the lessor and any guaranteed residual value accruing to the lessor
   C minimum lease payments under finance lease from the stand point of lessor and any unguaranteed residual value accruing to the lessor
8. Leased assets appear in the Balance Sheet of the lessee in the case of
   A all leases
   B operating leases
   C finance leases
9. Lease liabilities are
   A long-term liability
   B current liability
   C split between A and B

10. At the beginning of the lease
    A major portion of the payment is principal, with a small element of interest
    B major portion of the payment is interest, with a small element of principal
    C the principal and interest payments are equal

PRACTICAL QUESTIONS

Hire Purchase System

Section A : Cash Price is Given

1. On January 1, 2013, Sharda purchased a machine from Kusum on a hire-purchase basis. The particulars are as follows:
   (a) Cash price ₹ 10,000.
   (b) ₹ 4,000 to be paid on signing the contract.
   (c) Balance in three instalments of ₹ 2,000 plus interest.
   (d) Interest charged on outstanding balance at 5%.
   (e) Depreciation at 5% p.a. on the Straight-line Method.
   Give Journal Entries and the necessary Ledger Accounts for the year ended on 31st December, 2013, 2014 and 2015 in the books of both the parties.
2. On 1st April, 2012, A Ltd. purchased a machine from B Ltd. on hire-purchase basis. The cash price of the machine was ₹ 20,000. the payment was to be made at ₹ 5,000 on delivery and the balance in 3 equal annual instalments of ₹ 5,000, plus interest at 5% p.a. payable on 31st December each year. A. Ltd. charges depreciation at 10% p.a. on the original cost. Show Ledger Accounts in the books of A Ltd.
3. On 1st January, 2014, Sun Co. Ltd. took delivery from Star Co. Ltd. five machines on hire purchase system. A sum of ₹ 200 per machine was paid on delivery and the balance was payable in five instalments of ₹ 300 each per machine, annualy on 31st December. The vendors charge interest at the rate of 5% p.a. on the yearly balances. The cash value of each machine was ₹ 1,500. Depreciation was provided @ 10% p.a. under the Reducing Balance Method.
   (i) Show the calculation of Interest and Depreciation.
   (ii) Write up the Machinery Account and the Vendor Account in the books of Sun Co. Ltd.
4. On 1st January, 2011, J. Colliery Company purchased one car from Hindusthan Motor Ltd. The cash down price of the car was ₹ 50,000. It was agreed that ₹ 5,000 would be paid on signing the agreement and the balance by 4 equal annual instalments of ₹ 12,500 each commencing from 31st December, 2011. Colliery Company closes its books on 31st December. Depreciation is charged on car @ 10% p.a. on the Diminishing Balance Method.
   Show the necessary Ledger Accounts in the books of Hindusthan Motors Ltd. for 4 years.
5. The Madras Transport Company purchases a motor car from Bombay Motor Ltd. on a hire-purchase agreement on January 1, 2012 paying cash ₹ 10,000, and agreeing to pay three further instalments of ₹ 10,000 each on December 31 each year. The cash price of the car is ₹ 37,250 and Bombay Motor Ltd. charges interest at 5% p.a. The Madras Transport Company writes off 10% p.a. as depreciation on the Reducing Balance Method.
   Prepare necessary Ledger Accounts in the books of Bombay Motors Ltd.
6. Indian Plastics Ltd. purchased one Tempo delivery van under hire-purchase agreement from Hindustan Auto Ltd. On January 1, 2012, payments were to be made of ₹ 2,000 on that date and the balance in three equal instalments of ₹ 4,000 each on January 1, 2013,2014 and 2015. The cash price of the van was ₹ 12,894. Interest was charged @ 5% p.a. on the yearly balances. The purchaser decided to charge 20% on the written down value as depreciation each year. Show the account in the books of Indian Plastics Ltd. for the four years ending December 31, 2015.
7. On 1st January 2012 Wellman Co. Ltd purchased a machine from Machinery Co Ltd. on the hire-purchase system. The cash price of the machine was ₹ 33,525. Wellman Co. Ltd. paid ₹ 9,000 forthwith and ₹ 9,000 on 31st December every year for three years. Interest at 5% and depreciation at 10% on the diminishing balances were charged.
   Show the Machine Account, Machinery Co.Ltd. Account and Interest Suspense Account in the books of Wellman Co. Ltd. for three years.
8. On January 1, 2012, A purchased a machine (under Hire Purchase System) from B valued at ₹ 37,000. A sum of ₹ 5,000 was paid at the time of signing the contract and the balance in four yearly instalments of ₹ 8,000 plus interest at 5% payable on 31st December each year. The machine was depreciated at 10% on Diminishing Balance Method.
   Show Machine Account, Interest Suspense Account and Vendor's Account for four years in the books of A.
9. On 1st January, 2013, Engineer purchased machinery from Marshall on hire purchase system, over a period of three years. ₹ 5,000 was payable on delivery on 1st January, 2013 and the balance by following instalments on 31st December in each year : 2013 — ₹ 10,000; 2014 — ₹ 10,000; 2015 — Balance amount.

Marshall charged interest at 10% p.a. on the yearly balances. The cash value of the machinery on delivery was ₹ 30,000. Depreciation at the rate of 20% p.a. on diminishing balances was written off in each year. Engineer paid all the instalments on the due date.

Show the Machinery Account and Marshall's Account in the books of Engineer for the three years to 31st December, 2015.

10. Sri S. Gupta acquired a machine on 30.6.2014 from B.C.Ltd. on hire-purchase system. The cash price of the machine was ₹ 17,000. The agreement provided that he would pay ₹ 4,000 on the delivery of the machine and the balance in six half-yearly instalments of ₹ 2,400 each. B.C.Ltd charged interest at 6% per annum on half-yearly balances. The buyer closed his books of account on 31st December every year. Assuming that he decided to write off depreciation on the machine at 10% per annum (on diminishing balance method), show necessary Ledger Accounts in the books of S.Gupta.

Section B : Cash Price is not given

11. On 1st January, 2013, Model Industries Ltd. purchased a machine from Ideal Machineries Ltd. under hire purchase agreement. The terms were that ₹ 4,780 would be paid on delivery, that is on 1st January, 2013, and the balance in three consecutive yearly instalments of ₹ 9,261 each, payable on 31st December each year. The instalments included interest @ 5% per annum on the balance of the cash down price due.

    Calculate the cash down price of the machine and show the Machinery Account (assuming depreciation was charged @ 10% under the Reducing Balance Method) and the account of Ideal Machineries Ltd. in the books of Model Industries Ltd.

12. A machine was purchased on the 'hire purchase system'. Under the terms of agreement, out of the total purchase consideration, ₹ 5,600 would be paid on the siging of the agreement and the balance by 5 annual instalments of ₹ 3,850 each (interest being reckoned on the unpaid balance at 10% p.a.). The first instalment was paid one year after the date of purchase of the machine. Calculate the Cash down price of the machine and show the Vendor's Account and the 'Interest Paid' Account in the books of the purchaser.

13. Roadmasters Ltd. sold a motor lorry to Transport Corporation Ltd. under a hire-purchase agreement. **Terms** : ₹ 20,000 on signing the agreement on 1st January, 2012 and ₹ 20,000 in annual payments thereafter on 1st January for three years. The annual payments included the interest chargeable at 5 per cent. Present value of Re. 1 per annum for five years at 5 per cent is ₹ 4.33. Show the Transport Corporation Ltd's Account in the books of Roadmaster Ltd.

14. Madras Taxi Services Co. Ltd. purchased 3 taxis on 1.1.2013 from the Auto Services, Madras on hire purchase system. It was agreed upon to make payment as under:-

1.1.2013	On signing agreement	₹ 10,350
31.12.2013	At the end of the first year	₹ 19,965
31.12.2014	At the end of the second year	₹ 19,965
31.12.2015	At the end of the third year	₹ 19,965
	Total hire purchase price	₹ 70,245

Nothing more was payable after the 3rd instalment.

All the instalments are duly paid by the Madras Taxi Services Co. Ltd. Interest was reckoned @ 10% p.a. Depreciation was charged @ 20% p.a. on diminishing balance. Madras Taxi Services close its books on 31st December every year. Prepare : (1) Auto Services Madras Account; (2) Taxi Account; and (3) Interest Account.

15. X Ltd purchased machinery on hire purchase system from Y Ltd on 1st January, 2013. The terms were that X Ltd would pay ₹ 20,000 down on signing the contract and 4 instalments of ₹ 11,000 each commencing from the beginning of the next year. X Ltd charged depreciation at the rate of 10% per annum on cost under diminishing balance system. Y Ltd charged interest at the rate of 10% per annum in their hire purchase contract. Prepare Machinery Account and Y Ltd Account for 5 years in the books of X Ltd.

Section C : Repossession of Goods

16. Transport Ltd. purchased three buses from Arvind motors costing ₹ 75,000 each on hire-purchase system. Payment was to be made for each bus ₹ 45,000 down and the remainder in three equal instalments together with interest at 12%. Transport Ltd. wrote off depreciation at 20% on diminishing balance. It paid the first instalment at the end of the first year but could not pay the next. Arvind Motors agreed to leave one bus with the purchaser adjusting the value of the other two buses against the amount due. The buses were valued on the basis of 30% depreciation annually on Straight Line Method.

    Show the necessary entries in the books of Transport Ltd.

17. On 1st April 2014 X & Y Co. Ltd. acquired 4 machines of ₹ 50,000 each on hire-purchase system from Z Co. Ltd. The terms included cash down payment of ₹ 50,000 and payment of the balance in 3 equal annual instalments together with interest at 10% p.a.

    X & Y Co Ltd. paid the first instalment but failed to pay thereafter. The machines were depreciated at 20% p.a. on diminishing balance method.

Z Co. Ltd. agreed to leave two machines with X & Y Co. Ltd. and adjust the value of the two machines against the outstanding amount after depreciating the machines taken over at 30% p.a. on diminishing balance method.
The taken over machines were sold for ₹ 1,20,000 after incurring renovation expenses of ₹ 10,000.
Show Ledger Accounts in the books of both the parties assuming that the books are closed on 31st Dec. every year.

18. X purchased seven trucks on hire-purchase on 1.7.2014. The cash purchase price of each truck was ₹ 50,000. He was to pay 20% of the cash purchase price at the time of delivery and the balance in five half-yearly instalments starting from 31.12.2014 with interest @ 5% p.a.
On X's failure to pay the instalment due on 30.6.2015 it was agreed that X would return three trucks to the vendor and the remaining four would be retained by him. The vendor agreed to allow him a credit for the amount paid against these three trucks less 25%.
Show the relevant accounts in the books of X assuming that his books are closed in June every year and depreciation @ 20% is charged on trucks.

Section D : Hire Purchase Trading

19. Refrigeration Limited trade in refrigerators on hire-purchase system and the accountant furnished the following information for the year 2014 :

	₹		₹
Jan 1. Stock in shop	10,000	Dec. 31 Stock in shop	14,000
Instalments due and unpaid	6,000	Instalments due and unpaid	10,000
Stock out with customers on H.P. price	80,000	Stock out with customers on H.P. price	92,000
		Cash received during the year	1,60,000

He further stated that the company makes a gross profit of one third on cost. You are required to prepare the Hire Purchase Trading Account to ascertain the profits for the year.

20. CEE Ltd. has a hire purchase department. Goods are sold on hire purchase at cost plus 40%. From the information given below, prepare Hire Purchase Trading Account in the books of CEE Ltd :

	₹
1.7.2014 Goods out on H.P. (at H.P. price)	21,000
During the year ended 30th June, 2015:	
Goods sold on H.P. (at H.P. price)	1,05,000
Cash received	70,000
Goods received back valued at (hire purchase instalments unpaid ₹. 2,800)	800
30.6.2015 Goods with H.P. Customers (at H.P. price)	45,500

21. Rosemary Enterprises sells its merchandise under hire purchase schemes. Legal title to the goods is not relinquished until the customer fully pays the instalments.
A summary of the transactions of the firm for first four years of its existence is given below (all figures in ₹):

	2012	2013	2014	2015
Sales on H.P. basis	6,66,000	9,50,000	10,20,000	11,04,000
Opening Stock	—	1,20,000	1,60,000	2,40,000
Stock at close	1,20,000	1,60,000	2,40,000	3,20,000
Purchases	6,75,000	8,00,000	8,55,000	9,20,000
Amounts realised from customers :				
2012 Sales	2,20,000	2,80,000	1,00,000	55,000
2013 Sales	—	4,00,000	2,80,000	2,00,000
2014 Sales	—	—	4,80,000	4,00,000
2013 Sales	—	—	—	3,50,000

Indicate the realised gross profit for each of the years.

22. A Ltd. which sells a product on hire-purchase terms has the following transactions for the year ending on December 31, 2014. The gross profit is 25% on selling price (figures in ₹):

Jan. 1 Stock on hire at H.P. price	4,000	Dec. 31 Stock on hire at H.P. price	4,600
Stock in hand (in the shop)	500	Stock in hand (in the shop)	700
Instalments due (customers still paying)	300	Instalments due	500
		Cash received in instalments during the year	8,000

You are required to prepare Hire Purchase Trading Account to ascertain the profit for the year 2014.

23. Choudhury Brothers commenced business on 1.7.2014. During the year ended 30.6.2015, purchases amounted to ₹ 1,08,000 and ordinary sales to ₹ 1,24,000. In addition, the following sales were made under hire purchase arrangements—

Article	Cost ₹	Sale Price ₹	Deposit Paid ₹	Monthly Instalments ₹	Instalments paid during the year
Television set	3,000	4,500	500	20 of ₹ 200	8
Washing machine	4,000	6,000	600	12 of ₹ 450	2
Refrigerator	3,500	5,000	500	18 of ₹ 250	4

Instalments on the refrigerator could not be kept up and it was retruned on 30.6.2015. Stock in trade at 30.6.2015, excluding the returned refrigerator, amounted to ₹ 14,000. Prepare the Hire Purchase Trading Account, Memorandum Hire Purchase Debtors Account and the General Trading Account for the year ended 30.6.2015.

24. Mr. Bholla commenced business on 1st January, 2014. He effected sales in cash as well as on a hire-purchase basis. During the year 2014, his purchases amounted to ₹ 14,500. The cash sales were for ₹ 12.000. the following items were sold on a hire-purchase basis as per particulars below: (all figures in ₹)

	Cost	Sale Price	Initial Payment	Instalments paid during the year
Radio	200	350	50	125
Cycle	210	350	75	125
Encyclopaedia	400	600	100	150

The instalments on the encylopaedia could not be kept up and the same was repossessed on August 31, 2014. The closing stock including the encylopaedia amounted to ₹ 5,000.
Prepare the Hire-Purchase Trading Account; Memorandum Hire Purchase Debtors' Account and the General Trading Account for the year ending December 31, 2014.

25. A manufacturing company purchased machinery on hire-purchase basis on 1st June, 2014. Soon after the installation the machine gave trouble and finally broke down on 14th August, 2014. The suppliers agreed to replace the machine. A new agreement was signed for that purpose and a sum of ₹ 500 was paid for cancelling the first agreement by the manufacturing company. The following are the necessary particulars :

Particulars	1st Machine	2nd Machine
1. Date of Purchase	1.6.2014	31.8.2014
2. Cash Price	35,000	42,860
3. Initial Payment	6,920	—
4. Allowance for payments made under cancelled agreement	—	9,500
5. Hire charges	3,240	3,840
6. Hire Purchase price	38,240	46,700
7. Number of Instalments	18	24
8. Instalment payable every month commencing on	1.7.2014	1.10.2014
9. All payment were made on due dates		
10. Ignore depreciation on machinery		

You have to prepare the following Ledger Accounts in the books of the manufacturing company for the year ending 31st March, 2015 :
(a) Machinery on H. P. Account (b) Hire-Purchase Company's Account (c) Hire-Purchase Disposal Account
(d) Hire-Purchase Interest Suspense Account.

26. A company sells goods on hire-purchase on the basis of 25% down, the balance, with 20% interest thereon being payable in 8 equal quarterly instalments on 31st March, 30th June, 30th September and 31st December each year. The first instalment is payable at the end of the quarter in which the sale is made. The company transfers 50% , 30% and 20% of the interest to the Profit and Loss Account in the first , second and third years respectively.

Balance on 1.1.2014	₹
Hire Purchase Debtors	75,735
Hire Purchase Interest Suspense	9,900

Hire-Purchase sales (exclusive of Interset), which have evenly occured over each of the three calender years, are :
2012 — ₹ 80,000; 2013 — ₹ 1,00,000; 2014 — ₹ 76,000.
All dues were promptly paid in each year.
Make out for the year 2014.
(1) Hire-Purchase Debtors Account.
(2) Hire-Purchase Interest Suspense Account and prove the opening and closing balances of the latter account.

27. X commenced business on 1.1.2013 selling television sets for cash as well as hire purchase basis.
He started with a capital of ₹ 4,50,000 and acquired leasehold premises with a 10-year life for a premium of ₹ 2,40,000, furnitures and fittings for ₹ 1,50,000 and a motor van. The motor van was acquired under a hire purchase contract. The terms were : Cash price ₹ 1,20,000; Deposit ₹ 30,000 payable on 1.1.2013; Interest rate 10% p.a.; Three equal instalments on 31st December in 2013, 2014 and 2015.
The lease and fixtures are to be depreciated over the life of the lease and the motor van is to be depreciated @ 25% p.a. on the reducing balance.
During the period 1.1.2013 to 30.4.2013, the number of sets sold were :

	January	February	March	April
Cash Sales	20	60	90	120
Hire Purchase Sales	—	30	60	90

The prices and terms of purchase and sale were :
Cost price ₹ 3,000; Cash price ₹ 4,200; Hire purchase price ₹ 5,000. Hire purchase terms — deposit of ₹ 1,700 payable on the day of sale followed by 11 monthly instalments of ₹ 300 starting in the month following the sale.
During the period 1.1.2013 to 30.4.2013, the following payments were made:
Wages to sales assistant ₹ 68,400; Rent and other expenses ₹ 1,00,000; Suppliers ₹ 11,25,000.
On 30.4.2013, the firm repossessed 3 television sets that had been sold on hire purchase on 1.2.2013 and on which only 1 instalment has been paid. X valued the 3 repossessed sets at ₹ 700 each. X decided to take credit for gross profit in proportion to cash received in the accounting period and to spread interest evenly over the life of the agreement, except for repossessed sets when it was proposed to deal with them separately and to include profit or loss on repossession as a separate item in the Profit and Loss Account.
There were 40 television sets on hand at 30.4.2013 excluding the sets that had been repossessed.
Prepare a Trading and Profit and Loss Account for the period 1.1.2013 to 30.4.2013 which shows clearly the separate contributions from cash and hire purchase sales, and a Balance Sheet as at 30.4.2013.

28. Majestic & Co. commenced business on January 1, 2014 dealing in radio sets and record players. They sell goods both directly as well as on hire purchase. You are furnished with the following information for the year ended 31st December, 2014:

	Radio sets		Record players	
Purchases	No.	1,000		100
Sales: Direct for cash	No.	800		50
On hire purchase	No.	40		20
To employees as explained below	No.	3		2
Purchase cost per unit	₹	400	₹	1,200
Direct sales price per unit	₹	500	₹	1,500
Terms of hire purchase sale:				
Cash down at the time of delivery	₹	100	₹	300
Monthly instalments	₹	50	₹	150
Number of instalments		10		12
Instalment collected		260		110
Instalments due but not yet collected		15		10

During the year the firm repossessed 3 radio sets and 2 record players for failure to pay the instalments. The hire purchase customers had paid only 4 instalments each in respect of these radio sets and record players. At the time of repossession, the radio sets were valued at ₹ 200 each and the record players were valued at ₹ 500 each. The firm spent ₹ 30 per radio set and ₹ 70 per record player on reconditioning. These sets were sold to employees at a concessional rate of ₹ 300 per radio set and ₹ 700 per record player and the amount was recovered from their salaries before the close of the year.
You are required to prepare columnar :
(i) Hire Purchase Trading Account; (ii) Goods sold on Hire Purchase Account; (iii) Purchases Account; (iv) Goods Repossessed Account; and (iv) General Trading Profit and Loss Account.

Section E : Stock and Debtors Method

29. Ramchandra sells goods on hire purchase at cost plus 50%. From the following particulars relating to the hire purchase department find out the profit for the year ending 31st December, 2014 by following stockand debtors system (all figures in ₹):

Jan 1. Stock with hire purchase customers at S.P.	4,500	Dec. 31 Cash received from customers	30,000
Stock at shop at cost	9,000	Instalments due, customers paying	4,500
Instalments due	2,500	Goods repossessed (inst. due: ₹ 1,000) valued at	250
		Stock at shop at cost (exc. repossessed goods)	10,000
		Goods purchased during the year	30,000

30. Y Ltd. sells products on hire purchase terms, the price being cost plus $33^{1}/_{3}\%$. From the following particulars for 2014, prepare Hire Purchase Stock Account, Shop Stock Account, Hire Purchase Debtors Account, Stock Reserve Account and Hire Purchase Adjustment Account (for profit) (all figures in ₹):

Jan 1. Stock out on hire at H.P. price	1,20,000	Dec. 31 Stock out on hire at H.P. price	1,38,000
Stock in hand, at shop	15,000	Stock in hand at the shop	21,000
Instalments due (customers still paying)	9,000	Instalments due (customers still paying)	15,000
		Cash received during the year	2,40,000

31. The hire purchase department of New Appliances Ltd. sells television sets and room coolers. This department was started in 2014. The relevant information for the year ended 31st December, 2014 is as follows :-

Particulars	Television	Room Cooler	Particulars	Television	Room Cooler
Cost	5,400	2,000	Monthly Instalment	600	200
Cash Price	6,300	2,400	Number of instalments	10	12
Cash down payment	900	400			

During the year, 200 television sets and 240 room coolers were sold on hire purchase basis. Four television sets on which only 3instalments could be collected and 8 room coolers on which 5 instalments had been collected were repossessed. These were valued at ₹ 20,000; after reconditioning at a cost of ₹ 2,000, they were sold out-right for ₹ 28,000. Other instalments collected and those due customers still paying were respectively as : Television sets 540 and 40; Room coolers 800 and 60.

Prepare accounts on Stocks and the Debtors system to reveal the profit of the department. Show your workings.

32. R M Khan opened a business dealing in a new type of power tool of which there was one model only.

The cost price of each tool is ₹ 4,000 and he deals with them in the following ways :

(a) sells for cash from the shop for ₹ 5,600 each;

(b) sell on hire purchase when the HP selling price is ₹ 6,400, comprising a deposit of ₹ 1,600 and 8 quarterly instalments of ₹ 600 each, credit being taken immediately for the gross profit and each instalment being regarded as containing ₹ 100 interest, earned when the instalment is paid.

During the first year he bought 350 tools and these can be accounted for as follows :

Particulars	Tools
Sold for cash from shop	188
Sold on HP terms, the agreements still continuing	100
Repossessed from HP customers	2
In stock at the shop at year-end	60
	350

A summary of the cash receipts during the year shows :

Particulars		₹
Cash sales from shop		10,52,800
Hire purchase sales :		
40 — deposit only	64,000	
60 — deposit and 2 instalments	1,68,000	
	2,32,000	
Less: Instalments outstanding	3,000	2,29,000
Hire purchase repossessions — 2 deposits and one instalment each received before repossession		4,400
		12,86,200

The two tools which have been repossessed are added to the stock at the year-end at a value of ₹ 3,000 each.

When the business was started in January 2014, Khan brought in ₹ 15,00,000 cash as his capital. He has paid for all the 300 tools and also ₹ 2,50,000 as working expenses. There are no assets or liabilities other than these arising from the above. Khan has drawn from business ₹ 2,00,000 for his own use during the year.

You are required to prepare the Trading and Profit and Loss Account for the first year of business; and a Balance Sheet at 31st December, 2014.

Section F : Instalment Payment System

33. On 1st January 2014, Sincomed Company purchased three machines from the Chemical Machineries Ltd. under instalment payment system. The cash down price of each machine was ₹ 8,865. The total amount was paid in four equal instalments of ₹ 7,500 on 31st Decmber every year. The Chemical Machineries Ltd. charged interest at 5% per annum. Charge depreciation at 10% per annum on the diminishing balances. Show the Machine Account, Chemical Machineris Ltd. Account and Interest Suspense Account in the books of the purchasing company.
34. Youth Club purchases a T.V. costing ₹ 4,500 on instalment payments system on 1st January, 2012, from S. E. C. Company. It is agreed that ₹ 1,500 will be paid on signing the agreement and the balance in 3 equal annual instalments together with interest. Interest is charged at 10% per annum. Depreciation is charged at 15% per annum on diminishing balance method. Show T.V. Account and S. E. C. Company Account in the books of Youth Club for 3 years.
35. On 1st January, 2013, the Black Colliery Co. Ltd. purchased five wagons on the instalment system from Burn & Co Ltd. The cash price of the wagons was ₹ 7,45,000 and ₹ 2,00,000 was to be paid on signing the agreement and the balance in 3 instalments of ₹ 2,00,000 each at the end of each year. Interest is charged at 5% p.a. by the Burn & Co Ltd. The company has decided to write off 10% annually on the Diminishing balance of the cash value. Make the entries and open the necessary accounts in the books of the Black Colliery Co. Ltd. and Burn & Co. Ltd.
36. Buyers Ltd. purchased a truck on 1st January, 2014 on the instalment payment system, from Vendors Ltd. The cash down price was ₹ 3,00,000. The terms of the purchase were as under :
    (i) ₹ 1,20,000 is payable as deposit.
    (ii) The balance being payable by 12 quaterly instalments of ₹ 19,200 each following due from 1st April, 2014. The financial year of Buyers Ltd. ends on 30th June.

    On 30th September, 2015, the truck was sold for ₹ 2,00,000 and the balance instalment was settled for ₹ 1,02,000. Buyers Ltd. spreads the interest equally over the instalment period. Depreciation at 20% p.a. on cost was provided upto the date of sale.

    Show Truck Account; Vendors Ltd. Accounts and Interest Suspense Account in the books of Buyers Ltd.

Guide to Answers

Multiple Choice

1. (b); 2. (b); 3. (a); 4. (a); 5. (b); 6. B; 7. B; 8. C; 9. C; 10. B.

Practical Questions

1. **Last instalment — ₹ 2,100.**
2. **Last instalment — ₹ 5,250.**
3. **Interest : 1st year — ₹ 65; 2nd year — ₹ 53; 3rd year — ₹ 41; 4th year — ₹ 28; and 5th year — ₹ 13 (Adjusted).**
4. **Total interest ₹ 5,000 [(₹ 12,500 $\times$ 4 + ₹ 5,000) – ₹ 50,000]. Interest to be charged — 1st year : ₹ 2,000; 2nd year : ₹ 1,500; 3rd year : ₹ 1,000; and last year : ₹ 500. (please see Illustration 20 for help)**
5. **Interest — 1st year : ₹ 1,364; 2nd year : ₹ 931; last year : ₹ 455. Interst of ₹ 22 has been adjusted in the last instalment.**
6. **Interest — 2013 : ₹ 545; 2014 : ₹ 372; and 2015 : ₹ 189. Interest of ₹ 2 has been adjusted in the last instalment.**
7. **Interest — 2012 : ₹ 1,226; 2013 : ₹ 838; 2014 : ₹ 411. (Interest of ₹ 18 has been adjusted in the last instalment).**
8. **1st instalment : ₹ 9,600; 2nd instalment : ₹ 9,200; 3rd instalment : ₹ 8,800; and last instalment : ₹ 8,400.**
9. **Amount payable in 2015 : ₹ 10,175.**
10. **Interest in each instalment : ₹ 390; ₹ 330; ₹ 268; ₹ 204; ₹ 138; ₹ 70.**
11. **Cash price : ₹ 30,000.**
12. **Cash price : ₹ 20,200 (approx.)**
13. **Cash price : ₹ 1,06,600 (4.33 $\times$ ₹ 20,000 +₹ 20,000).**
14. **Cash price : ₹ 60,000. Interest — 2013 : ₹ 4,965; 2014 : ₹ 3,465; 2014 : ₹ 1,815.**
15. **Cash price : ₹ 54,869.**
16. **Loss on surrender : ₹ 36,000; Value of repossessed buses : ₹ 60,000; Balance of Arvind Motors Account : ₹ 7,200 .**
17. **Loss on surrender : ₹ 15,000. Value of repossessed machinery : ₹ 49,000. Balance of Z Co. Ltd. : ₹ 61,000; Balance of Machinery Account : ₹ 64,000 on 31.3.2013.**
18. **Loss on repossession : ₹ 79,500; Credit allowed for 3 trucks : ₹ 40,500. Balance of Truck Account as on 30.6.2013 : ₹ 1,60,000.**
19. **H.P. Trading : Gross profit : ₹ 41,000.**
20. **H.P. Trading : Gross profit : ₹ 21,000; Instalments due : ₹ 7,700.**
21. **Gross profit rate — 2012 : 16.67%; 2013 : 20%; 2014 : 24%; 2015 : 23.91%. Amount of gross profit — 2012 : ₹ 36,667; 2013: ₹ 1,26,667; 2014 : ₹ 1,87,867; 2015 : ₹ 2,28,852.**
22. **H.P. Trading : Gross profit : ₹ 2,050; Instalments due : ₹ 8,200; Goods sold on H.P. : ₹ 8,800; and its cost ₹ 6,600. Stock reserve : ₹ 1,150.**
23. **H.P. Trading : Gross profit : ₹ 1,650; General Trading — Profit : ₹ 40,500. H.P. Stock with customers : ₹ 4,600.**
24. **H.P. Trading : ₹ 238; H.P. Stock : ₹ 190; General Trading Profit (G.P.) : ₹ 3,077.**
25. **Balance of Machinery on H.P. Account on 31st March, 2015 — ₹ 42,860. Balance of Hire Purchase Company Account on 31st March, 2015 : ₹ 27,900. Balance of Interest Suspense Account on 31st March, 2015 : ₹ 1,959. Loss on disposal of Machine: ₹ 737.**

26. **Total instalments received in 2014 : ₹ 79,875; Outstanding instalments on 31.12.2014 : ₹ 63,900. Instalment credited to Profit and Loss Account : ₹ 12,600 ₹ (2,400 + 4,500 + 5,700). Sales : ₹ 87,400 ₹ (76,000 + 11,400).**
27. **Gross Profit : Cash ₹ 3,48,000; H.P. ₹ 80,424; Net Profit : ₹ 2,52,524; Total of Balance Sheet ₹ 12,00,524.**
28. **Net Profit : Radio Sets—₹ 86,127; Record Player—₹ 25,174; Total—₹ 1,11,301.**
Cash Received : ₹ 39,500; H.P. Profit : Radio Sets—₹ 5,917; Record Player—₹ 9,914; Total—₹ 15,831.
29. **H.P. Profit : ₹ 10,250; Instalments due during the year : ₹ 33,000.**
30. **H.P. Profit : ₹ 61,500; Instalments due during the year : ₹ 2,46,000; Purchases : ₹ 2,04,000.**
31. **H.P. Profit : ₹ 2,00,057; Total Stock Reserve : ₹ 2,89,943.**
32. **Gross Profit — ₹ 4,72,300; Net Profit — ₹ 2,24,700; Balance Sheet Total — ₹ 17,24,700.**
33. **Interest — 1st year : ₹ 1,330; 2nd year : ₹ 1,021; 3rd year : ₹ 697; and 4th year : ₹ 355 (₹ 2 has been adjusted).**
34. **Interest — 1st year : ₹ 300; 2nd year : ₹ 200; 3rd year : ₹ 100. Last instalment : ₹ 1,100.**
35. **Interest — 1st year : ₹ 27,250; 2nd year : ₹ 18,612; 3rd year : ₹ 9,138 (₹ 405 has been adjusted).**
36. **Interest suspense — ₹ 50,400; Interest charged to Profit and Loss Account — 30.6.2014 : ₹ 8,400; 30.6.20135: ₹ 16,800; 30.6.2016 : ₹ 12,000. Interest adjusted against Vendors Ltd. : ₹ 13,200.**

36

Departmental Accounts

Introduction

A business is generally split up into a number of departments when it sells different types of goods or carries on several activities under the same roof. Such departments are found in businesses of all sizes (particularly in urban areas). A department is generally a physical part of the rest of the business. It should not be assumed that departmental accounts refers only to departmental stores. In fact, they refer to the verious facets of a business. Each department is treated as a separate ***profit centre***, though none of the departments is separated geographically from the rest of the departments. This type of organisational subdivision creates a need for internal information about the operating results of each department. Since different departments may have different rates of growth, profitability and degrees of risk, managerial decisions in regard to pricing, closure etc. can be made on the basis of such information.Therefore, the various pros and cons of the actions to be taken to increase the over all profitability of the business concern can not be properly considered until the departmental profits and losses are known.

Advantages of Departmental Accounting

The main advantages of departmental accounting are as follows:

1. The performance of each department can be evaluated separately on the basis of trading results. An endeavour may be made to push up the sales of that department which is earning maximum profit.
2. It helps the management to decide whether to drop a department or add a new one.
3. The growth potential of a department as compared to others can be evaluated.
4. More detailed information can be provided to the users of the accounting information like the shareholders, investors, creditors etc.
5. Friendly rivalry between different departments may help to increase the overall profit of the organisation.
6. Departmental managers and staff can be rewarded properly on the basis of results.
7. It helps the management to determine the justification of capital outlay in each department.
8. It facilitates the comparison of expense items with those in other departments and in the previous period.

9. It helps to calculate stock turnover ratio of each department separately, and thus the efficiency of each department can be revealed.
10. Departmental accounting information also provides a basis for intelligent planning and control.

Methods of Departmental Accounts

In order to ascertain the departmental profit accurately, it is necessary to identify the different expenses and revenues of each department. The accounting system must be designed in such a manner that it provides maximum information and is simple to operate.

There are two methods of keeping Departmental Accounts:

(a) where separate set of books are kept for each department; and
(b) where accounts of all the departments are kept together on columnar books.

(a) Where Separate Set of Books are Kept for Each Department

This method of accounting is employed when the size of the organisation is very large or the law of the land requires the maintenance of separate books for each department. For example, in India, general insurance company is required to prepare separate revenue account for each type of business — fire, marine, accidents, etc.

Under this method each department is regarded as a separate unit and accounts are kept independently. At the year end the trading results of all the departments are combined to get the trading results of the organisation as a whole. This method is rarely used and is also expensive in operation.

(b) Where Accounts of All Departments are Kept Together on Columnar Books

When the size of the organisation is small, the entire book keeping system for the business as a whole is generally kept by a central accounts department.

A department does not maintain a full double-entry book-keeping system of its own, but some records are normally kept regarding purchases, sales and direct expenses, stock within the department, etc. The central accounts department generally maintains an analytical or columnar Purchase and Sales Day Book to distinguish between the purchases and sales of different departments.

After ascertaining purchases and sales of each department and also the direct expenses incurred, it only requires a departmental closing stock-taking in order to prepare a Trading Account for each department. Following is a specimen of Departmental Trading Account.

ABC Departmental Store Ltd.

Dr. Departmental Trading Account for the year ended ... Cr.

Particulars	Dept. A	Dept. B	Dept. C	Total	Particulars	Dept. A	Dept. B	Dept. C	Total
To Op. Stock	4,000	10,000	15,000	29,000	By Sales	50,000	70,000	80,000	2,00,000
To Purchases	37,000	45,000	55,000	1,37,000	By Cl. Stock	10,000	5,000	20,000	35,000
To Direct Exp.	10,000	5,000	5,000	20,000					
To G. P. c/d	9,000	15,000	25,000	49,000					
	60,000	75,000	1,00,000	2,35,000		60,000	75,000	1,00,000	2,35,000
Gross profit ratio	15%	20%	25%						

Under this system, the ***gross profit*** of individual department can be determined accurately. Where it is desired to determine the departmental net profit in addition to the gross profit, each department is charged with a share of the common expenses which is apportioned on a suitable basis.

Allocation of Departmental Expenses

In practice, the following general rules are usually applied for allocation and apportionment of expenses:

1. Expenses directly related to a particular department should be charged to that department. For example, salary of employees of a particular department or bad debts from the sale of a particular department can be charged to the concerned department directly.

2. The expenses which have a direct bearing with the sales should be apportioned on the basis of net sales. For example, advertisement expenses should be apportioned on the basis of departmental sales to outside customers.
3. All other business expenses, e.g. rent, rates, lighting, heating, depreciation, insurance etc. should be apportioned on the most logical basis. The nature of the expense, and the nature of the business will determine the basis for apportionment of expenses. The basis for apportionment of some important expenses are given below:

Sl.	Expenses	Basis
1.	(a) Travelling salesman's salary and commission (b) Selling expenses (c) After-sales service (d) Discount allowed (e) Freight outwards (f) Provision for discounts on debtors (g) Sales manager's salary and other benefits	Sales of each department
2.	(a) Rent, rates and taxes (b) Air conditioning expenses (c) Heating	Area or value of floor space
3.	Lighting	Light points
4.	Insurance on Stock	Average stock carried
5.	Insurance on Building	Area
6.	Insurance on Plant & Machinery	Value of Plant & Machinery
7.	Group insurance premium	Direct wages
8.	Power	H.P. or H.P. x Hours worked
9.	(a) Depreciation (b) Repairs and renewals	Value of assets in each department
10.	(a) Canteen expenses (b) Labour welfare expenses	Number of employees
11.	Works manager's salary	Time spent in each department
12.	Carriage inwards	Purchases of each department

There are certain types of expenses, most being of a financial nature, which cannot be apportioned on a suitable basis. Examples are loss on sale of investment or assets, damages payable for the infringement of law, interest on bank loan etc. There are also some purely financial incomes which cannot be suitably apportioned among different departments. To ascertain the total profit of a business as whole profits from all the departments should be added. If department(s) suffers a loss, it should be deducted from the total profits of the other departments. This figure should be brought down in one total and all the expenses should be deducted from that figure to arrive at the net profit.

Technique of Departmental Accounts

Columnar Purchases and Sales Books, etc. (Manual System)

If the number of departments are small, it is convenient to use columnar or analytical Purchase Day Book and Sales Day Book for recording credit purchases and credit sales of each department. Return Inwards Book and Return Outwards Book are ruled in a similar manner. For recording cash sales and cash purchases, special columns are also provided in the Cash Book.

Purchases Day Book

Date	Particulars	Invoice No.	L.F.	Total ₹	Departments		
					A	B	C
2013							
April 4	Century Mills Ltd.	19 / 11		40,000	—	—	40,000
18	Bombay Dyeing Ltd.	14 / 11		50,000	50,000	—	—
30	Raymond's Mills Ltd.	17 / 11		60,000	—	60,000	—
				1,50,000	50,000	60,000	40,000

The total monthly purchases of each department are posted to the debit of the respective Department's Purchases Account. The Suppliers' Account is credited in the usual manner.

In the General Ledger the Purchases Account will appear as follows:

Dr. **Purchases Account** **Cr.**

Date	Particulars	Departments			Date	Particulars	Departments		
		A	B	C			A	B	C
30.4.2013	To S. Creditors A/c	50,000	60,000	40,000					

The same ruling will do for Sales Day Book, Returns Inwards Book and Returns Outwards Book.

Computerised System

If the number of departments are very large, the use of separate journal column for each department would result in journal of unmanageable size. Now-a-days almost all large departmental stores are using computer to record transaction data directly into a computerised accounting system. With the help of computer terminals each department enter sales information into a main computer at the time each sale is rung up. Journals, ledgers and other reports are prepared at the end of each month for the use of the management.

Distinction between Departmental Accounts and Branch Accounts

1. In case of a dependent branch, all important accounting records are kept at the head office. The branch maintains only Cash Account and Customers Account (if necessary). However, an independent branch, usually maintains its own books of account and prepares its own Trading and Profit and Loss Account. In case of Departmental Accounts, all accounting records are maintained at one place and Departmental Trading and Profit and Loss Account is prepared accordingly.
2. As the departments are not geographically separated from each other, the problem of allocation of common expenditure among different departments arises. But in case of a branch account this problem of allocation of common expenditure does not arise since branches are geographically separated from each other.
3. In case of an independent branch, at the end of the accounting year, some adjustment and reconciliation of head office and branch accounts are required. In case of Department Accounts, the question of adjustments and reconciliation of accounts does not arise.
4. At the time of finalisation of accounts of head office, the conversion of foreign branch figures may create some problems. In case of Departmental Accounts, this type of problem does not arise.

Illustration 1

The following balances as at 31.12.2014 have been extracted from the books of Sri Ram & Co which has two departments:

Particulars	Dept. A (₹)	Dept. B (₹)
Opening Stock as on 1.1.2014	25,000	20,000
Purchases	2,30,000	1,90,000
Purchase Returns	2,000	1,000
Sales	6,33,000	4,92,000
Sales Returns	3,000	2,000
Wages	1,80,000	1,60,000
Miscellaneous Charges	35,000	32,000

General:

Sundry Debtors — ₹ 1,90,000; Sundry Creditors — ₹ 1,73,000; Plant and Machinery — ₹ 2,40,000; Leaseholds — ₹ 80,000; Buildings — ₹ 1,20,000; Furniture and Fittings — ₹ 48,000; Office and Selling Expenses — ₹ 1,28,000; Cash in hand on 31.12.2014 — ₹ 8,000; Cash at Bank on 31.12.2014 — ₹ 1,10,000; Capital — ₹ 5,00,000.

Plant and Machinery is to be depreciated by 10%; Buildings by 2%; Furniture and Fittings by 5%; Leaseholds are to be written-off by ₹ 8,000. The stock on hand as on 31.12.2014: Department A — ₹ 26,000; Department B — ₹ 24,000.

All unallocated expenditure is to be apportioned in the ratio of the net sales of each department.

Prepare in columnar form, the Trading, Profit and Loss Account of the two departments and Balance Sheet of the combined business as a whole on 31.12.2014.

Solution

Sri Ram & Co

Dr. Departmental Trading and Profit & Loss Account for the year ended 31st December, 2014 Cr.

Particulars	Dept A	Dept B	Particulars	Dept A	Dept B
To Opening Stock	25,000	20,000	By Sales less returns	6,30,000	4,90,000
To Purchases less returns	2,28,000	1,89,000	By Closing Stock	26,000	24,000
To Wages	1,80,000	1,60,000			
To Gross Profit b/d	2,23,000	1,45,000			
	6,56,000	5,14,000		6,56,000	5,14,000
To Miscellaneous Charges	35,000	32,000	By Gross Profit b/d	2,23,000	1,45,000
To Depreciation:					
On Plant & Machinery	13,500	10,500			
On Furniture & Fittings	1,350	1,050			
On Building	1,350	1,050			
To Leaseholds	4,500	3,500			
To Office & Selling Expenses	72,000	56,000			
To Net Profit — transferred to Capital	95,300	40,900			
	2,23,000	1,45,000		2,23,000	1,45,000

Balance Sheet of Sri Ram & Co. as at 31st December, 2014 Cr.

Liabilities	₹	₹	Assets	₹	₹
Capital (opening)	5,00,000		Leaseholds	80,000	
Add: Profit from Dept. A	95,300		Less: Written-off	8,000	72,000
Add: Profit from Dept. B	40,900	6,36,200	Buildings	1,20,000	
Sundry Creditors		1,73,000	Less: Depreciation	2,400	1,17,600
			Plant & Machinery	2,40,000	
			Less: Depreciation	24,000	2,16,000
			Furniture & Fittings	48,000	
			Less: Depreciation	2,400	45,600
			Closing Stock (₹ 26,000 + 24,000)		50,000
			Sundry Debtors		1,90,000
			Cash at Bank		1,10,000
			Cash in hand		8,000
		8,09,200			8,09,200

Working Note : Apportionment of Unallocated Expenditure

Particulars	Dept. A	Dept. B
(a) Depreciation:		
On Plant & Machinery	$\frac{24,000}{112} \times 63 =$ ₹ 13,500	$\frac{24,000}{112} \times 49 =$ ₹ 10,500
On Furniture & Fittings	$\frac{2,400}{112} \times 63 =$ ₹ 1,350	$\frac{2,400}{112} \times 49 =$ ₹ 1,050
On Buildings	$\frac{2,400}{112} \times 63 =$ ₹ 1,350	$\frac{2,400}{112} \times 49 =$ ₹ 1,050
(b) Leasehold	$\frac{8,000}{112} \times 63 =$ ₹ 4,500	$\frac{8,000}{112} \times 49 =$ ₹ 3,500
(c) Office & Selling Expenses	$\frac{1,28,000}{112} \times 63 =$ ₹ 72,000	$\frac{1,28,000}{112} \times 49 =$ ₹ 56,000

Illustration 2

From the following Trial Balance, prepare Departmental Trading and Profit and Loss Account for the year ended 31.12.2014 and a Balance Sheet as on that date in the books of P & Co. (all figures in ₹):

Particulars		Dr.	Cr.
Stock on 1.1.2014	Dept A	5,400	
	Dept B	4,900	
Purchases	Dept A	9,800	
	Dept B	7,350	
Sales	Dept A		16,900
	Dept B		13,520
Wages	Dept A	1,340	
	Dept B	240	
Rent		1,870	
Salaries		1,320	
Lighting and Heating		420	
Discount allowed		441	
Discount received			133
Advertising		738	
Carriage inwards		469	
Furniture and fittings		600	
Plant and Machinery		4,200	
Sundry Debtors		1,820	
Sundry Creditors			3,737
Capital			9,530
Drawings		900	
Cash in hand		32	
Cash at bank		1,980	
Total		43,820	43,820

The following information is also provided:

(a) Rent, lighting and heating, salaries and depreciation are to be apportioned to A and B Departments as 2 : 1.

(b) Other expenses and incomes are to be apportioned to A and B Departments on suitable basis.

(c) The following adjustments are to be made:
Rent pre-paid ₹ 370; Lighting and heating outstanding ₹ 180; and Depreciation on Furniture & Fittings and Plant & Machinery @ 10% p.a.

(d) The stock at 31.12.2014 : Department A — ₹ 2,748; Department B — ₹ 2,401.

Solution **P & Co.**

Dr. Departmental Trading and Profit & Loss Account for the year ended 31st December, 2014 Cr.

Particulars	Dept A	Dept B	Particulars	Dept A	Dept B
To Opening Stock	5,400	4,900	By Sales	16,900	13,520
To Purchases	9,800	7,350	By Closing Stock	2,748	2,401
To Carriage Inwards (Note 1)	268	201			
To Wages	1,340	240			
To Gross Profit b/d	2,840	3,230			
	19,648	15,921		19,648	15,921
To Rent	1,000	500	By Gross Profit b/d	2,840	3,230
To Salaries	880	440	By Discount received (Note 1)	76	57
To Lighting and heating	400	200	By Net Loss - transferred to Capital	339	—
To Discount allowed	245	196			
To Advertisement	410	328			
To Depreciation	320	160			
To Net Profit - transferred to Capital	—	1,463			
	3,255	3,287		3,255	3,287

Balance Sheet of P & Co. as at 31st December, 2014

Liabilities	₹	₹	Assets	₹	₹
Capital (opening)	9,530		Plant and Machinery	4,200	
Add: Profit from Dept. B	1,463		Less: Depreciation	420	3,780
Less: Loss from Dept. A	339		Furniture and Fittings	600	
	10,654		Less: Depreciation	60	540
Less: Drawings	900	9,754	Sundry Debtors		1,820
Outstanding exp. for lighting and heating		180	Stock in trade		5,149
Sundry Creditors		3,737	Cash at bank		1,980
			Cash in hand		32
			Prepaid rent		370
		13,671			13,671

Working Note: (1) Carriage inwards and discount received are apportioned in the purchase ratio and discount allowed and advertisement in the sales ratio.

Particulars	Dept. A	Dept. B
(a) Carriage Inward	$\frac{469}{17,150} \times 9,800 = ₹\ 268$	$\frac{469}{17,150} \times 7,350 = ₹\ 201$
(b) Discount received	$\frac{133}{17,150} \times 9,800 = ₹\ 76$	$\frac{133}{17,150} \times 7,350 = ₹\ 57$
(c) Discount allowed	$\frac{441}{30,420} \times 16,900 = ₹\ 245$	$\frac{441}{30,420} \times 13,520 = ₹\ 196$
(d) Advertisement	$\frac{738}{30,420} \times 16,900 = ₹\ 410$	$\frac{738}{30,420} \times 13,520 = ₹\ 328$
(e) Rent (₹ 1,870 – 370)	$\frac{1,500}{3} \times 2 = ₹\ 1,000$	$\frac{1,500}{3} \times 1 = ₹\ 500$
(f) Lighting & heating (₹ 420 + 180)	$\frac{600}{3} \times 2 = ₹\ 400$	$\frac{600}{3} \times 1 = ₹\ 200$
(g) Salaries	$\frac{1,320}{3} \times 2 = ₹\ 890$	$\frac{1,320}{3} \times 1 = ₹\ 440$
(h) Depreciation (₹ 420 + 60)	$\frac{480}{3} \times 2 = ₹\ 320$	$\frac{480}{3} \times 1 = ₹\ 160$

Illustration 3

M/s Suman Hosiery Mills produces three varieties of products: Sona, Mona and Dona. The cost of production during the year 2014 of these varieties amounted to ₹ 8,00,000. Output during the year were: Sona — 4,000 units; Mona — 8,000 units and Dona — 9,600 units.

Stock on 1st January, 2014 were: Sona — 450 units; Mona — 300 units and Dona — 600 units.

Sales during the year were: Sona — 4,100 units @ ₹ 48 each; Mona — 7,700 units @ ₹ 54 each and Dona — 10,000 units @ ₹ 60 each. The rate of gross profit is the same in each case. Total departmental expenses of ₹ 96,000 were to be apportioned to various products in the ratio of 1:2:2.

Prepare Departmental Trading Account.

Solution **M/s Suman Hosiery Mills**

Dr. **Departmental Trading Account for the year ended 31st December, 2014** **Cr.**

Particulars	Sona	Mona	Dona	Particulars	Sona	Mona	Dona
To Opening Stock (Note 1)				By Sales			
Sona (450 x ₹ 32)	14,400			Sona (4,100 x ₹ 48)	1,96,800		
Mona (300 x ₹ 36)		10,800		Mona (7,700 x ₹ 54)		4,15,800	
Dona (600 x ₹ 40)			24,000	Dona (10,000 x ₹ 60)			6,00,000
To Cost of Production:				By Closing Stock:			
Sona (4,000 x ₹ 32)	1,28,000			Sona (350 x ₹ 32)	11,200		
Mona (8,000 x ₹ 36)		2,88,000		Mona (600 x ₹ 36)		21,600	
Dona (9,600 x ₹ 40)			3,84,000	Dona (200 x ₹ 40)			8,000
To Department Gross Profit ($33^1/_3$ of Sales)	65,600	1,38,600	2,00,000				
	2,08,000	4,37,400	6,08,000		2,08,000	4,37,400	6,08,000

Tutorial Note: Departmental expenses of ₹ 96,000 should not be charged to Trading Account, because they are not directly related with production. However, for the purpose of determining departmental net profit, these expenses are to be charged to: Sona — ₹ 19,200; Mona — ₹ 38,400; and Dona — ₹ 38,400. The resultant profits will be: Sona — ₹ 46,400; Mona — ₹ 1,00,200; and Dona — ₹ 1,61,600.

Working Notes: For the purpose of calculating G.P. ratio, the cost of production to be deducted from the sale value of goods produced only.

(1) Calculation of Rate of Gross Profit and Cost of Production

	₹	₹
Sales value of goods produced:		
Sona : 4,000 x ₹ 48	1,92,000	
Mona : 8,000 x ₹ 54	4,32,000	
Dona : 9,600 x ₹ 60	5,76,000	12,00,000
Less: Total cost of production		8,00,000
Expected Gross Profit		4,00,000
(a) Rate of gross profit = $\frac{4,00,000}{12,00,000} \times 100 = 33\frac{1}{3}\%$ (on sales)		

(b) Respective departmental cost prices (i.e., Sales price less 33 $^1/_3$%) :
Sona : ₹ 48 – ₹ 16 = ₹ 32; Mona : ₹ 54 – ₹ 18 = ₹ 36; and Dona : ₹ 60 – ₹ 20 = ₹ 40.

(2) Calculation of Number of Units Unsold

Department	Opening Stock (+)	Production (—)	Sales (=)	Closing Stock
Sona (units)	450	4,000	4,100	350
Mona (units)	300	8,000	7,700	600
Dona (units)	600	9,600	10,000	200

Assumption : Cost of production and sales prices are constant for the last 2 years.

Illustration 4

Brahma Limited has three departments and submits the following information for the year ending on 31st March, 2013 :

Particulars	A	B	C	Total (₹)
Purchases (units)	5,000	10,000	15,000	—
Purchases (Amount)	—	—	—	8,40,000
Sales (units)	5,200	9,800	15,300	—
Selling price (₹ per unit)	40	45	50	—
Opening stock (units)	400	600	700	—

You are required to prepare Departmental Trading Account of Brahma Limited assuming that the rate of profit on sales is uniform in each case.

Solution

Brahma Ltd

Dr. Departmental Trading Account for the year ended 31st March, 2013 Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Opening Stock (Note 4)	14,400	10,800	30,000	By Sales (Note 6)	2,08,000	4,41,000	7,65,000
To Purchases (Note 2)	1,20,000	2,70,000	4,50,000	By Closing Stock (Note 5)	9,600	16,200	21,000
To Gross Profit	83,200	1,76,400	3,06,000				
	2,17,600	4,57,200	7,86,000		2,17,600	4,57,200	7,86,000

Working Notes :

(1) Calculation of Profit Margin Rate

Particulars	₹	₹
Department A (5,000 units @ ₹ 40)	2,00,000	
Department B (10,000 units @ ₹ 45)	4,50,000	
Department C (15,000 units @ ₹ 50)	7,50,000	
Total Sales Value		14,00,000
Less: Purchases (given)		8,40,000
Gross Profit		5,60,000

$$\text{Profit Margin Rate} = \frac{\text{Gross Profit}}{\text{Sales Value}} \times 100 = \frac{5,60,000}{14,00,000} \times 100 = 40\%$$

(2) Calculation of Purchase Price and Total Purchases of Each Department

Particulars	A	B	C
Selling Price per unit (₹)	40	45	50
Less: Profit Margin @ 40%	16	18	20
Purchase Price per unit (X)	24	27	30
Number of Units Purchased (Y)	5,000	10,000	15,000
Total Purchases (X) x (Y) (₹)	1,20,000	2,70,000	4,50,000

(3) Calculation of Opening Stock of Each Department

Department	A	B	C
Closing Stock (units)	400	600	700
Add: Sales (units)	5,200	9,800	15,300
	5,600	10,400	16,000
Less: Purchases (units)	5,000	10,000	15,000
Opening Stock (units)	600	400	1,000

(4) Calculation of Value of Opening Stock

Department A : 600 × ₹ 24 = ₹ 14,400
Department B : 400 × ₹ 27 = ₹ 10,800
Department C : 10,000 × ₹ 30 = ₹ 30,000

(5) Calculation of Value of Closing Stock

Department A : 400 × ₹ 24 = ₹ 9,600
Department B : 600 × ₹ 27 = ₹ 16,200
Department C : 700 × ₹ 30 = ₹ 21,000

(6) Calculation of Sales Value

Department A : 5,200 × ₹ 40 = ₹ 2,08,000
Department B : 9,800 × ₹ 45 = ₹ 4,41,000
Department C : 15,300 × ₹ 50 = ₹ 7,65,000

Illustration 5

Rohit Choudhury is the proprietor of a retail business which has two main departments which sell respectively hardware and electrical goods. On 31.12.2014, the balances in the books of the business were as follows :

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Capital		71,000	Drawings	3,000	
Sales — Hardware		59,000	Buildings (Cost)	43,000	
Electrical		29,500	Equipments at W.D.V. — Hardware	18,000	
Purchases — Hardware	20,000		Electrical	7,000	
Electrical	10,000		Debtors and Creditors	10,200	5,319
Stock on 1.1.2014 — Hardware	2,320		Bank	5,600	
Electrical	2,136		Rent and Rates	1,580	
Salaries — Hardware	20,560		Canteen Charges	875	
Electrical	15,440		Heating and Lighting	880	
Advertising	615		Insurance of Stock	940	
Discount allowed — Hardware	400		General Administrative Expenses	2,073	
Electrical	200		**Total**	1,64,819	1,64,819

Additional information —

(i) At 31.12.2014, the following amounts were outstanding :
Salaries — Hardware ₹ 250; Electrical ₹ 170; Heating and Lighting ₹ 20.

(ii) The general administrative expenses and the rent and rates included prepayments of ₹ 33 and ₹ 80 respectively.

(iii) Stocks at 31.12.2014 were : Hardware ₹ 2,800; Electrical ₹ 2,450.

(iv) Depreciation is to be provided on equipments at 10% on W.D.V.

(v) The managers of the hardware and electrical departments are to be paid a commission of 5% of the net profit (prior to the commission payment) of the respective departments.

(vi) In apportioning the various expenses between the two departments due regard is to be given to the following information :

	Number of Workers	Average Stock Levels (₹)	Floor Area (sq.ft)
Hardware	9	2,500	4,000
Electrical	6	2,200	2,000

(vii) The general administrative expenses are primarily incurred in relation to the processing of purchases and sales invoices.

Prepare a Departmental Trading and Profit and Loss Account and the Balance Sheet.

Solution

Rohit Choudhury

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	Hardware (₹)	Electrical (₹)	Particulars	Hardware (₹)	Electrical (₹)
To Opening Stock	2,320	2,136	By Sales	59,000	29,500
To Purchases	20,000	10,000	By Closing Stock	2,800	2,450
To Gross Profit c/d	39,480	19,814			
	61,800	31,950		61,800	31,950
To Salaries (including outstanding)	20,810	15,610	By Gross Profit b/d	39,480	19,814
To Advertising (Note 1)	410	205			
To Discount Allowed	400	200			
To Rent and Rates (Note 1)	1,000	500			
To Canteen Charges (Note 1)	525	350			
To Heating and Lighting (Note 1)	600	300			
To Insurance of Stock (Note 1)	500	440			
To General Administrative Exp. (Note 1)	1,360	680			
To Depreciation on Equipments	1,800	700			
To Managers' Commission	604	41			
To Net Profit (transferred to Capital)	11,471	788			
	39,480	19,814		39,480	19,814

Balance Sheet of Rohit Choudhury as at 31st December, 2014

Liabilities		₹	Assets		₹
Capital (Opening)	71,000		Buildings (cost)		43,000
Add: Profit from Hardware	11,471		Equipments at W.D.V. (₹ 18,000 + 7,000)	25,000	
Add: Profit from Electrical	788		Less: Depreciation (₹ 1,800 + 700)	2,500	22,500
	83,259		Stock — Hardware	2,800	
Less: Drawings	3,000	80,259	Electrical	2,450	5,250
Creditors		5,319	Debtors		10,200
Outstanding :			Bank		5,600
Salaries (₹ 250 + 170)		420	Prepayments :		
Heating and Lighting		20	General Administrative Expenses		33
Commission (₹ 604 + 41)		645	Rent and Rates		80
		86,663			86,663

Working Notes : **(1) Apportionment of Common Expenses**

Expenses	Basis	Hardware Department	Electrical Department
(i) Advertising	Sales	$\frac{615}{88,500} \times$ Rs $59,000 =$ ₹ 410	$\frac{615}{88,500} \times 29,500 =$ ₹ 205
(ii) Rent and Rates	Floor Area	$\frac{1,500 \text{ (Note 3)}}{6} \times 4 =$ ₹ 1,000	$\frac{1,500}{6} \times 2 =$ ₹ 500
(iii) Canteen Charges	Number of Workers	$\frac{875}{15} \times 9 =$ ₹ 525	$\frac{875}{15} \times 6 =$ ₹ 350
(iv) Heating and Lighting	Floor Area	$\frac{900 \text{ (Note 3)}}{6} \times 4 =$ ₹ 600	$\frac{900}{6} \times 2 =$ ₹ 300
(v) Insurance of Stock	Average Stock Level	$\frac{940}{4,700} \times 2,500 =$ ₹ 500	$\frac{940}{4,700} \times 2,200 =$ ₹ 440
(vi) General Administrative Expenses	Total of Sales and Purchases	$\frac{2,040 \text{ (Note 3)}}{1,18,500} \times 79,000 =$ ₹ 1,360	$\frac{2,040}{1,18,500} \times 39,500 =$ ₹ 680

(2) Managers' Commission:
Hardware : 5% of ₹ 12,075 = ₹ 604 (approx.)
Electrical : 5% of ₹ 829 = ₹ 41 (approx.)

(3) Rent and Rates : ₹ 1,580 – ₹ 80 (prepaid) = ₹ 1,500;
Heating and Lighting : ₹ 880 + ₹ 20 (outstanding) = ₹ 900;
General Administrative Expenses : ₹ 2,073 – ₹ 33 (prepaid) = ₹ 2,040

Illustration 6

The following balances as at 31.12.2014 have been extracted from the books of David, the proprietor of a departmental store :

Wages and Salaries ₹ 1,42,500; Maintenance ₹ 12,360; Rent ₹ 27,050; Advertising ₹ 15,000; Sundry Debtors ₹ 41,900; Sundry Creditors ₹ 16,800; Provision for doubtful debts ₹ 5,000; Investments ₹ 50,000; Furniture ₹ 46,500; Cash ₹ 21,550; Capital Account ₹ 2,00,000; Current Account ₹ 880 (Cr.); Drawings ₹ 75,120.

The records relating to the stocks are : (all figures in ₹)

	Stock on 1.1.2014	Purchases	Purchase Returns	Stock on 31.12.2014
Dept. X	10,700	94,600	900	21,000
Dept. Y	68,000	2,20,980	2,200	61,600

Additional information :

(1) Department X sells articles for ₹ 40 each which is equivalent to 80% above cost price, while department Y sells articles for ₹ 60 each which is equivalent to double the cost price.

(2) Write off bad debts ₹ 3,300 and adjust the provision for doubtful debts to 10% of the remaining outstanding debtors. These adjustments should be apportioned equally between department X and department Y.

(3) Provide ₹ 4,000 investment income due to be received.
(4) Provide ₹ 1,150 rent due to be paid.
(5) Depreciate furniture by 10%.
(6) All general expenses should be apportioned between department X and department Y on the basis of the number of articles sold by these departments during the year.

You are required to prepare Departmental Trading and Profit and Loss Account for the year ended 31.12.2014 and a Balance Sheet as on that date.

Solution **David**

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	Dept. X (₹)	Dept. Y (₹)	Particulars	Dept. X (₹)	Dept. Y (₹)
To Opening Stock	10,700	68,000	By Sales (Note 1)	1,50,120	4,50,360
To Purchases	94,600	2,20,980	By Closing Stock	21,000	61,600
Less: Returns	(900)	(2,200)			
To Gross Profit c/d	66,720	2,25,180			
	1,71,120	5,11,960		1,71,120	5,11,960
To Wages and Salaries (Note 3)	47,500	95,000	By Gross Profit b/d	66,720	2,25,180
To Maintenance (Note 3)	4,120	8,240	By Provision for Doubtful Debts (equally — Note 2)	570	570
To Rent (₹ 27,050 + 1,150)	9,400	18,800	By Departmental Loss c/d	1,930	—
To Advertising (Note 3)	5,000	10,000			
To Depreciation on Furniture (Note 3)	1,550	3,100			
To Bad Debts (equally)	1,650	1,650			
To Departmental Profit c/d	—	88,960			
	69,220	2,25,750		69,220	2,25,750
To Departmental Loss b/d		1,930	By Departmental Profit b/d		88,960
To Net Profit		91,030	By Accrued Income from Investments		4,000
		92,960			92,960

Balance Sheet of David as at 31st December, 2014

Liabilities		₹	Assets		₹
Capital Account		2,00,000	Furniture	46,500	
Current Account :	₹		Less : Depreciation	4,650	41,850
Opening balance	880		Stock (₹ 21,000 + 61,600)		82,600
Add : Net Profit	91,030		Sundry Debtors	41,900	
	91,910		Less : Bad Debts	3,300	
Less : Drawings	75,120	16,790		38,600	
Sundry Creditors		16,800	Less : Provision for Doubtful Debts	3,860	34,740
Outstanding Rent		1,150	Investments	50,000	
			Add : Accrued Income	4,000	54,000
			Cash		21,550
		2,34,740			2,34,740

Working Notes : **(1) Calculation of Sales**

Particulars	Dept X (₹)	Dept Y (₹)
Opening Stock	10,700	68,000
Add : Purchases	94,600	2,20,980
	1,05,300	2,88,980
Less: Purchases Return	900	2,200
	1,04,400	2,86,780
Less : Closing Stock	21,000	61,600
Cost of Goods Sold	83,400	2,25,180

(a) Department X sells goods at 80% above cost. Therefore, sales = ₹ 83,400 / 100 × 180 = ₹ **1,50,120**.

(b) Department Y sells goods at 100% above cost. Therefore, sales = ₹ ₹ 2,25,180 / 100 × 200 = ₹ **4,50,360**.

(2) Calculation of Excess Provision for Doubtful Debts

	₹
Balances of Sundry Debtors	41,900
Less : Bad Debts to be written off	3,300
Adjusted balance of Sundry Debtors	38,600

Existing balance of provision for doubtful debts	5,000
Less: Provision for Doubtful Debts required : 10% of ₹ 38,600	3,860
Excess	1,140

This excess provision for doubtful debts will be credited to department X and Y equally, i.e., ₹ 570 each.

(3) Calculation of Number of Articles Sold

Department X : ₹ 1,50,120 / 40 = 3,753

Department Y : ₹ 4,50,360 / 60 = 7,506

Ratio of number of articles sold : 3,753 : 7,506 or 1 : 2

All general expenses are to be apportioned in the ratio of 1 : 2.

Illustration 7

Robinhood is a retail trader whose stores has two departments dealing in clothing and sports equipment respectively. The following Trial Balance was extracted from books at 31.12.2014, the accounting year end :

Particulars	Dr. (₹)	Cr. (₹)
Sales — Clothing		1,20,000
Sports Equipment		1,60,000
Stock at cost at 1.1.2014 — Clothing	10,000	
Sports Equipment	16,000	
Purchases — Clothing and Sports Equipment	1,92,000	
Establishment Expenses — Clothing	15,000	
Sports Equipment	16,920	
Sales and Administrative Expenses — Clothing	7,400	
Sports Equipment	5,840	
Capital		20,000
Reserve		21,460
Creditors		5,800
Bank Overdraft		2,300
Debtors	8,600	
Building — At cost	20,000	
Provision for Depreciation		800
Furniture — At cost	26,000	
Provision for Depreciation		9,000
Vehicles — At cost	42,000	
Provision for Depreciation		20,400
Total	3,59,760	3,59,760

Additional information —

(a) Gross profit is earned as follows : Clothing — 1/3rd of sales; Sports equipment — 3/10th of sales.

(b) Stock is valued at cost on 31.12.2014 :
Clothing ₹ 8,000; Sports equipment ₹ 14,000

(c) Amounts prepaid at 31.12.2014 :
Establishment expenses — Clothing ₹ 300.

(d) Amount outstanding on 31.12.2014 :
Sales and administrative expenses — Clothing ₹ 200; Sports equipment ₹ 700.

(e) The sales staff receive commission in June of each year based on the gross profit earned in their department in the previous financial year :
Clothing — 2% of gross profit; Sports equipment — 3% of gross profit.

(f) In June 2014, additional furniture was acquired at a cost of ₹ 4,000 was debited to purchases.

(g) Depreciation is provided annually on fixed assets at the following percentage of the cost of assets held at the relevant accounting year end :
Building — 2%; Furniture — 10%; Vehicles — 20%.

(h) In August 2014, a motor vehicle which had been bought in January 2007 at a cost of ₹ 6,000 was scrapped, the firm did not receive anything for the scrap.

(i) The fixed assets depreciation is apportioned to departments as follows :

	Clothing	Sports Equipment
Building	1/2	1/2
Furniture	3/5	2/5
Vehicles	5/12	7/12

You are required to prepare the Trading and Profit and Loss Account for the year ended 31.12.2014 and the Balance Sheet as on that date.

Solution

Robinhood

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	Clothing (₹)	Sports Equipment (₹)	Particulars	Clothing (₹)	Sports Equipment (₹)
To Opening Stock	10,000	16,000	By Sales	1,20,000	1,60,000
To Purchases (Balancing figure)	78,000	1,10,000	By Closing Stock	8,000	14,000
To Gross Profit c/d (given)	40,000	48,000			
	1,28,000	1,74,000		1,28,000	1,74,000
To Establishment Expenses (Note 1)	14,700	16,920	By Gross Profit b/d	40,000	48,000
To Sales and Administrative Exp. (Note 2)	7,600	6,540			
To Outstanding Sales Staff Comm. (Note 5)	800	1,440			
To Depreciation on (Note 3) :					
Building (1 : 1)	200	200			
Furniture (3 : 2)	1,800	1,200			
Vehicles (5 : 7)	3,000	4,200			
To Loss on Scrap of Vehicle (Note 4)	500	700			
To Net Profit (transferred)	11,400	16,800			
	40,000	48,000		40,000	48,000

Balance Sheet of Robinhood as at 31st December, 2014

Liabilities		₹	Assets		₹
Capital (opening)	20,000		Building	20,000	
Add: Profit from Clothing	11,400		Less: Provision for depreciation	1,200	18,800
Add: Profit from Sports Equipment	16,800	48,200	Furniture (₹ 26,000 + ₹ 4,000)	30,000	
Reserve		21,460	Less: Provision for depreciation	12,000	18,000
Creditors		5,800	Vehicles (₹ 42,000 – ₹ 6,000)	36,000	
Outstanding :			Less: Provision for depreciation	22,800	13,200
Sales and Administrative Expenses (₹ 200 + 700)		900	Stock (₹ 8,000 + ₹ 14,000)		22,000
Sales Staff Commission		2,240	Debtors		8,600
Bank Overdraft		2,300	Prepaid Establishment Expenses		300
		80,900			80,900

Working Notes :

(1) Establishment Expenses

Clothing — ₹ 15,000 – ₹ 300 (prepaid) = ₹ 14,700.

(2) Sales and Administrative Expenses

Clothing — ₹ 7,400 + ₹ 200 (outstanding) = ₹ 7,600.

Sports Equipment — ₹ 5,840 + ₹ 700 (outstanding) = ₹ 6,540.

(3) Calculation of Depreciation

On Building — ₹ 20,000 @ 2% = ₹ 400.

On Furniture — ₹ 30,000 @ 10% = ₹ 3,000

On Vehicles — (₹ 42,000 – ₹ 6,000) @ 20% = ₹ 7,200.

(4) Loss on Scrap of Vehicle

	₹
Cost	6,000
Less: Accumulated depreciation (4 years @ ₹ 1,200)	4,800
Written down value on the date the asset was scrapped	1,200
Amount realised	Nil
Loss	1,200

Loss on scrap of vehicle will be shared by Clothing Department and Sports Equipment Department just like depreciation. Therefore, clothing department will bear the loss of ₹ 500 (5/12 of ₹ 1,200) and sports equipment department will bear the loss of ₹ 700 (7/12 of ₹ 1,200).

(5) Sales staff will get commission in June, 2013 on the basis of gross profit of 2014. Therefore, in the Profit and Loss Account of 2014, provision must be made for such future payment.

Illustration 8

Praveen Choudhury commenced trading on 1.4.2014 as Highway Stores, retail stationers and confectioners, with an initial capital of ₹ 30,000 which was utilised in the opening of a business Bank Account. All receipts and payments are passed through the Bank Account. The following is a summary of the items credited in the business Cash Book during the year ended 31.3.2015:

Particulars	(₹)	Particulars	(₹)
Purchase of fixtures and fittings :		Rent for the period 1.4.2014 to 30.4.2015	13,000
Stationery department	26,000	Rates for the year ended 31.3.2015	5,700
Confectionery department	15,000	Electricity	3,700
Staff salaries :		Advertising	11,000
Stationery department	22,000	Payment to suppliers	5,35,500
Confectionery department	15,400	Drawings	50,000

The purchases during the year under review were :

Stationery department ₹ 2,60,000; Confectionery department ₹ 2,92,500.

The above purchases do not include goods costing ₹ 5,000 bought by the business and then taken by Mr Choudhury for his own domestic use. The figure of ₹ 5,000 is included in payment to suppliers.

The gross profit in the stationery department is @ 20% on sales while in the confectionery department, it is @ 25% on sales. In both departments, sales in each month are always at a uniform level. The policy of Mr Choudhury is to have the month end stocks in each department just sufficient for the following month's sales. The prices of all goods bought by Highway Stores have not changed since the business began.

The sundry debtors at 31.3.2015 amounted to ₹ 90,000.

In August 2014, Mr Choudhury invested an additional capital of ₹ 90,000.

At 31.3.2015, outstanding electricity bill amounted to ₹ 1,100. Mr Choudhury has decided that expenses not incurred by a specific department should be apportioned to departments as follows :

1. Rent and rates — according to floor area occupied.
2. Electricity — according to consumption.
3. Advertising — according to turnover.

Two-thirds of the business floor space is occupied by the stationery department while three-quarters of the electricity is consumed by that department.

It has been decided that depreciation on fixtures and fittings should be provided @ 10% of the cost of assets held at the year end.

Required :

(a) A Trading and Profit and Loss Account for the year ended 31.3.2015 for the — (i) stationery department; and (ii) confectionery department.

(b) A Balance Sheet as on 31.3.2015.

Solution

Highway Stores

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st March, 2015 Cr.

Particulars	Stationery (₹)	Confectionery (₹)	Particulars	Stationery (₹)	Confectionery (₹)
To Purchases	2,60,000	2,92,500	By Sales (Note 4)	3,00,000	3,60,000
To Gross Profit c/d	60,000	90,000	By Closing Stock (Note 3)	20,000	22,500
	3,20,000	3,82,500		3,20,000	3,82,500
To Staff Salaries	22,000	15,400	By Gross Profit b/d	60,000	90,000
To Rent (₹ 13,000 – 1,000)	8,000	4,000			
To Rates (Note 7)	3,800	1,900			
To Electricity (₹ 3,700 + 1,100)	3,600	1,200			
To Advertising (Note 7)	5,000	6,000			
To Depreciation on :					
Fixtures and Fittings @ 10%	2,600	1,500			
To Net Profit	15,000	60,000			
	60,000	90,000		60,000	90,000

Balance Sheet of Highway Stores as at 31st March, 2015

Liabilities		₹	Assets		₹
Capital : Introduced	30,000		Fixtures and Fittings (₹ 26,000 + 15,000)	41,000	
Add: Further introduced	90,000		Less : Depreciation	4,100	36,900
Profit from Stationery	15,000		Stock (₹ 20,000 + ₹ 22,500) (Note 3)		42,500
Profit from Confectionery	60,000		Debtors		90,000
	1,95,000		Prepaid Rent (Note 6)		1,000
Less: Drawings (₹ 50,000 + 5,000)	55,000	1,40,000			
Creditors (Note 2)		22,000			
Outstanding Electricity		1,100			
Bank Overdraft (Note 1)		7,300			
		1,70,400			1,70,400

Working Notes :

Dr. **(1) Bank Account** **Cr.**

Particulars	₹	Particulars	₹
To Cash (Capital introduced)	30,000	By Fixtures and Fittings	41,000
To Sundry Debtors (Note 5)	5,70,000	By Staff Salaries	37,400
To Cash (Further capital)	90,000	By Rent	13,000
To Balance c/d	7,300	By Rates	5,700
		By Electricity	3,700
		By Advertising	11,000
		By Creditors	5,35,500
		By Drawings	50,000
	6,97,300		6,97,300

Dr. **(2) Creditors Account** **Cr.**

Particulars	₹	Particulars	₹
To Bank	5,35,500	By Purchases	
To Balance c/d	22,000	— Stationery	2,60,000
		— Confectionery	2,92,500
		By Drawings (Adjustment for stationery taken over)	5,000
	5,57,500		5,57,500

(3) Closing stock will be equal to next month's sale. Sales are uniform in each month.
Therefore, purchases during 2014-15 are equal to 13 months' sale. Therefore, closing stock will be —
Stationery department : ₹ 2,60,000 / 13 = ₹ 20,000. Confectionery department ₹ 2,92,500 / 13 = ₹ 22,500.

(4) Calculation of Sales

Stationery Department	₹	Confectionery Department	₹
Sales	100	Sales	100
Less: Gross Profit @ 20%	20	Less: Gross Profit @ 25%	25
Cost	80	Cost	75
Cost of Goods Sold (Purchases – Closing Stock)	2,40,000	Cost of Goods Sold (Purchases – Closing Stock)	2,70,000
Sales = $\frac{\text{Cost of Goods Sold}}{80} \times 100$	3,00,000	Sales = $\frac{\text{Cost of Goods Sold}}{75} \times 100$	3,60,000

(5) Total sales = ₹ 3,00,000 + ₹ 3,60,000 = ₹ 6,60,000. Amount due from sundry debtors at the end of the year ₹ 90,000.
Therefore, amount collected from sundry debtors = ₹ 6,60,000 – ₹ 90,000 = ₹ 5,70,000.

(6) Rent has been paid for 13 months (1.4.2014 to 30.4.2015).
Therefore, prepaid rent will be — ₹ 13,000 / 13 = ₹ 1,000.

(7) Apportionment of Common Expenses

Expenses	Basis	Stationery	Confectionery
(i) Rent	Floor Area (2 : 1)	₹ 12,000 x 2/3 = ₹ 8,000	₹ 12,000 x 1/3 = ₹ 4,000
(ii) Rates	Floor Area (2 : 1)	₹ 5,700 x 2/3 = ₹ 3,800	₹ 5,700 x 1/3 = ₹ 1,900
(iii) Electricity	Consumption (3 : 1)	₹ 4,800 x 3/4 = ₹ 3,600	₹ 4,800 x 1/4 = ₹ 1,200
(iv) Advertising	Turnover (5 : 6)	₹ 11,000 x 5/11 = ₹ 5,000	₹ 11,000 x 6/11 = ₹ 6,000

Illustration 9

X and Y are in partnership managing a small retail store which specialises in sweets and confectionary - managed by X and newspapers and periodicals - managed by Y. The partnership agreement provides for X to receive three-fifths of the profit, and Y two-fifths, each partner to be allowed 8% interest on capital and each to receive a commission of 10% of the profit of their respective sections prior to any other appropriation of profit. During the year to 31st March 2015, a trial balance extracted at that date revealed the following features. (all figures in ₹).

Particulars	Dr.	Cr.
Capital - X		14,000
Y		8,000
Current Accounts - X		2,020
Y	250	
Drawings - X	1,100	
Y	900	
Freehold shop premises	10,000	
Equipment (at written-down value) :		
Confectionery section	4,500	
Periodical section	3,500	
Purchases : Confectionery section	15,900	
Periodical section	17,700	
Stock at 1st April : Confectionery section	2,300	
Periodical section	3,100	
Sales : Confectionery section		18,500
Periodical section		21,500
Wages: Confectionery section	1,175	
Periodical section	1,470	
Miscellaneous expenses	230	
Rates	500	
Light and heat	400	
Advertising	250	
Debtors and creditors	1,800	2,100
Bad debts - Periodical section	95	
Cash in hand	950	
Cash at bank	50	
Provision for doubtful debts : Periodical section		50
Total	66,170	66,170

Additional information available:

(i) Stock at 31st March, 2015 was ₹ 3,600 in the Confectionery section, and ₹ 4,400 in the Periodical section.

(ii) The partners have agreed that rates should be apportioned between the Confectionery and Periodical sections on a 3:2 ratio, advertising on a 1:1 ratio, lighting and heating on a 2:3 ratio, and miscellaneous expenses on a 1:1 ratio.

(iii) Wages owing at 31st March, 2015 : ₹ 25 and ₹ 30 for the Confectionery and Periodical section respectively.

(iv) Advertising prepaid at 31st March, 2013 amounted to ₹ 100.

(v) The provision for doubtful debts is to be increased to 5% of the debtors of the Periodical section, which amount to ₹ 1,500 at 31st March 2015.

(vi) Equipment of both sections is to be depreciated at 10% of the written-down value at 1st April, 2014.

Required:

(a) Prepare a Trading and Profit and Loss Account for the Confectionery and the Periodical sections, and also for the business as a whole, for the year ended 31st March, 2015. (Note : A Balance Sheet is not required).

(b) Prepare an Appropriation Account for the year ended 31st March, 2015.

Solution **XY**

Dr. Departmental Trading and Profit & Loss Account for the year ended 31st March, 2015 Cr.

Particulars	Confec-tionery	Periodical	Total ₹	Particulars	Confec-tionery	Periodical	Total ₹
To Opening Stock	2,300	3,100	5,400	By Sales	18,500	21,500	40,000
To Purchases	15,900	17,700	33,600	By Closing Stock	3,600	4,400	8,000
To Wages (Note 1)	1,200	1,500	2,700				
To Gross Profit c/d	2,700	3,600	6,300				
	22,100	25,900	48,000		22,100	25,900	48,000
To Misc. Expenses	115	115	230	By Gross Profit b/d	2,700	3,600	6,300
To Rates	300	200	500				
To Advertising	75	75	150				
To Lighting & Heating	160	240	400				
To Bad Debts	—	95	95				
To Prov. for Bad Debts	—	25	25				
To Depreciation	450	350	800				
To Net Profit - transferred	1,600	2,500	4,100				
	2,700	3,600	6,300		2,700	3,600	6,300

Dr. Appropriation Account for the year ended 31st March, 2015 Cr.

Particulars	₹	Particulars	₹
To Commission:		By Net Profit	4,100
X	160		
Y	250		
To Interest on Capital:			
X	1,120		
Y	640		
To Share of Profit			
X	1,158		
Y	772		
	4,100		4,100

Working Notes:

(1) Wages : Confectionery ₹ 1,175 + outstanding ₹ 25 = ₹ 1,200; and Periodical ₹ 1,470 + outstanding ₹ 30 = ₹ 1,500.
(2) Miscellaneous expenses : Confectionery - 1/2 of ₹ 230 = ₹ 115 and Periodical - 1/2 of ₹ 230 = ₹ 115.
(3) Rates : Confectionery - 3/5 of ₹ 500 = ₹ 300 and Periodical 2/5 of ₹ 500 = ₹ 200.
(4) Advertising : Confectionery - 1/2 of (₹ 250 – ₹ 100) = ₹ 75 and Periodical 1/2 of ₹ 150 = ₹ 75.
(5) Lighting and heating : Confectionery - 2/5 of ₹ 400 = ₹ 160 and Periodical - 3/5 of ₹ 400 = ₹ 240.

Inter-Departmental Transfer

Sometimes prices are charged for goods or services transferred by one department to another department. Since each department is considered as a separate profit centre, it is necessary to have separate records for inter-departmental transfer. Generally a weekly or monthly Departmental Transfer Analysis Sheet is prepared to arrange all inter-departmental transfer. The sheet may be in the following form:

Departmental Transfer Analysis Sheet

Date	Supplying Departments			Receiving Departments		
2015	Dept X	Dept Y	Dept Z	Dept X	Dept Y	Dept Z
April 3	400	—	—	—	400	—
April 10	—	500	—	500	—	—
April 20	—	—	300	—	300	—
April 30	200	—	—	—	—	200
	600	500	300	500	700	200

At the end of the week/month, the transfer is recorded by passing the following entry:

Receiving Department Dr. [Transfer price]

To Supplying Department

Transfer prices can be cost-based or market-based. Dual pricing is also sometimes used. They are discussed below:

Cost-based Transfer Price

Under cost-based transfer pricing, the price may be based on actual cost, total cost or standard cost. Marginal cost is also sometimes used as a basis of ascertaining transfer price. Standard cost is preferred to actual cost since the inefficiency of one department cannot be passed on to another department. Taking full cost as transfer price means that the supplying departments' fixed cost becomes the variable cost of the receiving department.

Illustration 10

A firm had two departments X and Y. Department Y (which was a Manufacturing Department) received goods from Department X as its raw materials. Department X supplied the said goods to Y at cost price. From the following particulars you are required to prepare a Departmental Trading and Profit and Loss Account for the year ended on 31st December, 2014. (all figures in ₹).

Particulars	Dept X	Dept Y
Opening Stock (as on 1.1.2014)	2,50,000	75,000
Purchases (from outside suppliers)	10,00,000	20,000
Sales (to outside customers)	12,00,000	3,00,000
Closing stock (as on 31.12.2014)	1,50,000	50,000

The following information is to be taken into account:

(a) Depreciation of Buildings to be provided at 20% p.a. The value of the Building occupied by both the Departments was ₹ 1,05,000 (Department X occupying two-third portion and Department Y occupying the rest).

(b) Goods transferred from Department X to Department Y ₹ 2,50,000 at cost.

(c) Manufacturing Expenses amounted to ₹ 10,000.

(d) Selling expenses amounted to ₹ 15,000 (to be apportioned on the basis of sales of respective departments).

(e) General expenses of the business as a whole amounted to ₹ 58,000.

Solution

Dr. Departmental Trading and Profit & Loss Account for the year ended 31st December, 2014 Cr.

Particulars	X	Y	Total	Particulars	X	Y	Total
To Opening Stock	2,50,000	75,000	3,25,000	By Sales	12,00,000	3,00,000	15,00,000
To Purchases	10,00,000	20,000	10,20,000	By Y (transfer)	2,50,000	—	—
To X (transfer)	—	2,50,000	—	By Closing Stock	1,50,000	50,000	2,00,000
To Mfg. Expenses	—	10,000	10,000	By Gross Loss c/d	—	5,000	5,000
To Gross Profit c/d	3,50,000	—	3,50,000				
	16,00,000	3,55,000	17,05,000		16,00,000	3,50,000	17,05,000
To Gross Loss b/d	—	5,000	5,000	By Gross Profit b/d	3,50,000	—	3,50,000
To Selling Expenses	12,000	3,000	15,000				
To Depreciation	14,000	7,000	21,000				
To Dept. Profit c/d	3,24,000	(15,000)	3,09,000				
	3,50,000	—	3,50,000		3,55,000	—	3,50,000
To General Expenses			58,000	By Departmental Profit b/d			3,09,000
To Net Profit			2,51,000				
			3,09,000				3,09,000

Illustration 11

A hotel proprietor has two departments, viz, (i) Apartment Department, and (ii) Meals Department. Following trial balance of the business is given on 31.12.2014: (all figures in ₹)

Provisions	15,500	Income from Apartment Department	46,000
Stock of provisions in the beginning	1,020	Income from Meals Department	32,000
Cash at bank	10,000	Capital	2,20,000

Customers Account	800	Suppliers' Account	9,800
Buildings (1/10 is used for Meals Dept.)	2,10,000	Provision for Depreciation on Buildings	24,000
Furniture and equipments	60,000	Interest	1,130
General expenses	27,410		
Interest accrued	200		
Income Tax	400		
Life Insurance Premium (for Proprietor)	1,600		
Wages	6,000		
	3,32,930		3,32,930

Additional information: (i) The servants in the Apartment Department had occupied a room worth ₹ 120 and took meals worth ₹ 60. Similarly, servants in the Meals Department had occupied a room worth ₹ 150 and took meals worth ₹ 90; (ii) Wages are charged in the proportion of half to the Apartment Department, one- quarter to the Meals Department and remaining to the General Profit and Loss Account; (iii) Increase provision for depreciation of Buildings to ₹ 30,000; (iv) A sum of ₹ 800 representing accommodation ₹ 240, and meals ₹ 560 is to be charged to proprietor of the hotel.

You are required to prepare Final Accounts (including Balance Sheet) for the year ending 31.12.2014.

Solution

Dr. Departmental Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	Appartment Dept.	Meal Dept.	Particulars	Appartment Dept.	Meal Dept.
To Opening Stock of Provisions	—	1,020	By Income	46,000	32,000
To Provisions (purchases)	—	15,500	By Drawings	240	560
To Depreciation on Building	5,400	600	By Meal Dept - transfer	150	—
To Wages (Note 1)	3,000	1,500	By Appartment Dept - transfer	—	60
To Appartment Dept. - transfer	—	150			
To Meal Dept. - transfer	60	—			
To Departmental profit	37,930	13,850			
	46,390	32,620		46,390	32,620

Dr. General Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Wages (Note 1)	1,500	By Departmental Profit (₹ 37,930 + ₹ 13,850)	51,780
To General Expenses	27,410	By Interest	1,130
To Net Profit — transferred to Capital	24,000		
	52,910		52,910

Dr. Balance Sheet as at 31st December, 2014 Cr.

Liabilities		₹	Assets		₹
Capital	₹ 2,20,000		Building	₹ 2,10,000	
Add: Net Profit	₹ 24,000		Less: Provision for depreciation	₹ 30,000	1,80,000
	₹ 2,44,000		Furniture & Equipment		60,000
Less: Drawings (Note 2)	₹ 2,800	2,41,200	Customers Account		800
Suppliers Account		9,800	Interest Accrued		200
			Cash at Bank		10,000
		2,51,000			2,51,000

Working Notes:

(1) Wages as per trial balance = ₹ 6,000. Apartment Dept. will bear 1/2 of ₹ 6,000 = ₹ 3,000; Meals Dept. will bear 1/4 of ₹ 6,000 = ₹ 1,500; General Profit and Loss Account will bear ₹ 1,500.

(2) Total Drawing = ₹ 240 for accommodation + ₹ 560 for meals + ₹ 1,600 for L.I.P. + ₹ 400 for I.T. = ₹ 2,800.

(3) Departmental Transfer Analysis Sheet

Date	Nature of Service	Supplying Department (₹)		Receiving Department (₹)	
		Appartment Dept.	Meals Dept.	Appartment Dept.	Meals Dept.
?	Meal	—	60	60	—
?	Accommodation	150	—	—	150
		150	60	60	150

As per rule, receiving department will be debited and supplying department will be credited.

(i) Apppartment Dept.	Dr.	60	
To Meals Dept.			60
(ii) Meals Dept.	Dr.	150	
To Appartment Dept			150

Tutorial Note: No adjustment is required for providing facility to own departmental staff.

Illustration 12

Mohit Udyog operates a general business and the firm's Trial Balance prepared at 31.12.2014 was as follows:

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Purchases : Cars	83,500		Debtors and Creditors	14,000	10,800
Petrol	27,500		Bank	4,700	
Spare parts	4,000		Cash	14,600	
Capital		62,000	Freehold Garage Premises	42,000	
Stock on 1.1.2014 : Cars	9,000		Rates and insurance	1,900	
Petrol	2,800		Sales : Cars		1,20,000
Spare parts	400		Petrol		32,000
Workshop wages	10,200		Spare parts		4,700
Plant and Equipment	7,000		Repairs		14,700
Car salesmen's salaries	7,700		Petrol pump attendant's wages	3,100	
General expenses	6,300				
Office wages	5,500		**Total**	2,44,200	2,44,200

Other information is as follows :

(1) The plant and equipment, all of which is used for repair work, is to be depreciated by 10%.

(2) Stocks at 31.12.2014 were — Cars ₹ 7,400; Petrol ₹ 1,600; Spare parts ₹ 700.

(3) No entries have been made for the following —
(i) Petrol used in demonstration runs cost ₹ 200; (ii) Parts used in repair jobs cost ₹ 750;
(iii) Repairs on cars subsequently sold were charged out at ₹ 2,400.

(4) Expenses which cannot be specifically allocated to one activity are to be apportioned — 60% to Cars; 10% to Petrol; 10% to Spare parts; 20% to Repairs.

(5) General expenses accrued amount to ₹ 300, and a provision is to be made of ₹ 500 for car salesmen's commission.

Prepare Trading and Profit and Loss Account, preferably in columnar form, to show clearly the profit or loss in each of the four main areas of business activity for the year ended 31.12.2014.

Also prepare the Balance Sheet at that date.

Solution

Mohit Udyog

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	Cars (₹)	Petrol (₹)	Spare Parts (₹)	Repairs (₹)	Particulars	Cars (₹)	Petrol (₹)	Spare Parts (₹)	Repairs (₹)
To Opening Stock	9,000	2,800	400	—	By Sales	1,20,000	32,000	4,700	14,700
To Purchases	83,500	27,500	4,000	—	By Inter Departmental Sales	—	200	750	2,400
To Parts used in repairs (Note 2)	—	—	—	750	By Closing Stock	7,400	1,600	700	—
To Repairs on cars sold (Note 3)	2,400	—	—	—					
To Wages	—	3,100	—	10,200					
To Gross Profit c/d	32,500	400	1,750	6,150					
	1,27,400	33,800	6,150	17,100		1,27,400	33,800	6,150	17,100
To Office wages (Note 4)	3,300	550	550	1,100	By Gross Profit b/d	32,500	400	1,750	6,150
To Rates and insurance	1,140	190	190	380	By Net Loss	—	1,000	—	—
To Salesmen's salaries and commission(7,700 + 500)	8,200	—	—	—					
To General expenses (Note 4)	3,960	660	660	1,320					
To Demonstration petrol cost (Note 1)	200	—	—	—					
To Depreciation on: Plant and Equipment	—	—	—	700					
To Net Profit	15,700	—	350	2,650					
	32,500	1,400	1,750	6,150		32,500	1,400	1,750	6,150

Balance Sheet of Mohit Udyog as at 31st December, 2014

Liabilities		₹	Assets		₹
Capital (Opening)	62,000		Freehold Garage Premises		42,000
Add: Profit from Cars	15,700		Plant and Equipment	7,000	
Add: Profit from spare parts	350		Less: Depreciation	700	6,300
Add: Profit from Repairs	2,650		Stock (₹ 7,400 + 1,600 + 700)		9,700
Less: Loss from Petrol	(1,000)	79,700	Debtors		14,000
Creditors		10,800	Bank		4,700
Outstanding : General Expenses		300	Cash		14,600
Cars Salesmen's Commission		500			
		91,300			91,300

Working Notes :

(1) Petrol used for demonstration run will be treated as selling expenses of Car department and sales of Petrol department.

(2) Spare parts used in repairs ₹ 750 will be treated as direct expenses of Repairs department and sales of Spare parts department.

(3) Repairs on car subsequently sold ₹ 2,400 will be treated as direct expenses of Car department and sales of Repairs department.

(4) Apportionment of Common Expenses

Expenses	Basis	Total (₹)	Cars (₹)	Petrol (₹)	Spare Parts (₹)	Repairs (₹)
(i) General Expenses	6 : 1 : 1 : 2	6,600*	3,960	660	660	1,320
(ii) Office Wages	6 : 1 : 1 : 2	5,500	3,300	550	550	1,100
(iii) Rates and Insurance	6 : 1 : 1 : 2	1,900	1,140	190	190	380

*₹ 6,300 +₹ 300(outstanding) =₹ 6,600.

Illustration 13

Shri Gangaram sells two products manufactured in his own factory. The goods are made in two departments A and B for which separate sets of accounts are maintained. Some of the manufactured goods of Department A are used as raw materials by Department B and *vice versa*. From the following particulars, you are required to ascertain the total cost of goods manufactured in these two departments:

	Dept. A	Dept. B
Total units manufactured	10,00,000	5,00,000
Total cost to manufacture (excluding inter-departmental transfers)	₹ 10,000	₹ 5,000

Department A transferred 2,50,000 units to Department B and the latter transferred 1,00,000 units to the former.

Solution

Department A has transferred 1/4th of the units produced to B, whereas Department B has transferred 1/5th of the units produced.

Let, X be the total cost of Department A and Y be the total cost of Department B.

Therefore, $X = ₹\ 10{,}000 + {}^{1}/_{5}\ Y$ ... (1) and

$Y = ₹\ 5{,}000 + {}^{1}/_{4}\ X$ ... (2)

Putting the value of Y in the first equation, we get

$X = ₹\ 10{,}000 + {}^{1}/_{5}\ (₹\ 5{,}000 + {}^{1}/_{4}\ X)$

$= ₹\ 10{,}000 + ₹\ 1{,}000 + {}^{1}/_{20}\ X$

or, $X - {}^{1}/_{20}\ X = 11{,}000$,

Therefore X = ₹ 11,579 (approx.)

Putting the value of X as ₹ 11,579 in the 2nd equation, we get

$Y = ₹\ 5{,}000 + {}^{1}/_{4}\ (₹\ 11{,}579)$

or Y = ₹ 7,895 (approx.)

Ascertainment of the Total Cost of Goods Manufactured

Particulars	Dept. A	Dept. B
Cost as ascertained above (₹)	11,579	7,895
Less: Transfers to the other department	(${}^{1}/_{4}$) 2,895	(${}^{1}/_{5}$) 1,579
Net cost of goods manufactured	8,684	6,316

Market-based Transfer Price

To avoid passing on inefficiencies of one department to the other, market based transfer prices may be used. It does not give any advantage to either the selling or buying department, compared with trading with the outsiders. Sometimes a standard market price may also be used.

Dual Pricing

To motivate both the departments, buying and selling departments may be debited and credited respectively with two different prices. For example, buying department may be debited with the cost price and selling department credited with the market price.

If the goods are transferred by one department to another department at a profit and at the end of the accounting period such goods are included in the unsold stock, an appropriate adjustment must be made for unrealised profit on stock. The entry is :
General Profit and Loss Account Dr.
To Provision for Unrealised Profit on Stock Account
At the beginning of the next year reverse entry will be passed.
Provision for Unrealised Profit on Stock Account Dr.
To General Profit and Loss Account

Illustration 14

Raman carries on a business of selling (both wholesale and retail) electrical materials. The wholesale and retail departments are separately organised, all goods are purchased by the wholesale department which adds one-seventh on to cost for charging out goods transferred to the retail department. At 31.12.2014, the total balance of the business as a whole is as follows :

Particulars	Dr. (₹)	Cr. (₹)
Capital		1,00,000
Freehold Premises	65,000	
Motor Vans : Cost and Accumulated Depreciation (1.1.2014)	9,000	4,000
Motor Cars : Cost and Accumulated Depreciation (1.1.2014)	6,000	3,000
Fixtures etc : Cost and Accumulated Depreciation (1.1.2014)	7,800	7,300
Stock (1.1.2014) : Wholesale at Cost	65,000	
Retail and provision for unrealised profit	32,000	4,000
Debtors (31.12. 2014) : Wholesale customers only	67,100	
Creditors (31.12. 2014)		41,200
Bad Debts	6,800	
Discount Received		4,850
Discount Allowed	8,500	
Salaries : Van drivers	8,800	
Warehouse staff	24,300	
Shop staff	8,250	
Car and Van running expenses	5,400	
Other Expenses	15,500	
Sales : Wholesale		3,40,000
Retail		96,000
Purchases	3,28,000	
Cash and Bank (31.12. 2014)	400	21,800
Reserve		35,700
Total	6,57,850	6,57,850

Additional information —

(i) Transfers of goods amounted to ₹ 76,000 at transfer prices.
(ii) Stocks at 31.12.2014 : Wholesale at cost ₹ 71,500; Retail at transfer price ₹ 36,000.
(iii) There are four vans, one of which is likely to be in use by the retail department at any one time.
(iv) The two cars are used by X, who divides their time between the two departments as to two-thirds wholesale and one-third retail.
(v) Depreciation of cars and vans is at 20% p.a. on cost. It is estimated that the remaining costs of a car and a van (excluding drivers' wages) do not differ materially.
(vi) Other expenses are 80% wholesale.
(vii) No further depreciation need be provided on fixtures etc.

You are required to prepare Trading and Profit and Loss Account for the year ended 31.12.2014 and Balance Sheet as on that date.

Solution

Raman

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	Wholesale (₹)	Retail (₹)	Total (₹)	Particulars	Wholesale (₹)	Retail (₹)	Total (₹)
To Opening Stock	65,000	32,000	97,000	By Sales	3,40,000	96,000	4,36,000
To Purchases	3,28,000	—	3,28,000	By Transfer to Retail	76,000	—	—
To Transfer from Wholesale	—	76,000	—	By Closing Stock	71,500	36,000	1,07,500
To Gross Profit c/d	94,500	24,000	1,18,500				
	4,87,500	1,32,000	5,43,500		4,87,500	1,32,000	5,43,500
To Bad Debts (Note 1)	6,800	—	6,800	By Gross Profit b/d	94,500	24,000	1,18,500
To Discounts Allowed (N 1)	8,500	—	8,500	By Discount Received (Note 2)	4,850	—	4,850
To Salaries :							
Van drivers (Note 3)	6,600	2,200	8,800				
Warehouse staff	24,300	—	24,300				
Shop staff	—	8,250	8,250				
To Van Running Expenses (Note 4a)	2,700	900	3,600				
To Car Running Expenses (Note 4b)	1,200	600	1,800				
To Other Expenses	12,400	3,100	15,500				
To Depreciation on :							
Vans (3 : 1)	1,350	450	1,800				
Cars (2 : 1)	800	400	1,200				
To Net Profit c/d	34,700	8,100	42,800				
	99,350	24,000	1,23,350		99,350	24,000	1,23,350
To Provision for Unrealised Profit on Closing Stock (Note 5)			4,500	By Reserve b/d			35,700
To Reserve c/d			78,000	By Provision for Unrealised Profit on Opening Stock			4,000
				By Net Profit b/d			42,800
			82,500				82,500

Balance Sheet of Raman as at 31st December, 2014

Liabilities	₹	Assets		₹
Capital	1,00,000	Freehold Premises		65,000
Reserve	78,000	Motor Vans (at cost)	9,000	
Creditors	41,200	Less : Accumulated Depreciation	5,800	3,200
Bank Overdraft	21,800	Motor Cars (at cost)	6,000	
		Less : Accumulated Depreciation	4,200	1,800
		Fixtures (at cost)	7,800	
		Less : Accumulated Depreciation	7,300	500
		Stock	1,07,500	
		Less : Provision for Unrealised Profit	4,500	1,03,000
		Debtors		67,100
		Cash		400
	2,41,000			2,41,000

Working Notes :

(1) Goods are sold on credit by the wholesale department only. Therefore, discount allowed is totally related to wholesale department. Similarly, bad debt is also related to wholesale department.

(2) Goods are purchased by wholesale department. Therefore, discount received is totally related to wholesale department.

(3) Out of four vans, one van is used by the retail department. Therefore, 1/4th of van driver's salary is to be borne by the retail department and 3/4th is to be borne by the wholesale department.

(4) There are four vans and two cars. Total running cost is ₹ 5,400. Running cost of a car and a van (excluding driver's salaries) do not differ materially. Therefore, entire running cost will be distributed between van and car in the ratio of 2 : 1.

Vans running cost will be — 2/3 of ₹ 5,400 = ₹ 3,600.

Cars running cost will be — 1/3 of ₹ 5,400 = ₹ 1,800.

(a) Vans running cost will be shared by wholesale department and retail department in the ratio 3 : 1.

(b) Cars running cost will be shared by wholesale department and retail department in the ratio 2 : 1.

(c) Goods are transferred to retail deprtment by adding 1/7th to cost. Therefore, the unrealised profit on closing stock will be :

₹ 36,000 × 1/8 = ₹ 4,500.

Illustration 15

From the following data, prepare Departmental Trading and Profit and Loss Account for the year ended December 31, 2014:

Particulars	Dept. A	Dept. B
Opening Stock	40,000	—
Purchases from Outside	2,00,000	20,000
Wages	10,000	1,000
Transfer of Goods from Department A	—	50,000
Closing Stock at cost to the Department	30,000	10,000
Sales to Outsiders	2,00,000	71,000

B's entire stock represents goods from Department A which transfers them at 25% above its cost. Administrative and Selling Expenses amount to ₹ 15,000 which are to be allocated between Departments A and B in the ratio of 4 : 1 respectively. Also show the amount of provision to be made for unrealised profit.

Solution

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	Dept A (₹)	Dept B (₹)	Total (₹)	Particulars	Dept A (₹)	Dept B (₹)	Total (₹)
To Opening Stock	40,000	—	40,000	By Sales	2,00,000	71,000	2,71,000
To Purchases	2,00,000	20,000	2,20,000	By Goods transferred to B	50,000	—	—
To Goods from Dept A	—	50,000	—	By Closing Stock	30,000	10,000	40,000
To Wages	10,000	1,000	11,000				
To Gross Profit c/d	30,000	10,000	40,000				
	2,80,000	81,000	3,11,000		2,80,000	81,000	3,11,000
To Selling Expenses (4 : 1)	12,000	3,000	15,000	By Gross Profit b/d	30,000	10,000	40,000
To Net Profit c/d	18,000	7,000	25,000				
	30,000	10,000	40,000		30,000	10,000	40,000
To Provision for Unrealised Profit on Closing Stock (Note 1)			2,000	By Net Profit b/d			25,000
To Capital A/c (Net Profit transferred)			23,000				
			25,000				25,000

Working Note :

(1) Goods are transferred to Dept. A at cost plus 25%. It means the unrealised profit is 20% (25/125) on transfer price. Therefore, unrealised profit on closing stock = 20% of ₹ 10,000 = ₹ 2,000.

Illustration 16

A & Co has two departments P and Q. Department P sells goods to Department Q at normal selling prices. From the following particulars, prepare Departmental Trading and Profit and Loss Account for the year ended 31.3.2014 and also ascertain the Net Profit to be transferred to Balance Sheet :

	Department P (₹)	Department Q (₹)
Opening Stock	5,00,000	—
Purchases	28,00,000	3,00,000
Goods from P	—	8,00,000
Wages	3,50,000	2,00,000
Travelling Expenses	20,000	1,60,000
Closing Stock at cost to the Department	8,00,000	2,09,000
Sales	30,00,000	20,00,000
Printing and Stationery	30,000	25,000

The following expenses incurred for both the departments were not apportioned between the departments :

(a) Salaries ₹ 3,30,000; (b) Advertisement expenses ₹ 1,20,000; (c) General expenses ₹ 5,00,000; (d) Depreciation is to be charged @ 30% on the machinery value of ₹ 96,000.

The advertisement expenses of the departments are to be apportioned in the turnover ratio. Salaries and depreciation are to be apportioned in the ratio 2 : 1 and 1 : 3 respectively. General expenses are to be apportioned in the ratio 3 : 1.

Solution

A & Co

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st March, 2014 Cr.

Particulars	Dept P (₹)	Dept Q (₹)	Total (₹)	Particulars	Dept P (₹)	Dept Q (₹)	Total (₹)
To Opening Stock	5,00,000	—	5,00,000	By Sales	30,00,000	20,00,000	50,00,000
To Purchases	28,00,000	3,00,000	31,00,000	By Goods transferred to Q	8,00,000	—	—
To Goods from Dept P	—	8,00,000	—	By Closing Stock	8,00,000	2,09,000	10,09,000
To Wages	3,50,000	2,00,000	5,50,000				
To Gross Profit c/d	9,50,000	9,09,000	18,59,000				
	46,00,000	22,09,000	60,09,000		46,00,000	22,09,000	60,09,000
To Travelling Expenses	20,000	1,60,000	1,80,000	By Gross Profit b/d	9,50,000	9,09,000	18,59,000
To Printing and Stationery	30,000	25,000	55,000				
To Salaries (2 : 1)	2,20,000	1,10,000	3,30,000				
To Advertisement Expenses (3 : 2)	72,000	48,000	1,20,000				
To General Expenses (3 : 1)	3,75,000	1,25,000	5,00,000				
To Depreciation on Machinery (1:3)	7,200	21,600	28,800				
To Net Profit c/d	2,25,800	4,19,400	6,45,200				
	9,50,000	9,09,000	18,59,000		9,50,000	9,09,000	18,59,000
To Provision for Unrealised Profit on Closing Stock (Note 2)			38,000	By Net Profit b/d			6,45,200
To Capital A/c (Net Profit transferred)			6,07,200	By Provision for Unrealised Profit on Opening Stock			Nil
			6,45,200				6,45,200

Working Notes :

(1) Gross Profit Ratio of Department P = $\frac{9,50,000}{30,00,000 + 8,00,000} \times 100 = \mathbf{25\%}$

(2) Proportionate P Department's stock in Department Q

$$= \frac{\text{Purchase from Department P}}{\text{Total Purchases of Department Q}} \times \text{Total Stock of Department Q} = \frac{8,00,000}{11,00,000} \times \text{Rs } 2,09,000 = ₹\ 1,52,000$$

Unrealised profit = 25% of ₹ 1,52,000 = ₹ 38,000.

Illustration 17

The firm "Tantuja" has two departments - first one is "cloth" and the second is "tailoring". Tailoring department gets all its requirements of cloth from the cloth department at the usual selling price. From the following particulars prepare Departmental Trading Account and Profit and Loss Account for the year ended 31st March, 2015 : (all figures in ₹)

Particulars	Cloth Dept.	Tailoring Dept.
Manufacturing Expenses	—	1,08,000
Selling Expenses	45,000	18,000
Stock on 1.4.2014	5,40,000	72,000
Sales	36,00,000	7,20,000
Transfer of Cloth to Tailoring Dept.	4,50,000	—
Purchases	30,60,000	45,000
Stock on 31.3.2015	9,00,000	1,35,000

The stock in Tailoring Department may be assumed to consist 80% cloth and 20% other expenses. General expenses of the business for the year came to ₹ 2,07,000. In 2013-14 the Cloth Department earned a gross profit of 30% on sales.

Solution

Tantuja

Dr. Departmental Trading and Profit & Loss Account for the year ended 31st March, 2015 Cr.

Particulars	Cloth	Tailoring	Total	Particulars	Cloth	Tailoring	Total
To Opening Stock	5,40,000	72,000	6,12,000	By Sales	36,00,000	7,20,000	43,20,000
To Purchases	30,60,000	45,000	31,05,000	By Tailoring Dept. - transfer	4,50,000	—	—
To Cloth Dept. - transfer	—	4,50,000	—	By Closing Stock	9,00,000	1,35,000	10,35,000
To Manufacturing expenses	—	1,08,000	1,08,000				
To Gross Profit c/d	13,50,000	1,80,000	15,30,000				
	49,50,000	8,55,000	53,55,000		49,50,000	8,55,000	53,55,000

To Selling expenses	45,000	18,000	63,000	By Gross Profit b/d	13,50,000	1,80,000	15,30,000
To Departmental Profit c/d	13,05,000	1,62,000	14,67,000				
	13,50,000	1,80,000	15,30,000		13,50,000	1,80,000	15,30,000
To General expenses			2,07,000	By Departmental Profit b/d			14,67,000
To Provision for unrealised profit on Departmental Closing Stock (Note 2)			36,000	By Provision for unrealised profit on Departmental Opening Stock (Note 2)			17,280
To Net Profit transferred to Capital			12,41,280				
			14,84,280				14,84,280

Working Notes:

(1) Calculation of unrealised profit on stock

Rate of Gross profit in cloth department = $\frac{13,50,000}{40,50,000} \times 100 = 33\frac{1}{3}$ % on sales.

* (₹ 36,00,000 + ₹ 4,50,000) = ₹ 40,50,000.

(2) Element of cloth in tailoring department = 80%

Therefore, element of cloth in opening stock — 80% of ₹ 72,000 = ₹ 57,600

Element of cloth in closing stock — 80% of ₹ 1,35,000 = ₹ 1,08,000

Unrealised profit including in opening stock = 30% of ₹ 57,600 = ₹ 17,280

Unrealised profit included in closing stock = $33^1/_3$% on ₹ 1,08,000 = ₹ 36,000.

Illustration 18

Modern Engineering Works carried on business with two departments : Raw Materials and Manufacturing. The finished goods are produced by the Manufacturing Department with raw material supplied from Raw Materials Department at selling price.

Prepare Departmental Trading and Profit and Loss Account for the year ending on 31st December, 2014 after allocation of expenses on reasonable basis between the two departments.

Necessary particulars are furnished below :

	Raw Materials Department	Manufacturing Department
Opening Stock	60,000	10,000
Purchases	4,00,000	3,000
Raw materials transferred to Manufacturing Department	60.000	—
Sales	4,40,000	90,000
Manufacturing Expenses	—	12,000
Sellling Expenses	800	400
Closing Stock	40,000	12,000

It is estimated that the cost of closing stock in the hands of Manufacturing Department consists of 80% for raw materials and 20% for manufacturing expenses. The rate of gross profit earned during the preceding year by the Raw Materials Department was 10%. Other administrative expenses are as follows :

(i) Salaries ₹ 2,500; (ii) Insurance premium ₹ 800.

Solution **Modern Engineering Works**

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	R.M. Dept (₹)	Mfg. Dept (₹)	Total (₹)	Particulars	R.M. Dept (₹)	Mfg. Dept (₹)	Total (₹)
To Opening Stock	60,000	10,000	70,000	By Sales	4,40,000	90,000	5,30,000
To Purchases	4,00,000	3,000	4,03,000	By Raw Materials transferred to Manufacturing Dept.	60,000	—	—
To Manufacturing Expenses	—	12,000	12,000				
To Raw Materials from Mfg. Dept.	—	60,000	—	By Closing Stock	40,000	12,000	52,000
To Gross Profit c/d	80,000	17,000	97,000				
	5,40,000	1,02,000	5,82,000		5,40,000	1,02,000	5,82,000
To Selling Expenses	800	400	1,200	By Gross Profit b/d	80,000	17,000	97,000
To Salaries (Note 3)	2,119	381	2,500				
To Insurance Premium (Note 4)	656	144	800				
To Net Profit c/d	76,425	16,075	92,500				
	80,000	17,000	97,000		80,000	17,000	97,000

To Provision for Unrealised Profit on Closing Stock (Note 1)	1,536	By Net Profit b/d	92,500
To Capital A/c (Net Profit transferred)	91,764	By Provision for Unrealised Profit on Opening Stock	800
	93,300		93,300

Working Notes :

(1) Gross Profit Ratio of Raw Materials Department $= \dfrac{80,000}{(4,40,000 + 60,000)} \times 100 = \dfrac{80,000}{5,00,000} \times 100 = 16\%$

(2) Provision for Unrealised Profit on Opening Stock = (10,000 × 80%) × 10% = ₹ 800.

Provision for Unrealised Profit on Closing Stock = (12,000 × 80%) × 16% = ₹ 1,536.

(3) Salaries can be shared by the R.M. Dept and Mfg. Dept. in the ratio of Sales of each department. The ratio will be :

(4,40,000 + 60,000) : 90,000

or 5,00,000 : 90,000

or 50 : 9.

(a) Raw materials department's share = 2,500 / 59 × 50 = ₹ 2,119

(b) Manufacturing department's share = 2,500 / 59 × 9 = ₹ 381.

(4) Insurance premium can be shared by R.M. Dept. and Mfg. Dept. in the ratio of average stock of each department. The ratio will be :

$= \dfrac{(60,000 + 40,000)}{2} : \dfrac{(10,000 + 12,000)}{2}$

or 50,000 : 11,000

or 50 : 11

(a) Raw materials department's share = 800 / 61 × 50 = ₹ 656.

(b) Mfg. department's share = 800 / 61 × 11 = ₹ 144.

Illustration 19

O and K are two departments of Red Company of Calcutta. O Department sells goods to K Department at normal market prices. From the following particulars, prepare a Trading and Profit and Loss Account of the two departments for the year ended 31st March 2015:

Particulars	O	K	General
Stocks on April 1, 2014	12,000	Nil	—
Purchases	2,76,000	24,000	—
Goods from O Dept.	—	84,000	—
Wages	12,000	19,200	—
Salaries	8,000	5,000	—
Stock on March 31, 2015 at cost to Dept.	60,000	21,600	—
Sales	2,76,000	1,74,000	—
Stationery and Printing	2,560	1,960	—
Plant and Machinery	—	14,400	—
Salaries (General)	—	—	18,000
Miscellaneous Expenses	—	—	3,600
Advertisement	—	—	9,600
Bank charges	—	—	2,400

Depreciate Plant & Machinery by 10%. The general unallocated expenses are to be apportioned in the ratio — O:3, K:2.

Solution

Red Company

Dr. Departmental Trading and Profit & Loss Account for the year ended 31st March, 2015 Cr.

Particulas	Dept O	Dept K	Total	Particulas	Dept O	Dept K	Total
To Opening Stock	12,000	—	12,000	By Sales	2,76,000	1,74,000	4,50,000
To Purchases	2,76,000	24,000	3,00,000	By Goods transferred to K	84,000	—	—
To Goods from Dept O	—	84,000	—	By Closing Stock	60,000	21,600	81,600
To Wages	12,000	19,200	31,200				
To Gross Profit c/d	1,20,000	68,400	1,88,400				
	4,20,000	1,95,600	5,31,600		4,20,000	1,95,600	5,31,600

To Salaries	8,000	5,000	13,000	By Gross Profit b/d	1,20,000	68,400	1,88,400
To Printing & Stationery	2,560	1,960	4,520				
To Salaries (General)	10,800	7,200	18,000				
To Miscellaneous expenses	2,160	1,440	3,600				
To Advertisement	5,760	3,840	9,600				
To Bank charges	1,440	960	2,400				
To Depreciation	—	1,440	1,440				
To Net Profit c/d	89,280	46,560	1,35,840				
	1,20,000	68,400	1,88,400		1,20,000	68,400	1,88,400
To Provision for unrealised profit on Departmental Closing Stock (Note 1)			5,600	By Net Profit b/d			1,35,840
To Capital A/c (net profit transferred)			1,30,240	By Provision for unrealised profit on Dept. Opening Stock			Nil
			1,35,840				1,35,840

Working Note:

(1) Gross profit ratio of Department O = $\dfrac{1,20,000}{(2,76,000 + 84,000)} \times 100 = 33\frac{1}{3}\%$

Proportionate Department O stock in Department K = $\dfrac{\text{Purchases from Dept. O}}{\text{Total Purchases of Dept. K}} \times$ Total Stock of Dept. 'K'

$= \dfrac{84,000}{1,08,000} \times 21,600 =$ ₹ 21,600. Profit thereon : $33\frac{1}{3}\%$ of 16,800 = ₹ 5,600.

Illustration 20

M/s G,B,T carried on business as Drapers and Tailors in Jaipur. The partners G,B and T were in charge of the Departments, X,Y and Z respectively. The partners are entitled to a remuneration equal to 50% of the profits (without taking the Partner's remuneration into consideration) of the respective departments of which they are in charge and the balance of the profits are to be divided among G,B and T in the ratio of 5:3:2. The following are the balances of the revenue items in the books for the year ending March 31, 2015:

Opening Stock : X — ₹ 75,780; Y — ₹ 48,000; and Z — ₹ 40,000.
Purchases : X — ₹ 2,81,400; Y — ₹ 1,61,200; and Z — ₹ 88,800.
Sales : X — ₹ 3,60,000; Y — ₹ 2,70,000; and Z — ₹ 1,80,000.
Closing Stock : X — ₹ 90,160; Y — ₹ 34,960; and Z — ₹ 43,180.
Salaries and wages — ₹ 96,000; Advertising — ₹ 4,500; Rent — ₹ 21,600; Discount allowed — ₹ 2,700;
Discount received — ₹ 1,600; Sundry expenses — ₹ 24,300; Depreciation on Furniture & Fittings — ₹ 1,500.

(i) Prepare the Departmental Accounts for each of the three departments in columnar form.
(ii) Show the distribution of profits amongst the partners after taking into account the following:
(a) Goods having a transfer price of ₹ 21,400 and ₹ 1,200 were transferred from Departments X and Y respectively to Department Z. The inter-departmental transfers are made at 125% of the cost.
(b) The various items shall be apportioned amongst the three departments in the following proportions:

Nos.	Particulars	Department X	Department Y	Department Z
1.	Rent	2	2	5
2.	Salaries	1	1	1
3.	Depreciation	1	1	1
4.	Discounts received	8	5	3
5.	All the other expenses	On the basis of the sales (excluding inter-departmental transfers) of each department.		

(c) The opening stock of Department Z does not include any goods transferred from other departments, but the closing stock includes ₹ 17,100 valued at the inter-departmental transfer prices.

Solution

G.B.T.

Dr. Departmental Trading and Profit & Loss Account for the year ended 31st March, 2015 Cr.

Particulars	Dept. X	Dept. Y	Dept. Z	Particulars	Dept. X	Dept. Y	Dept. Z
To Opening Stock	75,780	48,000	40,000	By Sales	3,60,000	2,70,000	1,80,000
To Purchases	2,81,400	1,61,200	88,800	By Transfer	21,400	1,200	—

To Transfer	—	—	22,600	By Closing Stock	90,160	34,960	43,180
To Gross Profit c/d	1,14,380	96,960	71,780				
	4,71,560	3,06,160	2,23,180		4,71,560	3,06,160	2,23,180
To Salaries	32,000	32,000	32,000	By Gross Profit b/d	1,14,380	96,960	71,780
To Rent	4,800	4,800	12,000	By Discount received	800	500	300
To Advertising	2,000	1,500	1,000				
To Discount Allowed	1,200	900	600				
To Sundry Expenses	10,800	8,100	5,400				
To Depreciation	500	500	500				
To Departmental Profit	63,880	49,660	20,580				
	1,15,180	97,460	72,080		1,15,180	97,460	72,080

Dr. Appropriation Account for the year ended 31st March, 2015 Cr.

Particulars	₹	Particulars	₹
To Provision for unrealised profit on Departmental Closing Stock (Note 1)	3,420	By Departmental Profit	1,34,120
To Net Profit c/d	1,30,700		
	1,34,120		1,34,120
To Partners' Remuneration :		By Net Profit b/d	1,30,700
G (1/2 of ₹ 63,880)	31,940		
B (1/2 of ₹ 49,660)	24,830		
T (1/2 of ₹ 20,580)	10,290		
To Share of Profit :			
G (5/10 of ₹ 63,640)	31,820		
B (3/10 of ₹ 63,640)	19,092		
T (2/10 of ₹ 63,640)	12,728		
	1,30,700		1,30,700

Working Notes: (1) 1/5 of ₹ 17,100.

Illustration 21

X Ltd. has two departments A and B. From the following particulars prepare Departmental Trading Account and Consolidated Trading Account for the year ending 31st December 2014. (all figures in ₹)

Particulars	Dept. A	Dept. B
Opening Stock at cost	40,000	24,000
Purchases	1,84,000	1,36,000
Carriage Inward	4,000	4,000
Wages	24,000	16,000
Sales	2,80,000	2,24,000
Purchased goods transferred by Dept. B to Dept. A	20,000	—
Purchased goods transferred by Dept. A to Dept. B	—	16,000
Finished goods transferred by Dept. B to Dept. A	70,000	—
Finished goods transferred by Dept. A to Dept. B	—	80,000
Return of finished goods by Dept. B to Dept. A	20,000	—
Return of finished goods by Dept. A to Dept. B	—	14,000
Closing stock of Purchased goods	9,000	12,000
Closing stock of Finished goods	48,000	28,000

Purchased goods have been transferred mutually at their respective departmental purchase cost and finished goods at departmental market price and that 20% of the finished stock (closing) at each department represented finished goods received from the other department.

Solution **X Ltd.**

Dr. Departmental Trading Account for the year ended 31st December, 2014 Cr.

Particulars	Dept. A ₹	Dept. B ₹	Particulars	Dept. A ₹	Dept. B ₹
To Opening Stock	40,000	24,000	By Sales	2,80,000	2,24,000
To Purchases	1,84,000	1,36,000	By Transfer : Purchased goods	16,000	20,000
To Carriage Inwards	4,000	4,000	Finished goods	80,000	70,000
To Wages	24,000	16,000	By Returns : Finished goods	14,000	20,000
To Transfer : Purchased goods	20,000	16,000	By Closing. stock : Purchased goods	9,000	12,000
Finished goods	70,000	80,000	Finished goods	48,000	28,000
To Returns : Finished goods	20,000	14,000			
To Gross Profit c/d	85,000	84,000			
	4,47,000	3,74,000		4,47,000	3,74,000

Dr. Consolidated Trading Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
To Opening Stock (₹ 40,000 + 24,000)	64,000	By Sales (₹ 2,80,000 + ₹ 2,24,000)	5,04,000
To Purchases (₹ 1,84,000 + 1,36,000)	3,20,000	By Closing Stock :	
To Carriage Inwards (₹ 4,000 + 4,000)	8,000	Purchased goods (₹ 9,000 + ₹ 12,000)	21,000
To Wages (₹ 24,000 + 16,000)	40,000	Finished goods (Note 2)	71,720
To Gross Profit	1,64,720		
	5,96,720		5,96,720

Tutorial Note : For combined Trading Account, inter-departmental transfer should be ignored.

Working Notes : (1) Calculation of Stock reserve in Closing Stock

Particulars	Dept A (₹)	Dept B (₹)
Sales	2,80,000	2,24,000
Add: Transfer of finished goods	80,000	70,000
	3,60,000	2,94,000
Less: Return of finished goods	20,000	14,000
Sales (Net)	3,40,000	2,80,000
Gross profit	85,000	84,000
Rate of gross profit	$\frac{85,000}{3,40,000} \times 100 = 25\%$	$\frac{84,000}{2,80,000} \times 100 = 30\%$

Finished goods from other Department included in Closing Stock

Department A	₹	Department B	₹
20% of ₹ 48,000	9,600	20% of ₹ 28,000	5,600
Unrealised profit = 30% of ₹ 9,600 (30% is the G.P. ratio of Dept B)	2,880	Unrealised profit = 25% of ₹ 5,600	1,400

(2) Closing Stock of Finished Goods

	Dept A	Dept B	Total
Closing Stock (₹)	48,000	28,000	76,000
Less: Unrealised profit as calculated above	2,880	1,400	4,280
Closing stock (excluding unrealised profit)	45,120	26,600	71,720

Illustration 22

Bubbles Ltd has three operating departments. The details of operations of each department during 2014 had been as follows:

	Department I (₹)	Department II (₹)	Department III (₹)
Sales to Customers	4,00,000	6,00,000	8,00,000
Purchases from Outsiders	3,00,000	4,00,000	5,00,000
Opening Stock (out of local purchases)	80,000	1,00,000	1,20,000
Transfer to Department III	1,35,000	—	—
Closing Stock	50,000	50,000	1,00,000

Common expenses :

Selling commission ₹ 36,000; Depreciation ₹ 45,000; Administration expenses ₹ 1,60,000; Interest on capital ₹ 90,000.

Stock of department III includes 20% transfers from department I.

Prepare Departmental Trading and Profit and Loss Account and ascertain the net profit of the company after considering the following details :

	Department I (₹)	Department II (₹)	Department III (₹)
Fixed assets installed	3,60,000	2,00,000	1,60,000
Capital employed	2,00,000	3,00,000	3,00,000
Administration expenses to be shared	4/10	3/10	3/10

Department I transfers supplies to Department III at normal price less 10%.

Solution **Bubbles Ltd**

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	Dept I (₹)	Dept II (₹)	Dept III (₹)	Total (₹)	Particulars	Dept I (₹)	Dept II (₹)	Dept III (₹)	Total (₹)
To Opening Stock	80,000	1,00,000	1,20,000	3,00,000	By Sales	4,00,000	6,00,000	8,00,000	18,00,000
To Purchases	3,00,000	4,00,000	5,00,000	12,00,000	By Transfer to Dept III	1,35,000	—	—	—
To Transfer from Dept I	—	—	1,35,000	—	By Closing Stock	50,000	50,000	1,00,000	2,00,000
To Gross Profit c/d	2,05,000	1,50,000	1,45,000	5,00,000					
	5,85,000	6,50,000	9,00,000	20,00,000		5,85,000	6,50,000	9,00,000	20,00,000
To Selling Commission	8,000	12,000	16,000	36,000	By Gross Profit b/d	2,05,000	1,50,000	1,45,000	5,00,000
To Depreciation	22,500	12,500	10,000	45,000					
To Administrative Expenses	64,000	48,000	48,000	1,60,000					
To Interest on Capital	22,500	33,750	33,750	90,000					
To Net Profit c/d	88,000	43,750	37,250	1,69,000					
	2,05,000	1,50,000	1,45,000	5,00,000		2,05,000	1,50,000	1,45,000	5,00,000
To Provision for Unrealised Profit on Closing Stock (Note 2)				6,667	By Net Profit b/d				1,69,000
To Net Profit (Transferred)				1,62,333	By Provision for Unrealised Profit on Opening Stock				Nil
				1,69,000					1,69,000

Working Notes :

(1) Goods transferred by Department I to Department III at normal price less 10%. Normal price of goods transferred to Department III = ₹ 1,35,000 / 90 × 100 = ₹ 1,50,000.

Normal Gross Profit of Department I would have been :	₹	₹
Sales to outside customers		4,00,000
Transfer to Department III at normal price (as calculated above)		1,50,000
		5,50,000
Less: Cost of Goods Sold :	₹	
Opening Stock	80,000	
Purchases	3,00,000	
	3,80,000	
Less: Closing Stock	50,000	3,30,000
Gross Profit		2,20,000

$$\text{Normal rate of Gross Profit} = \frac{2,20,000}{5,50,000} \times 100 = 40\%$$

(a) Cost of goods transferred to Department III = 60% of ₹ 1,50,000 = ₹ 90,000.

(b) Value of goods transferred to Department III = ₹ 1,35,000

Therefore, profit on goods transferred (b – a) = ₹ 1,35,000 – ₹ 90,000 = ₹ 45,000.

$$\text{Ratio of profit made by Department I on goods transferred to Department III} = \frac{45,000}{1,35,000} \times 100 = 33\frac{1}{3}\%$$

(2) Stock of Department III includes 20% transferred from Department I, i.e., 20% of ₹ 1,00,000 = **₹ 20,000**.

Therefore, unrealised profit on closing stock = $33^1/_3$% of ₹ 20,000 = ₹ 6,667.

Illustration 23

Vijoya Ltd has three departments, I, N and K. For the year ended 31.12.2014, the information is given below :

Paticulars	I (₹)	N (₹)	K (₹)
Stock on 1.1.2014	13,500	18,000	27,000
Materials consumed	36,000	54,000	—
Manufacturing expenses	22,500	45,000	—
Stock on 31.12.2014	18,000	63,000	36,000
Unrealised profit on stock on 1.1.2014	—	4,500	6,000
Sales	—	—	1,53,000

Each department values its stocks at cost to the department concerned. Whereas department I transferred goods to department N at 30% above departmental cost, department N transferred to departrment K at 25% above departmental cost. Other expenses were : Staff remuneration ₹ 6,000; Stationery ₹ 4,500; Rent ₹ 27,000; Depreciation ₹ 18,000; and Advertising ₹ 13,500. These expenses are to be shared by the departments in the ratio of gross profit.

Prepare Departmental Trading and Profit and Loss Account.

Solution

Vijoya Ltd

Dr. Departmental Trading and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	Dept. I (₹)	Dept. N (₹)	Dept. K (₹)	Total (₹)	Particulars	Dept. I (₹)	Dept. N (₹)	Dept. K (₹)	Total (₹)
To Opening Stock	13,500	18,000	27,000	58,500	By Sales	—	—	1,53,000	1,53,000
To Direct Materials	36,000	54,000	—	90,000	By Transfer to Dept. N	70,200	—	—	—
To Manufacturing Expenses	22,500	45,000	—	67,500	By Transfer to Dept. K	—	1,55,250	—	—
To Transfer from Dept. I	—	70,200	—	—	By Closing Stock	18,000	63,000	36,000	1,17,000
To Transfer from Dept. N	—	—	1,55,250	—					
To Gross Profit c/d	16,200	31,050	6,750	54,000					
	88,200	2,18,250	1,89,000	2,70,000		88,200	2,18,250	1,89,000	2,70,000
To Staff Remuneration	1,800	3,450	750	6,000	By Gross Profit b/d	16,200	31,050	6,750	54,000
To Stationery	1,350	2,587	563	4,500	By Net Loss c/d	4,500	8,625	1,875	15,000
To Rent	8,100	15,525	3,375	27,000					
To Depreciation	5,400	10,350	2,250	18,000					
To Advertising	4,050	7,763	1,687	13,500					
	20,700	39,675	8,625	69,000		20,700	39,675	8,625	69,000
To Net Loss b/d				15,000	By Provision for Unrealised Profit on Opening Stock (₹ 4,500 + ₹ 6,000)				10,500
To Provision for Unrealised Profit on Closing Stock(Note 2)				15,989	By Profit and Loss A/c — Transfer				20,489
				30,989					30,989

Working Notes :

(1) Calculation of the Value of Transfer

(a) From Dept I to N	₹	(b) From Dept N to K	₹
Opening stock	13,500	Opening stock	18,000
Add: Materials consumed	36,000	Add: Materials consumed	54,000
Add: Manufacturing expenses	22,500	Add: Manufacturing expenses	45,000
	72,000	Add: Transfer (as calculated)	70,200
Less: Closing stock	18,000		1,87,200
Cost of goods transferred	54,000	Less: Closing stock	63,000
Add: Loading @ 30%	16,200	Cost of goods transferred	1,24,200
Value of transfer	70,200	Add: Loading @ 25%	31,050
		Value of transfer	1,55,250

(2) Calculation of Unrealised Profit on Closing Stock

(a) For Dept N	(b) For Dept K
Dept I transferred to Dept N at 30% above cost, i.e., unrealised profit included in Dept N's stock is at 30/130 on transfer price. Therefore, unrealised profit on stock $= \frac{30}{130}$ [Closing Stock $\times \frac{\text{Transfer}}{\text{Departmental Cost}}$] $= \frac{30}{130}$ [$63{,}000 \times \frac{70{,}200}{54{,}000 + 45{,}000 + 70{,}200}$] = ₹ 6,032 Total provision for unrealised profit = ₹ 6,032 (Dept N) + ₹ 9,957 (Dept K) = ₹ 15,989.	Dept N transferred to Dept K at 25% of cost, i.e., unrealised profit included in Dept. K's stock is 25/125 = 1/5 on transfer price. Therefore, unrealised profit on stock arising from Dept N 1/5 of ₹ 36,000 = ₹ 7,200. And unrealised profit on stock arising from Dept I = 30 / 130 (₹ 36,000 – ₹ 7,200) x (₹ 70,200 / ₹ 1,69,200) Therefore, total = (₹ 7,200 + ₹ 2,757) = ₹ 9,957.

Memorandum Stock Account and Memorandum Mark-up Account

For an adequate check on department stock, sometimes a Memorandum Stock Account is maintained at selling price/inflated price. A Memorandum Mark-up Account is also maintained for the loading (selling price – cost price). Departmental gross profit comes out from the Memorandum Mark-up Account. This Account can be compared with the Branch Adjustment Account which is prepared when goods are sent to branch at inflated price.

Accounting Arrangement

1. The opening stock is brought down on the debit side of the Memorandum Stock Account at selling price (cost + mark-up).
   Amount of mark-down on opening stock is brought down on the credit side of the Memorandum Stock Account.
2. The loading on opening stock is brought down on the credit side of the Memorandum Mark-up Account. Amount of mark-down on opening stock is brought down on the debit side of the Memorandum Stock Account.
3. ***For goods purchased***

Memorandum Stock Account	Dr. [Selling price]
To Purchases Account	[Cost price]
To Memorandum Mark-up Account	[Loading]

4. ***For sale of goods***

Sales Account	Dr. [Selling price]
To Memorandum Stock Account	[Selling price]

5. ***For transfer of goods by one department to another (say by X to Y)***

Y's Memorandum Stock Account	Dr. [Cost price]
To X's Memorandum Stock Account	[Cost price]

6. ***For loading on transfer by X Department***

Memorandum Mark-up Account	Dr. [Loading of X Department]
To Memorandum Stock Account	

7. ***For loading on goods received by Y Department***

Memorandum Stock Account	Dr. [Loading of Y Department]
To Memorandum Mark-up Account	

8. Sometimes goods may have to be marked-down due to competition or due to deterioration of goods lying in stock. In such a case, the entry will be:

Memorandum Mark-up Account	Dr. [Mark-down]
To Memorandum Stock Account	

9. ***For loss of stock***
   Loss of Stock Account Dr. [Cost price]
   Memorandum Mark-up Account Dr. [Loading]
   To Memorandum Stock Account [Selling price]

10. ***For mark-down on goods lying in stock***
    Memorandum Stock Account Dr.
    To Memorandum Mark-up Account

Now, the balance of Memorandum Stock Account will represent the closing stock at selling price. Loading on closing stock is to be carried forward. The balance of Memorandum Mark-up Account will represent gross profit.

Illustration 24

Southern Store Ltd. is a retail store operating two departments. The company maintains a Memorandum Stock Account and Memorandum Mark-up Account for each of the departments.

Supplies issued to the departments are debited to the Memorandum Stock Account of the department at cost plus the mark-up, and departmental sales are credited to this account. The mark-up on supplies issued to the departments is credited to the mark-up account for the department.

When it is necessary to reduce the selling price below the normal selling price, i.e., cost plus mark-up, the reduction (mark-down) is entered in the Memorandum Stock Account and in the mark-up account. Department Y has a mark-up of $33^1/_3$% on cost and Department Z 50% on cost.

Following information has been extracted from the records of Southern Store Ltd. for the year ended 31st December, 2014 (all figures in ₹) :

Particulars	Dept. Y	Dept. Z
Stock (1.1.2014) at cost	24,000	36,000
Purchases	1,62,000	1,90,000
Sales	2,10,000	2,85,000

1. The stock of Department Y at 1st January 2014 includes goods on which the selling price has been marked down by ₹ 510. These goods were sold in January 2014 at the reduced price.
2. Certain goods purchased in 2014 for ₹ 2,700 for department Y, were transferred during the year to department Z, and sold for ₹ 4,050. Purchase and sale are recorded in the purchases of department Y and the sales of department Z respectively, but no entries in respect of the transfer have been made.
3. Goods purcahsed in 2014 were marked down as follows:

	Dept. Y	Dept. Z
Cost	8,000	21,000
Mark down	800	4,100

   At the end of the year there were some items in the stock of department Z, which had been marked down to ₹ 2,300. With this exception, all goods marked down in 2014 were sold during the year at the reduced prices.
4. During stock taking at 31st December 2014 goods which had cost ₹ 240 were found to be missing in department Y. It was determined that the loss should be regarded as irrecoverable.
5. The closing stock in both departments are to be valued at cost for the purpose of the annual accounts.

You are required to prepare for each department for the year ended 31st December 2014:

(a) a Trading Account; (b) a Memorandum Stock Account; and (c) a Memorandum Mark-up Account.

Solution

Southern Stores Ltd.

Dr. Trading Account for the year ended 31st December 2014 Cr.

Particulars	Dept. Y	Dept. Z	Particulars	Dept. Y	Dept. Z
To Opening Stock, at cost	24,000	36,000	By Sales	2,10,000	2,85,000
To Purchases	1,62,000	1,90,000	By Dept. Z - transfer	2,700	—
To Dept Y - transfer	—	2,700	By Profit & Loss A/c - goods lost	240	—
To Gross profit	51,518	92,496	By Closing stock (Note 1)	24,578	36,196
	2,37,518	3,21,196		2,37,518	3,21,196

Dr. **Memorandum Stock Account** **Cr.**

Particulars	Dept. Y	Dept. Z	Particulars	Dept. Y	Dept. Z
To Balance b/d (cost + mark up)	32,000	54,000	By Balance b/d (Mark-down on opening stock)	510	—
To Purchases A/c	1,62,000	1,90,000	By Sales A/c	2,10,000	2,85,000
To Memorandum Mark Up A/c (Mark-up on purchases)	54,000	95,000	By Dept Z - transfer	2,700	—
To Dept Y - transfer	—	2,700	By Memorandum Mark Up A/c (mark up on transfer)	900	—
To Memorandum Mark Up A/c (Mark up on transferred goods)	—	1,350	By Memorandum Mark Up A/c (marked down)	800	4,100
To Memorandum Mark Up A/c (Note 2) (On marked down goods lying in stock)	—	344	By Loss of Stock A/c	240	—
			By Memorandum Mark Up A/c (on stock cost)	80	—
			By Balance c/d (closing stock)	32,770	54,294
	2,48,000	3,43,394		2,48,000	3,43,394

Dr. **Memorandum Mark Up Account** **Cr.**

Particulars	Dept. Y	Dept. Z	Particulars	Dept. Y	Dept. Z
To Balance b/d (Mark-down opening stock)	510	—	By Balance b/d (Mark-up on opening stock)	8,000	18,000
To Memorandum Stock A/c (mark up on transfer)	900	—	By Memorandum Stock A/c (Mark up on purchase)	54,000	95,000
To Memorandum Stock A/c (Mark-down)	800	4,100	By Memorandum Stock A/c (Mark up on transfer)	—	1,350
To Memorandum Stock A/c (mark down on goods destroyed)	80	—	By Memorandum Stock A/c (marked down on goods lying in stock)	—	344
To Gross profit (balancing figure)	51,518	92,496			
To Balance c/d (Mark-down closing stock)	8,192	18,098			
	62,000	1,14,694		62,000	1,14,694

Working Notes : (1) Ascertainment of Closing Stock at Cost

Particulars	Dept. Y	Dept. Z
Closing stock at Invoice price (from Memorandum Stock Account)	₹ 32,770	₹ 54,294
Closing Stock at cost	3/4 of ₹ 32,770 = ₹ 24,578	2/3 of ₹ 54,294 = ₹ 36,196
Loading on closing stock	1/3 of ₹ 24,578 = ₹ 8,192	1/2 of ₹ 36,196 = ₹ 18,098

(2) Ascertainment of Mark-down in Closing Stock of Dept. Z

$$\frac{(\text{Mark down})}{(\text{Value after down})} \times \text{Value of closing stock} = \frac{4{,}100}{27{,}400*} \times 2{,}300 = ₹\,344$$

*Value after mark-down = ₹ 21,000 + 50% of ₹ 21,000 – ₹ 4,100 = ₹ 27,400.

(3) Verification of Gross Profit

	₹ Dept. Y	₹ Dept. Z
Sales	2,10,000	2,85,000
Add: Mark down (₹ 510 + ₹ 800) / (₹ 4,100 – ₹ 344)	1,310	3,756
	2,11,310	2,88,756
Gross profit (Dept Y 1/4 and Dept Z 1/3)	52,828	96,252
Less: Mark down	1,310	3,756
Gross Profit as per Memorandum Mark up Account	51,518	92,496

Key Points

- A department is generally a physical part of the rest of the business. It should not be assumed that departmental accounts refers only to departmental stores. In fact, they refer to the verious facets of a business. Each department is treated as a separate ***profit centre***, though none of the departments is separated geographically from the rest of the departments.
- **Distinction between Departmental Accounts and Branch Accounts**
  - ¤ In case of a dependent branch, all important accounting records are kept at the head office. The branch maintains only Cash Account and Customers Account (if necessary). However, an independent branch, usually maintains its own books of account and prepares its own Trading and Profit and Loss Account. In case of Departmental Accounts, all accounting records are maintained at one place and Departmental Trading and Profit and Loss Account is prepared accordingly.
  - ¤ As the departments are not geographically separated from each other, the problem of allocation of common expenditure among different departments arises. But in case of a branch account this problem of allocation of common expenditure does not arise since branches are geographically separated from each other.
  - ¤ In case of an independent branch, at the end of the accounting year, some adjustment and reconciliation of head office and branch accounts are required. In case of Department Accounts, the question of adjustments and reconciliation of accounts does not arise.
  - ¤ At the time of finalisation of accounts of head office, the conversion of foreign branch figures may create some problems. In case of Departmental Accounts, this type of problem does not arise.
- Under cost-based transfer pricing, the price may be based on actual cost, total cost or standard cost. Marginal cost is also sometimes used as a basis of ascertaining transfer price. Standard cost is preferred to actual cost since the inefficiency of one department cannot be passed on to another department. Taking full cost as transfer price means that the supplying departments' fixed cost becomes the variable cost of the receiving department.
- If the goods are transferred by one department to another department at a profit and at the end of the accounting period such goods are included in the unsold stock, an appropriate adjustment must be made for unrealised profit on stock. The entry is :

  General Profit and Loss Account Dr.
  To Provision for Unrealised Profit on Stock Account

  At the beginning of the next year reverse entry will be passed.

  Provision for Unrealised Profit on Stock Account Dr.
  To General Profit and Loss Account

THEORETICAL QUESTIONS

1. (a) State briefly the advantages to be derived from a system of Departmental Accounts.
   (b) What difficulties are there in the way of arriving at the net profit of each department?
2. Is there any difference between Branches and Departments, from the accounting point of view?
3. Explain the distinguishing features between Departmental Accounts and Branch Accounts and the advantages derived from Departmental Accounts.
4. How the following indirect expenses are distributed amongst different departments?
   (i) Rent;
   (ii) Insurance premium;
   (iii) Lighting;
   (iv) Advertisement;
   (v) Depreciation; and
   (vi) Managing Director's remuneration.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below :

1. The expenses which have a direct bearing with the sales should be apportioned on the basis of net
   A profit
   B sales
   C none of these.
2. Friendly rivalry between different departments may help to increase the overall profit of
   A the organisation
   B a particular department
   C none of these.
3. In order to ascertain the departmental profit accurately, it is necessary to identify expenses and revenues of
   A the organisation
   B each department
   C none of these.
4. There may be some purely financial incomes which cannot be suitably apportioned
   A to a particular department
   B among different departments
   C none of these.
5. Each department is charged with a share of the common expenses which is apportioned
   A equally
   B on a suitable basis
   C none of these.

PRACTICAL QUESTIONS

1. Grewal Brothers own a business which has two departments, A and B.
   The following balances appeared in the books for the year ended 31.12.2014 :

Particulars	Dept A (₹)	Dept B (₹)	Total (₹)
Stock (1.1.2014)	5,800	6,400	12,200
Purchases	40,000	50,000	90,000
Sales	1,50,000	1,00,000	2,50,000
Wages of shop assistants			21,800
Rent, rates and insurance			4,320
Stationery and office expenses			1,260
Motor vehicle expenses and depreciation			3,240
Carriage on purchases			1,440
Light and heat			1,270

   You are required to prepare a Columnar Trading Account as specified above and Profit and Loss Account (columnar form is not required) for the year ended 31.12.2014, taking into consideration the following :
   (a) Carriage on purchases which is to be apportioned to the separate departments in proportion to purchases, and wages to be allocated on the same basis as sales.
   (b) Stock on 31.12.2014 was: Dept A — ₹ 9,000; Dept B — ₹ 6,000.
   (c) An amount owing for insurances, ₹ 120, has not been recorded in the books.
   (d) The provision for doubtful debts which is shown in the books at ₹ 300 is to be increased to ₹ 400.
2. Raj Singh runs a business which has two departments. The following balances were extracted from his books on 30.6.2015 :

Particulars	Dept. A (₹)	Dept. B (₹)	Common Expenses	₹
Opening Stock on 1.1.2015	12,000	13,000	Commission payable	1,500
Purchases	24,520	36,544	Salaries	15,100
Sales	86,030	89,070	Advertising	2,500
Closing Stock	12,100	13,300	Rates	1,450

Wages	22,800	21,200	Insurance	400
Returns in	1,030	4,070	Repairs	800
Returns out	520	544	Lighting and heating	2,000

You are required to prepare Departmental Trading and Profit and Loss Account for the six month ended on 30.6.2015, after taking into account the following information :

(a) (i) Salaries of ₹ 400 are outstanding;
(ii) Rates ₹ 250 have been paid in advance; and
(iii) Insurance ₹ 80 is prepaid.

(b) Commission, salaries and advertising are to be charged to the departments in proportion to net turnover (sales minus returns in); all other expenses are to be apportioned 1/4th to department A and 3/4th to department B.

3. M/s Z & Co has two departments. You are required to prepare the Trading and Profit and Loss Account for each department for the year ended on 31st March, 2015 on the basis of the following information :

Particulars	Dept. I (₹)	Dept. II (₹)
Opening Stock (1.4.2014)	25,000	20,000
Purchases	2,30,000	1,90,000
Sales	6,33,000	4,92,000
Sales Returns	3,000	2,000
Closing Stock (31.3.2015)	30,000	18,000
Wages	80,000	60,000
Salaries	40,000	25,000

Other common expenses : Rent ₹ 15,000; Electricity ₹ 6,000; Depreciation ₹ 18,000; Selling expenses ₹ 8,000. Some other relevant information is given below :

Particulars	Dept.A (₹)	Dept. B (₹)
Light Points	18	9
Value of Assets (₹)	1,50,000	1,20,000
Floor Area (sq.ft.)	300	200

4. A departmental stores carries on its business through five departments, A, B, C, D and E.

(i) The following information for 2014 is now made available to you:
Salaries and Commission ₹ 11,020; Rent and Rates ₹ 2,900; Insurance ₹ 1,160; Miscellaneous Expenses ₹ 2,610. All these expenses are chargeable to each department in proportion to the cost of the articles sold in the respective departments.

(ii) The following balances as at 31.12.2014 were ascertained: (all figures in ₹)

Particulars	A	B	C	D	E
Opening stock at cost	10,000	6,000	15,000	8,000	9,000
Purchases	1,00,000	60,000	20,000	52,000	60,000
Sales	96,000	62,000	19,000	46,000	60,000
Closing stock at cost	23,000	8,000	6,000	2,000	11,000

Prepare the Profit and Loss Account to show the final result of each department and also the combined results with respective percentages on sales.

5 The Trading and Profit and Loss Account of Hindustan Electronics for the year ending March 31, 2015 is as under: (all figures in ₹).

To Purchases:		By Sales:	
Transistors (X)	1,60,000	Transistors (X)	1,75,000
Tape Records (Y)	1,25,000	Tape Records (Y)	1,40,000
Spare parts for servicing & repair jobs (Z)	80,000	Servicing and repair jobs (Z)	35,000
To Wages	48,000	By Stock on 31.3.2015	
To Rent	10,800	Transistors (X)	60,100
To Sundry Expenses	11,000	Tape Records (Y)	20,300
To Net Profit	40,200	Spare parts for servicing and repair jobs (Z)	44,600
	4,75,000		4,75,000

Prepare Deparqtmental Accounts for each of the three Departments X, Y and Z mentioned above after taking into consideration the following:

(a) Transistors and Tape Recorders are sold at the showroom. Servicing and repairs are carried out at the workshop.

(b) Wages comprise: Showroom 3/4; Workshop 1/4.
It was decided to allocate the showroom wages in the ratio of 1:2 between Departments X and Y respectively.

(c) The workshop rent is ₹ 500 per month. The rent of the showroom is to be divided equally between Dept X & Y.

(d) Sundry expenses are to be allocated on the basis of the turnover of each department.

6. The Profit and Loss Account for the year ended 31st December 2014 of D Q Holidays Limited, a company which provides holidays at several resorts in Jammu and Kashmir is as follows: (all figures in ₹).

Agents' commission	90,600	Sales of holidays	9,06,000
Hire of aeroplanes	1,05,000	Net loss for the year	10,000
Coaches from airport to resort	7,000		
Hotel accommodation	5,81,400		
Salary & expenses of resort representatives	32,000		
Brochures, advertising, head office and common costs	1,00,000		
	9,16,000		9,16,000

The managing director has complained to you, as chief accountant, that the form of presentation of this Profit and Loss Account does not tell him where or why the net loss has been incurred and is of little use for management purposes.

You are required to redesign the Profit and Loss Account, using also the information given below, so that it will overcome the complaints of the managing director. You are given the following information:

1. The public book their holidays with the company through local travel agents who were paid a commission of 10% of the gross price of the holiday.
2. Holidays were offered at six resorts in Jammu and Kashmir, namely P, Q, R, S,T and U.
3. Only one hotel was used in each resort.
4. Flights were from Delhi Airport to three airports in Jammu and Kashmir, as follows:

Airport	For resorts	Annual cost (₹)
X	P and Q	30,000
Y	R and S	40,000
Z	T and U	35,000

5. Separate coaches were used for the journey from the aiport to each resort hotel. The annual costs of these were:
To Resort : P — ₹ 1,100; Q — ₹ 900; R — ₹ 1,400; S — ₹ 1,100; T — ₹ 1,700; and U — ₹ 800.
6. The annual cost of hotel accommodation at each resort were:
P — ₹ 3,05,900; Q — ₹ 1,53,200; R — ₹ 22,600; S — ₹ 45,400; T — ₹ 10,200; and U — ₹ 44,100.
7. A separate representative was employed at each resort, and the annual costs were:
P — ₹ 5,000; Q — ₹ 4,500; R — ₹ 6,000; S — ₹ 5,500; T — ₹ 5,700; and U — ₹ 5,300.
8. Sales of holidays at the various resorts were:
P — ₹ 4,80,000; Q — ₹ 2,49,000; R — ₹ 30,000; S — ₹ 60,000; T — ₹ 24,000; and U — ₹ 68,000.

7. Shivam Ltd has three departments D1, D2 and D3. From the following particulars calculate :
1. The Departmental Gross Profit for the year ended 31st March, 2015.
2. The values of stocks as on 31st March, 2015 :

Particulars	D1 (₹)	D2 (₹)	D3 (₹)
Stock as on 1st April, 2014	24,000	36,000	12,000
Purchases	1,46,000	1,24,000	48,000
Actual Sales	1,72,500	1,59,400	74,600
Gross Profit on normal selling prices	20%	25%	$33^1/_3$%

During the year some items were sold at discount and these discounts were reflected in the values of the sales shown above. The items sold at discount were :

Particulars	D1 (₹)	D2 (₹)	D3 (₹)
Sales at normal prices	10,000	3,000	1,000
Sales at actual prices	7,500	2,400	600

8. The following is the Trial Balance as at 31st December 2014 of a firm having two partners: A and B, who agreed to share the annual profits and losses in equal proportion. They have three distinct departments of business. You are required to prepare Departmental Trading and profit and Loss Account and the Balance Sheet as at 31st December 2014. While preparing the accounts, make the following provisions and adjustments: (1) Allow and charge interest @ 5% per annum on the partners' capitals and drawings respectively; (2) Write-off as bad and irrecoverable debts amounting to ₹ 1,600 and thereafter, increase the provision for bad and doubtful debts to 5% on book-debts outstanding; (3) Bring into account the purchase of stationery on credit for ₹ 200, not accounted for the Trial balance; (4) Write-off depreciation on Furniture and Fixtures @ 5% on cost; (5) ₹ 100 of the Insurance premium are prepaid; (6) The following are the values of the closing stock in the respective departments: Department X ₹ 10,462; Department Y ₹ 10,001; Department Z ₹ 4,940; (7) Advertisement materials of the value of ₹ 300 is in hand; it has not been adjusted in the Trial Balance; (8) All expenses and losses are to be apportioned among the respective departments in the proportion of 7 : 6 : 2.

Trial Balance as at 31st December, 2014

Particulars		Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Capital Account : A			33,333	Salaries	6,418	
Capital Account : B			16,666	Advertising	3,612	
Drawings Account : A		4,000		Investments Income		1,200
Drawings Account : B		3,000		Investments	20,000	
Stock (1.1.2014) : Dept	X	11,438		Debtors and Creditors	8,955	5,493
	Y	9,867		Printing and Stationery	485	
	Z	2,646		Carriage Inwards	450	
Purchases and Sales : Dept	X	34,657	55,194	Commission	1,107	
	Y	32,441	47,310	Postage, Telegrams & Telephone	942	
	Z	14,111	15,769	Provision for Bad Debts		300
Inter-Dept Transfers : Dept	X		1,501	Rent and Taxes	8,148	
	Y	1,201		Furniture	5,000	
	Z	300		Insurance	403	
Returns Inward : Dept	X	3,533		Miscellaneous Expenses	1,058	
	Y	3,029		Bank Overdraft		1,519
	Z	1,009		Discount	475	
				TOTAL	1,78,285	1,78,285

9. Orchard carried on trade as a fruit grower and as a canner. On December 31, 2014 the trial balance extracted from his book was as follows:

Particulars	Dr.	Cr.	Particulars	Dr.	Cr.
Orchard : Capital (1.1.2014)		13,500	Bought Ledger balances:		
Drawings	1,200		Farm		200
Freehold land and premises at cost	14,900		Cannery		740
Sales during the year		800	Purchases :		
Plant and machinery at cost:			Farm	250	
Farm	1,900		Cannery	1,210	
Cannery	4,800		Wages :		
Purchases of plant and machinery			Farm	1,600	
less sales during the year	500		Cannery	2,400	
Provisions for depreciation:			Sales :		
Farm		1,100	Farm		530
Cannery		1,640	Cannery		9,950
Fruit trees and bushes at cost	800		Trade expenses	920	
Stock (1.1.2014)			Administration and motor expenses		
Farm	400		(including loan interest to Sept. 30 2014)	584	
Cannery	1,650		Repairs :		
Loan at 6% (interest payable on			Farm	80	
March 31 and September 30)		8,000	Cannery	360	
Balance at bank	864		Salaries	1,400	
Sales ledger balances	642			36,460	36,460

You are instructed to prepare the accounts and are given further information as follows:

1. Provision is to be made for depreciation for the year of plant and machinery on cost at the end of the year at the rate of 10 per cent in the case of the farm and $7^{1}/_{2}$ per cent in case of the cannery.
2. During the year tractor, included in farm plant and machinery at a cost of ₹ 600 and in respect of which depreciation of ₹ 500 had been provided was sold for ₹ 300 and was replaced by a new tractor costing ₹ 800.
3. Fruit to the value of ₹ 2,200 was supplied by the farm to the cannery.
4. Stocks in hand on December 31 2014, were valued as follows: Farm ₹ 300, Cannery ₹ 1,720.
5. Amounts owing, excluding loan interest accrued due at the end of the year were: Purchases : Cannery (included in stock but not entered in the books) ₹ 140; Trade expenses ₹ 80.
6. Bought ledger balances at the end of the year included ₹ 320 for cans supplied. Since the books were closed the supplier agreed to allow ₹ 160 as the cans were sub-standard. This allowance had been taken into account in valuing the stock on December 31, 2014.
7. All expenses except where otherwise indicated, are to be apportioned on the basis : Farm — one-fourth, Cannery — three-fourths.
8. Orchard is to be charged ₹ 2 per week for expenses incurred on his private car.
9. Freehold land, sold for ₹ 850, had cost ₹ 350.
10. Pippin, the manager of the cannery, is to be credited with 5 per cent of the cannery profits after charging his commission.

You are required to prepare (a) Trading and Profit and Loss Account showing, separately, the net profit or loss of the farm and of the cannery for the year ended December 31, 2014, and (b) Balance Sheet as on that date. Ignore taxation.

10. The following is the Trial Balance of Automatic Motors and Garage on March 31 2015:

Particulars	Dr.	Cr.	Particulars	Dr.	Cr.
Opening Stock :			Capital Account		76,250
Petrol and Oil	1,675		Drawings	8,500	
Spare Parts and Tyres	5,500		Sales :		
Tools	2,200		Petrol and Oil		23,000
Hire Cars	72,000		Spare Parts and Tyres		37,000
Purchases :			Garage Receipts		4,000
Tools	4,000		Repairs Department		14,000
Spare Parts and Tyres	32,000		Hire Receipts		70,000
Petrol and Oil	41,250		Licence fees & permit fees for HireCars	3,000	
Advertising Expenses	4,500		Office expenses	4,000	
Rent, Rates and Taxes	12,000		Sundry Debtors	400	
Insurance Premia :			Sundry Creditors		1,200
On Hire Cars	4,000		Commission received on cars sold		5,000
Fire, theft and burglary cases	425		Loan		4,000
Wages :			Cash in hand and at bank	2,000	
Drivers	12,000				
Repairs Department	16,500				
Office	7,500				
Garage	1,000			2,34,450	2,34,450

The following additional information is also given to you:

(a) The loan was taken on January 1, 2015 on which 12% interest is to be paid.
(b) Stock in hand on March 31, 2015 were as under:
(i) Tools ₹ 5,000; (ii) Petrol and oil ₹ 4,300; (iii) Spare parts and tyres ₹ 10,000.
(c) Petrol and oil whose value were ₹ 15,600 and ₹ 1,800 were used by hired cars and the repairs department respectively.
Besides, the owner of the garage drew petrol and oil worth ₹ 3,000 for his personal car.
(d) The repairs department performed work during the year as under:
On owner's car ₹ 600; On hire cars ₹ 7,500.
(e) Spare parts used by the repairs department in the year cost ₹ 4,000 and the hire cars ₹ 750.
(f) Depreciation on hire cars to be provided at 30% p.a.
(g) Licences and taxes amounting to ₹ 200 on owner's car have been paid and included in rent, rates and taxes.

(h) Rent, rates and taxes to be distributed as under:
(i) Repairs department 1/2; (ii) Spare parts 1/4; (iii) Garage 1/8; and (iv) Office 1/8.

You are required to prepare a : (a) Department Trading Account; (b) Profit and Loss Account for the year ending March 31, 2013; and (c) Balance Sheet as on that date.

11. From January 1 2014, Ramesh & Co have been running three departments A, B and C and the following particulars have been taken from their books on December 31 2014:
Opening Stock : January 1 : A — ₹ 36,000; B — ₹ 24,000; and C — ₹ 20,000.
Purchases : A — ₹ 1,20,000; B — ₹ 1,00,000; and C — ₹ 95,000.
Goods from other departments : A — ₹ 8,000; B — ₹ 5,000; and C — ₹ 3,000.
Direct wages : A — ₹ 54,000; B — ₹ 48,000; and C — ₹ 35,000.
Sales : A — ₹ 2,44,000; B — ₹ 1,96,000; and C — ₹ 1,44,000.
Goods to other departments : A — ₹ 6,000; B — ₹ 4,000; and C — ₹ 6,000.
Stock in hand on December 31 : A — ₹ 49,000; B — ₹ 14,000; and C — ₹ 18,000.
Carriage inward : A — ₹ 3,000; B — ₹ 2,000; and C — ₹ 2,000.
Other information:
Drawing — ₹ 8,000; Printing & Stationery — ₹ 2,400; Carriage outwards — ₹ 6,000; Salaries — ₹ 24,000; Rent & Rates — ₹ 18,000; Bad debts — ₹ 3,600; Discount allowed — ₹ 8,400; Advertisement — ₹ 12,000; Miscellaneous expenses — ₹ 6,600.
Inter-departmental supplies have been made during the year by each department at market price and the stocks at close valued at cost to A department include ₹ 4,000 worth goods supplied by B. Miscellaneous expenses include ₹ 600 on account of supplies to a partner for personal expenses.
You are required to prepare Departmental Trading and Profit and Loss Account apportioning general unallocated expenses on the basis of turnover (i.e., sales plus transfers).

12. Complex Ltd. has 3 departments: A, B and C. The following information is provided : (all figures in ₹)

Particulars	Dept A	Dept B	Dept C
Opening Stock (1.4.2014)	3,000	4,000	6,000
Consumption of direct materials	8,000	12,000	—
Wages	5,000	10,000	—
Closing stock	4,000	14,000	8,000
Sales	—	—	34,000

Stocks of each department are valued at cost to the department concerned. Stocks of A Department are transferred to B at a margin of 50% above departmental cost. Stocks of B Department are transferred to C Department at a margin of 10% above departmental cost.
Other expenses were: Salaries — ₹ 2,000; Printing and stationery — ₹ 1,000; Rent — ₹ 6,000; Insurance paid — ₹ 4,000; Depreciation — ₹ 3,000.
Allocate expenses in the ratio of departmental gross profits. Opening figures of reserves for unrealised profits on departmental stocks were: Department B — ₹ 1,000; Department C — ₹ 2,000.
Prepare Departmental Trading and Profit and Loss Account for the year ended 31st March 2015.

13. You are given the following particulars of a business having three departments:

Particulars	Purchases	Opening Stock	Sales
Department A	1,000 Units	120 Units	1,020 Units @ ₹ 20 each
Department B	2,000 Units	80 Units	1,920 Units @ ₹ 22.50 each
Department C	2,400 Units	152 Units	2,496 Units @ ₹ 25 each

Additional information:
(i) Purchases were made at a total cost of ₹ 92,000.
(ii) The rate of gross profit is the same in each case.
(iii) Purchases and sales prices are constant for the last two years.
Prepare Departmental Trading Account for the year 2015.

14. You are given the following particulars of a business having three departments:

Particulars	Purchases	Opening Stock	Closing Stock
Department A	1,500 Units	200 Units	100 Units
Department B	1,000 Units	300 Units	160 Units
Department C	2,000 Units	150 Units	200 Units

Additional information:

(i) Purchases were made at a total cost of ₹ 92,000.

(ii) The percentage of gross profit on turnover is the same in each case.

(iii) Purchases and sales prices are constant for the last 2 years.

(iv) Selling price per unit: Department A ₹ 20; Department B ₹ 25; and Department C ₹ 30.

You are required to prepare Departmental Trading Account.

15. A company manufacturing electric components operates with two departments. Transfers are made between the departments of both purchased goods and manufactured finished goods. Goods purchased are transferred at cost and manufacturing goods are transferred only at selling price as in the case with open market.

Transactions for the year ended 30th June, 2015 are given below:

Particulars	Dept X (₹)	Dept Y (₹)
Opening Stock	20,000	15,000
Sales	1,90,000	1,35,000
Wages	12,500	7,500
Purchases	1,00,000	80,000
Closing stock :		
Purchased goods	2,000	5,000
Manufactured goods	7,000	8,000

The following were the transfers from Department X to Department Y : purchased goods ₹ 6,000 and finished goods ₹ 20,000 and from Department Y to Department X : purchased goods ₹ 5,000 and finished goods ₹ 35,000.

Stocks were valued at cost to the department concerned. Only in closing stock of manufactured goods in the departments transferred finished goods are 20%.

Draw out Departmental Trading Account and the Company's Trading Account for the year ended 30th June 2015.

Guide to Answers

Multiple Choice

1. B; 2. A; 3. B; 4. B; 4. B.

Practical Questions

1. **Gross Profit : Deparment A — ₹ 99,480; Department B — ₹ 40,080; Net Profit : ₹ 1,29,250.**
2. **Departmental Profits : A — ₹ 27,470; B — ₹ 15,110.**
3. **Departmental Profits : A — ₹ 2,57,500; B — ₹ 1,93,500.**
4. **Departmental Profits : A — ₹ 3,693; B — ₹ 462; C — ₹ 11,769 (loss); D — ₹ 15,538; and E — ₹ 1,538.**
5. **Net Profits : Department X — ₹ 55,200; Department Y — ₹ 4,500; Loss : Department Z ₹ 19,500.**
6. **Departmental Profits / Loss : Q — ₹ 15,10,000; S — ₹ 41,000 (Loss); U — ₹ 20,000 (Loss); Total (Loss) ₹ 10,000.**
7. **Departmental Gross Profit : D1 — ₹ 32,500; D2 — ₹ 39,400; D3 — ₹ 24,600.
Closing Stock : D1 — ₹ 30,000; D2 — ₹ 40,000; D3 — ₹ 10,000.**
8. **Departmental Gross Profit : X — ₹ 17,319; Y — ₹ 10,593; and Z — ₹ 2,583. Departmental Net Profit : X — RS 5,993; Y — ₹ 864; and Z — ₹ 660 (loss). Balance Sheet total — ₹ 57,541.**
9. **Departmental Gross Profit : Farm — ₹ 780; Cannery — ₹ 4,230. Departmental Net Profit : Farm — ₹ 260 (loss); Cannery — ₹ 1,200. Net Profit of the business as a whole — ₹ 1,590; Balance Sheet total — ₹ 22,966.**
10. **Departmental Net Profit : Garage — ₹ 1,525; Petrol — ₹ 4,775; Spare parts — ₹ 11,300; Car Hire — ₹ 550; Repairs — ₹ 7,300 (loss); Net profit transferred to Capital Account — ₹ 2,130. Balance Sheet total — ₹ 72,100.**
11. **Departmental Profit : A — ₹ 44,500; B — ₹ 8,200; C — ₹ 7,100 (loss).**
12. **Departmental Loss : Department A — ₹ 2,000; Department B — ₹ 1,000; Department C — ₹ 1,000; Net loss transferred to Profit and Loss Account ₹ 4,918.**
13. **Rate of Gross Profit : 25%. Departmental Gross Profit : A — ₹ 4,080; B — ₹ 8,640; and C — ₹ 12,480.**
14. **Rate of Gross Profit : 20%. Departmental Gross Profit : A — ₹ 6,400; B — ₹ 5,700; and C — ₹ 11,700.**
15. **Departmental Gross Profit : X — ₹ 52,500; Y — ₹ 59,500; Company's Profit — ₹ 1,11,110. Rate of Gross Profit : X — 25%; Y — 35%. Unrealised Profit on Stock : X — ₹ 49; Y — ₹ 400.**

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Lease Accounting

Introduction

A ***Lease*** is a contract by which the owner of an asset, the ***Lessor***, allows another person, the ***Lessee***, to use it in exchange for regular payments. Leasing has become extremely common in the business world. From the lessee's point of view, ***leasing*** provides an alternative to the purchase of an asset required for use in the business. The main distinguishing feature of leasing is that the lessee never obtains legal ownership of the asset during lease period. The advantage is that the lessee obtains the unrestricted use of the asset for a specified period without incurring major capital expenditure or incurring long-term loan, while the rental can be paid to the lessor out of the income generated by the use of the asset over that specified period.

The range of assets covered by the leasing agreements is very wide. Plant and Machinery, Land and Buildings, Cars, Ships and Aircraft are frequently leased.

Before the introduction of AS—19 : Leases, many enterprises were disclosing in the Balance Sheet neither the leased assets nor the full lease liabilities. Now, AS—19 ensures that the entity controlling the assets, irrespective of ownership, ***recognises the assets and resulting liability*** in order to provide a true and fair view of the financial position.

Objective

The objective of this Statement is to prescribe, for lessees and lessors, the appropriate accounting policies and disclosures in relation to finance leases and operating leases.

Scope

This Statement should be applied in accounting for all leases other than:

(a) lease agreements to explore for or use natural resources, such as oil, gas, timber, metals and other mineral rights; and

(b) licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights; and

(c) lease agreements to use lands.

This Statement applies to agreements that transfer the right to use assets even though substantial services by the lessor may be called for in connection with the operation or maintenance of such assets.

This Statement does not apply to agreements that are contracts for services that do not transfer the right to use assets from one contracting party to the other.

Example : X Ltd. has taken on lease a fully furnished office. The lessor provides secretarial services and all office equipments. This is covered by AS—19.

Definitions

The following terms are used in this Statement with the meanings specified:

Lease

A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

Finance Lease

A finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset.

Operating Lease

An operating lease is a lease other than a finance lease.

Non-cancellable Lease

A non-cancellable lease is a lease that is cancellable only:

(a) upon the occurrence of some remote contingency; or
(b) with the permission of the lessor; or
(c) if the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or
(d) upon payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonably certain.

Inception of the Lease

The inception of the lease is the earlier of the date of the lease agreement and the date of a commitment by the parties to the principal provisions of the lease.

Lease Term

The lease term is the non-cancellable period for which the lessee has agreed to take on lease the asset together with any further periods for which the lessee has the option to continue the lease of the asset, with or without further payment, which option at the inception of the lease it is reasonably certain that the lessee will exercise.

Minimum Lease Payments

Minimum lease payments are the payments over the lease term that the lessee is, or can be required, to make excluding contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor, together with:

(a) in the case of the lessee, any residual value guaranteed by or on behalf of the lessee; or
(b) in the case of the lessor, any residual value guaranteed to the lessor:
    i. by or on behalf of the lessee; or
    ii. by an independent third party financially capable of meeting this guarantee.

However, if the lessee has an option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable that, at the inception of the lease, is reasonably certain to be exercised, the minimum lease payments comprise minimum payments payable over the lease term and the payment required to exercise this purchase option.

Fair Value

Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction.

Economic Life

Economic life is either:

(a) the period over which an asset is expected to be economically usable by one or more users; or

(b) the number of production or similar units expected to be obtained from the asset by one or more users.

Useful Life

Useful life of a leased asset is either:

(a) the period over which the leased asset is expected to be used by the lessee; or

(b) the number of production or similar units expected to be obtained from the use of the asset by the lessee.

Residual Value

Residual value of a leased asset is the estimated fair value of the asset at the end of the lease term.

Guaranteed Residual Value

Guaranteed residual value is:

(a) in the case of the lessee, that part of the residual value which is guaranteed by the lessee or by a party on behalf of the lessee (the amount of the guarantee being the maximum amount that could, in any event, become payable); and

(b) in the case of the lessor, that part of the residual value which is guaranteed by or on behalf of the lessee, or by an independent third party who is financially capable of discharging the obligations under the guarantee.

Unguaranteed Residual Value

Unguaranteed residual value of a leased asset is the amount by which the residual value of the asset exceeds its guaranteed residual value.

Example : Magma Leasing Ltd. has given a car on lease for 4 years to Sita Travels Ltd. The cost of the car is ₹ 5,00,000. The estimated residual value of the car is ₹ 50,000 at the end of the lease.

A dealer of 2nd hand car gives a guarantee to purchase the car for ₹ 40,000 at the end of the lease period. This ₹ 40,000 is the guaranteed residual value. The remaining ₹ 10,000 is the unguaranteed residual value.

Gross Investment

Gross investment in the lease is the aggregate of the minimum lease payments under finance lease from the standpoint of the lessor and any unguaranteed residual value accruing to the lessor.

Unearned Finance Income

Unearned finance income is the difference between:

(a) the gross investment in the lease; and

(b) the present value of

(i) the minimum lease payments under a finance lease from the standpoint of the lessor; and

(ii) any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease (***See Illustration 2***).

Net Investment

Net investment in the lease is the gross investment in the lease less unearned finance income.

Interest Rate Implicit in the Lease

The interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of

(a) the minimum lease payments under a finance lease from the standpoint of the lessor; and
(b) any unguaranteed residual value accruing to the lessor, to be equal to the fair value of the leased asset.

Lessee's Incremental Borrowing Rate of Interest

The lessee's incremental borrowing rate of interest is the rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.

Contingent Rent

Contingent rent is that portion of the lease payments that is not fixed in amount but is based on a factor other than just the passage of time (e.g., percentage of sales, amount of usage, price indices, market rates of interest).

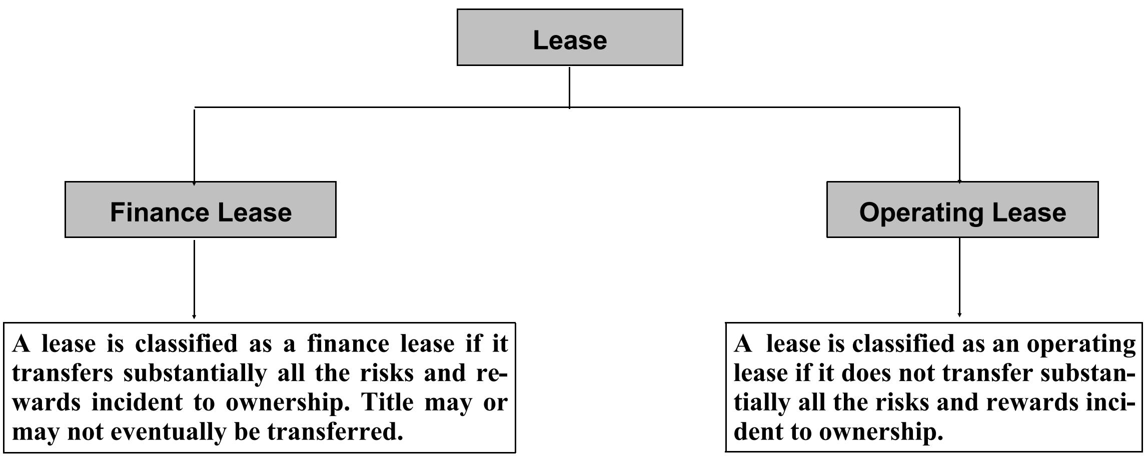
Example : Fast Food Ltd. has taken a restaurant on lease in New Delhi Railway Station. Rent payable per month is ₹ 20,000 plus 10% of sales as contingent rent.

Hire Purchase

The definition of a lease includes agreements for the hire of an asset which contain a provision giving the hirer an option to acquire title to the asset upon the fulfillment of agreed conditions. These agreements are commonly known as hire purchase agreements. Hire purchase agreements include agreements under which the property in the asset is to pass to the hirer on the payment of the last installment and the hirer has a right to terminate the agreement at any time before the property so passes.

Classification of Leases

The classification of leases adopted in this Statement is based on the extent to which risks and rewards incident to ownership of a leased asset lie with the lessor or the lessee. Risks include the possibilities of losses from idle capacity or technological obsolescence and of variations in return due to changing economic conditions. Rewards may be represented by the expectation of profitable operation over the economic life of the asset and of gain from appreciation in value or realisation of residual value.



Since the transaction between a lessor and a lessee is based on a lease agreement common to both parties, it is appropriate to use consistent definitions. The application of these definitions to the differing circumstances of the two parties may sometimes result in the same lease being classified differently by the lessor and the lessee.

Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than its form. Examples of situations which would normally lead to a lease being classified as a ***finance lease*** are:

(a) the lease transfers ownership of the asset to the lessee by the end of the lease term;

(b) the lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised;

(c) the lease term is for the major part of the economic life of the asset even if title is not transferred;

(d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and

(e) the leased asset is of a specialised nature such that only the lessee can use it without major modifications being made.

Indicators of situations which individually or in combination could also lead to a lease being classified as a ***finance lease*** are:

(a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;

Example : Your company, Go Airways Ltd. has taken on lease an aircraft for 5 years. If the company wants to cancel the lease, it will have to pay all the remaining payment up to the end of the lease. This is a finance lease, because there is no way of paying a reduced rental.

(b) gains or losses from the ***fluctuation in the fair value of the residual fall to the lessee*** (for example in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and

Example : Magma Leasing Ltd. has given a car on lease for 4 years to Sita Travels Ltd. The cost of the car is ₹ 5,00,000. The estimated residual value is ₹ 50,000.

As per the terms and conditions of the lease, if the car's residual value is more than ₹ 50,000, When the car is sold, Sita Travels Ltd. (lessee) will receive the excess money. If it is less than ₹ 50,000, Sita Travels Ltd. will have to pay Magma Leasing Ltd. the deficit amount. This is a financial lease.

(c) the lessee can continue the lease for a secondary period at a rent which is substantially lower than the market value.

Example : Your company Modern Printer Ltd. has taken on lease a printing machine for 5 years at a commercial rent from HMT Ltd. At the end of the lease period, your company can continue to rent at 1/10th of the present rental but a service contract is to be signed with the HMT Ltd.

HMT Ltd. does not want the printing machine back. It would prefer to leave it with the lessee for a minimum rent and earn some income from service contract.

This is a finance lease, as the lessor wants that the lessee should enjoy the entire economic life of the machine.

Lease classification is made at the ***inception of the lease***. If at any time the lessee and the lessor agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification of the lease, the revised agreement is considered as a new agreement over its revised term. Changes in estimates (for example, changes in estimates of the economic life or of the residual value of the leased asset) or changes in circumstances (for example, default by the lessee), however, do not give rise to a new classification of a lease for accounting purposes.

Characteristics of A Finance Lease

1. Lessor retains title to asset but transfers substantially (not, of course, identically) the risks and rewards incident to owner of an asset.
2. The full cost of the asset will generally be repaid by the lessee to the lessor.
3. Lessee is responsible for insurance and maintenance of the asset.
4. Lessee cannot sell the asset without the permission of the lessor.
5. Lessee has the right of uninterrupted use of the asset till lease payments are made.
6. The contractual obligation to pay the lessor is generally non-cancellable.
7. At the end of the lease-term the lessor can take back the possession of the asset from the lessee or there can be a bargain purchase/renewal option.

Characteristics of Operating Lease

1. The lessee pays a periodic rental to the lessor for the period of the lease.
2. The lessor retains the risks and rewards of ownership.
3. The lessor assumes responsibility for repairs, maintenance and insurance.
4. An operating lease is usually short-term.
5. The lessee has use of the asset generally over a period which is less than its useful economic life.

Distinction Between Finance Lease and Operating Lease

	Finance Lease		Operating Lease
1.	The lease exists generally for the whole useful life of the asset and rentals receivable are sufficient to recoup capital outlay and show a profit.	1.	The lease period is less than the useful life of the asset. The lessor relies on subsequent leasing or eventual sale of the asset to cover the capital outlay and show a profit.
2.	The lessor usually does not deal directly in this type of asset.	2.	The lessor may very well carry on a trade in this type of asset.
3.	The lessor does not retain the risks and rewards of ownership.	3.	The lessor is usually responsible for repairs and maintenance.
4.	The lease agreement cannot generally be cancelled. the lessee has a liability for the payments.	4.	The lease can sometimes be cancelled at a short notice.
5.	The substance of the transaction is the purchase of the asset by the lessee financed by a loan from the lessor.	5.	The substance of the transaction is the short-term rental of an asset.
6.	Lessee will record it as an asset.	6.	Lessor will record it as an asset.

Illustration 1

On 1st January, 2015 Gamon India Ltd. leased a heavy duty new crane from Magma Leasing Co. Ltd. The capital cost of the crane is ₹ 25,00,000. 6 half-yearly payments of ₹ 5,00,000 are payable. 1st installment is payable on 1st January, 2015. The estimated economic life of the crane is 5 years with a nil residual value. The leasing company has offered a secondary term of 3 years for ₹ 2,00,000 per annum only. Gamon India Ltd. has not yet decided if they will accept it.

After the expiry of lease period, the crane is expected to have a residual value of ₹ 5,00,000. As per the lease agreement, Gamon India Ltd. will get 90% of the proceeds should the assets be sold.

How this lease should be classified ?

Solution

The minimum lease payment = (₹ 5,00,000 × 6)	₹	30,00,000
Fair value of the asset (capital cost)	₹	25,00,000
Finance Charge	₹	5,00,000

This will be classified as a finance lease on the following grounds :

(i) The primary lease period is 3 years which is majority of asset's economic life.

(ii) The lessee has the option to extend the lease for a secondary period at a much lower rent.

(iii) The lessee will get 90% of the proceeds of sale of the crane.

Illustration 2

An equipment is leased for 3 years and its useful life is 5 years. Both the cost and the fair value of the equipment are ₹ 3,00,000. The amount will be paid in 3 installments and at the termination of lease — lessor will get back the equipment. The unguaranteed residual value at the end of 3 years is ₹ 40,000.

The Implicit Rate of Return (IRR) of the investment is 10%. The present value of annuity factor of Re 1 due at the end of 3rd year at 10%. IRR is 2.4868. The present value of ₹ 1 due at the end of 3rd year at 10% rate of interest is 0.7513.

(i) State with reason whether the lease constitutes finance lease.

(ii) Calculate unearned finance income.

Solution (i)

This lease constitutes finance lease on the following grounds :

(1) The primary lease period is 3 years which is majority of assets' economic value.

(2) The present value of lease payments is 89.98% (See Working Note below) of the fair value which is substantial portion thereof.

Working Note :

Present value of residual value — ₹ 40,000 × 0.7513 = ₹ 30,052.

Present value of lease payment — ₹ 3,00,000 – ₹ 30,052 = ₹ 2,69,948.

Percentage of fair value = $\frac{2,69,948}{3,00,000}$ = 89.98%

Solution (ii)

Annual lease payments = $\frac{2,69,948}{2.4868}$ = ₹ 1,08,552

Annual lease payment has been calculated on the basis that :

[Present value of lease payments plus residual value = Fair value of the assets (cost)].	₹
Gross investment in the lease [(₹ 1,08,552 × 3) + ₹ 40,000]	3,65,656
Less: Cost of the equipment	3,00,000
Unearned finance income	65,656

Leases in Financial Statement of Lessees

Finance Leases

At the inception of a finance lease, the lessee should recognise the lease as an asset and a liability. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of the lease. However, if the fair value of the leased asset exceeds the present value of the minimum lease payments from the standpoint of the lessee, the amount recorded as an asset and a liability should be the present value of the minimum lease payments from the standpoint of the lessee. In calculating the present value of the minimum lease payments the discount rate is the interest rate implicit in the lease, if this is practicable to determine; if not, the lessee's incremental borrowing rate should be used.

Illustration 3

X Ltd wishes to acquire a new machine. The company could purchase outright for cash for ₹ 8,10,000 or alternatively, enter into a finance lease agreement. The asset has an estimated useful life of 5 years with a residual value of ₹ 4,250. The terms and conditions of the finance lease agreement are as follows :

(i) Minimum lease payment ₹ 2,00,000 p.a. payable on first day of each year.

(ii) Lessee is responsible for insurance and maintenance of the machine.

You are required to calculate :

(i) interest rate implicit in lease; and

(ii) present value of minimum lease payment.

Solution

(i) Interest Rate Implicit in Lease

This is the discount rate, which when applied at the outset of the lease equates the following :

(a) the fair value of the asset;

(b) the present value of minimum lease payments plus any **unguaranteed residual value**.

Here in this ***Illustration***,

(a) Fair value of the asset = ₹ 8,10,000.

(b) Present value of lease payment at different rate of interest is calculated as follows :

Lease Payments (Beginning)	Present Value Factor at 11%	Present Value of Lease Payments	Present Value Factor at 12%	Present Value of Lease Payments	Present Value Factor at 13%	Present Value of Lease Payments
2,00,000	1	2,00,000	1	2,00,000	1	2,00,000
2,00,000	.900	1,80,000	.893	1,78,600	.885	1,77,000
2,00,000	.811	1,62,200	.797	1,59,400	.783	1,56,600
2,00,000	.731	1,46,200	.712	1,42,400	.693	1,38,600
2,00,000	.659	1,31,800	.636	1,27,200	.613	1,22,600
*4,250	.593	2,520	.567	2,410	.543	2,308
(*at the end of 5th year)						
		8,22,720		8,10,010		7,97,108

From the above calculation, it is clear that 12% rate of interest will equate the fair value.
Therefore, 12% is the implicit rate of interest in the lease.
(ii) Present Value of Minimum Lease Payments (12% rate of interest)

Year (Beginning)	Amount of Lease Payments	Present Value of ₹ 1	Present Value of Lease Payments
1	2,00,000	1	2,00,000
2	2,00,000	.893	1,78,600
3	2,00,000	.797	1,59,400
4	2,00,000	.712	1,42,400
5	2,00,000	.636	1,27,200
	10,00,000		8,07,600

It should be noted that the lessee will record the machine at ₹ 8,07,600, although the fair value of the asset is ₹ 8,10,000.

Presentation of the Asset and Liability

Transactions and other events are accounted for and presented in accordance with their substance and financial reality and not merely with their legal form. While the legal form of a lease agreement is that the lessee may acquire no legal title to the leased asset, in the case of finance leases the substance and financial reality are that the lessee acquires the economic benefits of the use of the leased asset for the major part of its economic life in return for entering into an obligation to pay for that right an amount approximating to the fair value of the asset and the related finance charge.

If such lease transactions are not reflected in the lessee's balance sheet, the economic resources and the level of obligations of an enterprise are understated thereby distorting financial ratios. It is therefore appropriate that a finance lease be recognised in the lessee's balance sheet both as an asset and as an obligation to pay future lease payments. At the inception of the lease, the asset and the liability for the future lease payments are recognised in the balance sheet at the same amounts.

It is not appropriate to present the liability for a leased asset as a deduction from the leased asset in the financial statements. The liability for a leased asset should be presented separately in the balance sheet as a current liability or a long-term liability as the case may be.

Initial Direct Cost

Initial direct costs are often incurred in connection with specific leasing activities, as in negotiating and securing leasing arrangements. The costs identified as directly attributable to activities performed by the lessee for a finance lease are included as part of the amount recognised as an asset under the lease.

Apportion of Lease Payments

Lease payments should be apportioned between the finance charge and the reduction of the outstanding liability. The finance charge should be allocated to periods during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

Schedule of payments, split between capital and interests is normally available from the lessor.

Depreciation and Impairment

A finance lease gives rise to a depreciation expense for the asset as well as a finance expense for each accounting period. The depreciation policy for a leased asset should be consistent with that for depreciable assets which are owned, and the depreciation recognised should be calculated on the basis set out in Accounting Standard (AS) 6, Depreciation Accounting. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset should be fully depreciated over the lease term or its useful life, whichever is shorter.

To determine whether a leased asset has become impaired, an enterprise applies the Accounting Standard dealing with impairment of assets, that sets out the requirements as to how an enterprise should perform the review of the carrying amount of an asset, how it should determine the recoverable amount of an asset and when it should recognise, or reverse, an impairment loss.

Illustration 4

Lessee Ltd. took a machine on lease from Lessor Ltd., the fair value being ₹ 7,00,000. The economic life of the machine as well as lease term is 3 years. At the end of each year Lessee Ltd. pays ₹ 3,00,000. Guaranteed Residual Value (GRV) is ₹ 22,000 on expiry of the lease. Implicit Rate of Return (IRR) is 15% p.a. and present value factors at 15% are 0.869, 0.756 and 0.657 at the end of first, second and third years respectively.

Calculate the value of machine to be considered by the Lessee Ltd. and the interest (finance charges) in each year.

Solution **Calculation of Present Value of Minimum Lease Payments**

End of	Minimum Lease Payments	Present Value at 15%	Present Value Amount (₹)
1st Year	3,00,000	0.869	2,60,700
2nd Year	3,00,000	0.756	2,26,800
3rd Year	3,00,000	0.657	1,97,100
	(Residual Value) 22,000	0.657	14,454
			6,99,054

Value of machine will be the lower of fair value and present value of minimum lease payment *plus* residual value. Hence, present value of minimum lease payment *plus* residual value is ₹ 6,99,054 but the fair value is ₹ 7,00,000. Therefore, the value of machine will be taken as ₹ **6,99,054**.

Calculation of Interest (Finance Charge)

Year (A)	Balance Due (₹) (B)	Interest @ 12% for the Year (15% of B) (C)	Repayment of Capital (₹ 3,00,000 – C) (₹) (D)	Closing Balance (B – D) (₹) (E)
1st	6,99,054	1,04,858	1,95,142	5,03,912
2nd	5,03,912	75,587	2,24,413	2,79,499
3rd	2,79,499	41,925	2,58,075	*21,424 (Residual Value)

*The difference between this figure and guaranteed residual value (₹ 22,000) is due to approximation.

Journal Entries

1. For the acquisition of the asset under lease

Asset under Lease Account Dr.
To Lease Payable Account

2. For the payment of the first instalment

Lease Payable Account Dr.
To Bank Account

3. For the interest payable

Interest Account Dr.
To Interest Payable Account

4. For the depreciation of the asset

Depreciation Account Dr.
To Provision for Depreciation Account

5. For the repayment of capital and interest

Lease Payable Account Dr.
Interest Payable Account Dr.
To Bank Account

6. For the payment of insurance, taxes, maintenance, etc.

Taxes Account	Dr.
Insurance Account	Dr.
Maintenance on Asset Account	Dr.
To Bank Account	

7. For writing-off provision for depreciation

Provision for Depreciation Account	Dr.
To Asset under Lease Account	

8. For closing interest, depreciation, insurance and maintenance

Profit and Loss Account	Dr.
To Interest Account	
To Depreciation Account	
To Insurance Account	
To Maintenance Account	

9. For purchase of the asset on the termination of the lease

Asset Account	Dr.
To Bank Account	

Illustration 5

On 1.1.2012, X leased a machine from Y on the following terms :

(1) It is to be treated as a finance lease, since substantially all risks and rewards incident to ownership will be transferred by lessor to the lessee.
(2) The ownership of the asset will be transferred to the lessee at the end of the lease period.
(3) The lessee will make ten annual payments of ₹ 33,000 each.

Other information :

(1) The cost of the asset is ₹ 1,78,207, expected life 15 years and scrap value ₹ 37,957.
(2) The cost incurred in installing the machine is ₹ 8,250.
(3) The present value of the minimum lease payments is ₹ 1,86,457 (@ 12% p.a.).
(4) The first instalment is paid on 31.12.2012.

You are required to :

(i) Prepare a complete schedule for 10 years showing the division of lease rent between repayment of capital and finance charge.
(ii) Pass Journal Entries in the books of X for the first three years.

Solution

(i) Statement Showing the Schedule of Payments

Year (A)	Opening balance (B)	Interest @ 12% for the year (12% of B) (C)	Repayment of Capital (₹ 33,000 – (C) (D)	Closing balance [(B) – (D)] (E)
1	1,86,457	22,375	10,625	1,75,832
2	1,75,832	21,100	11,900	1,63,932
3	1,63,932	19,672	13,328	1,50,604
4	1,50,604	18,072	14,928	1,35,676
5	1,35,676	16,281	16,719	1,18,957
6	1,18,957	14,275	18,725	1,00,232
7	1,00,232	12,028	20,972	79,260
8	79,260	9,511	23,489	55,771
9	55,771	6,692	26,308	29,463
10	29,463	3,537	29,463	—

In the books of the X
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
1.1.2012	Asset under Lease A/c	Dr.		1,86,457	
	To Lease Payable A/c				1,86,457
	(Being the acquisition of the asset under lease)				
31.12.2012	Interest A/c	Dr.		22,375	
	To Interest Payable A/c				22,375
	(Being the interest payable for the first year)				
"	Lease Payable A/c	Dr.		10,625	
	Interest Payable A/c	Dr.		22,375	
	To Bank A/c				33,000
	(Being the repayment of capital and interest)				
"	Depreciation A/c	Dr.		9,900	
	To Provision for Depreciation A/c				9,900
	(Being the depreciation on the leased asset under straight-line method)				
"	Profit and Loss A/c	Dr.		33,275	
	To Interest A/c				22,375
	To Depreciation A/c				9,900
	(Being the interest and depreciation charged to Profit and Loss Account)				
31.12.2013	Interest A/c	Dr.		21,100	
	To Interest Payable A/c				21,100
	(Being the interest payable for the second year)				
"	Lease Payable A/c	Dr.		11,900	
	Interest Payable A/c	Dr.		21,100	
	To Bank A/c				33,000
	(Being the repayment of capital and interest)				
"	Depreciation A/c	Dr.		9,900	
	To Provision for Depreciation A/c				9,900
	(Being the depreciation for the second year)				
"	Profit and Loss A/c	Dr.		31,000	
	To Interest A/c				21,100
	To Depreciation A/c				9,900
	(Being the interest and depreciation charged to Profit and Loss Account)				
31.12.2014	Interest A/c	Dr.		19,672	
	To Interest Payable A/c				19,672
	(Being the interest payable for the first year)				
"	Lease Payable A/c	Dr.		13,328	
	Interest Payable A/c	Dr.		19,672	
	To Bank A/c				33,000
	(Being the repayment of capital and interest)				
"	Depreciation A/c	Dr.		9,900	
	To Provision for Depreciation A/c				9,900
	(Being the depreciation for the third year)				
"	Profit and Loss A/c	Dr.		29,572	
	To Interest A/c				19,672
	To Depreciation A/c				9,900
	(Being the interest and depreciation charged to Profit and Loss Account)				

Operating Leases

Lease payments under an operating lease should be recognised as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

For operating leases, lease payments (excluding costs for services such as insurance and maintenance) are recognised as an expense in the statement of profit and loss on a straight line basis unless another systematic basis is more representative of the time pattern of the user's benefit, even if the payments are not on that basis.

Leases in the Financial Statements of Lessors

Leases in Financial Statement of Lessor

Finance Leases

An enterprise, e.g., a finance or a leasing company buys an asset from outside with the specific purpose of leasing it to a lessee. The lessor of a finance lease treats the transaction as ***a sale of an asset*** on long-term credit with the assumption that collection of periodic rentals is reasonably certain and there is no uncertainty about the future costs to be incurred with regard to the transaction. Therefore, a finance lease should be recorded in the lessor's Balance Sheet as a long-term ***debtor*** at the amount of the ***net investment in the lease***. Therefore, in the books of the lessor, a physical asset is converted into a non-current financial asset, i.e., debtors.

The lessor should recognise assets given under a finance lease in its balance sheet as a receivable at an amount equal to the net investment in the lease.

Where the cash flows under a finance lease may be predicted with reasonable certainty, the total finance charge should be allocated to different accounting periods during the lease term so as to produce a constant periodic rate of return on the remaining balance. This means to apply the finance charges at a constant percentage on the reducing net investment in the asset being leased.

The recognition of finance income should be based on a pattern reflecting a constant periodic rate of return on the net investment of the lessor outstanding in respect of the finance lease.

The manufacturer or dealer lessor should recognise the transaction of sale in the statement of profit and loss for the period, in accordance with the policy followed by the enterprise for outright sales. If artificially low rates of interest are quoted, profit on sale should be restricted to that which would apply if a commercial rate of interest were charged. Initial direct costs should be recognised as an expense in the statement of profit and loss at the inception of the lease.

Illustration 6

Global Ltd. has initiated a lease for three years in respect of an equipment costing ₹ 1,50,000 with expected useful life of 4 years. The asset would revert to Global Ltd. under the lease agreement.

The other information available in respect of lease agreement are :

(i) the unguaranteed residual value of the equipment after the expiry of the lease term is estimated at ₹ 20,000;
(ii) the implicit rate of interest is 10%; and
(iii) the annual payments have been determined in such a way that the present value of the lease payment plus the residual value is equal to the cost of asset.

Ascertain in the hands of Global Ltd. :

(i) Annual Lease Payment;
(ii) The unearned finance income;
(iii) The segregation of financial income;

Solution

(i) Calculation of Annual Lease Payment
(Assumed to be paid at the end of the year)

	₹
Cost of the equipment	1,50,000
Unguaranteed residual value	20,000
Present value of residual value @ 10% (₹ 20,000 × 0.7513)	15,026
Fair Value to be Recovered for Lease Payment	
Cost of equipment	1,50,000
Less: Present value of residual value	15,026
	1,34,974

Cumulative P.V. for 3 years @ 10% = 2.4868 (See Annuity Table)

Annual Lease Payment = $\frac{1,34,974}{2.4868}$ = **₹ 54,276**

(ii) Unearned Financial Income

Total lease payments (₹ 54,276 × 3)	1,62,828
Add: Residual value	20,000
Gross Investments	1,82,828
Less: Cost of equipment	1,50,000
	32,828

(iii) Calculation of Finance Income

Year	Lease Rentals (₹)	Finance Charges @ 10% on outstanding amount of the year (₹)	Repayment (₹)	Outstanding Liability (₹)
0	—	—	—	1,50,000
1	54,276	15,000	39,276	1,10,724
2	54,276	11,072	43,204	67,520
3	74,276 (Including residual value)	*6,756	67,520	—

* Actual interest is ₹ 6,752. The difference is due to approximation which has been adjusted in finance charge.

Journal Entries

1. For the purchase of an asset

Asset Account	Dr.
To Bank Account	

2. For leasing out the asset to the lessee

Rent Receivable Account	Dr.
To Asset Account	

3. For the receipt of the first instalment

Bank Account	Dr.
To Rent Receivable Account	

4. For the interest receivable

Interest Receivable Account	Dr.
To Interest Account	

5. For the receipt of rent and interest

Bank Account	Dr.
To Rent Receivable Account	
To Interest Receivable Account	

6. For transferring interest

Interest Account	Dr.
To Profit and Loss Account	

7. For the sale of the asset on termination of the lease

Bank Account	Dr.
To Profit on Sale of Asset Account	

Illustration 7

On 1.1.2012, X leased a machine from Y on the following terms :

(1) It is to be treated as a finance lease, since substantially all risks and rewards incident to ownershi- will be transferred by lessor to the lessee.
(2) The ownership of the asset will be transferred to the lessee at the end of the lease period.
(3) The lessee will make ten annual payments of ₹ 33,000.

Other information :

(1) The cost of the asset is ₹ 1,78,207, expected life 15 years and scrap value ₹ 37,957.
(2) The cost incurred in installing the machine is ₹ 8,250.
(3) The present value of the minimum lease payments is ₹ 1,86,457 (@ 12% p.a.).
(4) The first instalment is paid on 31.12.2012.

You are required to :

(i) Prepare a complete schedule for 10 years showing the division of lease rent between repayment of capital and finance charge.
(ii) Pass Journal Entries in the books of Y for the first three years.

Solution

(i) Statement Showing the Schedule of Payments

Year (A)	Opening balance (B)	Interest @ 12% for the year (12% of B) (C)	Repayment of Capital (₹ 33,000 – (C) (D)	Closing balance [(B) – (D)] (E)
1	1,86,457	22,375	10,625	1,75,832
2	1,75,832	21,100	11,900	1,63,932
3	1,63,932	19,672	13,328	1,50,604
4	1,50,604	18,072	14,928	1,35,676
5	1,35,676	16,281	16,719	1,18,957
6	1,18,957	14,275	18,725	1,00,232
7	1,00,232	12,028	20,972	79,260
8	79,260	9,511	23,489	55,771
9	55,771	6,692	26,308	29,463
10	29,463	3,537	29,463	—

In the books of the Y
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
?	Machinery A/c (₹ 1,78,207 + 8,250)	Dr.		1,86,457	
	To Bank A/c				1,86,457
	(Being the purchase of machinery and the payment of direct expenses for leasing)				
1.1.2012	Rent Receivable A/c	Dr.		1,86,457	
	To Machinery A/c				1,86,457
	(Being the leasing out of the machinery to the lessee)				
31.12.2012	Interest Receivable A/c	Dr.		22,375	
	To Interest A/c				22,375
	(Being the interest charged for the first year)				
"	Bank A/c	Dr.		33,000	
	To Rent Receivable A/c				10,625
	To Interest Receivable A/c				22,375
	(Being the repayment of capital and interest charges received)				
"	Interest A/c	Dr.		22,375	
	To Profit and Loss A/c				22,375
	(Being interest credited to Profit and Loss Account)				
31.12.2013	Interest Receivable A/c	Dr.		21,100	
	To Interest A/c				21,100
	(Being the interest charged for the second year)				
"	Bank A/c	Dr.		33,000	
	To Rent Receivable A/c				11,900
	To Interest Receivable A/c				21,100
	(Being the repayment of capital and interest charges received)				
"	Interest A/c	Dr.		21,100	
	To Profit and Loss A/c				21,100
	(Being interest credited to Profit and Loss Account)				
31.12.2014	Interest Receivable A/c	Dr.		19,672	
	To Interest A/c				19,672
	(Being the interest charged for the third year)				
"	Bank A/c	Dr.		33,000	
	To Rent Receivable A/c				13,328
	To Interest Receivable A/c				19,672
	(Being the repayment of capital and interest charges received)				
"	Interest A/c	Dr.		19,672	
	To Profit and Loss A/c				19,672
	(Being interest credited to Profit and Loss Account)				

Operating Leases

An asset held by a lessor under an operating lease is required to be recorded as a fixed asset because the lessor keeps with himself all the substantial burdens and benefits of ownership.

Para 39 of AS—19 states that ***the lessor should present an asset given under operating lease in its balance sheet under fixed assets***.

Rental income is recognised in the Profit and Loss Account is a revenue to the lessor on a straight-line basis, even if the payments are not received on such a basis. However, if another systematic and rational basis is more representative of the time pattern in which the lessor receives rentals, it can also be used.

Para 40 of AS—19 states that ***lease income from operating leases should be recognised in the statement of profit and loss on a straight line basis over the lease term, unless another systematic basis is more representative of the time pattern in which benefit derived from the use of the leased asset is diminished***.

Para 43 of AS—19 states that ***the depreciation of leased assets should be on a basis consistent with the normal depreciation policy of the lessor for similar assets, and the depreciation charge should be calculated on the basis set out in AS 6, Depreciation Accounting***.

Journal Entries

1. For the purchase of the asset

Asset Account Dr.
To Bank Account

2. For the rental received on lease

Bank Account Dr.
To Lease Rent Account

3. For the depreciation of the asset

Depreciation Account Dr.
To Provision for Depreciation Account

4. For the payment of taxes, insurance and maintenance of the asset

Taxes Account Dr.
Insurance Account Dr.
Maintenance of Leased Asset Account Dr.
To Bank Account

Illustration 8

ABC Ltd., a leasing company, purchased a machine for ₹ 1,19,063 and leased that to PQR Ltd. on 1.1.2012. The lease is non-cancellable and the lease period is 4 years. The life of the machine is estimated to be 5 years and the estimated scrap value is ₹ 1,400.

The lessee is entitled to buy the asset at the scrap value at the end of the lease period. The lessee is required to pay ₹ 35,000 p.a. in advance towards the capital repayment and financial charges. The implicit interest rate of the lessor is 12%. Assume that repairs are estimated to be ₹ 2,800.

Pass Journal Entries in the books of both the parties.

Solution

Statement Showing the Schedule of Payments

Year (A)	Opening Balance (B)	Interest @ 12% for the year (12% of (B) (C)	Repayment of Capital (₹ 35,000 – (C) (D)	Closing Balance [(B) – (D)] (E)
1	1,19,063	—	35,000	84,063
2	84,063	10,088	24,912	59,151
3	59,151	7,098	27,902	31,249
4	31,249	*3,751	31,259	—

* Actual interest is ₹ 3,750 but it has been adjusted to ₹ 3,751.

In the books of the ABC Ltd. (Lessor)
Journal

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
?	Machinery A/c Dr.		1,19,063	
	To Bank A/c			1,19,063
	(Being the purchase of machinery for leasing)			
1.1.2012	Rent Receivable A/c Dr.		1,19,063	
	To Machinery A/c			1,19,063
	(Being the leasing out of the machinery to the lessee)			

"	Bank A/c Dr. To Rent Receivable A/c (Being the first instalment received)			35,000	 35,000
31.12.2012	Interest Receivable A/c Dr. To Interest A/c (Being the interest charged)			10,088	 10,088
"	Interest A/c Dr. To Profit and Loss A/c (Being interest credited to Profit and Loss Account)			10,088	 10,088
1.1.2013	Bank A/c Dr. To Rent Receivable A/c To Interest Receivable A/c (Being the repayment of capital and interest charges received)			35,000	 24,912 10,088
31.12.2013	Interest Receivable A/c Dr. To Interest A/c (Being the interest charged)			7,098	 7,098
"	Interest A/c Dr. To Profit and Loss A/c (Being interest credited to Profit and Loss Account)			7,098	 7,098
1.1.2014	Bank A/c Dr. To Rent Receivable A/c To Interest Receivable A/c (Being the repayment of capital and interest charges received)			35,000	 27,902 7,098
31.12.2014	Interest Receivable A/c Dr. To Interest A/c (Being the interest charged)			3,751	 3,751
"	Interest A/c Dr. To Profit and Loss A/c (Being interest credited to Profit and Loss Account)			3,751	 3,751
1.1.2005	Bank A/c Dr. To Rent Receivable A/c To Interest Receivable A/c (Being the repayment of capital and interest charges received)			35,000	 31,249 3,751

In the books of the PQR Ltd. (Lessee)
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
1.1.2012	Asset under Lease A/c To Lease Payable A/c (Being the acquisition of the asset under lease)	Dr.		1,19,063	 1,19,063
"	Lease Payable A/c To Bank A/c (Being the first instalment paidt)	Dr.		35,000	 35,000
31.12.2012	Depreciation A/c (Note 1) To Provision for Depreciation A/c (Being the depreciation charged)	Dr.		23,813	 23,813
"	Interest A/c To Interest Payable A/c (Being the interest payable)	Dr.		10,088	 10,088
"	Profit and Loss A/c To Depreciation A/c To Interest A/c (Being depreciation and interest charged to Profit and Loss Account)	Dr.		33,901	 23,813 10,088
1.1.2013	Lease Payable A/c Interest Payable A/c To Bank A/c (Being the repayment of capital and interest)	Dr. Dr.		24,912 10,088	 35,000
31.12.2013	Depreciation A/c To Provision for Depreciation A/c (Being the depreciation charged)	Dr.		23,813	 23,813

"	Interest A/c To Interest Payable A/c (Being the interest payable)	Dr.	7,098	7,098
"	Profit and Loss A/c To Depreciation A/c To Interest A/c (Being depreciation and interest charged to Profit and Loss Account)	Dr.	30,911	23,813 7,098
1.1.2014	Lease Payable A/c Interest Payable A/c To Bank A/c (Being the repayment of capital and interest)	Dr. Dr.	27,902 7,098	35,000
31.12.2014	Depreciation A/c To Provision for Depreciation A/c (Being the depreciation charged)	Dr.	23,813	23,813
"	Interest A/c To Interest Payable A/c (Being the interest payable)	Dr.	3,751	3,751
"	Profit and Loss A/c To Depreciation A/c To Interest A/c (Being depreciation and interest charged to Profit and Loss Account)	Dr.	27,564	23,813 3,751
1.1.2015	Lease Payable A/c Interest Payable A/c To Bank A/c (Being the repayment of capital and interest)	Dr. Dr.	31,249 3,751	35,000
31.12.2015	Depreciation A/c To Provision for Depreciation A/c (Being the depreciation charged)	Dr.	23,813	23,813
"	Profit and Loss A/c To Depreciation A/c (Being depreciation charged to Profit and Loss Account)	Dr.	23,813	23,813

Working Note : (1) Depreciation = ₹ 1,19,063 / 4 = ₹ 23,813.

Sale and Leaseback Transactions

A sale and leaseback transaction occurs when an owner sells an asset and immediately reacquires the right to use the asset by entering into a lease with the purchaser—which may be either a finance lease or an operating lease. The original owner of the asset becomes the lessee of a lease agreement and the purchaser, the lessor.

For the purpose of sale and leaseback, the asset is generally sold to a finance or leasing company. The sum of the periodic rentals or lease period is independent of the selling price of the asset and may not represent the asset's fair value. There is no specific problem as far as the lessor is concerned. His net cash investment is the purchase price and that should be equal to the present value of minimum lease payments. In his books, accounting treatments are same as what has been explained previously.

From the lessee's point of view, the accounting problem is at what amount should the asset be recorded in the books and, in effect, when he should recognise a gain or loss from the sale of the asset that is now being used.

As a general rule, the acquisition cost should be considered as the original cost. The present value of minimum lease payments is not considered as the value of the leased asset, since the sale and leaseback are independent. The gain or loss from the sale of such an asset is deferred and recognised depending on whether it is a finance lease or an operating lease. the treatment is consistent with the economic substance of the transaction.

Following steps are to be followed :

(i) If the fair market value is lower than the original cost, the original cost is adjusted to the fair market value—the difference in values is recognised as a loss.

(ii) When sale is recorded, the difference between sale price and the original cost is recognised as unrealised gain or loss.

(iii) When leaseback is recorded the asset under finance lease should be valued at the present value of minimum lease payments.

(iv) The unrealised gain or loss is treated as an extra-cost account and is amortized in the same manner, the asset is depreciation.

Para 48 of AS—19 states that ***if a sale and leaseback transaction results in a finance lease, any excess or deficiency of sales proceeds over the carrying amount should not be immediately recognised as income or loss in the financial statements of a seller-lessee. Instead, it should be deferred and amortised over the lease term in proportion to the depreciation of the leased asse***t.

Para 50 of AS—19 states that ***if a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, any profit or loss should be recognised immediately. If the sale price is below fair value, any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortised over the period for which the asset is expected to be used***.

Para 52 of AS—19 states that ***for operating leases, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value should be recognised immediately***.

Illustration 9

ABC Ltd. makes a special purpose machine for its own use, the fair market value of which is ₹ 61,000. Under a sale and leaseback agreement, it is sold to PQR Ltd. on 1.1.2013 for ₹ 69,902 and leased back for its entire expected life of 4 years. The implicit rate of interest for the lessor is 12%. The total lease rental is payable in 4 equal instalments of ₹ 23,014 starting from 31.12.2013. The asset has no salvage value and ABC Ltd. follows straight-line method of depreciation. The construction cost recorded in the books is ₹ 58,800.

Pass Journal Entries in the books of ABC Ltd. for the first two years.

In the books of ABC Ltd.
Journal

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
1.1.2013	Bank A/c	Dr.		69,902	
	To Machinery A/c				58,800
	To Unrealised Gain under Sale and Leaseback A/c				11,102
	(Being the sale of machinery for lease and leaseback — unrealised ₹ 11,102)				
	Machinery under Lease A/c	Dr.		69,902	
	To Lease Payable A/c				69,902
	(Being the acquisition of the asset under lease)				
31.12.2013	Interest A/c	Dr.		8,388	
	To Interest Payable A/c				8,388
	(Being the interest payable @ 12% on ₹ 69,902)				
"	Lease Payable A/c	Dr.		14,626	
	Interest Payable A/c	Dr.		8,388	
	To Bank A/c				23,014
	(Being the repayment of capital and interest)				
"	Depreciation A/c (Note 1)	Dr.		14,700	
	Unrealised Gain under Sale and Leaseback A/c (Note 2)	Dr.		2,775	
	To Provision for Depreciation A/c				17,475
	(Being the depreciation on assets and amortisation of unrealised rent)				
"	Profit and Loss A/c	Dr.		23,088	
	To Depreciation A/c				14,700
	To Interest A/c				8,388
	(Being depreciation and interest charged to Profit and Loss Account)				
31.12.2014	Interest A/c	Dr.		6,633	
	To Interest Payable A/c				6,633
	(Being the interest payable)				
"	Lease Payable A/c	Dr.		16,381	
	Interest Payable A/c	Dr.		6,633	
	To Bank A/c				23,014
	(Being the repayment of capital and interest)				

"	Depreciation A/c Unrealised Gain under Sale and Leaseback A/c To Provision for Depreciation A/c (Being the depreciation on assets and amortisation of unrealised rent)	Dr. Dr.	14,700 2,775	 17,475
"	Profit and Loss A/c To Depreciation A/c To Interest A/c (Being depreciation and interest charged to Profit and Loss Account)	Dr.	21,333	 14,700 6,633

Working Notes :

(1) Depreciation = ₹ 58,800 / 4 = ₹ 14,700.

(2) Unrealised Gain under Sale and Leaseback to be adjusted = ₹ 11,102 / 4 = ₹ 2,775 (approx.)

KEY POINTS

- **Lease** : A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.
- **Finance Lease** : A finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset.
- **Operating Lease** : An operating lease is a lease other than a finance lease.
- **Non-cancellable Lease** : A non-cancellable lease is a lease that is cancellable only upon the occurrence of some remote contingency; or with the permission of the lessor; or if the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or upon payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonably certain.
- **Fair Value** : Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction.
- **Contingent rent** is that portion of the lease payments that is not fixed in amount but is based on a factor other than just the passage of time (e.g., percentage of sales, amount of usage, price indices, market rates of interest).
- An **operating lease** is a lease which is not a finance lease. It is of a short-term nature — assets are generally leased

THEORETICAL QUESTIONS

1. What is a lease ? What are the types of leases ?
2. Distinguish between finance lease and operating lease.
3. State the methods of accounting for finance lease and operating lease.
4. What is sale and leaseback agreement ? How they are accounted for in the books of lessor and lessee ?
5. How should finance leases be prepared in the financial statement of lessor and lessee ?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below.

1. A lease that transfers substantially all the risks and rewards incident to ownership is called
   A finance lease
   B operating lease
   C none of these.
2. Residual value of a leased asset is the estimated fair value of the asset at the end of the
   A economic life of the asset
   B lease term
   C none of these.
3. A lease is generally
   A cancellable
   B non-cancellable
   C none of these.

4. Lease payments under an operating lease should be recognised as an
   A expense
   B asset
   C none of these.
5. The lessor should present an asset given under operating lease in its balance sheet under
   A current assets
   B fixed assets
   C none of these.

PRACTICAL QUESTIONS

1. X and Company leases an asset on a non-cancellable lease contract with a lease term of 5 years from 1.1.2012. The rental is ₹ 35,000 p.a. payable in advance. The leased asset could have been purchased for cash, at the start of the lease for ₹ 1,04,250. X and Company is required to pay all maintenance and insurance costs as they arise, which are estimated to be ₹ 15,000. The lessee estimates that the asset will have a useful life of 8 years. The guaranteed and unguaranteed residual value at the end of the lease term is ₹ 15,000 and ₹ 10,000 respectively.
   Pass journal entries in the books of both the parties. Show your workings clearly (make assumptions, where necessary).
2. ABC Manufacturing Company has entered into an agreement with a finance company, to lease a machine for a 4-year period. Under the terms of the agreement, the machine is to be made available to ABC Manufacturing Company on 1.1.2013, when an immediate payment of ₹ 1,50,000 has to be made, followed by seven semi-annual payments of an equivalent amount.
   The fair value of the machine on 1.1.1999 is ₹ 9,60,000. The estimated life of such machines is 4 years. ABC Manufacturing Company can borrow money from the bank @ 18% p.a.
   ABC Manufacturing Company has a policy of depreciating the machines in this type that it owns over a 4-year period on a straight-line basis.
   You are required to :
   (i) prepare a complete schedule for 4 years showing the division of lease rent between repayment of capital and finance charge.
   (ii) pass journal entries in the books of both the parties for the lease term.
3. PQR Manufacturing Company, whose accounting year is 31st December, has acquired two items of machinery on leases, the terms of which would mean that they should be treated as finance leases.
   The details are as under :
   Item A
   10 annual instalments of ₹ 1,00,000 each, the first payable on 1.1.2012. The machine was completely installed and first operated on 1.1.2012 and its purchase price on that date was ₹ 8,00,000. The machine has an estimated useful life of 10 years at the end of which it will be of no value.
   Item B
   10 annual instalments of ₹ 1,50,000 each, the first payable on 1.1.2014. The machine was completely installed and first operated on 1.1.2016 and its purchase price on that date was ₹ 16,70,000. The machine has an estimated useful life of 12 years at the end of which it will be of no value.
   You are required to pass necessary journal entries.

Guide to Answers

Multiple Choice

1. A; 2. B; 3. B; 4. A; 5. B.

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Farm Accounting

A farm is an area of land (and/or water), together with appropriate buildings, where crops are grown or animals are reared for commercial purposes. Therefore, farming activities mainly consist of growing crops and rearing livestock. Crop is any group of plants grown by people for food or other use. Livestock is an asset consisting of fish, animals or birds. It is usually applied to an agricultural business to refer to cattle, pigs, sheep etc.

Farm accounts are accounts giving the results of farming activities. They are intended to keep a record of each farming activity to ascertain the cost and profit/loss of each such type of activity.

Farming transactions are recorded mostly on cash basis. If the size of the farming business is small, it may not be necessary to follow the double entry principles of accounting. The books of account can be maintained under single entry system with a proper record of receipts and payments of cash. If the activities are large, transactions should be recorded under double entry principles like any other business. But, there are special problems concerned with the valuation of growing crops, marketable produce and livestock. Marketable produce may be valued at its ***net realisable value*** rather than cost. In effect, the profit on it is included in the accounts for the accounting year in which it is produced. This is justified by the certainty attaching to many market selling prices. Livestock may be valued on the ***Herd Basis***. *Herd* means a large number of domestic animals, especially cattle, often of the same breed, that are kept, driven or reared together. Herd basis allows for developing value as animals mature and new ones are born. Use of this basis allows the farmer to treat a collection of animals of the same type as a fixed asset. The alternative would be to treat each animal separately and thus to determine the profit/loss on the occasion of each disposal.

Illustration 1

The following information is provided by a firm for the year ended 31.12.2014 (all figures in ₹) :

	Grains	Seeds	Fertilisers
Opening Stock (1.1.2014)	16,000	1,200	6,000
Purchases (during 2014)	—	3,600	16,400
Closing Stock (31.12.2014)	7,400	600	800

Sale of Grains — ₹ 64,000; Grains distributed as wages — ₹ 6,600; Grains taken for personal use — ₹ 8,600; Grains consumed by livestock section — ₹ 5,400; Wages — ₹ 7,400; Maintenance of machinery — ₹ 3,800; Depreciation of machinery — ₹ 5,000; Crop insurance — ₹ 1,200.

Prepare Crops Account to ascertain the Gross Profit / Loss made by this section of the firm.

Solution

Dr. Crops Account for the year ended 31st December, 2014 Cr.

Particulars		₹	₹	Particulars		₹	₹
To Opening Stock :	Grains	16,000		By Sale of Grains		64,000	
	Seeds	1,200		By Grains Distributed as Wages		6,600	
	Fertilisers	6,000	23,200	By Grains Taken for Personal Use		8,600	
To Purchases :	Seeds	3,600		By Grains transferred to Livestock Section		5,400	84,600
	Fertilisers	16,400	20,000	By Closing Stock :	Grains	7,400	
To Wages		7,400			Seeds	600	
Add: Grains Distributed as Wages		6,600	14,000		Fertilisers	800	8,800
To Maintenance of Machinery			3,800				
To Depreciation on Machinery			5,000				
To Crop Insurance			1,200				
To Gross Profit c/d			26,200				
			93,400				93,400

Illustration 2

From the following information, prepare the Cattle Account for the year ended 31.3.2015 in the books of a farm :

		Nos.	₹			Nos.	₹
Purchases :	Cattle	200	5,85,000	Opening Stock :	Cattle	100	3,00,000
	Cattle Feed	—	1,35,000		Cattle Feed	—	30,000
Sales :	Cattle	150	5,62,500	Closing Stock :	Cattle	115	5,85,000
	Slaughtered Cattle	40	1,80,000		Cattle Feed	—	37,500
	Carcases	5	750				

Out of calves born during the year 4 died and the carcases of the calves did not realise anything. Crops worth ₹ 22,500 were used as cattle feed. ₹ 15,000 was estimated to be wages for rearing. Slaughter house expenses amounted to ₹ 22,500. Depreciation ₹ 7,500 and insurance ₹ 3,750 were to be charged.

Solution

Dr. Cattle Account for the year ended 31st March, 2015 Cr.

Particulars	Nos.	₹	Particulars		Nos.	₹
To Opening Stock	100	3,00,000	By Sales :	Cattle	150	5,62,500
To Purchases	200	5,85,000		Slaughtered Cattle	40	1,80,000
To Calves Born (Note 1)	14	—		Carcases	5	750
To Cattle Food Consumed (Note 2)		1,27,500	By Calves Died		4	—
To Transfer from Crops		22,500	By Closing Stock		115	5,85,000
To Wages		15,000				
To Slaughter House Expenses		22,500				
To Depreciation		7,500				
To Insurance		3,750				
To Net Profit		2,44,500				
	314	13,28,250			314	13,28,250

Working Notes :

(1) Calculation of Calves Born		Nos.	Nos.	**(2) Calculation of Cattle Feed Consumed**		₹
Opening Stock			100	Opening Stock		30,000
Add:	Purchased		200	Add: Purchases		1,35,000
			300			1,65,000
Less:	Sold	150		Less: Closing Stock		37,500
	Slaughtered	40		**Cattle Feed Consumed**		1,27,500
	Carcases	5				
	Died	4				
	Closing Stock	115	314			
Calves Born			14			

Illustration 3

From the following information, you are required to prepare Crops and Livestock Account, and the Profit and Loss Account for the year ended 31st December, 2014 :

Particulars		₹	Particulars	₹
Opening Stock :	Crops and Fertilisers	90,000	Maintenance of Machinery	28,000
	Cattle	60,000	Mortgage Interest	24,000
	Sheep	40,000	Bank Interest	8,000
Closing Stock :	Seeds	5,600	Farm Machinery	2,00,000
	Cattle	1,10,000	Staff Salary	72,000
	Sheep	65,000	Manager's Salary	24,000

	Cattle Feed	17,000	Rent		16,400
Purchases :	Seeds and Fertilisers	20,000	Sales:	Cattle	1,40,000
	Cattle	90,000		Sheep	80,000
	Sheep	20,000		Milk	1,00,000
	Cattle feed	22,000		Paddy	3,40,000
Expenses :	Crop	38,000		Fruits	36,000
	Livestock	44,000		Vegetables	24,000

Additional information :

(1) Crops worth ₹ 7,000 were consumed by the livestock.

(2) Depreciation @ 10% p.a. on Farm Machinery is to be provided.

Solution

Crops and Livestock Account, and the Profit and Loss Account

Dr. for the year ended 31st December, 2014 Cr.

Particulars	Crops ₹	Livestock ₹	Particulars	Crops ₹	Livestock ₹
To Opening Stock :			By Sales :		
Crops and Fertilisers	90,000	—	Cattle	—	1,40,000
Cattle	—	60,000	Sheep	—	80,000
Sheep	—	40,000	Milk	—	1,00,000
To Purchases :			Paddy	3,40,000	—
Seeds and Fertilisers	20,000	—	Fruits	36,000	—
Cattle	—	90,000	Vegetables	24,000	—
Sheep	—	20,000	By Transfer to Livestock	7,000	—
Cattle feed	—	22,000	By Closing Stock :		
To Expenses	38,000	44,000	Seeds	5,600	—
To Transfer from Crop	—	7,000	Cattle	—	1,10,000
To Gross Profit c/d	2,64,600	2,29,000	Sheep	—	65,000
			Cattle feed	—	17,000
	4,12,600	5,12,000		4,12,600	5,12,000
To Maintenance of Machinery		28,000	By Gross Profit b/d (₹ 2,64,600 + 2,29,000)		4,93,600
To Mortgage Interest		24,000			
To Bank Interest		8,000			
To Staff Salary		72,000			
To Manager's Salary		24,000			
To Rent		16,400			
To Depreciation on Farm Machinery		20,000			
To Net Profit		3,01,200			
		4,93,600			4,93,600

Illustration 4

From the following Trial Balance and additional information, prepare Final Accounts of Dhanmandi Farm :

Particulars		Dr. (₹)	Cr. (₹)	Particulars		Dr. (₹)	Cr. (₹)
Opening Stock (1.1.2014) :	Livestock	1,87,500	—	Purchases :	Livestock	37,500	—
	Paddy	75,000	—		Cattle feed	75,000	—
	Cattle feed	13,750	—		Fertilisers	20,000	—
	Fertilisers	6,250	—		Seeds	7,250	—
	Seeds	3,750	—	Repairs and Maintenance		15,000	—
Capital		—	5,52,250	Expenses :	Crop	63,000	—
Land and Building		3,43,750	—		Livestock	15,625	—
Farm Equipments		1,87,500	—		General	14,625	—
Debtors and Creditors		26,250	32,500	Sales :	Livestock	—	60,000
Bank		10,625	—		Paddy	—	2,65,000
Cash		9,125	—		Milk	—	1,96,250
Outstanding General Expenses		—	5,500	**TOTAL**		11,11,500	11,11,500

Additional information :

(1) Closing Stock (31.12.2014) : Livestock ₹ 1,65,000; Paddy ₹ 37,500; Cattle feed ₹ 7,500; Fertilisers ₹ 4,375; Seeds ₹ 3,375.

(2) Depreciation to be provided on : Land and building @ 2% p.a; Farm equipments @ 10% p.a.

(3) The owner withdrew the following from the firm : Milk ₹ 7,500; Paddy ₹ 11,875.

Solution

Dhanmandi Farm

Dr. Crops and Livestock Account, and Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars		Crops ₹	Livestock ₹	Particulars		Crops ₹	Livestock ₹
To Opening Stock :	Livestock	—	1,87,500	By Sales :	Livestock	—	60,000
	Paddy	75,000	—		Paddy	2,65,000	—
	Cattle feed	—	13,750		Milk	—	1,96,250
	Fertilisers	6,250	—	By Drawings :	Milk	—	7,500
	Seeds	3,750	—		Paddy	11,875	—
To Purchases :	Livestock	—	37,500	By Closing Stock :	Livestock	—	1,65,000
	Cattle feed	—	75,000		Paddy	37,500	—
	Fertilisers	20,000	—		Cattle feed	—	7,500
	Seeds	7,250	—		Fertilisers	4,375	—
To Expenses		63,000	15,625		Seeds	3,375	—
To Gross Profit c/d		1,46,875	1,06,875				
		3,22,125	4,36,250			3,22,125	4,36,250

	₹	₹		₹
To Repairs and Maintenance		15,000	By Gross Profit b/d (₹ 1,46,875 + 1,06,875)	2,53,750
To General Expenses		14,625		
To Depreciation on :	₹			
Land and Building	6,875			
Farm Equipments	18,750	25,625		
To Net Profit (Transferred to Capital Account)		1,98,500		
		2,53,750		2,53,750

Balance Sheet of Dhanmandi Farm as at 31st December, 2014

Liabilities	₹	₹	Assets		₹	₹
Capital :			Land and Building		3,43,750	
Opening Balance	5,52,250		Less: Depreciation		6,875	3,36,875
Add: net Profit	1,98,500		Farm Equipments		1,87,500	
	7,50,750		Less: Depreciation		18,750	1,68,750
Less: Drawings (₹ 7,500 + 11,875)	19,375	7,31,375	Closing Stock :	Livestock	1,65,000	
Creditors		32,500		Paddy	37,500	
Outstanding General Expenses		5,500		Cattle Feed	7,500	
				Fertilisers	4,375	
				Seeds	3,375	2,17,750
			Debtors			26,250
			Bank			10,625
			Cash			9,125
		7,69,375				7,69,375

Illustration 5

Khetibari Farm presents the following balances for the year ended 31.3.2015 :

Particulars	₹	Particulars	₹
Agricultural Equipments	18,00,000	Land	25,00,000
Capital	45,00,000	Cash and Bank	90,000
Debtors	6,40,000	Loan from Bank	10,00,000
Opening Stock of Crops	5,00,000	Opening Stock of Fertiliser	2,20,000
Opening Stock of Livestock	4,00,000	Sales of Livestock	11,00,000
Purchase of Livestock	2,30,000	Farm Workers' Wages	1,60,000
Farmhouse Electricity	30,000	Farm Manager's Salary	1,20,000
Livestock Feed Purchase	4,70,000	Sales of Crops	22,50,000
Creditors	90,000	Administrative Expenses	40,000
Interest	1,20,000	Crop Insurance	40,000
Farmhouse	6,80,000	Purchase of Fertiliser	6,00,000
Crops Processing Expenses	3,00,000		

Depreciation is to be charged on agricultural equipment @ 10% p.a.; and on farm house @ 5% p.a. The former is to be borne fully by the crops section while the latter is to be equally shared by the crops section and the livestock section.

Livestock section is to bear 25% of all manpower cost. During the year, crops worth ₹ 50,000 were used as livestock feed. Farmhouse electricity is to be shared equally by the two sections.

The closing stock of crops, fertiliser, livestock and livestock feed amounts to ₹ 2,00,000; ₹ 2,40,000; ₹ 3,20,000 and ₹ 20,000 respectively. Loan from bank is used for crops section and livestock section in the ratio of 2 : 1 respectively.

Prepare the Crops and Livestock Account, and Profit and Loss Account for the year ended 31.3.2015 and the Balance Sheet as on that date.

Solution

.

Khetibari Farm
Crops and Livestock Account, and Profit and Loss Account
for the year ended 31st March, 2015

Dr **Cr.**

Particulars		Crops ₹	Livestock ₹	Particulars		Crops ₹	Livestock ₹
To Opening Stock :	Crops	5,00,000	—	By Sales :	Livestock	—	11,00,000
	Livestock	—	4,00,000		Crops	22,50,000	—
	Fertiliser	2,20,000	—	By Transfer to Livestock		50,000	—
To Purchases :	Livestock	—	2,30,000	By Closing Stock :	Crops	2,00,000	—
	Livestock feed	—	4,70,000		Fertilisers	2,40,000	—
	Fertiliser	6,00,000	—		Livestock	—	3,20,000
To Farm Workers' Wages		1,20,000	40,000		Livestock feed	—	20,000
To Crops Processing Expenses		3,00,000	—				
To Transfer from Crops		—	50,000				
To Gross Profit c/d		10,00,000	2,50,000				
		27,40,000	14,40,000			27,40,000	14,40,000
To Farmhouse Electricity		15,000	15,000	By Gross Profit b/d		10,00,000	2,50,000
To Farm Manager's Salary		90,000	30,000				
To Interest		80,000	40,000				
To Administrative Expenses		30,000	10,000				
To Crop Insurance		40,000	—				
To Depreciation on :							
Agricultural Equipments		1,80,000	—				
Farmhouse		17,000	17,000				
To Net Profit (Transferred to Capital Account)		5,48,000	1,38,000				
		10,00,000	2,50,000			10,00,000	2,50,000

Balance Sheet of Khetibari Farm as at 31st March, 2015

Particulars	₹	₹	Particulars		₹	₹
Capital : Opening Balance	45,00,000		Land			25,00,000
Add: Net Profit (₹ 5,48,000 + 1,38,000)	6,86,000	51,86,000	Farmhouse		6,80,000	
Loan from Bank		10,00,000	Less: Depreciation		34,000	6,46,000
Creditors		90,000	Agricultural Equipments		18,00,000	
			Less: Depreciation		1,80,000	16,20,000
			Debtors			6,40,000
			Closing Stock :	Crops	2,00,000	
				Fertiliser	2,40,000	
				Livestock	3,20,000	
				Livestock feed	20,000	7,80,000
			Cash and Bank			90,000
		62,76,000				62,76,000

THEORETICAL QUESTIONS

1. What is a farm ? What are farm activities ?
2. What special problems may arise while valuing closing stock in farm accounting ?
3. Explain what do you mean by Herd Basis ?

PRACTICAL QUESTIONS

1. From the information given below, ascertain gross profit / loss from each of the following activities :
   (a) mushrooms; (b) poultry; (c) dairy; (d) crops.
   Also, ascertain the net profit / loss of the firm for the year ended 31.3.2015.
   (i) (figures in ₹)

Date	Fertilisers	Mushrooms	Poultry	Poultry Feed	Cattle	Cattle Feed	Crops	Growing Crops	Seeds
1.4.2014	24,000	5,000	30,000	8,000	6,30,000	16,000	84,000	62,000	10,800
31.3.2015	32,000	7,400	70,000	16,000	8,04,000	15,000	1,10,000	86,000	9,000

(ii) Purchases made during the year ended 31.3.2015 — Fertilisers ₹ 70,000; Mushroom seeds ₹ 10,400; Poultry ₹ 1,10,000; Poultry feed ₹ 35,000; Cattle ₹ 2,40,000; Cattle feed ₹ 35,000; Seeds ₹ 15,600.

(iii) Expenses incurred during the year ended 31.3.2015 — Wages ₹ 75,600; Repairs ₹ 3,800; Insurance ₹ 7,400; Bank interest ₹ 16,600.

(iv) The owner has withdrawn the following from the farm — Milk ₹ 6,400; Butter ₹ 1,400; Eggs ₹ 1,400; Crops ₹ 10,000; Vegetables ₹ 1,600; Fruits ₹ 400; Poultry ₹ 2,200.

(v) Depreciation to be charged on farm equipments ₹ 5,000.

(vi) Sales made during the year ended 31.3.2015 — Vegetables ₹ 17,000; Mushrooms ₹ 18,000; Crops ₹ 2,04,000; Fruits ₹ 18,000; Flowers ₹ 12,000; Milk ₹ 95,000; Eggs ₹ 56,000; Butter ₹ 25,400; Cattle ₹ 90,000; Poultry ₹ 82,000.

2. From the following Trial Balance and additional information, prepare farm accounts for the year 2014 :

Particulars	Dr. (₹)	Cr. (₹)	Particulars	Dr. (₹)	Cr. (₹)
Capital	—	1,90,000	Expenses : Crop — Labour	7,800	—
Opening Stock : Fertilisers	8,600	—	Direct costs	800	—
Paddy	30,000	—	Cattle — Labour	6,000	—
Cattle	60,000	—	Medicines	1,800	—
Cattle Feed	4,000	—	Dairy Expenses	2,200	—
Loan @ 8% p.a. (taken on 1.1.2012)	—	24,000	Equipments	46,000	—
General Expenses	2,400	—	Buildings	1,40,000	—
Purchases : Fertilisers	1,300	—	Sales : Paddy	—	65,000
Seeds	12,000	—	Cattle	—	15,000
Cattle	6,400	—	Dairy Products	—	36,000
Cattle Feed	1,600	—	Cash	14,000	—
Creditors	—	14,900	**TOTAL**	3,44,900	3,44,900

Additional information —

(1) Depreciation @ 10% p.a. is to be provided on equipments.

(2) The owner has consumed the following for personal purposes — Paddy ₹ 2,000; Dairy products ₹ 4,000.

(3) Closing Stock— Fertilisers ₹ 600; Paddy ₹ 4,600; Cattle ₹ 66,000; Cattle feed ₹ 1,600.

Guide to Answers

Practical Questions

1. **Gross Profit : Mushrooms ₹ 10,000; Poultry ₹ 44,600; Dairy ₹ 1,16,200; Crop ₹ 2,33,600; Net Profit : ₹ 2,96,000.**
2. **Gross Profit : ₹ 51,500; Net Profit : ₹ 43,380; Balance Sheet total : ₹ 2,68,200.**

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Introduction to Indian Government Accounting

Commercial Accounting and Government Accounting

Commercial accounting pertains to a firm, which is a ***production unit***, as per its economic definition. A firm may be known by different names as per its form and character — a joint stock company or a partnership or a single-owner entity. It is to be remembered that in India, a firm is a partnership, while a corporate body is a company. The production unit or the firm carries on its operations with an eye on profit-maximisation. Indeed, it is the chief motivation of a commercial enterprise. Necessarily, the accounts of a firm are directed to this end, i.e., profit-maximising, and to pointing out the loopholes in the pursuit of its objectives and indicating albeit indirectly, reasons for them. To put it another way, commercial accounting reflects upon financial management in so far as it falls short of its objective — that of earning maximum profit.

A government is, on the other hand, an agency of the state, carrying out its ideals and objectives through positive functions. A state exists to promote good life, as observed by Aristotle. This maxim is indeed eternal — a state is and should be there for giving its population a taste of good life, rather better and better life. What Aristotle implied by good life has been conceptualised by the economic concept of welfare (or well-being). Thus, the state exists to promote welfare, i.e., it strives to give its citizens a better and better quality of life. How it should be done is decided by the government, which in a democracy consists of representatives of the people. The government decides for itself the catalogue of functions for securing the above objective — promotion or welfare of the people — which, of course, varies from time to time as dictated by the situation.

To be able to discharge its catalogued functions, the government has to raise money and to spend it as per dictates of the representatives of the people. This is what is broadly called ***financial administration***, and herein comes the role of government accounting, which points out any aberration and also by its analysis, a better course of action. To reiterate, while profit-maximisation is the motive of a firm, maximisation of welfare is the objective of the state. This broad difference in the source of motivation enumerates the differences between commercial accounting and government accounting. For example, the idea of loss is never entertained by a commercial entity, while the government may have to run a service at a loss for public welfare. Thus, government accounting may be directed to a loss-minimisation, which is never the charge of commercial accounting except in the short run.

We may now enumerate the broad differences between government accounting and commercial accounting.

(1) Accounting Methods

A commercial enterprise generally prepares the following ***two basic*** statements:

(a) Profit and Loss Account — to ascertain the profit earned or loss incurred during an accounting period.

(b) Balance Sheet — to ascertain financial position of the business as on the last day of the accounting period.

Again, the purpose of commercial accounting is to ascertain profit or loss for an accounting period, which usually has numerous financial transactions on behalf of the business unit. The essential idea behind maintaining books of account is to show the correct position regarding each head of income and expenditure. A commercial entity maintains a permanent record of each transaction of the business and shows its financial effect on the enterprise. Thereafter, the combined effect of all the transactions made during an accounting period upon the financial position of the business as a whole is ascertained. Therefore, commercial accounting includes not only the maintenance of accounting records, but also the preparation of financial and economic information which involves the ***measurement of transactions*** and other events pertaining to a business. To operate a business profitably and to keep it solvent, its profitability and solvency should be measured at regular intervals. For this, it is essential to know whether a business is earning sufficient profits or incurring losses and if it has sufficient money to pay off its debts. Commercial accounting provides all this information which enables the management to guide the business along a profitable and solvent course.

The first point to note is that government accounts are mostly kept on a cash basis. The reason for this can be well comprehended from the nature of government functions. A government has to decide upon its range of activities first and then decide how to get the money for it — through taxation, borrowing or deficit financing. Thus, the government decides the size of the coat first and then proceeds to gather the necessary cloth through methods so chosen as to put the least burden on the community. Imposition of ***least burden*** is the first directive principle of government finance.

Besides the state, of whom government is an agency, is regarded as a vast benefit club. Necessarily, it does not have a profit motive. Indeed, it is not after profit-making except in public-commercial enterprises. Even in some of these enterprises, it may run services or produce goods at a loss for promoting the welfare of the people (for example supplying electricity in sparsely populated areas or running hill railways). Hence, the saying:' It may pay a government to run a service at a loss'.

Since profit motive is absent, the Profit and Loss Account is rarely prepared for the government (except, of course, in the case of certain listed public enterprises). It is thus not important for the government authorities to know how much they are likely to accrue in the future. What is more important for them is to ascertain how much cash they may draw upon for the socially oriented activities the government has decided to carry on or expand. Thus, ***cash basis accounting*** becomes the norm for government finance.

(2) Financial Statements

As pointed out earlier, every commercial enterprise prepares a Profit and Loss Account and a Balance Sheet. While the Profit and Loss Account serves as a report that summarises the revenues and expenses of an accounting period to reflect the changes in various critical areas of firm's operations, the Balance Sheet shows the financial position of a business by detailing the sources of funds and their utilisation.

But in case of government accounting, most of the transactions are recorded on the ***single entry basis***. The following two statements are generally prepared:

(a) Government Account — to show the net result of all incomes and expenditures including expenditure on capital account; and

(b) Statement of Balancing Accounts — to show whether the government owes or has to receive money.

Government accounts are maintained strictly on a ***cash basis*** as contrasted to commercial accounting which maintains accounts on ***mercantile basis***.

(3) Classification of Account Heads

In a commercial enterprise, for the purpose of analysis and record, accounts are broadly divided into four classes — real, nominal, personal and valuation. But in the case of government accounting, this classification becomes much wider than in that of commercial accounting. Though government accounting broadly comprises three categories of accounts, each category is subdivided into major heads of account. Also, major heads are further subdivided into minor heads and so on. This process is continued till the preparation of detailed heads of account. The three main accounts are: (i) consolidated fund; (ii) contingency fund; and, (iii) public accounts. The consolidated fund is again classified into : (i) Revenue and Expenditure Heads; (ii) Capital Receipts and Disbursement Heads; and (iii) Public Debt and Loans and Advances. Public Account is also divided into: (i) Debt and deposit division; and (ii) Remittance division.

Objectives of Government Accounting

Accounting is very important in a democracy where people have a right to know how government finances are being managed by their representatives. This knowledge enables them to have faith in their representatives or substitute them by new ones. The above role of government accounting may be discussed separately as following:

(1) Information about Revenue

Revenue of the government is of vital importance in so far as it has a bearing on the pockets of the people. The pockets should be touched only to the extent welfare is promoted. Whether this rule is being observed is indicated by the accountant's analysis and collection.

Government revenues are classified into (a) tax revenues and (b) non-tax revenues. Information about both the types has to be sufficient to enable the government to decide which way to stretch its arms next year or withdraw them to the needed extent. Gone are the tyrannical days of government. Today, it has to meet the people's directive, and the directive is for general well-being. By providing information about revenue in detail, government accounting enables the people to form their idea about the directive to be given.

(2) Information about Expenditure

After revenue information, government accounting seeks to provide information on different expenditures. This is rather mandatory in nature in view of the fact that expenditure sanctioning authorities like the legislature have a right and really want to know whether expenditures have been made as per sanctions. It is to be noted that expenditure of public money raised through taxation and borrowing etc., is sanctioned by the representatives of the people who compose the legislature.

(3) Information about Loans and Deposits

As already indicated, public money consists of loans, deposits and other receipts besides tax revenue. Public borrowing is rather inevitable. Likewise, governments also lend money to different parties, individual or otherwise. These loans and deposits must be fully displayed in government accounting so as to provide information to the legislature who authorises the raising of money through this method .

(4) Information about Cash Availability

Finances are raised through taxation and borrowing and other methods throughout the year, while expenditures are also incurred perennially. Thus, there may exist a gap between cash receipts and cash availability at any given time. Those who are authorised to make expenditures must be made aware of this. And, it is the function of the government accounts to provide information about this. This information also encompasses ***bank reconciliation***.

Some Terms and Expressions of Government Finance

In government finance one often comes across certain expressions which are unfamiliar in private accounts parlance. They are: (a) demand for grant; (b) supplementary grant; (c) treasury; (d) votable and non-votable items; (e) Public Accounts Committee; (f) Comptroller and Auditor General of India, etc. These are discussed below :

(a) Demand for grant : A basic principle of government finance is that no expenditure can be made by any public authority without parliamentary sanction, and the public authority has to request the parliament for such sanction. It is this request which is called demand for grant. The demand may be granted, refused or reduced. A refusal or reduction may jeopardise the legitimacy of the government in a parliamentary democracy, if it is taken as an expression of no-confidence in it.

(b) Supplementary grant : Normal grants are demanded at the time of presentation of the budget, but the amount granted may be found inadequate at some later date. A supplementary demand for grant may then be made. For example, the amount rated for drought relief may be found inadequate because of prolonged failure of the monsoons; and then an additional grant may be requested by the ministry. If granted, this becomes a supplementary grant for drought relief.

(c) Treasury : It is a term adopted from the British financial system. In simple language, it means the place where all government monies are treasured for the purpose of public payments. In Britain, the prime minister is also the first Lord of the Treasury, i.e., the head of government pay office. In India, there is no central treasury as such, but there are district treasuries in the states. There are sub-divisional treasuries too in some cases, which are called sub-treasuries. These treasuries are for making public payments. Normally a branch of the State Bank of India or a nationalised bank is attached to the treasury which together function as "government pay office".

The treasury system is being increasingly phased out in this country and the vacuum is being filled up by the State Bank or by state associated banks.

(d) Votable and non-votable items : Certain items of expenditure are charged to the consolidated fund or the Public Account. They are to be incurred regardless of legislative approval. They are called non-rateable items or items charged.

Other items are votable and expenditures thereon can be made only after parliamentary sanction. The government makes the demand for grants for these items of expenditure. This demand may be reduced or even rejected but in the case of non-votable items, it can just be debated and nothing more.

(e) Public Accounts Committee : This is a committee of parliament or of state legislature to scrutinise expenditures of public monies by the executive branch of the government. No minister can be a member of this committee, nor a member of the party in power. In other words, it consists of the opposition members who are to check whether the expenditures have been made according to the form and norms laid down by the legislature. Any deviation reported to the Comptroller and Auditor General of India also is brought to the notice of the House. But, scrutiny by the Public Accounts Committee is, at best, in the nature of a post-mortem. The omissions of the government are brought into focus after they have been committed. Yet, it helps build public opinion about the government, which is very important in a parliamentary system like ours.

(f) Comptroller and Auditor General of India : Legislative control over the purse of the nation is one of the basic principles of parliamentary form of government that obtains in this country as well as in Britain and other commonwealth countries. This control is exercised through different modes and agencies, the chief agency being the Comptroller and Auditor General of India (CAGI).

Thus, following the British practice, the constitution of India provides for CAGI under articles 148 – 150.

The CAGI is appointed by the president but is removable only by impeachment in the same manner and on the same grounds as a judge of the supreme court or a high court.

The duties, powers and functions of CAGI are varied, as given below :

(1) He is to advise the President on the form in which account of both the centre and the states are to be kept.

(2) He is to check that the amounts granted or authorised by the legislatures have been properly spent.

(3) He is to submit his audit reports to the president and to the state governments, who in their turn, have to place them before their respective legislatures.

(4) The CAGI is an important institution in government finance, nay, for that purpose, of any parliamentary finance.

Basic Principles of Government Accounting in India

Government accounting in India largely follows the British pattern. The following points are relevant in this regard.

(1) Pinpointing Responsibility

The Indian audit and accounts department, which functions under the aegis of the CAGI, is responsible for maintaining all government accounts except of railways, defence and transactions made outside the territorial limits of the country. Of late, a tendency of maintaining accounts departmentally is also being witnessed.

(2) Accounting Systems

Normally, the government follows the single entry system of keeping accounts. But in certain matters, such as loans and borrowings, the double entry system is also pursued. The reason behind this is to ascertain the exact balance. Books are kept with a view to preparing a trial balance for correcting errors.

(3) Public Sector Commercial Enterprises

The system of double entry book keeping on accrual basis is followed in respect of public sector commercial enterprises. The Profit and Loss Account and the Balance Sheet are prepared for the undertakings. But other appropriate management accounting techniques like cash and fund flow statements, ratio analysis, budgetary control, etc. are also resorted to for cost control and thus for profit effectiveness.

(4) Recording and Consolidation of Transactions

In government accounting system, transactions are initially recorded in different account and then consolidated in such a way as to display the combined results during the period in question. For example, expenditures under the head contingencies are first recorded, consolidated and then so analysed as to show the splitting-up under the different heads.

(5) Incomes and Expenditures Classifications

It is customary for the government to classify services under different heads and then sub-classify these services according to their essential natures. For example, government activities, as in our central budgets, are classified into: (i) general services; (ii) social services; (iii) economic services, and (iv) grants-in-aid and contributions.

The general services are further classified into: (i) administrative services; (ii) defence services; (iii) servicing of debts; and (iv) fiscal services; and so on.

Likewise, revenues are classified into: (i) tax revenue; and (ii) non-tax revenue.

Tax revenue, again, consists of: (i) taxes on incomes and expenditures; (ii) taxes on property and capital transactions; and (iii) taxes on commodities and services.

Following the same pattern, non-tax revenue is split-up into: (i) fiscal services; (ii) interest receipts (from the state governments, public sector projects, the corporate sector or from the individual); (iii) dividends and profits, and (iv) those designated as social services.

The classification proceeds further — each item is classified into major heads, then minor heads and, lastly into subheads.

(6) Maintaining Internal Accounts

Every paisa of the public money is to be accounted for. The function of recording each transaction and maintenance of internal accounts is a job of the department through which transactions take place. The job also may be centralised in the treasury in a small country. (such centralisation is not quite possible in a vast country with huge transactions, like our own).

(7) Combined Accounts

Federal though it may be, the government is normally viewed as a single whole. Incomes and expenditures of the government as a whole are a matter of interest and concern for all the citizens. A consolidated account of the incomings and outgoings needs to be prepared for popular scrutiny and review. In India, this is done by the accounts and audit department, which largely functions under the aegis of the CAGI, which is a constitutional authority for overseering the purse of the nation.

In some cases, however, consolidated budgets of the states are separately shown from that of the centre [refer Reserve Bank Bulletin or the Economic Survey].

Government Financial Administration

As an army marches on its stomach, so does a government on its revenues and receipts. Gone are the days of autocracy when the government authorities could make any expenditures they liked and in any amounts. Today, in a democracy, in particular, they have to raise money and expend them in accordance with certain norms fixed by popular opinion. And in matters of expenditure in particular, government is accountable to the people. This is called ***public accountability***. In other words, government has to convince the people through their chosen representatives in the legislature that monies have been spent for the purposes of which they were raised. These requirements make what is called the system of financial administration, format of which varies in detail from country to country but broadly is of the same shape and nature in all democracies.

In India, the system of financial administration follows the British pattern inasmuch as it has been a British legacy. It may be analysed thus:

(1) Consolidated Funds

In the federal system of government prevailing in India, there is a consolidated fund for the centre and for each of the states. To this fund all monies raised and received through taxation, borrowings, etc., are credited, and from this, all expenditures are met as per authorisation of Parliament at the centre and Legislatures in the states.

(2) Contingency Funds

Besides the consolidated funds, there is a contingency fund both for the centre and for each of the states.

The difference between the two is as follows:

To the consolidated fund, all monies received in the normal way are credited and all normal expenditures are defrayed therefrom. On the other hand, the contingency fund remains at the disposal of the President or the Governor, as the case may be, to enable the respective governments to meet expenditure in contingencies like war, earthquake, flood, etc., pending authorisation by parliament or the legislatures.

(3) Public Accounts

Like any individual a government has to have its own account, which is called Public Account. To this account are credited all money receipts as per fixed norms and rules.

(4) Budget

It is one of the basic principles of financial administration in a democracy that all money receipts and expenditures have to be budgeted and sanctioned. This means that estimates of expenditures are made, consolidated and classified and expenditure incurred for each of the heads as per legislative sanction. It is to be noted here that without legislative sanction neither a paisa can be raised through taxation or borrowing, nor can it be spent on any account, except from the Contingency Account, in which case no sanction is necessary.

Thus a budget — proposal for raising money and for making expenditures — must be passed by the legislature, which consists of people's representatives. In India, the formal name of the budget is Annual Financial Statement, of the Central Government or of a state government, as the case may be.

The budget has to be presented before Parliament or a state legislature before 31st of March, which is the last day of the financial year, also simply called the fiscal.

The budget has to display:

(a) The monies that are charged upon the Consolidated Fund in each case. In the case of the Centre, the sums in connection with the office of the President, the Vice President, the Supreme Court Judges etc. are charged upon the Consolidated Fund of India. This means they are to be appropriated from the Consolidated Fund without any Parliamentary approval. Members of Parliament may just discuss the proposals for these expenditures but can neither reject nor reduce any sum of this nature asked for.

(b) Other expenditures are to be made ***out of the consolidated fund*** as per parliamentary sanction. Parliament may sanction, reject or reduce any sum asked for by the government through the budget proposal.

It is to be noted that in all financial matters it is the Lower House or the Lok Sabha which is supreme. The Upper House or the Rajya Sabha may discuss, debate, propose but cannot impose any modification in a budget proposal.

The budget is normally presented by the finance minister at both levels of the government — the central and the state.

(5) Appropriation Act

Parliamentary or legislatory approval of budget proposal does not authorise the government to proceed with its expenditures immediately, for which purpose an Appropriation Act has to be passed. This means that the executive branch of government has to be authorised through this Act to make expenditures as per parliamentary approval. This is why, immediately after the presentation of the budget, at both layers of government, Appropriation Bills are introduced and when a bill is passed, it becomes an act — the law enabling the government to make expenditure lawfully.

(6) Disbursement of Grants

The Appropriation Act formalises appropriation for the purpose of expenditure to each of the ministries or departments of the government. In other words, parliament or the legislative assembly okays the grants for each of the government departments. When this is done, it is communicated to them and, they can then make expenditures within the sanctioned limits for their own purposes.

(7) Supplementary Budget

Sometimes, after the expiration of a period of time, it is found that monies sanctioned in the original budget have become or are going to be inadequate for the entire fiscal (financial year). In such cases, supplementary budgets are presented for obtaining parliamentary or legislative sanction.

(8) Financial Control and Audit

That the monies are spent as per legislative authorisation is overseen by the Comptroller and Auditor-General of India, who is an important officer of the parliament. Of late, he has somewhat relaxed his control over state finance. Yet, both the central and the state financial administration remain under his overall control. But his analysis and report are largely of the nature of a post mortem examination — they are done after the expenditures have already been made and prevention is not possible. Yet, the Comptroller and Auditor-General reports (CAG reports) are in the nature of both reflection and caution, seeking to keep the government within the four walls of parliamentary sanction. In a popular government, this is very important, no doubt.

Classification of Government Accounting in India

For a specific treatment of government accounts in India, the constitution of India has clearly provided for three funds or accounts:

(1) The Consolidated Fund of India;
(2) The Public Account; and
(3) The Contingency Fund of India.

Each of them will perhaps bear a word of exposition.

(1) Consolidated Fund of India

There is both for the centre and each of the states, a consolidated fund to which all incomes received by the government are credited. These income comprise all revenues, (i) tax or non-tax; (ii) all short-term loans like the Treasury Bills and ways and means, and (3) moneys received by the government in repayment of loans its had advanced previously.

Certain expenditures like the salaries and allowances of the President, the Chief Election Commissioner, the Comptroller and Auditor General of India, the Supreme Court charged upon it, i.e.,they have to paid out of regardless of legislative sanction. They are described as non-rateable items of expenditure.

In the case of states, salaries and allowances of the governor, and the high court judges etc. come under this category. Except these charged items of expenditure, all the other votable items have to be appropriated out of the consolidated fund through financial legislation passed by parliament or the state legislatures.

It is for the audit and accounts department of the government of India to record the amounts thus drawn and to scrutinise that they have been lawfully appropriated.

(2) Public Account

To the public account are deposited all the monies raised through loans (other than short-term advances through the Treasury Bill procedure, etc.) which go to the Consolidated Fund. To be precise, Public Account consists of money raised through loans, advances and deposits for which the government undertakes the liability of refunding at some future date. Some of the money receipts like the provident fund or deposits in the ***panchayat*** may initially be kept in the Remittance and Suspense Account for final remittance to the Consolidated Fund or for retaining by the public account itself.

(3) Contingency Fund

This fund is for meeting contingencies like earthquakes, floods, foreign aggression, etc. Theoretically, the fund remains at the disposal of the President in the case of the centre, and the Governor, in the case of a State. They can authorise appropriation from the fund to meet contingencies, pending approval by the Parliament or the state legislature.

Accounting Procedure of Government Expenditure

The form in which government accounts are to be kept is decided by the President in consultation with the Comptroller and Auditor-General of India. The pattern has to be uniform both for the centre and the states.

The Constitution of India provides that an Annual Financial Statement, popularly called the budget, is to be laid before Parliament in the case of the centre, and in the case of states, before their respective legislatures. This has to be passed by them before the next fiscal year (1st April of the current year to 31st March of the next calendar year). It is the approved budget that authorises the executive branch of the government to incur expenditure out of the consolidated fund. For this purpose, Appropriation Bills are introduced by the executive for being passed by the legislatures. If the Appropriation Bill is not passed, the government will be unable to incur any expenditure and, thus, its smooth functioning will be jeopardised.

The basic procedure principle is to put down all government expenditures in the three funds viz., the consolidated fund, the contingency fund, and the public account.

(1) Consolidated Fund

It is a broad head consisting of three divisions: (a) revenue division, (b) capital division, and (c) public debt division.

(a) Revenue division In the revenue division are accorded all receipts from taxes and other sources and all expenditures therefrom. When the receipts and expenditures do not balance (as normally they do not) the division exhibits either deficit or surplus during the (fiscal) year concerned. The following heads comprise the revenue receipts: (i) ***tax revenues*** : as per budgetary classification, all taxes on income and expenditure on property, on capital transactions and on commodities and services; and (ii) ***non-tax revenues*** : all interest receipts, dividends and profits, charges for fiscal services and grants-in-aid and contributions. On the expenditure side, the classification is as follows:

(a) General services : The following comprise the general services: administrative services, defence service, and servicing of loans and debts.

(b) Social services : Social services head consists of education, sports and games, health and family welfare, information and broadcasting and also arts and culture. These services are basically intended to improve the quality of social life.

(c) Economic services : Economic services consists of those which are directed to contributory economic life of facilitating production, or providing infrastructure for it. Agriculture and allied activities, power generation, transport and communication come under this head.

(d) Grants-in-aid and contributions : All grants-in-aid and contributions in all forms are made from the consolidated fund. Consequently, they constitute an important expenditure head under revenue division. Of course, the head is of more importance for the centre than for the states inasmuch as the states do not defray much expenditure as grants-in-aid though they make some contributions now and then.

(b) Capital division As can be well guessed, capital division consists of capital receipts and capital expenditures. Capital receipts are receipts of a capital nature, i.e., sums received all at once such as from discarded assets like plants and machinery. Capital expenditures consist of those long-run costs incurred either for increasing tangible capital assets or for reducing recurring liabilities thereon. For example, commutation of pension is an instance of capital expenditure. It reduces pension payment liability in the future and its expenditure on a new implement reduces the cost of running a project.

(c) Public debt Public debt is a broad category in so far as it includes all loans raised by the government from the public, and all loans and advances taken by it from the central bank and other statutory authorities. Hence, this division of public debt goes under the name of public debt, loans and advances division. It consists of all loans raised, taken and granted as also all advances obtained and granted. Since they are all loans, they are concerned with repayment or recovery, as the case may be. Transactions under this division are grouped into sections, which again are subdivided into major heads of account, then into minor heads, subheads and so on.

Furthermore, the heads of expenditure under each of these heads and subheads are classified as ***charged*** and ***voted***. ***Charged*** are those which are to be incurred and, therefore, charged on the consolidated fund of India. On the other hand, ***voted*** are those items, which may not be incurred or at least as per demands made by the executive. Whether charged or voted, any expenditure from the consolidated fund can be made after authorisation by the legislature — the central parliament or the state legislature.

(2) Contingency Fund

Expenditures under contingency fund require authorisation after they have been met. This fund is at the disposal of the President in respect of the centre, and of the Governor in a state. These functionaries are authorised to expend from the fund concerned to meet contingencies pending final authorisation by the legislature concerned. Necessarily, this final authorisation is in the nature of a post mortem approval or compulsory ***ex-post facto*** legislation.

(3) Public Account

Public account is in no way related to the capital division of the consolidated fund. The former consists of all monies received by or on behalf of the government outside of the consolidated fund. This account consists of two main divisions: (i) debt and deposit division; and (ii) remittance division.

(i) Debt and deposit division This division consists of all liabilities of the government in the shape of debts and loans, and of all refundable deposits such as earnest money and court deposits.

(ii) Remittance division This division is concerned with remittances from one head to another or from one place to another with a view to making adjustments among accounting circles.

Since the division deals with adjustments alone, approval of the legislature is not necessary for making payments on public account.

A Point to Note

An important point to note in respect of classification of government expenditure is that the manner in which it is done has a closer reference to the department incurring a particular expenditure than to the object for which it is done. It is the President in the case of the centre and the Governor in the case of a state, who orders, in consultation with the Comptroller and Auditor-General of India, how the transactions are to be classified. Here, consultation may be taken to mean 'on the advice of'. Thus, classification of the transactions is the preserve of the Comptroller and Auditor-General, and consultation with the President or the Governor, as the case may be, is just a formality.

The office of the Comptroller and Auditor General of India, not only directs the classification, but also sees to it that it is properly observed. This is one of the primary functions of government audit, i.e. of the institution of the Comptroller and Auditor General of India.

THEORETICAL QUESTIONS

1. Distinguish between commercial accounting and government accounting.
2. State the accounting methods for government accounting.
3. State the objectives of government accounting.
4. State the basic principles of government accounting in India.
5. Discuss the accounting procedure for government expenditure.
6. Write short notes on :
   (a) Public account; (b) Consolidated fund; (c) Demand for grant; and (d) Votable and non-votable items.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below.

1. Government accounts are mostly kept on a
   A cash basis
   B credit basis
   C none of these.
2. Treasury is a term adopted from the
   A Indian financial system
   B British financial system
   C none of these.
3. For keeping accounts, the government follows
   A single entry system
   B double entry system
   C none of these.
4. When the receipts and expenditures do not balance, Revenue division exhibits
   A deficit
   B surplus
   C either deficit or surplus.
5. Public account is in no way related to the capital division of the
   A contingency fund
   B consolidated fund
   C none of these.

Guide to Answers

Multiple Choice

1. A; 2. B; 3. A; 4. C; 5. B.

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Insolvency Accounts

Introduction

Insolvency is the inability of a debtor to pay debts as they fall due. A person is said to be insolvent when his liabilities exceed his assets and against whom the court makes an order of adjudication. In English law, the terms *bankrupt* and *bankruptcy* are used in same sense as the terms *insolvent* and *insolvency* are used in Indian law. Bankruptcy has been defined by Blackstone as, "a proceeding by which, when a debtor cannot pay his debts or discharge his liabilities or the person to whom he owes money or has incurred liabilities cannot obtain satisfaction of their claims, the State, in certain circumstances, takes possession of his property by an officer appointed for the purpose and such property is realised and distributed in equal proportions among the persons to whom the debtor owes money or has incurred pecuniary liabilities".

The law relating to insolvency in India is contained in two statutes:

(a) ***The Presidency Towns Insolvency Act of 1909*** which applies to the Presidency Towns of Mumbai, Kolkata and Chennai.

(b) ***The Provincial Insolvency Act of 1920*** which applies to the rest of India.

The two Acts are based on the same principles. However, the following are the points of differences, mostly to matters of procedure, between the two Acts.

1. The procedure from the date of presentation of petition to the date of adjudication.
2. The duties of the debtor, including his examination.
3. The person in whom the debtor's property is to be vested.
4. The Doctrine of Relation Back.
5. The constitution of the courts.

The main objectives of the insolvency legislation are :

(a) to secure an equitable distribution of property of the debtor among the creditors;

(b) to enable the debtor to be free from debts and to make a fresh start; and

(c) to protect the interests of the creditors and the public.

The above two Acts are applicable only to individuals, firms, Hindu undivided families and not to joint stock companies. For a joint stock company, the word "insolvency" is substituted by the word "liquidation". The special provisions of the Companies Act, 2013 are applicable for the liquidation of a company.

Important Terms / Expressions

Act of Insolvency

An 'Act of Insolvency' is an act of the debtor upon which an insolvency petition may be grounded, if committed before presentation of the petition and being one of the nine acts specified in statutes stated above.

Dividend

It means the proportion of payment to be made per rupee to the unsecured creditors from the realisable estate of the insolvent.

Official Receivers / Assignees

They are the officers appointed by the insolvency court to supervise the realisation and administration of the estate and the conduct of the debtors. Under Provincial Insolvency Act, 1920, this officer is called ***Official Receiver*** and under Presidency Towns Insolvency Act, 1909 it is known as ***Official Assignee***.

Preferential Creditors

Preferential Creditors are those who are given preference in payment over all other unsecured creditors.

Secured Creditors

Secured Creditors are those who are holding a mortgage, charge or lien on the property of the debtor as a security.

Unsecured Creditors

Unsecured Creditors are those who are not holding a mortgage, charge or lien on the property of the debtor. Creditors have provided loan to the insolvent debtor on his personal security.

When Can a Person be Declared Insolvent ?

A person can be adjudicated insolvent if the following two conditions are satisfied :

(a) he must be a debtor and his assets must be insufficient to meet all his liabilities; and

(b) he has committed an 'act of insolvency'.

Each of the following acts committed by the debtor is an act of insolvency.

1. If, in India or elsewhere, he transfers all or substantially all of his property to a third person for the benefit of creditors generally;
2. If, in India or elsewhere, he transfers any of his properties with the interest to defraud or delay his creditors;
3. If, in India or elsewhere, he makes a fradulent conveyance, gift, delivery or transfer of any property;
4. If he is trying to run away from his dwelling house or his usual place of business or to go out of India to prevent communication from his creditors with an intent to defeat or delay the creditors;
5. If any of his property has been sold or attached for a period of not less than 24 days in execution of the decree of any court for the payment of money. Under Provincial Insolvency Act, only a sale in execution is an act of insolvency, not attachment in execution;
6. If he has filed a petition to the court that he be adjudged as insolvent;
7. If he is imprisoned in execution of the decree of any court for the payment of money;
8. If he has given any notice to any creditor that he has suspended or is about to suspend payment of his debts;
9. Failure to comply with an insolvency notice.

The Procedures of Insolvency

The insolvency procedure under Indian Law is quite simple. Under both the Acts, insolvency is done through the following successive stages :

Stage 1

Presentation of an insolvency petition in a competent court of law with the evidence of it. The petition may be filed either by the insolvent debtor himself or by his creditors.

Stage 2

The appointment of an interim Assignee or Receiver. (He will function till the Regular Receiver is appointed)

Stage 3

Passing the order of adjudication, and

Stage 4

The discharge of the insolvent.

Accounting Procedures

When a debtor is adjudicated as insolvent, he is required to submit to the Official Receiver / Assignee a ***Statement of Affairs*** supported by a schedule known as ***Deficiency Account***. The Statement of Affairs shows the estimated financial position of the debtor while the Deficiency Account explains how he has arrived in that position.

Statement of Affairs

A Statement of Affairs is similar to a Balance Sheet but it shows the expected realisable values of the assets owned by the debtor and a list of his liabilities, indicating clearly the nature of creditors: unsecured, secured, partly secured, and preferential creditor. This statement is prepared in the prescribed form and supported by schedules marked 'A to H' successively which contains detailed list of the different types of creditors and of the debtor's property.

Difference Between Statement of Affairs and Balance Sheet

Though a Statement of Affairs is very similar to a Balance Sheet in look, the following are the important points of difference between the two :

(1) The Balance Sheet of a sole proprietorship or a partnership firm is not prepared according to any Act or in any prescribed form, whereas a Statement of Affairs is to be prepared in a prescribed form according to the rules given in the Insolvency Acts.

(2) A Balance Sheet is generally prepared on a stated day, i.e., on the last date of the accounting period, whereas a Statement of Affairs is prepared on the eve of liquidation of the business, i.e., when the order of adjudication is passed against the debtor.

(3) A Balance Sheet records assets and liabilities at their book values but in a Statement of Affairs, assets are shown at their estimated realisable values and liabilities at their payable values, which is commonly known as "expected to rank".

(4) A Balance Sheet shows intangible or fictitious assets like goodwill, preliminary expenses, deferred revenue expenditure etc. Such types of assets do not appear in a Statement of Affairs.

(5) A Balance Sheets shows proprietor's capital, reserves, drawings, interest on capital/drawings. But a Statement of Affairs excludes all these accounts.

(6) A Balance Sheet shows capital as a liability to the owner being the excess of assets over liabilities. But in a Statement of Affairs, capital disappears from the liabilities side and deficiency appears on the assets side, being the difference between the excess of liabilities over asets.

(7) In the Balance Sheet assets are recorded in the order of liquidity or dischargeability or in the order of permanence. But in a Statement of Affairs the assets are classified as Properties, Book Debts and Bills of Exchange. Moreover, the assets which were used as securities for loans availed of previously, are not shown on the assets but on the liabilities side as a deduction from the concerned loan.

(8) A Balance Sheet does not classify creditors. But in a Statement of Affairs, creditors are broadly classified as unsecured, fully secured, partly secured and preferential creditors.

(9) The Balance Sheet of a sole trader does not include personal assets or liabilities of the sole trader. But the Statement of Affairs of a sole trader includes the above assets and liabilities as well.

(10) In a Balance Sheet, contingent liabilities do not appear on the liabilities side — they are disclosed as a footnote at the bottom of the Balance Sheet. But in a Statement of Affairs, contingent liabilities appear on the liabilities side to the extent expected to rank.

The prescribed form of a Statement of Affairs and those of its accompanying schedules are given below :

STATEMENT OF AFFAIRS

(As required by the Presidency-Towns Insolvency Act, 1909)
In the High Court of Judicature at ...
In Insolvency

To the Insolvent — You are required to fill up, carefully and accurately, this sheet and the several sheets A, B, C, D, E, F, G and H, showing the state of your affairs on the day on which the order of adjudication was made against you, viz., the .... day of .... 201............
Such sheet, when filled up, will constitute your schedule and must be verified by Oath or Declaration.

Gross liabilities	Liabilities (as stated and estimated by Debtor)	Expected to Rank	Assets (as stated and estimated by Debtor)	Book value	Estimated to Produce
₹		₹		₹	₹
***	Unsecured Creditors as per List A	***	Properties as per List E viz. —		
***	Creditors fully secured as per List B ***		(a) Cash at Bankers	***	***
	Estimated value of securities ***		(b) Cash in hand	***	***
	Surplus ***		(c) Cash deposited with solicitor for		
	Less : amount thereof carreid to List C ***		costs of petition	***	***
	Balance thereof contra ***		(d) Stock-in-Trade	***	***
***	Creditors partly secured as per List C ***		(e) Machinery	***	***
	Less : estimated value of securities ***	***	(f) Trade fixtures, fittings, utensils etc.	***	***
***	Creditors for rent, taxes, salaries		(g) Furniture	***	***
	and wages etc., payable in full as		(h) Life policies	***	***
	per List D ***		(i) Other property	***	***
	Deducted as per contra ***		Book Debts as per List F, viz.		
			Good ***		
			Doubtful ***		
			Bad ***	***	***
			Estimated to produce		***
			Bills of Exchange or other similar		
			securities on hand as per List G	***	
			Estimated to produce		***
			Surplus from securities in the hands of		
			creditors fully secured (per contra)	***	***
			Deduct creditors for preferential rent,		***
			rates, taxes, wages, etc. (per contra)		***
					***
			Deficiency as explained in List H		***
***		***			***

I/We .... make oath/solemnly affirm, and say that the above statement and several Lists hereunto annexed marked, A, B, C, D, E, F, G and H are, to the best of my/our knowledge and belief, a full, true, and complete statement of my/our affairs on the date of the above-mentioned order of adjudication made against me/us.

Affirmed at .... this ....
Sworn day of ....
before me Signature ....
Commissioner

LIST A: UNSECURED CREDITORS

The names to be arranged in alphabetical order and numbered consecutively, preferential creditors, being placed first. The information indicated by the column headings must be furnished fully.

No.	Name	Address in Full and Occupation	Amount of Debt		Date when contracted		Consideration, i.e., "Wages", "Taxes", "Goods Sold And Delivered", "Work and Labour Done", "Money Lent", &c.
					Month	Year	
	Preferential Creditors Ordinary Creditors						

LIST B: FULLY SECURED CREDITORS

No.	Name of Creditor	Address in full and occupation	Amount of Debt		Date when contracted		Conside-ration	Particulars of Security	Date when given	Estimated value of security at present		Estimated surplus from security	
					Month	Year							

LIST C: PARTLY SECURED CREDITORS

No.	Name of Creditor	Address in full and occupation	Amount of Debt		Date when contracted		Conside-ration	Particulars of Security	Month and Year when given	Estimated value of security at present		Balance of Debts Unsecured	
					Month	Year							

LIST D : PREFERENTIAL CREDITORS

No.	Name	Address & Occupation	Nature of Claim	Period during which claim accrued due	Date when due	Amount of claim	Amount payable in full	Difference ranking for Dividend

LIST E : PROPERTY

Full Statement and Nature of Property	Estimated to produce ₹	P
(a) Cash at bankers (b) Cash in hand (c) Cash deposited with solicitor, if any, for costs of petition (d) Stock in trade at (cost ₹ ....) (e) Machinery at (cost ₹ ....) (f) Total fixtures, fittings, utensils, at (g) Household furniture and effects (h) Life Policies (i) Other property (state particulars), viz.,		

LIST F : BOOK DEBTS

No.	Name of Debtor	Address in full and Occupation	Amount of Debt						Ledger Folio	When contracted		Estimated to produce	Particulars of any Securities held for Debt
			Good		Bad		Doubtful			Month	Year		

LIST G : BILLS AND NOTES

No.	Acceptor of Bill or Maker of Note	Address in full	Amount of bill or note	Date when due	Estimated to produce	Particulars of any property held as security for payment of bill or note

The different items of Statement of Affairs are explained below :

Liabilities Side

Unsecured Creditors as per List A

It includes creditors for goods, creditors for expenses, creditors on bills payable and creditors on unsecured loans. In respect of preferential creditors, the amount in excess of the preferential limit should also be included in this list. It should be noted that this list will also include both the business and private liabilities of the insolvent. On insolvency of the debtor, no distinction is made between those liabilities.

The total amount payable to unsecured creditors is taken to the column "Expected to Rank".

Fully Secured Creditors as per List B

This list will include those creditors who provided loans to the insolvent debtor against mortgage, lien, charge or hypothecation of some of the debtor's assets.

It should be noted that any estimated surplus from any such asset should be transferred to the assets side of the Statement of Affairs and it is shown under the heading '***Surplus from securities in the hands of creditors fully secured (as per contra)***'.

If the partly secured creditors hold a second mortgage or charge on such assets, then the balance of the security (after meeting full secured creditors claim) should be transferred to partly secured creditors.

The total amount payable to Secured Creditors is ***not taken*** to the column "***Expected to Rank***".

Partly Secured Creditors as per List C

This list will include those creditors who hold securities which are insufficient to meet the entire debt. On the Statement of Affairs, the available securities are deducted from the debt and any deficiency extended into the main column "***Expected to Rank***".

Preferential Creditors as per List D

This list will include those unsecured creditors who are given preference in payment over all other unsecured creditors.

Amount available (after meeting realisation expenses and remuneration to the Official Assignee or Receiver) is paid to the preferential creditors at once.

The following types of creditors come under this head :

Presidency Towns Insolvency Act, 1909		Provincial Insolvency Act, 1920	
1.	All debts due to Government or local authority	1.	All debts due to Government or local authority.
2.	Salaries of clerks for services rendered during the prcceding four months, not exceeding ₹ **300 per clerk**.	2.	Salaries of clerks for services rendered during the preceding four month, not exceeding ₹ **20 per clerk**.
3.	Wages of servants and workmen for services rendered during the preceding four months, not exceeding ₹ **100 per worker**.	3.	Wages of servants and workmen for services rendered during the preceding four months not exceeding ₹ **20 per worker**.
4.	Rent due to landlord not exceeding one month's rent.	4.	Rent is not preferential.

Preferential creditors are shown in the liabilities side of the Statement of Affairs but the amount is not extended to outer column. However, the amount is deducted from the asset side, since they are payable in full. The preferntial creditors are paid in full before paying anything to those in the succeeding class. If the estate of the debtor is insufficient to pay all these debts, they will rank equally.

It should be noted that charges for electric light, gas, telephone, and sales tax are not treated as preferential creditors.

Assets Side

Property as per List E

This list will include cash at bank; cash in hand; cash deposited with solicitors; stock in trade; machinery; furniture, fittings and utencils, etc.; life policies and other properties.

Book Debts as per List F

Book debts are classified under the heading "Good", "Doubtful" and "Bad", the total of which is extended as being the amount expected to be realised from Sundry Debtors.

Bills and Notes as per List G

Bills Receivables and Promissory Notes are listed under this heading.

Deficiency Account

Deficiency Account is prepared by the insolvent debtor with the objective to show how the insolvency has been brought about and to explain deficiency or surplus, as the case may be. This account is supposed to be as per List H of the Insolvency Act. It is filed with the Statement of Affairs. This account should relate back to twelve months before the date of adjudication or to such other period as the court or Official Receiver / Assignee may have fixed.

This account looks like a Capital Account of a trader with two sides (left hand side and right hand side) without the words "To" and "By". On the left hand side, the capital plus all that increase capital (e.g., profit, interest, commission, salary, etc., payable to the proprietor) are shown. On the right hand side, losses; bad debts, withdrawals, etc., (all that reduce capital) are shown.

In case of a sole proprietor, any surplus of household assets over household liabilities are shown on the left hand side. Similarly, any excess of household liabilities over household assets are shown on the right hand side. The excess of right hand side total over left hand side total is called ***deficiency***. Similarly, the excess of left hand side total over right hand side total is called ***surplus***. It should be noted that this figure (deficiency/surplus) must tally with the figure appearing in the Statement of Affairs.

LIST H : DEFICIENCY ACCOUNT (or SURPLUS ACCOUNT)

1.	Excess of assets over liabilities on... (a)	₹	1.	Excess of liabilities over assets on ...(a)	₹
2.	Net profit arising from carrying on business from ... to ... after meeting usual trade expenses (a).		2.	Net Loss arising from carrying on business from ... to ... the date of adjudication (a)	
3.	Income or profit from other sources.		3.	Bad debts as per List F	
4.	Deficiency as per Statement of Affairs (b)		4.	Expenses incurred since .. other than usual business expenses, viz., household expenses	
			5.	Other losses: Speculation loss Realisation loss	
			6.	Surplus as per Statement of Affairs (b)	
		(C)			(C)

Explanation

(a) This date should be 12 months before the date of adjudication or such other time as the Official Receiver / Assignee may have fixed.
(b) Strike out words which do not apply.
(c) These figures should agree.

Key Points to Remember in Respect of Liabilities side of the Statement of Affairs

1. ***A column for "Gross Liabilities" is to be provided on the extreme left hand side. All liabilities including contingent liabilities are shown in this column at full value. The figures of this column are not to be considered for calculation of deficiency/surplus.***
2. ***A column for "Expected to Rank" is to be provided on the extreme right hand side with an inner column.***
3. ***Preferential creditors are shown only in the inner column (it is actually deducted from the assets side).***
4. ***Fully secured creditors are also shown only in the inner column along with the estimated value of security.***
5. ***All items of the liabilities side of the Balance Sheet of the insolvent debtor are not taken in the liabilities side of the Statement of Affairs (e.g., capital of the insolvent debtor) — only liabilities to third parties are shown.***
   It should be noted that a loan received from wife cannot be treated as liabilities to third party. However, when the amount is provided out of the "Stridhan" given by her parents, it is to be considered as "Unsecured Creditor".
6. ***After meeting the fully secured creditors, the balance of the security should be transferred to partly secured creditors, provided the security was offered as a second charge on mortgage.***
7. ***No creditors are entitled to receive any interest from the estate of the insolvent debtor from the date of insolvency. However, interst @ 6% p.a. is allowable upto the date of payment to creditors, if all debts of the insolvent debtors are discharged in full.***

Key Points to Remember in Respect of Assets side of the Statement of Affairs

1. ***Two columns are to be provided on the extreme right hand side. First column will show "Book Value" and the second column "Expected to Produce".***
2. ***Assets offered as securities are not shown in the assets side of the Statement of Affairs. Any surplus left after satisfying secured creditors (if there is no partly secured creditors who have second charge on the assets) are shown under the heading "Surplus from Securities in the hands of the creditors fully secured".***
3. ***The amount of preferential creditors is deducted from the total of "Expected to Produce" column of the assets side.***
4. ***Only legally clean properties are shown on the assets side.***

Illustration 1

Assets of Mr. Least Bothered of Mumbai on 30th June 2015 as shown by his books were ₹ 28,000 and his liabilities were ₹ 22,000. He filed his petition in the insolvency court and estimated his deficiency to be ₹ 15,000. After making the above estimate, he found that the following items were not passed through his books of accounts :

Interest @ 6% on his capital. A contingent liability of ₹ 1,250 on bills discounted by him for ₹ 5,000. Amount due as wages ₹ 300; salary ₹ 200; rent ₹ 100; taxes ₹ 150.

Prepare Statement of Affairs and Deficiency Account.

Solution **Statement of Affairs of Mr. Least Bothered as on 30th June, 2015**

Gross Liabilities ₹	Liabilities		Expected to Rank ₹	Assets	Book Value ₹	Estimated to Produce ₹
27,000	Unsecured creditors as per List 'A' (Note 1)		23,250	Property as per List 'E' (Note 3)	28,000	7,000
	Fully secured creditors as per List 'B'	***		Book debts as per List 'F'	—	—
	Estimated value of security	***		Bills of exchange as per List 'G'	—	—
	Surplus	***		Surplus from securities in the hands of fully		
	Less : Amount thereof carried to List 'C'	***		secured creditors as per contract	—	—
	Surplus carried to contra	***			28,000	7,000

	Creditors partly secured as per List 'C' *** Less : Estimated value of securities ***	***	Preferential creditors for wages, salaries and rent as per List 'D' deducted as per contra		750
					6,250
	Creditors for wages, salaries and rent payable in full as per List 'D' (Note 2) 750		Deficiency as explained in List 'H'		17,000
750	Deducted as per contra 750				
27,750		23,250			23,250

Deficiency Account (List H)

Particulars	₹	Particulars	₹
Excess of assets over liabilities (Capital)	6,000	Loss on sale of assets (Note 4)	21,000
Deficiency as per Statement of Affairs	17,000	Loss on bill discounted (Net)	1,250
		Loss due to expenses (Wages ₹ 300 + salary ₹ 200 + rent ₹ 100 + taxes ₹ 150)	750
	23,000		23,000

Working Notes:

(1) List A : Unsecured Creditors (Figures in Rupees)

Particulars	Gross Liabilities	Expected to Rank
Liabilities	22,000	22,000
Contingent Liability for bill	5,000	1,250
	27,000	23,250

(2) List D : Preferential Creditors

	₹
Wages	300
Salaries	200
Taxes	150
Rent	100
	750

(3) Realisable Value of Assets

Deficiency = Liabilities expected to Rank – Assets estimated to produce.

or, Assets estimated to produce = Liabilities expected to Rank – Deficiency = ₹ 22,000 – ₹ 15,000 = ₹ 7,000.

(4) Loss on Sale of Assets : Book value – Realisable value = ₹ 28,000 – ₹ 7,000 = ₹ 21,000 (Loss).

(5) Interest on Capital : Mr. Least Bothered has become insolvent at the beginning of this year. He must pay his creditor first before taking interest on capital. Therefore, interest on capital has been ignored.

Illustration 2

Mr. Haradhan is insolvent. He supplies to you the following information as on March 31, 2015 :

Particulars	₹	Particulars	₹
Creditors for goods	52,500	Stock (expected to realise 60%)	52,500
Salary due to clerks	700	Book debts (good)	7,000
Taxes due to Government	2,100	Book debts (doubtful, expected to realise 40%)	17,500
Bank loan secured by lien on stock of ₹ 35,000	17,500	Bill receivable (₹ 5,250 bad)	8,750
Cash in hand	100	Bills discounted (₹ 3,500 bad)	10,500
Furniture (expected to realise ₹ 3,500)	7,000	Loan from Mrs. Haradhan	17,500

Mr. Haradhan commenced business six years ago with a capital of ₹ 43,750. He drew ₹ 8,750 each year for private purposes, but did not maintain proper books of accounts. Mrs. Haradhan gave up her jewellery valued at ₹ 7,000 to the receiver.

Prepare the Statement of Affairs and Deficiency Account of Mr. Haradhan.

Solution **Statement of Affairs of Mr. Haradhan as on 31st March, 2015**

Gross Liabilities ₹	Liabilities	Expected to Rank ₹	Assets	Book Value ₹	Estimated to Produce ₹
80,500	Unsecured creditors as per List 'A' : (Note 1)	73,500	Property as per List 'E' :		
17,500	Secured creditors as per List 'B' : 17,500		Cash in hand	100	100
	Estimated value of security (Note 3) 21,000		Stock (₹ 52,500 – ₹ 35,000)	17,500	10,500
	3,500		Furniture	7,000	3,500
	Surplus carried to contra 3,500		Jewellery of wife	—	7,000
Nil	Partly secured creditors as per List 'C' :	Nil	Book debts as per List 'F' :		
			Good	7,000	7,000
	Creditors for rent, rates etc. payment in full		Doubtful	17,500	7,000
	as per List 'D' (Note 4) 2,800		Estimated to realise 40%	—	
	Deducted as per contra 2,800		Bills rec. as per List 'G' : ₹ (8,750 – 5,250)	8,750	3,500
			Surplus from securities in the hands of fully secured creditors as per contra		3,500
				57,850	42,100

			Preferential creditors for rents, rates, etc. deducted as per contra		2,800
					39,300
			Deficiency as explained in List 'H' :		34,200
98,000		73,500			73,500

Deficiency Account (List H)

Particulars	₹	Particulars	₹
Excess of assets over liabilities as on 1st April, 2009	43,750	Bad debts as per List 'F' :	10,500
Net profit arising from carrying on business from 1st April, 2009 to the date of adjudication, after meeting usual expenses (Note 2)	11,300	Expenses incurred other than usual business expenses viz. household expenses since 1st April, 2009 (₹ 8,750x6)	52,500
Income or profit from other sources :		Other Losses :	
Jewellery from wife	7,000	Loss on realisation of assets	
Deficiency as per Statement of Affairs	34,200	Stock (40% of ₹ 52,500)	21,000
		Furniture	3,500
		Receivable	5,250
		Loss on bills discounted	3,500
	96,250		96,250

Working Notes :

(1) List A : Unsecured Creditors

Particulars	Gross ₹	Expected to Rank
Trade creditors	52,500	52,500
Liabilities for bills disc.	10,500	3,500
Loan from Mrs. Haradhan*	17,500	17,500
	80,500	73,500

* It has been included in unsecured creditors on the assumption that it was given from her "Stridhan".

(2) For calculating net loss, a Balance Sheet is to be prepared on 31.3.2015 as under:

Balance Sheet as at 31.3.2015

Liabilities	₹	Assets	₹
Capital	43,750	Furniture	7,000
Creditors	52,500	Stock	52,500
Bank loan	17,500	Debtors ₹ (7,000 + 17,500)	24,500
Loan from Mrs. Haradhan	17,500	Bills receivable	8,750
Salary outstanding	700	Drawings ₹ (8,750 x 6)	52,500
Taxes outstanding	2,100	Cash	100
Profit & Loss (Bal. figure)	11,300		
	1,45,350		1,45,350

(3) 60% of ₹ 35,000 (stock); (4) Salary ₹ 700 + Government tax ₹ 2,100 = ₹ 2,800.

Illustration 3

A filed his petition for bankruptcy on 31st December, 2014. His books showed that he owed ₹ 50,000 to trade creditors; ₹ 30,000 to creditors holding lien on stock-in-trade for ₹ 8,000; ₹ 10,000 mortgage on works; and ₹ 1,000 for salaries, wages and rates. Bills for exchange for ₹ 10,000 had been discounted with his bankers, and it was estimated that there was a liability of ₹ 3,000 in respect of them.

A's assets were :

Consignments ₹ 20,000; estimated to realise ₹ 2,000; Good book debts, ₹ 18,000; Doubtful debts ₹ 6,000 estimated to realise ₹ 3,000. Bad debts, ₹ 15,650; Works cost, ₹ 1,00,000 (depreciated out of the profit and loss to ₹ 75,000), estimated to realise ₹ 50,000; Furniture and fittings ₹ 2,000, estimated to realise ₹ 1,000; Stock-in-trade ₹ 25,000 estimated to realise ₹ 8,000; Cash ₹ 1,350.

He commenced business on 1st January 2010 with a capital of ₹ 90,000. After charging annually ₹ 5,000 for depreciation on works and ₹ 5,500 for interest on capital, the trading shows profit of ₹ 6,500 in 2010, ₹ 5,000 in 2011 and losses of ₹ 6,000 in 2012; ₹ 7,000 in 2013 and ₹ 9,500 in 2014. He lost ₹ 14,500 in speculation while his drawings averaged ₹ 4,000 a year.

Draw up his Statement of Affairs and Deficiency Account.

Solution **Statement of Affairs of A as on 31st December, 2014**

Gross Liabilities ₹	Liabilities		Expected to Rank ₹	Assets	Book Value ₹	Estimated to Produce ₹
60,000	Unsecured creditors as per List 'A' : (Note 1)		53,000	Property as per List 'E' :		
10,000	Secured creditors as per List 'B' :	10,000		Cash	1,350	1,350
	Estimated value of security	50,000		Consignments	20,000	2,000
		40,000		Stock-in-trade (Note 2)	17,000	5,440
	Surplus carried to contra	40,000		Furniture & fittings	2,000	1,000

30,000	Partly secured creditors as per 'C' : 30,000		Book debts as per List 'F' :		
	Estimated value of security (Note 2) 2,560	27,440	Good	18,000	18,000
1,000	Creditors for salaries, wages, rates etc.		Doubtful	6,000	
	payable in full as per List 'D' : 1,000		Bad	15,650	
	Deducted as per contra 1,000		Estimated to realise	—	3,000
			Surplus from securities in the hands of full secured creditors as per contra		40,000
				80,000	70,790
			Preferential creditor for rent, rates, etc. deducted as per contra		1,000
					69,790
			Deficiency as explained in List 'H' :		10,650
1,01,000		80,440			80,440

Deficiency Account (List H)

Particulars	₹	Particulars	₹
Excess assets over liabilities on 1st January, 2010	90,000	Net loss arising from carrying on business from 1st January, 2010, to the date of adjudication	22,500
Net profit arising from business from 1st Jan., 2010 to the date of adjudication after meeting usual trade expenses	11,500	Bad debts as per List 'F' : ₹ (15,650 + 3.000)	18.650
Income or profit from other sources :		Expenses incurred other than usual business since 1st January, 2010 ₹ (5,000 x 4)	20,000
Interest on capital ₹ (5,500 x 5)	27,500		
Deficiency as per Statement of Affairs	10,650	Other Losses :—	
		Loss on realisation of assets	
		Stock-in-trade	17,000
		Furniture	1,000
		Consignments	18,000
		Works	25,000
		Loss on speculation	14,500
		Loss on bills discounted	3,000
	1,39,650		1,39,650

Working Notes:

(1) List A : Unsecured Creditors

Particulars	Gross Liability	Expected to Rank
Trade creditors	50,000	50,000
Contingent liability for bill discounted	10,000	3,000
Total (₹)	60,000	53,000

(2) Realisable Value of Stock

₹ 8,000 / 25,000 x 8,000 = ₹ 2,560. The value of remaining stock will be ₹ 8,000 / 25,000 x 17,000 = ₹ 5,440.

Illustration 4

Shiam Mohan filed a petition for bankruptcy on 30th June. His books showed the following in balance :

Particulars	₹	Particulars	₹
Cash in hand	10	Sundry creditors :	
Fixtures and fittings (estimated to produce ₹ 80)	250	Trade creditors	2,000
Stock in trade (estimated to produce ₹ 1,200)	1,800	Bills payable	2,000
Sundry debtors		Mrs. Shiam Mohan	200
Good : ₹ 1,000; Doubtful (estimated at 50%) : ₹ 2,000; Bad : ₹ 2,000	5,000	Bank overdraft	1,200
		Capital	1,660
	7,060		7,060

Liability on bills discounted ₹ 500, expected to rank ₹ 100. The amount due to Mrs. Shiam Mohan was a loan out of money given to her by Shiam Mohan.

His household furniture etc., was valued at ₹ 250. He owned a house valued at ₹ 750, having a mortgage on it of ₹ 600 at 4%. Interest paid up to the preceding 31st December.

Preferential Creditors amounted to ₹ 35 (included in Sundry Creditors) and ₹ 15 for rates on the house.

Prepare a Statement of Affairs and Deficiency Account.

Solution **Statement of Affairs of Mr. Shiam Mohan as on 30th June ....**

Gross Liabilities ₹	Liabilities	Expected to Rank ₹	Assets	Book Value ₹	Estimated to Produce ₹
5,865	Unsecured creditors as per List 'A' : (Note 4)	5,265	Property as per List 'E' :		
612	Secured creditors as per List 'B' 612		Cash in hand	10	10
	Estimated value of security 750		Stock in trade	1,800	1,200
	138		Fixtures & fittings	250	80
	Surplus carried to contra 138		Household furniture		250
50	Creditors for rent, rates etc. payable in full		Book debts as per List 'F'		
	as per List 'D' : 50		Good	1,000	1,000
	Deducted as per contra 50		Doubtful	2,000	
			Bad	2,000	
			Estimated to produce		1,000
			Surplus from securities in the hands of fully secured creditors as per contra		138
				7,060	3,678
			Preferential creditors for rates, rent etc deducted as per contra (Note 6)		50
					3,628
			Deficiency as explained in List 'H'		1,637
6,527		5,265			5,265

Deficiency Account (List H)

Particulars	₹	Particulars	₹
Excess of assets over liabilities on	1,660	Bad debts as per List 'F' : ₹ (2,000 + 1,000)	3,000
Income or Profit from other sources since	....	Loss on realisation of assets :	
Surplus from private property (Note 3)	373	Stock in trade	600
Loan from Mrs. Shiam Mohan (Note 1)	200	Fixtures & fittings	170
Deficiency as per Statement of Affairs	1,637	Loss on Bills Discounted (Net)	100
	3,870		3,870

Working Notes: **(1)** The amount due to Mrs. Shiam Mohan was a loan out of money given to her by Shiam Mohan. Therefore, she can not claim it as debt. **(2)** Interest on mortgage on house : ₹ 600 x 4/100 x 6/12 = ₹ 12. Private liabilities = ₹ 600 + ₹ 12 = ₹ 612.

(3) Surplus from Private Property	₹
Household furniture	250
House	750
	1,000
Less: Private liabilities (Note 2)	612
	388
Less: Rates on the house (Private liability)	15
	373

(4) List A : Unsecured Creditors	Gross Liability	Expected to Rank
Trade creditors ₹ (2,000 – 35)	1,965	1,965
Bills payable	2,000	2,000
Bank overdraft	1,200	1,200
Loan from Mrs. Shiam Mohan	200	—
Liability for bills discounted	500	100
	5,865	5,265

(5) List B : Fully Secured Creditors

	Liability	Value of Security
Mortgage on house	612	750

(6) List D : Preferential Creditors	
Preferential creditors	35
Rates on house	15
	50

(7) No distinction has been made between the business assets and liabilities and private assets and liabilities because it is a sole proprietorship business.

Illustration 5

Mr. Foolhardy finds himself insolvent on 31st December, 2014. You are instructed to prepare his Statement of Affairs & Deficiency Account from the following information (all figures in ₹)

Sundry Debtors : Good	10,000	Bills payable	4,000
Doubtful (estimated ₹ 10,000)	15,250	Creditors for salaries, wages etc. (of which ₹ 1,250 are preferential)	2,000
Shares in B Ltd. (estimated to realise ₹ 37,500)	45,000	Fixtures & fittings (estimated to realise ₹ 3,250)	4,500
Creditors on open account	48,250	Cash in hand	80
Creditors holding first charge on shares in B Ltd.	17,500		

Creditors holding second charge on shares in B Ltd. (to the extent of ₹ 15,000)	20,000	Stock in trade (estimated to realise ₹ 14,000)	16,420
		Bills receivable (estimated to realise ₹ 4,500)	6,000
		Speculation loss	10,000

Foolhardy started business on 1st January 2012 with a capital of ₹ 40,000. He earned a profit of ₹ 7,500 in the first year, lost ₹ 10,250 in the second year and ₹ 14,150 in the third year, after allowing ₹ 1,800 as interest on capital per annum. His drawings amounted to ₹ 13,000. He has household furniture of estimated value of ₹ 3,000 and there is a private creditor for ₹ 5,000.

Solution **Statement of Affairs of Mr. Foolhardy as on 31st December, 2014**

Gross Liabilities ₹	Liabilities		Expected to Rank ₹	Assets	Book Value ₹	Estimated to Produce ₹
58,000	Unsecured creditors as per List 'A' : (Note 1)		58,000	Property as per List 'E' :		
17,500	Secured creditors as per List 'B' :	17,500		Cash in hand	80	80
	Estimated value of security	37,500		Stock in trade	16,420	14,000
		20,000		Fixtures & fittings	4,500	3,250
	Surplus carried to List 'C'	15,000		Household furniture	—	3,000
		5,000		Book debts as per List 'F' :		
	Surplus carried to Contra	5,000		Good	10,000	10,000
20,000	Partly sec. creditors as per List 'C' :	20,000		Doubtful	15,250	
	Estimated value of security	15,000	5,000	Bad	—	
1,250	Creditors for salaries, wages as per :			Estimated to produce	—	10,000
	List 'D'	1,250		Bills receivable as per List 'G' :	6,000	4,500
	Deducted as per contra	1,250		Surplus from securities in the hands of fully secured creditors as per contra		5,000
					52,250	49,830
				Preferential creditors for salaries, wages, etc., deducted as per contra		1,250
						48,580
				Deficiency as explained in List 'H'		14,420
96,750			63,000			63,000

Deficiency Account (List H)

Particulars	₹	Particulars	₹
Excess of assets over liabilities (capital)	40,000	Net loss arising from carrying on business from 1st January, 2012 to to the date of adjudication	24,400
Net profit arising from carrying on business from 1st January, 2012 to the date of adjudication after meeting usual trade expenses	7,500	Bad debts as per List 'F' : ₹ (15,250 – 10,000)	5,250
Income or profit from other sources :		Expenses incurred other than usual business expenses, viz. Household expenses since 1st January, 2012	13,000
Interest on capital (₹ 1,800 x 3)	5,400	Other Losses :	
Deficiency as per Statement of Affairs	14,420	Loss on sale of assets	
		Shares in B Ltd. ₹ (45,000 – 37,500)	7,500
		Furniture & fittings	1,250
		Stock in trade	2,420
		Bill receivable	1,500
		Loss on speculation	10,000
		Excess of private liability over private assets	2,000
	67,320		67,320

Working Notes :

(1) List 'A' : Unsecured Creditors

Particulars	Gross Liabilities ₹	Expected to Rank ₹
Creditors on open account	48,250	48,250
Creditors for salaries, wages, etc.	750	750
Bills payable	4,000	4,000
Private creditors	5,000	5,000
	58,000	58,000

(2) List 'B' : Fully Secured Creditors

Particulars	Liabilities ₹	Value of Securities ₹
Creditors holding 1st charge on shares of B. Ltd.	17,500	37,500

(3) List 'C' : Partly Secured Creditors

Creditors holding 2nd charge on shares of B Ltd.	20,000	15,000

(4) No distinction has been made between the business assets and liabilities and private assets and liabilities because it is a sole proprietorship business.

Illustration 6

On 31st December 2014 Shri Sadanand Khaitan files his petition in bankruptcy on which date the Receiving Order was made. You are instructed by the Official Receiver in Bankruptcy to assist the debtor in the preparation of the Statement of Affairs and Deficiency Account. Your investigations disclosed the following:

Assets	Book value	Estimated to Produce
Freehold property of a book value of ₹ 1,20,000 estimated to produce ₹ 1,00,000, a first mortgage thereon having been given to fully secured creditors and a second charge limited to ₹ 10,000 to partly secured creditors:	₹	₹
Stock in trade	57,840	39,000
Trade fixtures and fittings	7,000	3,000
Book debts : Good	61,410	61,410
Doubtful	27,010	20,000
Bad	17,330	Nil
Bills receivable	3,000	Nil
Cash in hand	270	270

Liabilities : His liabilities amounted to ₹ 3,54,500 of which ₹ 74,000 was fully secured, ₹ 38,000 partly secured and ₹ 2,500 was preferential. There was also a contingent liability on bills under discount of ₹ 27,400 of which ₹ 2,000 was expected to rank. He has household furniture of the estimated value of ₹ 2,500 and Life Policies of the surrender value of ₹ 6,000. A creditor for ₹ 5,000 gave up his claims against Shri Khaitan.

On 1st January 2012 his capital was ₹ 1,30,000.

During the three intervening years, trading results, interest on capital and drawings were as follows:

Year ending	Trading Results	Drawings	Interest on Capital
31st December, 2012	₹ 3,760 (Profit)	₹ 8,400	₹ 6,500
31st December, 2013	₹ 75,230 (Loss)	₹ 10,000	₹ 6,000

Accounts for 2014 were not made up; but he had withdrawn ₹ 15,000 for domestic use.

Prepare the Statement of Affairs and Deficiency Account.

Solution **Statement of Affairs of Shri Sadanand khaitan as on 31st December, 2014**

Gross Liabilities ₹	Liabilities		Expected to Rank ₹	Assets	Book Value ₹	Estimated to Produce ₹
2,62,400	Unsecured creditors as per List 'A' :		2,37,000	Property as per List 'E' :		
74,000	Secured creditors as per List 'B'	74,000		Cash in hand	270	270
	Estimated value of securities	1,00,000		Stock in trade	57,840	39,000
		26,000		Trade fixtures & fittings	7,000	3,000
	Transferred to List 'C' :	10,000		Household furniture		2,500
		16,000		Life policies		6,000
	Surplus carried to contra	16,000		Bad debts as per List 'F' :		
38,000	Partly secured creditors as per List 'C' :	38,000		Good	61,410	61,410
				Doubtful	27,010	
	Estimated value of security	10,000	28,000	Bad	17,330	
2,500	Creditors for rent, rates, taxes payable in full as per List : 'D'	2500		Estimated to produce		20,000
	Deducted as per contra	2500		Bills receivable as per List 'G' :	3,000	Nil
				Surplus from securities in the hands of fully secured creditors as per contra		16,000
					1,73,860	1,48,180
				Preferential creditors for rent, rates & taxes etc. deducted as per contra		2,500
						1,45,680
				Deficiency as explained in List 'H' :		1,19,320
3,76,900			2,65,000			2,65,000

Deficiency Account (List H)

Particulars	₹	Particulars	₹
Excess of assets over liabilities (capital)	1,30,000	Loss arising from carrying on business from 1st January, 2012 to the date of adjudication ₹ (75,230 + 98,270)	1,73,500
Net profit arising from carrying on business from 1st January, 2012 to the date of adjudication after meeting usual trade expenses	3,760	Bad Debts as per List 'F'	24,340
		Expenses incurred other than usual business expenses,	

Income or profit from other sources :		viz. Household expenses since 1st January, 2012	33,400
Interest on capital ₹ (6,500 + 6,000)	12,500	Other Losses :	
Life policies	6,000	Loss on realisation of assets :	
Household furniture	2,500	Stock	18,840
Claim gave up by creditors	5,000	Trade fixtures & fittings	4,000
Deficiency as per Statement of Affairs	1,19,320	Freehold property	20,000
		Bills receivable	3,000
		Loss on bills discounted	2,000
	2,79,080		2,79,080

Working Notes :

(1) Ascertainment of Profit or Loss for 2014

Balance Sheet as on 31st December, 2014 (Based on Book Value)

Liabilities		₹	Assets	₹
Capital	1,30,000		Freehold property	1,20,000
Add: Interest for 2012 & 2013	12,500		Trade fixtures & fittings	7,000
	1,42,500		Stock in trade	57,840
Add: Profit for 2012	3,760		Sundry debtors	1,05,750
	1,46,260		Bills receivable	3,000
Less: Loss for 2013	75,230		Cash in hand	270
	71,030		Profit & Loss Account (Balancing figure) — Loss of 2014	98,270
Less: Drawings 2012, 2013 & 2014	33,400	37,630		
Secured Creditors		74,000		
Partly secured creditors		38,000		
Preferential creditors		2,500		
Unsecured creditors		2,40,000		
		3,92,130		3,92,130

List 'A' : Unsecured Creditors

Particulars		Gross Liabilities ₹	Expected to Rank ₹
Total Liabilities	3,54,500		
Less: Fully secured creditors	(74,000)		
Less: Partly secured creditors	(38,000)		
Less: Preferential creditors	(2,500)		
Less: Claim gave up by creditors	(5,000)	2,35,000	2,35,000
Contingency liabilities for bill		27,400	2,000
		2,62,400	2,37,000

Insolvency of a Partnership Firm

A partnership firm has no seperate legal entity apart from its partners. An order of adjudication passed against a partnership firm automatically becomes an order against the individual partners of the firm.

The main difference between the insolvency of a partnership firm and that of a sole proprietor is that in case of the latter, no distinction is made between private assets and liabilities and business assets and liabilities. But this distinction is made in respect of each partner in the case of insolvency of a partnership firm.

In the case of insolvency of a firm, the joint estate of the partners as a firm and their separate estates as individuals are administered separately. ***The separate estate of each partner is to be utilised first for paying his private debts***. Any surplus from the separate estate can be utilised for paying firm's debts. But any deficiency of his private estate is not included in the joint estate. Similarly, the joint estate of the firm is to be utilised first for paying the debts of the firm. Hence, a separate Statement of Affairs and a Deficiency Account are to be prepared for the firm as well as for each partner and the deficiency of a partner will not be transferred to the Statement of Affairs of the firm. Here, it should be noted that the question of insolvency of a firm does not arise if any of the partners has sufficient assets to pay off debts.

Illustration 7

Prepare Statement of Affairs and Deficiency Account of C and Company, who filed the petition on 31st December 2014. Their books showed that they owed ₹ 40,100 of which creditors amounting to ₹ 6,500 held stock of the estimated value of ₹ 7,500, others amounting to ₹ 29,000 held stock of the estimated value of ₹ 15,000 and a mortgage on the property at Calcutta valued at ₹ 13,000, the landlord being a preferential creditor for ₹ 100. Bills had been discounted amounting to ₹ 3,500 in respect of which it was estimated that the firm would be liable for ₹ 500.

The assets consisted of Book Debts Good ₹ 1,500. Doubtful ₹ 600, estimated to produce ₹ 300 and Bad ₹ 700, Furniture and fittings ₹ 300, estimated to realise ₹ 150, Cash ₹ 50, Bills receivable ₹ 350, Stock ₹ 1,600, estimated to produce ₹ 1,200. The firm commenced business on 1st January 2010 with a capital of ₹ 25,000. After charging ₹ 1,000 a year for interest on capital, and ₹ 1,300 a year for partners' salaries (which were credited to the capital accounts and not withdrawn) they made a profit in the first year of ₹ 2,700, but in the succeeding four years losses were incurred of ₹ 2,500; ₹ 3,200; ₹ 4,500 and ₹ 6,000 respectively. They drew out cash at the rate of ₹ 1,200 a year. The property at Calcutta cost ₹ 22,000 and the stock mortgaged was subject to discount of 25 per cent.

Solution **Statement of Affairs of C & Company as on 31st December, 2014**

Gross Liabilities ₹	Liabilities		Expected to Rank ₹	Assets	Book Value ₹	Estimated to Produce ₹
8,000	Unsecured creditors as per List 'A' :		5,000	Property as per List 'E' :		
6,500	Secured creditors as per List 'B' :	6,500		Cash	50	50
	Estimated value of security	7,500		Stock	1,600	1,200
		1,000		Furniture and fittings	300	150
	Surplus carried to contra	1,000		Book Debts as per List 'F' :		
29,000	Partly secured creditors as per			Goods	1,500	1,500
	List 'C' :	29,000		Doubtful	600	
	Estimated value of security	28,000	1,000	Bad	700	
100	Creditors for rent, rates, payable in full			Estimated to produce		300
	as per List 'D' :	100		Bills Receivable as per List 'G' :	350	350
	Deducted as per contra	100		Surplus from securities in the hands of		
				fully secured creditors as per contra		1,000
					5,100	4,550
				Pref. creditors for rent deducted as per contra		100
						4,450
				Deficiency as explained in List 'H'		1,550
43,600			6,000			6,000

Deficiency Account (List H)

Particulars	₹	Particulars	₹
Excess of assets over liabilities (capital)	25,000	Net loss arising from carrying on business from 1st January, 2010 to the date of adjudication (Note 1)	16,200
Net profit arising from carrying on business from 1st January 2010 to the date of adjudication after meeting usual trade expenses	2,700	Bad debts as per List 'F' :	1,000
Income or profit from other sources :		Expenses incurred other than usual business expenses, viz. household expenses since 1st January, 2010 (₹ 1,000 x 6)	6,000
Interest on capital (₹ 1,000 x 5)	5,000	Other Losses :	
Salary credited (₹ 1,300 x 5)	6,500	Loss on sale of assets :	
Deficiency as per Statement of Affairs	1,550	Stock (Note 4)	7,900
		Furniture and fittings	150
		Property at Calcutta	9,000
		Loss on bills discounted (Net)	500
	40,750		40,750

Working Notes: (1) Total net loss : ₹ (2,500 + 3,200 + 4,500 + 6,000) = ₹ 16,200.

(2) Unsecured Creditors

	₹
Total creditors	40,100
Less: Fully secured creditors	6,500
	33,600
Less: Partly secured creditors	29,000
	4,600
Less: Preferential creditors	100
	4,500

(3) List A : Unsecured Creditors

	Gross Liability (₹)	Expected to Rank (₹)
Unsecured creditors (Note 2)	4,500	4,500
Liability for bills discounted	3,500	500
	8,000	5,000

(4) Calculation of loss on stock mortgaged

(₹ 7,500 + ₹ 15,000) x 25/75 + ₹ 400 = ₹ 7,900

Illustration 8

A and B carrying on business in partnership share profits and losses in the proportion of two-thirds and one-third. They file their petition in bankruptcy on September 30, 2014, when their Balance Sheet showed the following position:

Liabilities	₹	Assets	₹
Bank overdraft secured by a charge on machinery	30,000	Machinery	18,000
Sundry creditors	64,500	Furniture	2,500
Bills payable	5,000	Stock	14,200
A's capital	12,400	Debtors (including ₹ 3,000 for dishonoured bill and	
B's capital	4,200	₹ 2,000 doubtful of recovery)	29,500
		Investments	12,800
		A's Drawings	6,200
		B' Drawings	3,000
		Speculation losses carried forward	20,300
		Cash	1,400
		Profit and Loss A/c	8,200
	1,16,100		1,16,100

The assets of the firm are estimated to realise as under : machinery ₹ 12,000; furniture ₹ 2,000; investments ₹ 16,500; and stock ₹ 12,000. Some goods left for safe custody with the firm by X, of the book value of ₹ 4,000, were estimated to be worth ₹ 1,000.

The Bank overdraft was further secured by a charge on B's cottage. Creditors include ₹ 1,200 due to Preferential Creditors and ₹ 5,400 in respect of a claim against the firm which is not expected to rank.

It is expected that A's private estate would show a deficit of ₹ 4,100. B had no personal property other than the cottage which is expected to realise ₹ 8,000.

Prepare the Statement of Affairs and the Deficiency Account of the firm.

Solution **Statement of Affairs of A & B as on 30th September, 2014**

Gross Liabilities ₹	Liabilities	Expected to Rank ₹	Assets	Book Value ₹	Estimated to Produce ₹
62,900	Unsecured creditors as per List 'A'	62,900	Property as per List 'E'		
30,000	Partly secured creditors as per List 'C' ₹ 30,000		Cash	1,400	1,400
			Investments	12,800	16,500
	Estimated value of security 12,000	18,000	Stock (Note 1)	18,200	13,000
1,200	Creditors for rent, rates, and taxes etc.		Furniture	2,500	2,000
	payable in full as per List 'D' 1,200		Book Debts as per List 'F'		
	Deducted as per contra 1,200		Good	24,500	24,500
			Doubtful	2,000	—
			Bad	3,000	—
			Estimated to produce	—	—
				64,400	57,400
			Preferential creditors for rent, rates, etc.		1,200
					56,200
			Deficiency as explained in List 'H'		24,700
94,100		80,900			80,900

Deficiency Account (List H)

Particulars	₹	Particulars	₹
Excess of assets over liabilities as on 30th Sept., 2014	16,600	Net loss arising from carrying on business from ... to	
Profit or income from other sources	—	the date of adjudication	8,200
Profit on realisation of investments	3,700	Bad debts as per List 'F'	5,000
Goods with X (Doctrine of reputed ownership)	1,000	Expenses incurred other than usual business expenses	
Claim not expected to rank	5,400	viz., Household expenses since	9,200
Deficiency as per Statement of Affairs	24,700	Other Losses:	
		Loss on realisation of assets	
		Stock ₹ (14,200 – 12,000)	2,200
		Furniture ₹ (2,500 – 2,000)	500
		Machinery ₹ (18,000 – 12,000)	6,000
		Speculation Loss	20,300
	51,400		51,400

Working Notes :

(1) Total value of stock = ₹ (14,200 + 4,000) = ₹ 18,200. Expected amount to be realised = ₹ (12,000 + 1,000) = ₹ 13,000.

(2) It is assumed that B's private liabilities are more than his private assets. Therefore, B's statement of affairs will also show a deficit. The calculation of bank claim against B's cottage is as follows :
Deficit of all the creditors of the firm ₹ (62,900 + 18,000 = ₹ 80,900) is ₹ 24,700. Therefore, deficit of the bank = ₹ 24,700 x ₹ 18,000 / ₹ 80,900 = ₹ 5,496. The bank will claim ₹ 5,496 against the cottage. The balance of ₹ 2,504 (₹ 8,000 – ₹ 5,496) will be available for distribution to B's creditors.

Illustration 9

A and B are in partnership and file their petition in bankruptcy. From the following particulars, prepare the Statement of Affairs and Deficiency Accounts of the joint estate as also the private estates of the partners. (all figures in ₹)

Balance Sheet

Liabilities	A and B	A	B	Assets	A and B	A	B
Mortgage on Freehold	3,000	—	—	Freeholds	6,000	—	—
Bank overdraft	3,000	—	—	Plant	6,500	—	—
Sundry creditors	12,400	1,500	2,900	Furniture	400	1,000	1,200
Preferential creditors	100	—	—	Stock	5,500	—	—
Capital A	3,000	—	—	Debtors	5,000	—	—
Capital B	2,000	—	—	Investments	—	2,500	800
Surplus	—	5,000	1,100	Cash	100	—	—
				Capitals in A and B	—	3,000	2,000
	23,500	6,500	4,000		23,500	6,500	4,000

The bank overdraft was secured by a second mortgage on freeholds, and B's personal guarantee, supported by the deposit of B's investments as collateral security.

The firm's assets are estimated to realise the following : freehold ₹ 4,500; plant ₹ 3,000; furniture ₹ 150; stock ₹ 3,100; debtors: good ₹ 2,575; doubtful ₹ 1,000 (50 paisa in the rupee), bad ₹ 1,425 (nil); A's assets : furniture ₹ 600, investments ₹ 2,000; B's assets : furniture ₹ 800; investments ₹ 300.

Solution **Statement of Affairs of A and B as on ... ...**

Gross Liabilities ₹	Liabilities		Expected to Rank ₹	Assets	Book Value ₹	Estimated to Produce ₹
12,400	Unsecured creditors as per List 'A'		12,400	Property as per List 'F' :		
3,000	Secured creditors as per List 'B	3,000		Cash	100	100
	Estimated value of securities			Stock	5,500	3,100
	(Freehold)	4,500		Furniture	400	150
		1,500		Plant	6,500	3,000
	Adjusted in List 'C'	1,500		Book Debts as per List 'F' :		
3,000	Partly secured creditors			Good	2,575	2,575
	as per List 'C'	3,000		Doubtful	1,000	
	Estimated value of security	1,500	1,500	Bad	1,425	
100	Creditors for rent, taxes, rates & taxes			Estimated to produce		500
	fully payable as per List 'D'	100		Surplus from A's estate		1,100
	Deducted as per contra	100			17,500	10,525
				Preferential creditors for rent, rates & taxes		100
						10,425
				Deficiency as explained in List 'H'		3,475
18,500			13,900			13,900

Deficiency Account of M/s. A & B (List H)

Particulars	₹	Particulars	₹
Excess of Assets over Liabilities*	5,000	Bad Debts as per List 'F'	1,925
Income or profit from other sources :		Other Losses:	
Surplus from A's estate	1,100	Loss on realisation of assets:	
Deficiency as per Statement of Affairs	3,475	Stock ₹ (5,500 – 3,100)	2,400
		Furniture ₹ (400 – 150)	250
		Plant ₹ (6,500 – 3,000)	3,500
		Freehold ₹ (6,000 – 4,500)	1,500
	9,575		9,575

* After adjustment of profit, loss and drawings.

Statement of Affairs of A as on ...

Gross Liabilities ₹	Liabilities	Expected to Rank ₹	Assets	Book Value ₹	Estimated to Produce ₹
1,500	Unsecured creditors as per List 'A'	1,500	Property as per List 'E' :		
	Surplus carried to the firm of M/s A & B,		Investment	2,500	2,000
	as explained in List 'H'	1,100	Furniture	1,000	600
			Capital in the firm of M/s A & B	3,000	—
1,500		2,600		6,500	2,600

Deficiency / Surplus Account of A

Particulars	₹	Particulars	₹
Excess of assets over liabilities	5,000	Other Losses:	
		Loss on realisation of assets:	
		Investment	500
		Furniture	400
		Loss of capital in the firm of M/s. A & B	3,000
		Surplus as per Statement of Affairs	1,100
	5,000		5,000

Statement of Affairs of B as on ...

Gross Liabilities ₹	Liabilities		Expected to Rank ₹	Assets	Book Value ₹	Estimated to Produce ₹
2,900	Unsecured creditors as per List 'A'		2,900	Property as per List 'E' :		
	Partly secured creditors as per List 'C'	375		Furniture	1,200	800
375	Estimated value of security	300	75	Deficiency as explained in List 'H'		2,175
3,275			2,975			2,975

Deficiency / Surplus Account of B

Particulars	₹	Particulars	₹
Excess of assets over liabilities	1,100	Other Losses:	
Deficiency as per Statement of Affairs	2,175	Loss on realisation of assets:	
		Investment	500
		Furniture	400
		Loss of capital in the firm of M/s. A & B	2,000
		Creditors of the firm (Note 2)	375
	3,275		3,275

Tutorial Note : Surplus from A's estate after meeting private liability is ₹ 1,100. This surplus is to be carried to the Statement of Affairs of the firm and can be utilised for paying firm's debts. But the deficiency of B's estate will not be carried forward to firm's statement of affairs.

Working Notes:

(1) Calculation of amount paid by the firm for Bank Loan	₹	(2) Calculation of Creditors of the firm
As partly secured creditors	1,500	The balance of ₹ 375 (₹ 3,000 – ₹ 2,625) should be treated as partly secured creditors of 'B' because the bank holds personal guarantee of B.
As unsecured creditors ₹ (10,425 / 13,900 x 1,500)	1,125	
	2,625	

Key Points

- Insolvency is the inability of a debtor to pay debts as they fall due. A person is said to be insolvent when his liabilities exceed his assets and against whom the court makes an order of adjudication.
- The law relating to insolvency in India is contained in two statutes:
  - (a) ***The Presidency Towns Insolvency Act of 1909*** which applies to the Presidency Towns of Mumbai, Kolkata and Chennai.
  - (b) ***The Provincial Insolvency Act of 1920*** which applies to the rest of India.
- It means the proportion of payment to be made per rupee to the unsecured creditors from the realisable estate of the insolvent.
- Preferential Creditors are those who are given preference in payment over all other unsecured creditors.
- Secured Creditors are those who are holding a mortgage, charge or lien on the property of the debtor as a security.

THEORETICAL QUESTIONS

1. What do you understand by a Statement of Affairs and a Deficiency Account? How are these prepared?
2. How does the insolvency of a partnership firm differ from the insolvency of an individual?
3. What do you mean by preferential creditors?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below.

1. The provincial Insolvency Act of 1920 is applicable to :
   A individuals only
   B individuals, firms and limited company
   C individuals, firms and hindu undivided family.
2. Official receiver is appointed by the
   A the chief justice of India
   B the insolvency court
   C none of the above.
3. All debts due to government or local authority are treated as :
   A secured creditors
   B unsecured creditors
   C preferential creditors.
4. Charges for electric light, gas and telephone :
   A are not treated as preferential creditors
   B are treated as preferential creditors
   C are treated as secured creditors.

PRACTICAL QUESTIONS

Insolvency of Individuals

1. On January 1, 2012 Raman commenced business with a capital of ₹ 6,350. His profits for the years 2012 and 2013 amounted to ₹ 5,554. In 2014 he suffered a loss of ₹ 2,500. His total drawings upto December 31, 2014 were ₹ 9,000. From the following figures prepare a Statement of Affairs and the Deficiency Account of Raman as on December 31, 2014. Cash ₹ 230; Stock-in-trade ₹ 1,000; Debtors — good ₹ 7,000; doubtful ₹ 1,800; bad ₹ 1,500; Furniture and fittings ₹ 564; Investments in shares ₹ 500; Unsecured creditors (including ₹ 1,000 of his wife) ₹ 13,000; secured creditors ₹ 2,500; Value of securities held by secured creditors ₹ 3,500; Preferential creditors for rent, rates and taxes ₹ 190. Assume the stock realised ₹ 666; fixtures and fittings ₹ 282; investments in shares at book value and the bad and doubtful debts ₹ 600.
2. Prepare Statement of Affairs and Deficiency Account of Mr. Gambler as at 31st December, 2014. (all figures in ₹)

Cash	500	Securities held by fully secured creditors	8,000
Stock (estimated to realise ₹ 2,000)	3,000	Securities held by partly secured creditors	6,000
Furniture (estimated to realise ₹ 1,600)	2,500	Partly secured creditors	8,000
Bills receivable (estimated to realise ₹ 1,900)	2,400	Fully secured creditors	5,000
Debtors — Good	5,000	Unsecured creditors	25,000
Doubtful (estimated to produce ₹ 1,000)	2,500	Preferential creditors	1,000
Bad	2,100		

   On 1st January 2012 he commenced business with a capital of ₹ 10,000. His profits for 2012 and 2013 amounted to ₹ 5,000. He suffered a loss of ₹ 4,000 in 2014. He lost ₹ 10,000 in speculation. His drawings amounted to ₹ 8,000.
3. A merchant became insolvent on January 1, 2015 on which date his total assets were ₹ 75,000 and liabilities ₹ 65,000 and he estimated a deficiency of ₹ 20,000; before taking the following items into consideration which were not passed through his account books:
   (1) Interest on his capital of ₹ 25,000 at 6% for one year.
   (2) A contingent liability for ₹ 3,000 on bills discounted by him for ₹ 8,000.
   (3) Amounts due as wages ₹ 300; as salaries ₹ 600; as rent ₹ 500; as rates and taxes ₹ 1,000.
   (4) A loan of ₹ 5,000 taken from a friend for the marriage of his daughter and ₹ 2,000 from his wife.
   Showing detailed working notes, prepare a Statement of Affairs and the Deficiency Account of the merchant.

4. Mr. Dukhi finds himself insolvent on 31.12.2014. On that date, his position was as follows : (all figures in ₹)

Sundry Debtors — Good	15,000	Stock (estimated to realise ₹ 32,000)	40,500
Doubtful (estimated to produce ₹ 10,000)	22,000	Bills receivable (estimated to realise ₹ 5,200)	12,000
Bad	8,000	Sundry creditors	80,000
Shares in Rosy Co. (estimated to produce ₹ 12,000)	30,000	Creditors holding first charge on shares in Green Co.	25,000
Shares in Green Co. (estimated to produce ₹ 68,000)	75,000	Creditors holding second charge on shares in Green Co. to the extent of ₹ 40,000	52,000
Loss through speculation	13,000		
Furniture (estimated to produce ₹ 4,000)	5,000	Bills Receivable discounted (expected to rank ₹ 6,500)	8,000
Cash in hand	500	Creditors for rent, taxes etc. of which ₹ 2,800 are preferential	4,000
Cash at bank	1,000		

He commenced his business with a capital of ₹ 70,000 on 1st January, 2012 and the business resulted in a profit of ₹ 20,000. He incurred losses of ₹ 6,000 and ₹ 2,000 in two years, after allowing ₹ 1,000 as interest on capital each year. Withdrawals for the whole period amounted to ₹ 24,000. Prepare Statement of Affairs and Deficiency Account.

5. Dil Mohan filed his petition on 31st December 2014 and his Statement of Affairs consisted of the following:

Particulars	₹	Particulars	₹
Creditors for goods	37,500	Book Debts	
Bills payable	2,500	Good	10,000
Creditors secured by lien on shares	20,000	Doubtful & bad (estimated to produce ₹ 1,000)	5,000
Creditors secured by lien on stock	7,500	Consignments considered good	2,500
Liability on bills discounted (estimated to rank ₹ 1,500)	3,500	Stock (estimated to realise ₹ 20,000)	30,000
Mortgage on factory	5,000	Cash at Bank	50
Creditors payable in full	1,500	Fixtures (estimated to realise ₹ 750)	1,500
Bills of exchange	700	Cottages (estimated to realise ₹ 1,500)	3,400
Factory (estimated to realise ₹ 5,500)	10,000	Shares (estimated to realise ₹ 8,000)	7,500
Machinery (estimated to realise ₹ 6,000)	7,500		

On 1st January six years ago, he had a capital of ₹ 25,000. Profits were made in the six years totalling ₹ 22,750 and losses were incurred totalling ₹ 12,500 after allowing ₹ 1,250 per year interest on capital. Withdrawals amounted to ₹ 38,600. Prepare Statement of Affairs and Deficiency Account.

6. Mr. S. Srinivasan of Salem commenced business on January 1, 2015 with a capital of ₹ 65,000. His profit for the three years were ₹ 35,000; he did not prepare accounts for the next two years. His drawings averaged ₹ 4,800 per annum. On December 31, 2014 an order of adjudication was made against him when his affairs were as follows:

Particulars	₹	Particulars	₹
Building cost ₹ 60,000, estimated to realise	20,000	Mortgage on buildings	10,000
Plant & machinery : cost ₹ 28,000 estimated to realise	10,000	Unsecured creditors	40,000
Book debts : Good ₹ 12,000; Doubtful ₹ 4,000 estimated to realise ₹ 1,000		Household furniture	3,000
		Household debts	2,000
Bad debts	10,000	Furniture : cost ₹ 2,000, estimated to realise	800
Bills receivable discounted and expected to rank	5,000	Stock : cost ₹ 16,000, estimated to realise	11,000
Preferential creditors	1,000	Cash in hand	200
Partly secured creditors (security : Life Policy estimated to be worth ₹ 8,000)	23,000		

Mr. S. Srinivasan gave up his jewellery valued at ₹ 2,500 to the official receiver. You are required to prepare the Statement of Affairs and the Deficiency Account from the above particulars.

7. Sattaram is insolvent. He supplies to you the following information as at June 30, 2015: (all figures in ₹)

Creditors for goods	30,000	Stock (expected to realise 60%)	30,000
Salary due to clerk	400	Book debts — Good	4,000
Taxes owing to Government	1,200	Doubtful (expected to realise 40%)	10,000
Bank loan sec. by lien on stock of bk. value of ₹ 20,000	10,000	Bills receivable (₹ 3,000 bad)	5,000
Cash in hand	100	Bills discounted (₹ 2,000 bad)	6,000
Furniture (expected to realise ₹ 2,000)	4,000	Loan from Mrs. Sattaram	10,000

Sattaram commenced business six years ago with a capital of ₹ 25,000. He drew ₹ 5,000 each year for private purpose but did not maintain proper books of account. Mrs. Sattaram gave up her jewellery valued at ₹ 4,000 to the receiver. Prepare the Statement of Affairs and the relevant Deficiency Account.

8. Govind filed his petition for bankruptcy on December 31, 2014 on which date his books showed the following balances:

Particulars	Dr. (₹)	Cr. (₹)
Cash in hand	200	
Fixtures and fittings (estimated to produce ₹ 1,600)	5,000	
Stock in trade (estimated to produce ₹ 24,000)	36,000	
Trade creditors		40,000
Bills payable		44,000
Sundry debtors : Good	20,000	
Doubtful (estimated to produce 50%)	40,000	
Bad	40,000	
Bank overdraft		24,000
Capital		33,200
	1,41,200	1,41,200

Preferential creditors included trade creditors amounting to ₹ 700.
Liability on bills discounted was ₹ 10,000 out of which ₹ 2,000 were expected to rank. His household furnitures, etc., was valued at ₹ 5,000. He owned a house valued at ₹ 15,000 having a mortgage on it of ₹ 12,000 at 4% interest, which was paid on 30th June, 2013. Creditor for rates on the house amounted to ₹ 300. Prepare the Statement of Affairs and Deficiency Account of Govind.

9. On December 31, 2014 Insolvent filed his petition for bankruptcy on which date a receiving order was made. The debtor requests you to assist him in the preparation of a Deficiency Account and a Statement of Affairs from the following details:

Particulars	Book Value ₹	Estimated to Produce ₹
Business Assets		
Freehold property subject to a first charge to the bank and a second charge to sundry creditors	1,50,000	2,00,000
Stock in trade	3,20,000	1,50,000
Fixtures and fittings	16,000	5,000
Book Debts :		
Good	80,000	80,000
Doubtful	40,000	20,000
Bad	10,000	—
Bills receivable	2,500	1,000
Cash in hand	4,000	4,000
Business Liabilities		
Overdraft with bank (secured fully against freehold property)		1,20,000
Sundry creditors (partly secured)		6,00,000
Liabilities for rent, salaries, etc., claimed as preferential debts		5,000
Contingent liability for bills under discount : ₹ 24,000 — expected to rank		2,500
Personal assets not recorded in business books:		
Surrender value of Life policies ₹ 15,000; Household furniture expected to yield ₹ 3,000		

Insolvent started business in 2011 with a capital of ₹ 1,50,000 and details about profit and loss up to December 31, 2014 are :

Year ended	Trading Results (₹)	Drawings (₹)	Interest on Capital (₹)
To 31st December, 2011	15,000 (Profit)	9,000	12,000
To 31st December, 2012	60,000 (Loss)	18,000	6,000
To 31st December, 2013	8,000 (Profit)	18,000	4,000
To 31st December, 2014		16,000	2,000

Out of the drawings, he purchased jewellery for ₹ 10,000 (for his wife) whose market value on December 31, 2014 was ₹ 20,000. This is available for meeting Insolvent's debts. Losses for the year 2012 included speculation losses of ₹ 20,000.

10. Raghunath finds himself insolvent on December 31, 2014. His position is as follows:

Particulars	₹	Particulars	₹
Sundry Debtors : good ₹ 5,000; doubtful ₹ 30,000 (estimated to produce ₹ 25,000); bad ₹ 15,000		Creditors holding a first charge on the shares of Alexander Co. Ltd.	40,000
1,000 shares in Asian Co. Ltd. (estimated to produce ₹ 15,000)	25,000	Bills Payable	4,000
Shares in Alexander Co. Ltd. (estimated to realise ₹ 75,000)	91,500	Creditors for Rent, rates, taxes, wages, etc. (of which ₹ 4,600 is preferential)	5,000
Loss through betting	2,000	Furniture and fixtures (estimated to realise ₹ 3,000)	15,000
Creditors on open account	85,600	Cash in hand and in bank	550
Creditors holding a second charge on the shares in Alexander Co. Ltd. to the extent of ₹ 25,000	30,000	Stock in trade (estimated to realise ₹ 30,450)	35,950
		Bills receivable (estimated to realise ₹ 7,000)	9,000

Raghunath started with a capital of ₹ 70,000 on January 1, 2012 and the business resulted in a profit of ₹ 8,800 and ₹ 10,100 for the first two years respectively and a loss of ₹ 5,000 for the third year, after allowing ₹ 3,500 as interest on capital each year. Withdrawals for the whole period amounted to ₹ 30,000.

Prepare the Deficiency Account and the Statement of Affairs.

11. Shree Bhagyawan filed his insolvency petition on December 31, 2014 and his Statement of Affairs was composed of the following figures. Prepare a Statement of Affairs and Deficiency Account of Shree Bhagyawan.

Particulars		Dr. (₹)	Cr. (₹)	Estimated to realise or rank (₹)
Buildings		70,000	—	60,000
Machinery		3,00,000	—	2,40,000
Electric Machinery		2,20,000	—	2,20,000
Furniture		60,000	—	30,000
Stock-in-trade		13,00,000	—	9,00,000
Book debts :				
Good		4,00,000	—	4,00,000
Doubtful		1,00,000	—	40,000
Bad		1,00,000	—	—
Investments		3,20,000	—	3,20,000
Mortgage on Electric Machinery		—	2,00,000	2,00,000
Loan partly secured on investments		—	8,00,000	8,00,000
Loan fully secured by lien on stock in trade		—	2,000	2,000
Loan unsecured		—	15,00,000	15,00,000
Liability on Bills Discounted worth ₹ 1,40,000		—	—	70,000
Preferential creditors		—	60,000	60,000
Bills of exchange		28,000	—	28,000
Cash with bank		2,000	—	2,000
Capital account:	₹			
Introduced on 1.1.2010	10,00,000			
Add profit	4,10,000			
Add interest	2,00,000			
	16,10,000			
Less: Drawings	12,72,000		3,38,000	
		29,00,000	29,00,000	

Insolvency of Partnership Firms

12. Ploughman and Carter are equal partners. Insolvency petition is filed on 30.6.2015. The Balance Sheet as on 30.6.2015 is as follows (realisable value indicated in brackets):

Liabilities	₹	Assets	₹
Mortgage Loan (on Freehold)	20,000	Freehold (₹ 60,000)	80,000
Bank O/D (secured by second mortgage on Freehold)	80,000	Plant and Machinery (₹ 36,000)	60,000
Preferential creditors	3,000	Fixture (₹ 2,000)	6,000
Unsecured creditors	1,00,000	Stock (₹ 20,000)	40,000
Capital — Ploughman	44,000	Debtors (₹ 30,000)	50,000
		Cash	1,000
		Carter — Capital overdrawn	10,000
	2,47,000		2,47,000

The overdraft is secured, in addition to second mortgage, by Ploughman's personal guarantee, against which his investments have been deposited. Ploughman's investments are estimated to realise ₹ 34,000 and after meeting his guarantee his private estate was insolvent. Carter was solvent and ₹ 19,000 was available from his estate for firm's creditors.

Prepare:

(a) Statement of Affairs (indicating rate of dividend for unsecured creditors); (b) Deficiency Account; (c) Capital Accounts in the Ledger (assuming realisations are as per estimates).

13. The following particulars of M/s. Unfortunate, a firm consisting of two partners, Abdul and Rahim are given:
    (1) The firm was formed two years ago. The firm made a profit of ₹ 15,000 in the first year. Then it incurred substantial losses.
    (2) Mohammed, a minor, was admitted to the benefits of partnership from the beginning.
    (3) The firm is insolvent.
    (4) The financial position of the firm and the partners are given below: (all figures in ₹)

Liabilities	Firm	Abdul	Rahim	Mohammed
Mortgage loan	22,000	—	—	—
Unsecured creditors	10,000	2,000	5,000	—
Preferential creditors	10,000	—	—	—
Assets				
Buildings (realisable value ₹ 25,000)	20,000	—	—	—
Other assets (realisable value ₹ 5,000) [firm assets]	20,000	—	1,000	10,000

    (5) Other assets of Mohammed include ₹ 5,000 deposited in a Bank. This represented the share of profit drawn from the firm,
    (6) The partners Abdul and Rahim each had contributed ₹ 10,000 and Mohammed, the minor, contributed ₹ 5,000 when the business was commenced. The partners shared profits equally.

Prepare the Statement of Affairs of the firm and of two partners and also the firm's Deficiency Account.

Guide to Answers

Multiple choice

1. C; 2. B; 3. C; 4. A.

Practical Questions

1. **Deficiency ₹ 2,912.**
2. **Deficiency ₹ 13,000; Total of Statement of Affairs ₹ 27,000.**
3. **Deficiency ₹ 32,400.**
4. **Deficiency ₹ 19,800; Total of Statement of Affairs ₹ 99,700.**
5. **Deficiency ₹ 19,500; Total of Statement of Affairs ₹ 53,500.**
6. **Loss ₹ 18,200; Deficiency ₹ 12,500; Total of Statement of Affairs ₹ 62,000.**
7. **Deficiency ₹ 19,500; Total of Statement of Affairs ₹ 42,100.**
8. **Deficiency ₹ 36,750.**
9. **Loss : 2014 ₹ 1,78,500; Deficiency ₹ 2,29,500.**
10. **Deficiency ₹ 3,600.**
11. **Deficiency ₹ 3,92,000.**
12. **Deficiency ₹ 35,000; Total of Statement of Affairs ₹ 1,40,000; Dividend rate for rupee of unsecured creditors 75 paisa in a rupee.**
13. **Deficiency of the firm ₹ 12,000; Deficiency of Abdul = ₹ 2,000; Deficiency of Rahim = ₹ 4,000. Private assets of Mohammed (minor) has not been considered as his assets which cannot be used for paying the firm's debts.**

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Voyage Accounts

Introduction

A voyage is a journey made by water or in space. Voyage accounting is accounting for a voyage which includes both the outward and return journies. In this chapter, we are concerned with voyage accounting in the shipping industry.

In the shipping industry, voyages are numbered and each voyage is separately accounted for. A Voyage Account is just like a Profit and Loss Account in form — the only difference is that it is not prepared for a particular accounting period but for a particular voyage and includes both outward and return journey of the vessel.

Voyage Account is debited with all expenses relating to the voyage, including stores, wages, insurance, commission, brokerage, depreciation, etc. On the other hand, this account is credited with all earnings, freight, passage money (if any). This account is closed at the end of the voyage and the profit or loss is ascertained after making proper adjustment for any balances of unconsumed stores or fuel. These unconsumed stores and fuel are carried forward to the succeeding Voyage Account of the same vessel. The profit or loss is transferred to General Profit and Loss Account. If the voyage is incomplete at the end of the accounting year, a proportionate amount of expenses and incomes earned are carried forward to the next year as ***Voyage-in-Progress***.

Important Terms/Expressions in connection with Voyage Accounting

Address Commission This is a commission paid by the shipping companies to the brokers for procurement of freight from different parties. If a ship has been chartered, the commission is payable either to the agents of the charterers or to the charterers themselves. It is computed as a percentage on the freight earned including primage (discussed below) and it is debited to Voyage Account as an expense.

Primage This is an additional freight, calculated as a percentage of freight earned. Previously, it represented the commission payable to the captain of the ship to encourage him in the safe delivery of the cargo. However, at present it is an income of the shipping company and credited to Voyage Account.

Passage Money It is collected from a few passengers carried side by side with the merchandise. It is an income of the shipping company and is credited to the Voyage Account.

Bunker Costs The term 'bunker' means the bin where ship's coal are kept. Now-a-days in place of coal, diesel and fuel are used. Cost incurred for diesel, fuel and fresh water is termed as 'Bunker Costs".

Port Charges Amount payable to the port authority for using the port facility for loading and unloading of the cargo is called Port Charges.

Illustration 1

S.S. Jai Hind commenced a voyage on 1st October 2014 from Bombay to London and back. The voyage was completed on 30th November, 2014. It carried a consignment of tea on its outward journey and of Machinery on its return journey. The ship was insured and the annual premium was ₹ 1,20,000. Prepare Voyage Account from the following particulars:

Particulars	₹	Particulars	₹
Freight earned (Outward)	5,00,000	Sundry expenses	25,000
Freight eaned (Inward)	3,50,000	Passage money received	50,000
Port dues	25,000	Lighterage charges	33,000
Bunker	1,50,000	Depreciation (Annual)	4,80,000
Wages and salaries	2,50,000	Address comm. 5% on outward and 4% on inward freight	
Stores	84,000	Primage is 5% on freight	

The manager is entitled to 5% commission on the profit earned after charging such commission. Stores and coal on hand were valued at ₹ 15,000 on 30th November, 2014.

Solution **Voyage Account of S.S. Jai Hind**

Dr. **[Voyage No. ...; Period : 1st October to 30th November, 2014]** **Cr.**

Particulars	₹	Particulars		₹
To Port dues	25,000	By Outward freight	5,00,000	
To Bunker	1,50,000	*Add* : Primage 5%	25,000	5,25,000
To Wages and salaries	2,50,000	By Inward freight	3,50,000	
To Stores	84,000	*Add* : Primage 5%	17,500	3,67,500
To Sundry expenses	25,000	By Passage money		50,000
To Lighterage charges	33,000	By Closing stock of stores & coal		15,000
To Depreciation (Note 1)	80,000			
To Insurance (Note 2)	20,000			
To Address commission (Note 3) :				
— 5% on outward freight	26,250			
— 4% on inward freight	14,700			
To Manager's commission (Note 4)	11,883			
To Net Profit — Transferred to Profit & Loss A/c	2,37,667			
	9,57,500			9,57,500

Working Notes :

(1) Depreciation for 2 months = ₹ 4,80,000 / 12 x 2 = ₹ 80,000.

(2) Insurance for 2 months = ₹ 1,20,000/12 x 2 = ₹ 20,000.

(3) Address commission is payable on freight and primage. Address commission on outward freight — 5% of ₹ 5,25,000 = ₹ 26,250; Address commission on inward freight — 4% of ₹ 3,67,500 = ₹ 14,700.

(4) Profit before charging commission is ₹ 2,49,550; Commission payable to manager — 5/105 x ₹ 2,49,550 = ₹ 11,883.

Illustration 2

The S. S. Odyssey undertook a voyage from Athens to Calcutta starting 1st January, 2015 and reaching on 31st March, 2015. The cargo consisted of 900 tonnes of foodgrains and 100 tonnes of engineering goods. The freight charges were ₹ 150 per tonne for foodgrains and ₹ 100 per tonne for engineering goods. In addition, primage was 10%. Brokerage was payable at 5%. The expenses were :

Expenses	Athens (₹)	Calcutta (₹)	Other expenses	₹
Coal and diesel	20,000	—	Stores	10,000
Port charges	9,000	2,000	Discharging expenses	2,000
Harbour wages	3,000	1,000	Postage	1,000
Loading charges	2,000	—	Salaries of crew	10,000

The ship was insured for ₹ 10,00,000 at 1% for voyage policy of Hull. The freight was insured @ $^1/_2$%. Depreciation is charged on the written-down value of the ship at 5% per annum. The value as on 1st January, 2015 was ₹ 8,00,000. Prepare the Voyage Account.

Solution **Voyage Account of S.S. Odyssey**

Dr. **[Voyage No. ...; Period : 1st January to 31st March, 2015]** **Cr.**

Particulars	₹	Particulars		₹
To Coal and diesel	20,000	By Freight (Note 1)	1,45,000	
To Port charges	11,000	*Add* : Primage 10%	14,500	1,59,500
To Harbour wages	4,000			
To Loading charges	2,000			
To Other expenses :				
Stores	10,000			
Discharging expenses	2,000			
Postage	1,000			
Salaries of Crew	10,000			
To Depreciation (Note 1)	10,000			
To Insurance :				
Hull (1% on ₹. 10,00,000)	10,000			
Freight ($^1/_2$% on ₹ 1,59,500)	798			
To Brokerage (5% on ₹ 1,59,500)	7,975			
To Net Profit — Transferred to Profit & Loss A/c	70,727			
	1,59,500			1,59,500

Working Notes :

(1) Calculation of Freight Earned	₹	(2) Calculation of Depreciation	₹
Foodgrains (900 x ₹ 150)	1,35,000	₹ 8,00,000 x 5/100 x 3/12	₹ 10,000
Engineering Goods (100 x ₹ 100)	10,000		
	1,45,000		

Illustration 3

M.V. Indian Empress is regularly employed on cargo trade between India and East Africa. Ship set on her voyage on 1st July, 2015 and arrived at her destination on 14th August, 2015. You are requested to prepare a Voyage Account bearing in mind the following particulars:

(i) The vessel was purchased in 2007 for ₹ 100 lakhs and at the time of purchase had 16 years of working life left; (Depreciation on ship is charged on straight line basis).

(ii) Standing cost per day excluding recovery of depreciation is ₹ 22,000.

(iii) The vessel consumes daily 14 tonnes of fuel oil, 2 tonnes of diesel and 15 tonnes of fresh water. The costs of these are ₹ 1,000, ₹ 1,350 and ₹ 20 per tonne respectively.

(iv) The vessel loaded the under-mentioned cargo:
4,000 tonnes on which freight of ₹ 375 per tonne was charged and 3,500 tonnes on which the rate of freight was ₹ 190 per tonne. Both the rates are to be enhanced by a surcharge of 20% over the basic rates.

(v) Freight brokers were due a brokerage of 2-$^1/_2$%.

(vi) Port charges at loading and discharging ports were ₹ 40,000 and ₹ 85,000 respectively.

Solution **Voyage Account of M.V. Indian Express**

Dr. **[Voyage No. ...; Period : 1st July to 14th August, 2015]** **Cr.**

Particulars	₹	Particulars	₹
To Standing cost (₹ 22,000 x 45)	9,90,000	By Freight (Note 1)	25,98,000
To Bunker cost (Note 2)	7,65,000		
To Port charges (₹ 40,000 + ₹ 85,000)	1,25,000		
To Depreciation (Note 3)	77,055		
To Brokerage (Note 4)	64,950		
To Net Profit — Transferred to Profit & Loss A/c	5,75,995		
	25,98,000		25,98,000

Working Notes :

(1) Calculation of Freight Earned	₹	(2) Bunker Cost	₹
4,000 tonnes @ ₹ 375 per tonne	15,00,000	Fuel (14 x 45 x ₹ 1,000)	6,30,000
3,500 tonnes @ ₹ 190 per tonne	6,65,000	Diesel (2 x 45 x ₹ 1,350)	1,21,500
	21,65,000	Fresh water (15 x 45 x ₹ 20)	13,500
Add : Surcharge 20%	4,33,000		7,65,000
	25,98,000	**(4) Brokerage**	
(3) Depreciation for 45 days		$2^1/_2$% on ₹ 25,98,000	64,950
₹ 1,00,00,000 x 1/16 x 45/365	77,055		

Illustration 4

S.S. Kanishka sailed from Calcutta Port on 1.2.2015 and arrived at Madras Port on 31.3.2015 via Visakhapatnam Port on voyage no. 403. The following goods were loaded:

1,000 m.t. and 200 m.t. at Calcutta Port for Madras Port and Visakhapatnam Port respectively. Another 500 m.t. were loaded at Visakhapatnam for Madras. The freight charges were:

Calcutta Port to Madras Port	₹ 600 per m.t.
Calcutta Port to Visakhapatnam Port	₹ 500 per m.t.
Visakhapatnam Port to Madras Port	₹ 400 per m.t.

The freight is subject to 10% primage, 5% address commission and 2.5% brokerage. The freight was insured at $^1/_2$%. The hull was insured for the voyage at 1%. Depreciation was provided at 3% p.a. The cost of the ship is ₹ 1 crore. The following were the expenses incurred at different ports: (all figures in ₹)

	Calcutta	Visakhapatnam	Madras
Port charges	36,000	20,000	20,000
Coal	1,00,000	30,000	—
Captains contingencies	7,000	2,000	10,000
Harbour wages	10,000	20,000	15,000

Stores purchased for the voyage amounted to ₹ 50,000. Opening stock of stores was ₹ 40,000 and closing stock was estimated at ₹ 30,000. Stock of coal at close was estimated at ₹ 30,000 as against stock of ₹ 10,000 at the beginning. The ship was not come back to Calcutta port in the near future as part of the voyage programme. Salaries and wages amounted to ₹ 80,000 p.m. Prepare this Voyage No. 403 Account.

Solution

Voyage Account of S.S. Kanishka

Dr. [Voyage No. 403.; Period : 1st February to 31st March, 2015] Cr.

Particulars	₹	Particulars		₹
To Port charges	76,000	By Freight (Note 2)	9,00,000	
To Coal consumed (Note 1)	1,10,000	*Add* : Primage 10%	90,000	9,90,000
To Stores consumed (Note1)	60,000			
To Catain's contingencies	19,000			
To Address commission (Note 3)	49,500			
To Harbour wages	45,000			
To Brokerage (Note 4)	24,750			
To Freight Insurance (Notes 5)	4,950			
To Hull insurance (1% of ₹ 1 crore)	1,00,000			
To Hull depreciation (Note 6)	50,000			
To Salaries & wages (₹ 80,000 x 2)	1,60,000			
To Net Profit — Transferred to Profit & Loss A/c	2,90,800			
	9,90,000			9,90,000

Working Notes :

(1) Calculation of Stores & Coal Consumed	Stores ₹	Coal ₹
Opening Stock	40,000	10,000
Add : Purchases	50,000	1,30,000
	90,000	1,40,000
Less : Closing Stock	30,000	30,000
	60,000	1,10,000

(2) Calculation of Freight Earned	₹
Calcutta to Madras 1,000 tons @ ₹ 600	6,00,000
Calcutta to Visakhapatnam 200 tonnes @ ₹ 500	1,00,000
Visakhapatnam to Madras 500 tonnes @ ₹ 400	2,00,000
Total	9,00,000

(3) Address commission is payable on freight and primage @ 5%. Therefore, address commission is 5% of ₹ 9,90,000 = ₹ 49,500.

(4) Brokerage is payable @ 2.5% on freight including primage. Therefore, total brokerage = ₹ 9,90,000 x 2.5/100 = ₹ 24,750.

(5) Freight insurance is payable @ 1/2% on ₹ 9,90,000, i.e., ₹ 4,950.

(6) Depreciation = 3% of ₹ 1,00,00,000 = ₹ 3,00,000 p.a. Therefore, depreciation for 2 months will be ₹ 3,00,000/12 x 2 = ₹ 50,000.

Illustration 5

S.S. Jalasakti sailed from Bombay on 1st February, 2015 and arrived at Calcutta on 31st March, 2015 via Marmagoa, Cochin and Vizag. She was loaded with 800 tons of cotton at Bombay for Vizag. At Cochin a further load of 600 tons of cocoanut oil was booked for Calcutta. Besides, 100 tons of textiles were also loaded at Bombay for Marmagoa. The freight charges were as follows:

Bombay to Vizag : ₹ 80 per ton; Bombay to Marmagoa : ₹ 25 per ton; and Cochin to Calcutta : ₹ 60 per ton plus primage 10% and subject to commission at 4% and brokerage at 2%. The following were the expenses at different ports :

	Bombay (₹)	Marmagoa (₹)	Cochin (₹)	Vizag (₹)	Calcutta (₹)
Coal	14,000	—	—	2,000	—
Port charges	4,000	600	1,000	1,000	3,000
Captain's expenses	800	500	300	600	700
Harbour wages	1,200	700	1,100	1,200	2,000
Loading charges	1,600	—	1,200	—	—

The following were the other expenses:

Stores supplied ₹ 8,400; Discharging expenses ₹ 5,200; Despatching of funds ₹ 400; Interest on advances ₹ 500; Portage bills ₹ 600.

The ship was insured for ₹ 5,00,000 at 1.5% premium for the voyage and the total freight was insured at $^1/_2$% premium. Depreciation is to be charged on the book value of the ship at ₹ 4,50,000 at 4% p.a. The wages of the sailors are ₹ 8,400 per month. Prepare the Voyage Account.

Solution **Voyage Account of S.S. Jalasakti**

Dr. **[Voyage No. ...; Period : 1st February to 31st March, 2015]** **Cr.**

Particulars	₹	Particulars		₹
To Coal	16,000	By Freight (Note 1)	1,02,500	
To Port charges	9,600	*Add* : Primage 10%	10,250	1,12,750
To Captain's expenses	2,900			
To Harbour wages	6,200			
To Loading charges	2,800			
To Stores supplied	8,400			
To Discharging expenses	5,200			
To Despatching of funds	400			
To Interest on advances	500			
To Postage	600			
To Commission (4% on ₹ 1,12,750)	4510			
To Brokerage (2% on ₹ 1,12,750)	2,255			
To Depreciation (Note 2)	3,000			
To Insurance —Ffreight	564			
To Insurance — Voyage (1.5 % on ₹ 5,00,000)	7,500			
To Wages of all sailors (₹ 8,400 x 2)	16,800			
To Net Profit — Transferred to Profit and Loss A/c	25,521			
	1,12,750			1,12,750

Working Notes :

(1) Calculation of Freight Earned	₹	**(2) Calculation of Depreciation**	₹
Bombay to Vizag : 80 tonnes @ ₹ 80 per tonne	64,000	₹ 4,50,000 x 4/100 x 2/12	3,000
Bombay to Marmagoa : 100 tonnes @ ₹ 25 per tonne	2,500		
Cochin to Calcutta : 600 tonnes @ ₹ 60 per tonne	36,000		
	1,02,500		

Illustration 6

S.S. Himalaya set out on a voyage from Calcutta to Bombay. On December 31, 2014 on which date the accounts are to be closed, the return voyage had not been completed. The details for the entire voyage to Bombay and back to Calcutta completed after December 31 were :

Freight ₹ 4,00,000; Coal consumption ₹ 70,000; Stores consumed ₹ 30,000; Port charges ₹ 15,000; Salaries of the crew ₹ 40,000; Depreciation ₹ 40,000; Insurance (ship) ₹ 20,000; Insurance (freight) ₹ 8,000; Primage 10%; Address commission 5%. Only ₹ 1,50,000 freight was available on the return journey. Prepare the Voyage Account up to December 31.

Solution **Voyage Account of S.S. Himalaya**

Dr. **[Voyage No. ...; Period : ... ... 2014 to 31.12.2014]** **Cr.**

Particulars	₹	Particulars		₹
To Coal consumed	70,000	By Freight	4,00,000	
To Stores consumed	30,000	*Add* : Primage 10%	40,000	4,40,000
To Port charges	15,000	By Voyage in progress (Note 2)		1.18,750
To Salary of the crew	40,000			

To Insurance :				
Ship		20,000		
Freight		8,000		
To Address commission (Note 1)		22,000		
To Depreciation		40,000		
To Voyage in progress :	₹			
— Freight	1,50,000			
— Primge 10%	15,000	1,65,000		
To Net Profit — Transferred to Profit & Loss A/c		1,48,750		
		5,58,750		5,58,750

Working Notes :
(1) Address Commission is payable on freight and primage @ 5%. Therefore, address commission is 5% of ₹ 4,40,000 = ₹ 22,000.

(2) Voyage in Progress	₹
1/2 of total expenses (excluding address commission and freight insurance) i.e., ₹ 2,15,000*	1,07,500
Address commission & freight insurance $\left[\frac{1,50,000}{4,00,000} \times (8,000 + \text{Rs } 22,000)\right]$	11,250
* It is assumed that the expenses on the full return voyage have also been already included.	1,18,750

Illustration 7

Bharat Shipping Ltd. of Bombay acquired a new ship, M.V. Jalabahi at a cost of ₹ 25,00,000. The ship was ready for service on 1.1.2015. Upto 31.3.2015, the ship had made 2 complete voyages one to London and back and was half way through the next to London. The ship carried the following freight :

To London 7,500 tonnes @ ₹ 30 per tonne. From London 9,000 tonnes @ ₹ 25 per tonne. Unfinished voyage 9,500 tonnes @ ₹ 25 per tonne. The following expenses were incurred: Salaries and wages of crew ₹ 80,000; Fuel ₹ 40,000; Sundry stores ₹ 8,000; Port dues — Bombay ₹ 8,400 and London ₹ 6,000; Stevedoring @ ₹ 2 per tonne ₹ 52,000; Share of overhead for the ship for the period ₹ 30,000.

You are further informed that 5% commission was paid to agents in addition to 1% address commission. An insurance policy was taken out @ 2% p.a. on the ship and freight was insured at a premium of ₹ 1,200 p.a.

You are required to prepare the Voyage Account for the period of 3 months ending on 31.3.2015.

Solution

Voyage Account of M.V. Jalabahi

Dr. [Voyage No. ...; Period : 1st January to 31st March, 2015] Cr.

Particulars	₹	Particulars	₹
To Salaries & wages of crew	80,000	By Freight (Note 1)	6,87,500
To Fuel	40,000	By Voyage in progress (Note 4)	70,210
To Sundry stores	8,000		
To Port dues :			
Bombay	8,400		
London	6,000		
To Stevedoring	52,000		
To Overhead	30,000		
To Insurance for 3 months			
Ship	12,500		
Freight	300		
To Address commission (Note 3)	6,875		
To Commission (Note 4)	34,375		
To Voyage in progress (Note 5)	2,37,500		
To Net Profit — Transferred to Profit & Loss A/c	2,41,670		
	7,57,710		7,57,710

Working Notes :

(1) Calculation of Freight Earned	₹	**(2) Expenses of Incomplete Voyage to be c/f**	₹
Bombay to London : 7,500 tonnes @ ₹ 30 per tonne	2,25,000	Address commission @ 1% on ₹ 2,37,500	2,375
London to Bombay : 9,000 tonnes @ ₹ 25 per tonne	2,25,000	Commission @ 5% on ₹ 2,37,500	11,875
Unfinished voyage : 9,500 tonnes @ ₹ 25 per tonne	2,37,500	Stevedoring (9,500 x ₹ 2)	19,000
	6,87,500	Port dues (Bombay — 1/3 of ₹ 8,400)	2,800

(3) Address commission is payable @ 1% on ₹ 6,87,500	6,875	**1/5 of other expenses**:	₹	
(4) Ordinary commission is payable @ 5% on ₹ 6,87,500	34,375	Salaries & wages of crew	80,000	
(5) Freight of incomplete voyage : 9,500 x ₹ 25	2,37,500	Fuel	40,000	
		Sundry stores	8,000	
		Overheads	30,000	
		Insurance — Ship	12,500	
		Insurance — Freight	300	34,160
			1,70,800/5	70,210

Illustration 8

M.V. India Glory is employed on conference trade and is on a regular run between India and the United Kingdom. The conference freight rate is ₹ 200 per freight tonne to be enhanced by a surcharge of 20% for port congestion and an adjustment of + $7^1/_2$% for currency factor.

The vessel arrived in Calcutta on 20th February, 2015 and started loading cargo. Loading was over on 1st March (morning) when she set sail for London where she arrived on the night of the 20th of March 2015. Unloading of the cargo was over and the vessel commenced her next employment on 1st April, 2015 (evening). The total voyage time was calculated at 40 days.

At Calcutta, the ship took in 8,500 freight tonnes. The following direct expenses were incurred :

(i) Entry fee, tug hire, berth hire at Calcutta ₹ 72,000.
(ii) Port charges at London ₹ 85,000.
(iii) Hooghly river dues and light house dues ₹ 7,600.
(iv) Insurance premia on cargo at 0.25% of the basic freight rate.
(v) Stevedoring charges are ₹ 18 and ₹ 25 per freight tonne at Calcutta and London respectively.
(vi) Consumption of bunkers:
  (a) During port stay — 4 tonnes of fuel oil and 25 tonnes of fresh water per day.
  (b) On sailing days — 12 tonnes of fuel oil and 10 tonnes of fresh water per day;
  Cost of fuel oil — ₹ 1,350 and fresh water ₹ 25 per tonne.
(vii) Annual costs of maintenance of ship (you can adopt 360 days as normal working days in a year):
  (a) Salaries to officers and crew ₹ 30,00,000.
  (b) Insurance premia ₹ 12,15,000.
  (c) Repairs and maintenance ₹ 25,00,000.
  (d) Interest on loan and capital ₹ 11,25,000.
  (e) Working life of vessel bought for ₹ 75 lakhs is to be taken as six years.
(viii) Freight brokerage at $1^1/_2$% is payable.

Kindly draw a Voyage Account and ascertain the result of the voyage.

Solution

Voyage Account of M.V. India Glory

Dr. [Voyage No. ...; Period : 20th February to 31st March, 2015] Cr.

Particulars	₹	Particulars		₹
To standing charges (Note 1)	10,10,000	By Freight :		
To Consumption of bunkers (Note 2)	4,49,500	8500 x ₹ 20137,00,000		
To Entry fee, tug hire, berth hire at Calcutta	72,000	*Add* : Surcharge @ 20%	3,40,000	
To London port charges	85,000		20,40,000	
To Hooghly river dues and light house dues	7,600	*Add* : Currency factor =$7^1/_2$%	1,53,000	
To Stevedoring charges (Note 3)	3,65,500		21,93,000	
To Cargo insurance (Note 4)	4,250	*Less* : Brokerage $1^1/_2$%	32,895	21,60,105
To Net Profit — Transferred to Profit & Loss A/c	1,66,255			
	21,60,105			21,60,105

Working Notes :

(1) Calculation of Proportionate Standing Charges	₹
Depreciation (1/6 of ₹ 75,00,000)	12,50,000
Salaries of officers and crew	30,00,000
Insurance premia	12,15,000
Repairs & maintenance	25,00,000
Interest on loan capital	11,25,000
Annual Standing Cost	90,90,000

Standing charges for 40 days = ₹ 90,90,000 x 40/360 = ₹ 10,10,000

(2) Consumption of Bunkers	Fuel oil (Tonnes)	Fresh water (Tonnes)
Port Stay 20 days	80	500
Sailing 20 days	240	200
Total consumption (A)	320	700
Cost per tonne (B)	₹ 1,350	₹ 25
Total (A x B)	4,32,000	17,500

(3) Stevedoring Charges @ ₹ 43 (18 + 25) on 8,500 tonnes = ₹ 3,65,500.

(4) Cargo Insurance @ 1/4% on 8,500 tonnes @ ₹ 200 per tonne = ₹ 4,250.

Illustration 9

S. S. Jalaksha voyaged from Visakhapatnam for Calcutta on 1st February, 2015. On 31st March, 2015, when the accounts of the company are closed, S.S. Jalakha was on her way back to Visakhapatnam from Calcutta on Voyage No. 707, having covered half of the return voyage. The following details of expenses and income for the entire voyage to and from Calcutta are furnished :

	₹
Freight charges	8,00,000
Port charges	30,000
Salary of crew	80,000
Consumption of : Coal	1,40,000
Stores	60,000
Insurance of : Ship for the voyage	1,00,000
Freight	40,000
Depreciation of the ship for the two months of the voyage	80,000

Primage is at 10% on freight charges. Address commission is at 5% on freight charges and primage. Only ₹ 3,00,000 freight was available on return journey to Visakhapatnam. Three-fourths of the total voyage including return journey is complete on 31st March, 2015. Of the total expenses, expenses unconnected with freight shall be carried forward as "in process" for the balance of the journey. As freight is actually earned only on completion of a voyage, you have to carry forward the freight in respect of the return journey as well as all incidental incomes.

Prepare Voyage Account for the period 1st February, 2015 to 31st March, 2015.

Solution

Voyage Account of S. S. Jalaksha

Dr. [Voyage No. 707; Period : 1st February, 2015 to 31st March, 2015] Cr.

Particulars	₹	Particulars	₹
To Coal Consumed	1,40,000	By Freight Charges	8,80,000
To Stores Consumed	60,000	By Primage (10% of ₹ 8,00,000)	80,000
To Port Charges	30,000	BY Voyage-in-Progress (Note 1)	2,63,167
To Salary of Crew	80,000		
To Insurance of :			
Ship for Voyage	1,00,000		
Freight	40,000		
To Depreciation on Ship	80,000		
To Address Commission :			
5% on ₹ 8,00,000	40,000		
5% on ₹ 80,000	4,000		
To Voyage-in-Progress (Note 2)	3,30,000		
To Net Profit — Transferred to Profit & Loss A/c	2,39,167		
	11,43,167		11,43,167

Working Notes :

(1) Calculation of Voyage-in-Progress	₹	(2) Calculation of Freight and Primage of Unfinished Voyage	₹
1/2 of Expenses not connected with freight (excluding depreciation) [i.e., 1/2 of (₹ 1,40,000 + ₹ 60,000 + ₹ 30,000 + ₹ 80,000 + ₹ 1,00,000)]	2,05,000	Freight on Return Journey	3,00,000
		Primary (10% of ₹ 3,00,000)	30,000
			3,30,000
1/3 of Depreciation (Note 3)	26,667		
3/8 of Freight Insurance	15,000		
Address Commission @ 5% on ₹ 3,30,000	16,500		
	2,63,167		

(3) Amount of depreciation given in the question pertains to two months, i.e., for one Up journey and one half of return journey. Hence, 1/3rd of the depreciation is to be carried forward.

Illustration 10

M.V. Indian Glory owned by Hindustan Shipping Company Ltd., on the Bombay-London lines trade. Her daily standing charges (fixed costs) are ₹ 45,000. In the period between July 1 and December 31, 2014 the ship had finished one round voyage to London and on the date when the books of account of the company were closed at the end of the year, the vessel was on her way to London, having sailed out of Bombay after midnight of 21st December. Loading for London commenced on 1.12.2014.

From the following details, prepare a Voyage Account.

Freight earned:

(a) Completed voyage — Bombay to London : (1) 20,000 tonnes textiles at ₹ 280 per tonne;
10,000 tonnes copra at ₹ 340 per tonne.
On textiles a surcharge of 10% was also recovered.
London to Bombay : 32,000 tonnes of urea at ₹ 300 per tonne.

(b) Unfinished voyage : 30,000 tonnes of general cargo at ₹ 240 per tonne plus a surcharge of 15%.

Expenses :

(a) Stevedoring expenses : (i) at ₹ 20 per tonne at Bombay for general cargo and ₹ 25 per tonne for textiles and copra; (ii) at London on a uniform rate of £ 1 per tonne.

(b) Fuel consumption :
(i) On sailing days : 30 tonnes of fuel oil per day; 5 tonnes of diesel per day.
(ii) On days in port : 10 tonnes of fuel oil per day; 5 tonnes of diesel per day.
(iii) Cost per tonne : Fuel oil ₹ 1,400 per tonne; diesel ₹ 2,500 per tonne.

(c) Port dues : at London £ 2,000; at Bombay ₹ 2,40,000 (inclusive of ₹ 60,000 for the incomplete voyage).

(d) Sundry stores ₹ 60,000.

(e) During the period, the vessel was in Bombay port for 70 days and in London port for 40 days.

(f) Conversion rate per £ 1 could be adopted at ₹ 20.

Solution

Voyage Account of M.V. Indian Glory

Dr. [Voyage No. ...; Period : 1st July to 31st December, 2014] Cr.

Particulars	₹	Particulars	₹
To Standing charges (₹ 45,000 x 184)	82,80,000	By Freight (Note 1)	2,74,40,000
To Fuel consumed (Note 2)	69,48,000	BY Voyage-in-Progress (c/d)	31,66,500
To Stevedoring charges (Note 3)	32,30,000		
To Port dues	2,80,000		
To Sundry stores	60,000		
To Voyage-in-Progess (c/d)	82,80,000		
To Net Profit — Transferred to Profit & Loss A/c	35,28,500		
	3,06,06,500		3,06,06,500

Working Notes :

(1) Calculation of Freight Earned	₹
Bombay to London :	
20,000 tonnes of textile @ ₹ 308 (i.e., 280 + 10%) per tonne	61,60,000
10,000 tonnes of copra @ ₹ 340 per tonne	34,00,000
London to Bombay :	
32,000 tonnes of urea @ ₹ 300 per tonne	96,00,000
Unfinished voyage :	
30,000 tonnes of general cargo @ ₹ 276 per tonne (i.e., 240 + 15%)	82,80,000
	2,74,40,000

(2) Fuel Consumption	Fuel oil (Tonnes)	Diesel (Tonnes)
Stay at port 110 days	1,100	550
Sailing 74 days	2,220	370
	3,320	920
Cost of fuel oil @ ₹ 1,400 per tonne and diesel @ ₹ 2,500 per tonne	₹ 46,48,000	₹ 23,00,000

(3) Stevedoring Charges	₹
At Bombay :	
30,000 tonnes of textiles & copra @ ₹ 25 per tonne	7,50,000
At London :	
30,000 tonnes of textiles & copra @ ₹ 20 per tonne	6,00,000
32,000 tonnes of urea @ ₹ 20 per tonne	6,40,000
At Bombay :	
32,000 tonnes of urea @ ₹ 20 per tonne	6,40,000
30,000 tonnes of general cargo @ ₹ 20 per tonne	6,00,000
	32,30,000

(4) Expenses of Incomplete Voyage	₹
Fuel oil (Note 5)	7,14,000
Diesel (Note 5)	3,87,500
Stevedoring charges	6,00,000
Port charges	60,000
Standing charges for 31 days @ ₹ 45,000	13,95,000
Sundry Stores (1/6 on time basis)	10,000
	31,66,500

(5) Fuel Consumption on Incomplete Voyage	Fuel oil (Tonnes)	Diesel (Tonnes)
Stay at port 21 days	210	105
Sailing 10 days	300	50
	510	155
Cost per tonne	1,400	2,500
Total	7,14,000	3,87,500

Key Points

- A Voyage Account is just like a Profit and Loss Account in form — the only difference is that it is not prepared for a particular accounting period but for a particular voyage and includes both outward and return journey of the vessel.
- ***Address Commission:*** This is a commission paid by the shipping companies to the brokers for procurement of freight from different parties.
- ***Primage*** : This is an additional freight, calculated as a percentage of freight earned.
- ***Passage Money*** : It is collected from a few passengers carried side by side with the merchandise. It is an income of the shipping company and is credited to the Voyage Account.

THEORETICAL QUESTIONS

1. What is a Voyage Account ? Why is it prepared ?
2. Write short notes on : (i) Address commission; (ii) Bunker cost; (iii) Primage; and (iv) Passage money.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below :

1. A voyage is a journey made by water or
   A road
   B in space
   C none of these.
2. A voyage account, in form, is just like a
   A trading account
   B rofit and loss account
   C none of these.
3. Address commission is calculated as a percentage on the freight earned including
   A primary
   B passage money
   C none of these.
4. The voyage account is closed at the end of the
   A accounting period
   B voyage
   C none of these.
5. The voyage account is prepared for a particular
   A voyage
   B accounting period
   C none of these.

PRACTICAL QUESTIONS

1. S.S. Maharaja commenced a voyage on 1st April, 2015 from Bombay to London and back. The voyage was completed on 31st May, 2015. She carried a consignment of tea on her outward journey and of woolen garments on her return journey. The ship was insured at an annual premium of ₹ 24,000.
   From the following particulars, prepare a Voyage Account:

Particulars	₹	Particulars	₹
Port charges	4,800	Annual depreciation	84,000
Coal	30,000	Freight earned(Outward)	1,10,000
Wages	50,000	Freight earned (Return)	75,000
Sundry expenses	12,000	Passage money received	10,000
Stores purchased	16,000	Stores & coal in total were in hand at the end of journey	6,000

Address commission @ 4% on outward and 5% on return freight. The manager is entitled to the commission of 10% on the profit earned before charging such commission.

2. S.S. Sagarika commenced a voyage on 1st June, 2015 from Bombay to London and back. The voyage was completed on 31st July, 2015. She carried tea cargo on its outward journey and machinery on her return journey. The ship was insured at an annual premium of ₹ 24,000. Prepare a Voyage Account from the following information :

Particulars	₹	Particulars	₹
Port dues	5,000	Bunker Coal	30,000
Salaries & wages	50,000	Stores	16,800
Miscellaneous expenses	11,600	Depreciation (annual)	96,000
Freight earned —		Passage money received	10,000
Outward	1,00,000	Lighterage charges	5,000
Return	70,000		

Address commission received @ 5% on outward and 4% on inward freight. Primage is 5% on freight. Stores and coal on hand on 31st July, 2015 was valued at ₹ 3,000. Commission to manager is payable at 5% on the profit earned on this voyage after charging such commission.

3. Great India Shipping Co. Ltd. of Bombay acquired a new ship M.V. Sumudra at a cost of ₹ 37,50,000. The ship was ready for service on 1st April, 2015. An insurance policy was taken out at 2% p.a. on the ship, freight was insured at ₹ 10,000 per annum. During 3 months ended 30th June, 2015, the ship completed one round trip to Calcutta and was half through the second trip (single way) to Calcutta.
The ship carried the following cargo:
To Calcutta — 9,000 tons @ ₹ 300 per ton (2 trips)
From Calcutta — 10,000 tons @ ₹ 270 per ton (2 trips)
To Calcutta — 12,000 tons @ ₹ 250 per ton (1 trip).
5% commission was paid to agents in addition to 1% address commission. The expenses were as follows:
Salaries and wages of the crew ₹ 8,00,000; Fuel ₹ 4,00,000; Sundry stores ₹ 80,000; Port dues (Bombay ₹ 70,000; Calcutta ₹ 50,000) ₹ 1,20,000; Stevedoring at ₹ 20 per ton — ₹ 6,20,000; Share of overheads for the ship for the period ₹ 2,50,000. Provide depreciation for the period at 5% per annum. Prepare the Consolidated Voyage Account for the period of three months ending 30th June, 2015.

4. The following details are furnished by a Shipping Company in connection with voyage no. 45 which was commenced from port A on 1st February 2015. The ship arrived at port D on 31st March, 2015 when the voyage was completed. 2,000 tons and 500 tons were loaded at port A for port D and C respectively. Another 300 tons were loaded at C for D. The freight charges were : A to D ₹ 100 per ton; A to C ₹ 80 per ton; and C to D ₹ 50 per ton.
The freight is subject to 10% primage, 5% address commission and 3% brokerage. The freight was insured at $^1/_2$%. The hull was insured for the voyage @ 1%. Depreciation is provided @ 5% p.a.

Particulars	A (₹)	B (₹)	C (₹)	D (₹)
Port Charges	5,000	1,000	3,000	3,000
Coal	18,000	—	4,000	—
Captain's expenses	1,200	800	600	900
Harbour wages	4,000	—	3,000	2,500

Stores provided at commencement amounted to ₹ 8,000. Opening stock of stores was ₹ 5,000 and closing stock is estimated at ₹ 2,000. Stock of coal at close is estimated at ₹ 4,500 as against stock ₹ 1,500 beginning. Salaries and wages of sailors etc., amount to ₹ 12,000 per month. Prepare the Voyage Account.

5. Packard Streamship Ltd. owes a tramp steamer by name "M.V. Vaikunt" which was chartered on a voyage on 1st March, 2015 on the following terms:
(i) Bombay to Basra with general cargo at ₹ 500 per tonne. The charter stipulates for an address commission to the charterers at 2% of the freight payable on raising the bill of lading together with a brokerage of 5% to the charter's agent, one third of which is repayable to the ship.
(ii) Basra to Dubai with fertilizers at ₹ 240 per tonne. Address commission of 2% on freight payable to charterers and a brokerage of 1% is payable to agents on signing the charter.
The vessels is insured with Lloyds on an annual premium of ₹ 6,60,000. The master of the vessel is entitled to 1% of the net profits of each voyage after charging such commission.
Further details are:
Repairs and renewals : At Bombay ₹ 40,000 and at Basra ₹ 18,000.
Stores suppliers and provisions : At Bombay ₹ 1,40,000 at Basra ₹ 1,60,000 and at Dubai ₹ 90,000 out of which ₹ 40,000 was in stock at conclusion of voyage.
Consumption of Bunkers : Fuel oil 6 tonnes a day, diesel 2 tonnes a day and fresh water 25 tonnes a day while the vessel in port and fuel oil 15 tonnes a day, diesel 2 tonnes a day and fresh water 25 tonnes a day while sailing. Fuel oil, diesel and fresh water cost ₹ 1,200; ₹ 2,500 and ₹ 50 per tonne respectively.

Stevedoring charges : At Bombay ₹ 20 per tonne; at Basra ₹ 15 per tonne for loading and ₹ 20 per tonne for discharging and at Dubai ₹ 12 per tonne for load/discharge.
Captain's expenses : At Basra ₹ 16,000 and at Dubai ₹ 20,000.
Port charges : At Bombay ₹ 60,000; at Basra ₹ 70,000 and at Dubai ₹ 54,000.
The steamer loaded the following cargo : At Bombay general cargo 8,000 tonnes, out of which 6,000 tonnes were to be discharged at Basra and the rest at Dubai. The freight from Bombay to Dubai was fixed at ₹ 600 per tonne.
At Basra : Fertiliser - for discharge at Dubai 6,000 tonnes.
The ship completed the voyage on 30th April, 2015. Number of sailing days as per ship's log came to 16.
Prepare a Voyage Account bearing in mind that the company has to provide towards special survey repairs of the ship ₹ 24 lakhs every year.

6. S.S. Brahmaputra commenced a voyage on 1st October, 2014 from Bombay to London and back. The voyage was completed on 30th November, 2014. It carried a consignment of Tea on its outward journey and of Machinery on its return journey. The ship was insured at an annual premium of ₹ 1,32,000.
You are given the following particulars in connection with the voyage:

Particulars	₹	Particulars	₹
Port due	30,000	Sundry expenses	40,000
Bunker	1,75,000	Passage money received	75,000
Wages & salaries	2,80,000	Lighterage charges	45,000
Stores	90,000	Depreciation (annual)	4,80,000
Freight : Outward	5,60,000		
Freight : Inward	4,00,000		

Address commission 5% on outward and 4% on inward freight.
Primage is 5% on freight.
The manager is entitled to 5% commission on the freight earned after charging such commission. Stores and coal on hand were valued at ₹ 11,997 on 30th November, 2014.
Prepare the Voyage Account.

Guide to Answers

Multiple Choice

1. B; 2. B; 3. A; 4. B; 5. A.

Practical Questions

1. **Manager's commission — ₹ 6,205; Profit on voyage — ₹ 35,845.**
2. **Address commission — ₹ 8,190; Manager's commission — ₹ 2,139; Profit on voyage — ₹ 42,771.**
3. **Cost of voyage in progress — ₹ 7,62,958; Profit on voyage — ₹ 33,20,833.**
4. **Profit on voyage — ₹ 1,55,658.**
5. **Commission to master — ₹ 28,114; Profit on voyage — ₹ 28,11,436.**

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Royalty Accounts

Introduction

The owner of an asset (e.g. mines, quarries, patent, copyright, etc), as a business arrangement, may allow another party (lessee, licencee, publisher, etc) the right to use that asset against some consideration. Such a consideration is calculated with reference to the quantity produced or sold. This payment to the owner by the user of the asset is termed as ***royalty***. We can therefore say that the royalty is the amount of consideration paid by one party to the owner of the asset in return for the right to use that asset. For example, when a publisher publishes a book, he makes a payment — royalty to the author which is based on the number of copies sold.

A royalty is, generally, paid to the owner of the right, under the following cases:

1. where the owner of a mine allows another the right to extract minerals from land;
2. where right such as patents or copyrights are licenced in favour of another;
3. where an author, artist or designer gives exclusive rights to another to copy the work.

In this chapter, the generic term 'landlord' has been used to include lessors, authors and patent owners and the term 'lessee' to include publishers, licencees, etc.

Some Terms / Expressions Used in Connection with Accounting for Royalty

Minimum Rent / Dead Rent

A contract is entered into between the landlord and the lessee for payment of royalty, ususally calculated upon the quantum of production or sale at a certain stipulated rate. This means that if there is little or no production or sale, the landlord would receive little or no royalty at all, thus undermining the monetary interest of the landlord. For some reasons or other, the lessee may not take that much dash and enthusiasm in the execution of the work to which royalty relates. To avoid such a situation, the landlord and the lessee agree upon a minimum periodical amount that the landlord will receive from the lessee, even if the actual royalty as calculated on the basis of actual production or sale is less than such minimum amount. This assured and mutually agreed periodical minimum amount is known as "***Minimum Rent***".

Example: Suppose royalty per ton of production is ₹ 100 and the minimum (annual) rent is ₹ 5,00,000. Now, if the actual production is 3,000 tons, then actual royalty would become ₹ 3,00,000. In this case the minimum rent of ₹ 5,00,000 will have to be paid by the lessee. On the other hand, if the actual production is 6,000 tons, then the actual royalty would become ₹ 6,00,000. In this case ₹ 6,00,000 will have to be paid by the lessee.

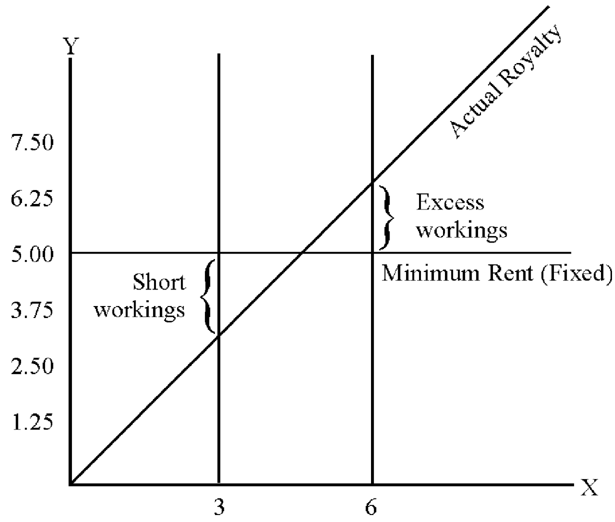
Thus, as there is a stipulation for minimum rent, then either the minimum rent or the actual royalty whichever is more shall have to be paid by the lessee.

The minimum rent is also called ***dead rent***, ***certain rent***, ***fixed rent***, etc.

Shortworkings / Redeemable Dead Rent

Shortworkings is the amount by which the minimum rent exceeds the actual royalty. In other words, it refers to the amount by which the actual royalty falls short of the minimum rent. In the above example, the shortworkings is ₹ 2,00,000 (₹ 5,00,000 – ₹ 3,00,000). Where there is shortworkings in any period the lessee is liable to pay the minimum rent and, in effect, shortworkings becomes the part of the minimum rent not represented by the use of rights.

The question of shortworkings will arise only when there is a stipulation for minimum rent in the agreement. The following diagram will help to understand the above matters:



Excess Workings / Surplus

It refers to the amount by which the actual royalty exceeds the minimum rent. In the above example, the excess workings is ₹ 1,00,000 (₹ 6,00,000 – ₹ 5,00,000) if the production is 6,000 tons.

Ground Rent / Surface Rent

It refers to the fixed yearly or half-yearly rent payable by the lessee to the landlord in addition to the minimum rent.

Recoupment of Shortworkings

Generally the royalty agreement contains a provision for carrying forward of shortworkings with a view to adjust it in the future. In the subsequent years, such shortworking is adjusted against the surplus royalty. This process of adjustment is called ***recoupment of shortworkings***. The right of recoupment of shortworkings enables the lessee to recover the excess payment, made in the earlier years (when actual royalty was less than minimum rent) in subsequent years. A time is usually set upon the number of years for which such shortworkings can be recouped. This time limit for recoupment of shortworkings may be fixed or fluctuating. If the shortworkings (partly or wholly) cannot be recouped within the specified time, they lapse and are charged to Profit and Loss Account in the year when that specified time limit for recoupment ends. Therefore, ***shortworkings are the losses of the lessee, not in the year of their occurence, but in the year they lapse***.

Fixed right : When the lessee can recoup shortworkings within a certain period from the date of the lease, it is termed as ***fixed right***. For example, shortworkings can be recouped within four years from the date of lease. The shortworkings of subsequent years cannot be recouped. (***Illustration 1***)

Fluctuating right : When the lessee can recoup shortworkings of any year during the next following year(s), as per agreement, it is termed as ***fluctuating right***. For example, shortworkings can be recouped in the next two years subsequent to the year of shortworkings.

Any shortworkings which cannot be recouped within the specified period becomes irrecoverable and it should be charged to Profit and Loss Account in the year in which it becomes so. However, the recoupable shortworkings should be carried forward and they are shown in the Balance Sheet as a current asset.

Creation of Provision Against Shortworkings

Recoupable shortworkings are shown in the Balance Sheet as a current asset though it is not certain that in future they can be recouped. For different reasons (such as fall in demand, increase in completion, etc) it may not be possible to recoup the shortworkings in future though the legal right to recoup exists. Therefore, as a prudent policy, a provision for recoupable shortworkings should be made by debiting Profit and Loss Account in the year in which shortworkings arise. In this case, in the Balance Sheet, provision is to be shown on the liability side and shortworkings on the assets side. The irrecoverable shortworkings are adjusted against such provision instead of charging it to the Profit and Loss Account of the year in which it becomes irrecoverable. After shortworkings are recouped, the excess provision is credited to Profit and Loss Account as a prior period adjustment.

The above method of accounting for shortworkings is adopted, when the amount of shortworkings is huge and chances of recovery uncertain.

Purpose of Fixing Minimum Rent

The following are the main purposes of fixing a minimum rent:

1. The landlord receives periodically at least a minimum rational amount.
2. The lessee is indirectly inspired for the sake of his own interest to reach a minimum level of performance.
3. In the absence of minimum rent, the lessee may acquire rights from different landlords to obviate competition and deliberately may under-utilise such rights.

How does Minimum Rent and Shortworkings Arise?

From lessee's point of view

When the amount of actual royalty as calculated on the actual production or sale at the agreed rate is less than the amount of minimum rent, minimum rent comes into picture. As stated earlier the shortfall of actual royalty as compared with the minimum rent is called shortworkings. Thus actual royalty is less than minimum rent,

Minimum rent – Actual royalty = Shortworkings.

or, ***Minimum rent = Actual royalty + Shortworkings***.

From landlord's point of view

Minimum rent = Actual royalty receivable + Shortworkings suffered by the lessee.

In fact, landlord is to receive the higher of the minimum rent and the actual royalty. Therefore, when the actual royalties fall short of minimum rent, he gets the minimum rent. In this case, the expression 'Royalty Suspense' is more appropriate than 'Shortworkings Allowable'.

Therefore, the equation will be: ***Minimum rent = Royalty receivable + Royalty suspense***

It is called "Royalty Suspense" because, usually the extra payment (i.e. over the actual royalty) that the landlord receives, can be recovered by the lessee from the excess working (when the royalty is more than minimum rent). The matter of recovery hangs uncertainly over future, and that is why it is called "Royalty Suspense".

Strike and Lockout, etc

In the event of a strike or lockout, the minimum rent can be reduced proportionately ***only when there is an agreement to that effect between the parties***. Otherwise as per Section 56 of the Contract Act, the strikes and lockout will not be an excuse for reduction in the minimum rent.

In the examination when it is given that there was strike or lockout for some period, the minimum rent cannot be reduced proportionately without giving a proper note.
In this connection, it should be noted that there may be an agreement between the parties to reduce shortworkings instead of minimum rent in the event of any strike or lockout. (Illustration 12)

Income Tax

As per the provision of the Income Tax Act 1961, it is the duty of the payer of royalty to deduct tax at the prescribed rate, and to deposit the tax so deducted to the credit of the Central Government within a specified time. The payment may be made at any office of the RBI or SBI or its subsidiaries conducting Government business.

This tax deducted at source in no way affects the amount of charge for royalty. The landlord will get the amount of royalty after adjustment of tax. ***Income Tax is also deductible on any amount paid as minimum rent***.

Accounting Entries in the Books of User [Lessee/Licencee/Publisher]

1. Where a minimum rent exists with right to recoup shortworkings

(a) Where the actual royalty is less than the minimum rent

(i) Royalties (Payable) Account	Dr. [Actual royalties for the period]
Shortworkings Account	Dr. [Amount by which the royalties fall short]
To Landlord Account	[Minimum rent]
(ii) Landlord Account*	Dr. [Minimum rent]
To Bank Account	[Net amount paid]
To Income Tax Payable Account	[Tax deducted at source]
(iii) Manufacturing / Profit and Loss Account	Dr. [Transfer]
To Royalties (Payable) Account	[Actual royalties for the period]

If the user is a manufacturer and royalties are calculated on the basis of production, the actual royalties are debited to Manufacturing Account. Where royalties are calculated on the basis of sales, they are debited to Profit and Loss Account.
In case of a limited company which does not prepare Manufacturing Account separately, the actual royalties are charged to Statement of Profit and Loss.

Alternatively,

When a separate ***Minimum Rent Account*** is maintained by the user, the accounting entries will be as follows:

(i) Minimum Rent Account	Dr. [Minimum rent payable]
To Landlord Account*	
(ii) Royalties (Payable) Account	Dr. [Actual royalties for the period]
Shortworkings Account	Dr. [Amount by which the royalties fall short of minimum rent]
To Minimum Rent Account	
(iii) Landlord Account*	Dr. [Minimum rent]
To Bank Account	[Net amount paid]
To Income Tax Payable Account	[Tax deducted at source]
(iv) Manufacturing / Profit and Loss Account	Dr. [Transfer]
To Royalties (Payable) Account	[Actual royalties for the period]

* Landlord to include lessor, authors and patent owners.

[It should be noted that Minimum Rent Account is opened generally in the year when actual royalty is less than minimum rent.]

There are different opinions in respect of opening the Minimum Rent Account, because, even without opening this the entries can be effected all right, as shown below:

Suppose, actual royalty payable is ₹ 5,00,000 and the minimum rent is ₹ 8,00,000.

When Minimum Rent Account is not opened, the entry will be:

Royalty (Payable) Account	Dr.	₹ 5,00,000	
Shortworkings Account	Dr.	₹ 3,00,000	
To Landlord Account			₹ 8,00,000

When Minimum Rent Account is opened, the entry will be:

(i) Minimum Rent Account	Dr.	₹ 8,00,000	
To Landlord Account			₹ 8,00,000
(ii) Royalty (Payable) Account	Dr.	₹ 5,00,000	
Shortworkings Account	Dr.	₹ 3,00,000	
To Minimum Rent Account			₹ 8,00,000

If the entries (i) and (ii) are combined; the effect will be:

Royalty (Payable) Account	Dr.	₹ 5,00,000	
Shortworkings Account	Dr.	₹ 3,00,000	
To Landlord Account			₹ 8,00,000

So the result would be the same as without opening the Minimum Rent Account.

Thus, it is found that even without maintaining the Minimum Rent Account, the same result can be achieved. However, there are sufficient grounds to maintain the Minimum Rent Account.

1. ***Minimum Rent Account is debited and Landlord Account is credited only in the year when shortworkings arise. So it helps to identify the particular year when the performance was not upto the minimum level and the causes of such shortworkings can be examined by the lessee and necessary steps taken.***
2. ***Minimum rent may vary from year to year; according to the lease agreement. In such a situation, a Minimum Rent Account can also be opened.***

(b) Where the actual royalty is more than the minimum rent

(i) Royalties (Payable) Account To Landlord Account	Dr. [Actual royalties for the period]
(ii) Landlord Account To Shortworkings Account	Dr. [Shortworkings, if any recouped during the period]
(iii) Landlord Account To Bank Account To Income Tax Payable Account	Dr.
(iv) Profit and Loss Account To Shortworkings Account	Dr. [Shortworkings which cannot be recouped]
(v) Manufacturing / Profit and Loss Account To Royalties (Payable) Account	Dr.

Key Points to Remember

1. ***When the royalty agreement does not contain a clause for minimum rent, the question of shortworkings and its recoupment does not arise.***
2. ***The landlord is always entitled to get either the minimum rent or the actual royalty whichever is more, subject to any adjustment for shortworkings recouped.***
3. ***Minimum Rent Account is generally opened when the actual royalty is less than the minimum rent.***
4. ***In the event of a strike or lockout, the minimum rent can be reduced if there is an agreement between the parties.***

Key Points to Remember (contd.)

5. ***Recoupable shortworkings should be carried forward and shown in the Balance Sheet as a current asset.***
6. ***Lapsed shortworkings should be charged to Profit and Loss Account in the year in which it becomes irrecoverable.***
7. ***Royalty on actual production should be charged to Manufacturing Account if the royalty payable is based on production. If the royalty is payable on the basis of sales, it should be charged to Profit and Loss Account. In case of a limited company, royalty payable on the basis of production should be charged to Profit and Loss Account and it is shown in the production or manufacturing section of the Profit and Loss Account.***
8. ***In any particular year if a part or whole of the shortworkings lapse the landlord can get only the minimum rent.***

Illustration 1

The Raniganj Coal Co. Ltd. took from Ram a lease of coalfield for a period of 25 years from January 1, 2011 on a royalty of 50 paise per ton of coal raised, with a minimum rent of ₹ 30,000 per year and power to recoup shortworkings during the first three years of the lease. The annual output was as follows (in tons):

2011 — 10,000; 2012 — 70,000; 2013 — 80,000; and 2014 — 1,20,000.

You are required to pass necessary Journal Entries in the books of The Raniganj Coal Co Ltd. when (a) no separate Minimum Rent Account is maintained; (b) a separate Minimum Rent Account is maintained. Ignore taxation.

Solution

In solving a practical question, certain preliminary workings are necessary. These can conveniently be prepared in a tabular format.

Workings : Analysis of Royalties Payable [All figures in ₹]

Year	Output (Tons)	Actual Royalties	Minimum Rent	Excess Workings	Shortworkings				Amount Payable
					Suffered	Recouped	Written-off	C/F	
2011	10,000	5,000	30,000	—	25,000	—	—	25,000	30,000
2012	70,000	35,000	30,000	5,000	—	5,000	—	20,000	30,000
2013	80,000	40,000	30,000	10,000	—	10,000	10,000	—	30,000
2014	1,20,000	60,000	30,000	30,000	—	—	—	—	60,000

Explanations:

(i) In the year 2011 the actual royalty is ₹ 5,000 but the minimum rent is ₹ 30,000. Therefore, the shortworkings = ₹ 25,000 (₹ 30,000 – ₹ 5,000). Minimum payment is, therefore, ₹ 30,000.

(ii) In the year 2012 the actual royalty is ₹ 35,000. Therefore, the excess workings = ₹ 5,000. Only ₹ 5,000 of the 2011's shortworkings can be recouped. The balance shortworkings of ₹ 20,000 to be carried forward to next year (2013).

(iii) In the year 2013 the actual royalty is ₹ 40,000. Therefore, the excess workings = ₹ 10,000. Only ₹ 10,000 of the 2011's shortworkings can be recouped. The balance ₹ 10,000 to be written-off to Profit and Loss Account because 2013 is the last year for recoupment of shortworkings.

(a) In the books of The Raniganj Coal Co. Ltd.

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2011 Dec. 31	Royalties (Payable) A/c	Dr.	5,000	
	Shortworkings A/c	Dr.	25,000	
	To Ram A/c			30,000
	(Being royalties @ 50 paise per ton on 10,000 tons subject to a minimum rent of ₹ 30,000)			
"	Ram A/c	Dr.	30,000	
	To Bank A/c			30,000
	(Being the amount paid in respect of royalties)			
"	Profit and Loss A/c	Dr.	5,000	
	To Royalties (Payable) A/c			5,000
	(Being the transfer of Royalties (Payable) Account to Profit and Loss Account)			
2012 Dec. 31	Royalties (Payable) A/c	Dr.	35,000	
	To Ram A/c			35,000
	(Being royalties @ 50 paise per ton on 70,000 tons)			
"	Ram A/c	Dr.	5,000	
	To Shortworkings A/c			5,000
	(Being ₹ 5,000 recovered against shortworkings of 2011)			

"	Ram A/c Dr. To Bank A/c (Being the amount paid in respect of royalties)	30,000	30,000
"	Profit and Loss A/c Dr. To Royalties (Payable) A/c (Being the transfer of Royalties (Payable) Account to Profit and Loss Account)	35,000	35,000
2013 Dec. 31	Royalties (Payable) A/c Dr. To Ram A/c (Being royalties @ 50 paise per ton on 80,000 tones)	40,000	40,000
"	Ram A/c Dr. To Shortworkings A/c (Being ₹ 10,000 recovered against shortworkings of 2011)	10,000	10,000
"	Ram A/c Dr. To Bank A/c (Being the amount paid in respect of royalties)	30,000	30,000
"	Profit and Loss A/c Dr. To Royalties (Payable) A/c (Being the transfer of Royalties (Payable) Account to Profit and Loss Account)	40,000	40,000
"	Profit and Loss A/c Dr. To Shortworkings A/c (Being shortworkings irrecoverable transferred to Profit and Loss Account)	10,000	10,000
2014 Dec. 31	Royalties (Payable) A/c Dr. To Ram A/c (Being royalties @ 50 paise per ton on 1,20,000 tons)	60,000	60,000
"	Ram A/c Dr. To Bank A/c (Being the amount paid in respect of royalties)	60,000	60,000
"	Profit and Loss A/c Dr. To Royalties (Payable) A/c (Being the transfer of Royalties (Payable) Account to Profit and Loss Account)	60,000	60,000

(b) **Journal** **Dr.** **Cr.**

Date	Particulars	₹	₹
2011 Dec. 31	Minimum Rent A/c Dr. To Ram A/c (Being the amount payable as minimum rent)	30,000	30,000
"	Royalties (Payable) A/c Dr. Shortworkings A/c Dr. To Minimum Rent A/c (Being royalties @ 50 paise per ton on 10,000 tons — the balance is transferred to Shortworkings Account)	5,000 25,000	30,000
"	Ram A/c Dr. To Bank A/c (Being the amount paid in respect of royalties)	30,000	30,000
	Profit and Loss A/c Dr. To Royalties (Payable) A/c (Being the transfer of Royalties (Payable) Account to Profit and Loss Account)	5,000	5,000
	Accounting entries for 2012; 2013 and 2014 are same as in solution (a)		

Tutorial Note : (1) Minimum Rent Account is opened generally in the year when actual royalty is less than the minimum rent.
(2) In practice all cash transactions are recorded in the Cash Book.

Illustration 2

The Bengal Coal Co. Ltd. holds a lease of coal mines for a period of ten years, commencing from 1st January 2009. According to the lease, the company is to pay 75 paise as royalty per ton with a minimum rent of ₹ 15,000 per year. Shortworkings can, however, be recovered out of the royalty in excess of the minimum rent of the next two years only. For the year of a strike the minimum rent is to be reduced to 60%. The output in tons for the 6 years is as under:

2009 — 10,000; 2010 — 12,000; 2011 — 25,000; 2012 — 20,000; 2013 — 50,000; and 2014 — 15,000 (strike).

Write up the necessary Ledger Accounts in the books of Bengal Coal Co. Ltd.

Solution

Working Notes : **Analysis of Royalties Payable** **[All figures in ₹]**

Year	Output (Tons)	Actual Royalties	Minimum Rent	Excess Workings	Shortworkings				Amount Payable
					Suffered	Recouped	Written-off	C/F	
2009	10,000	7,500	15,000	—	7,500	—	—	7,500	15,000
2010	12,000	9,000	15,000	—	6,000	—	—	13,500	15,000
2011	25,000	18,750	15,000	3,750	—	3,750	*3,750	6,000	15,000
2012	20,000	15,000	15,000	—	—	—	**6,000	—	15,000
2013	50,000	37,500	15,000	22,500	—	—	—	—	37,500
2014	15,000	11,250	9,000	2,250	—	—	—	—	11,250

*As per the lease agreement, shortworkings of any year can be recouped out of the excess workings of the next two years. In 2009, the shortworkings were ₹ 7,500. The last year for recoupment is 2011. In 2011, excess workings were ₹ 3,750 only. Therefore, the balance ₹ 3,750 (₹ 7,500 – ₹ 3,750) is to be written-off in 2011.

**In 2010, the shortworkings are ₹ 6,000. The last year for recoupment is 2012. In 2012, there are no excess workings. Therefore, the whole amount of ₹ 6,000 is to be written-off in 2012.

In the books of The Bengal Coal Co. Ltd.

Dr. **Royalties Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2009	To Landlord A/c	7,500	31.12.2009	By Profit and Loss A/c	7,500
31.12.2010	To Landlord A/c	9,000	31.12.2010	By Profit and Loss A/c	9,000
31.12.2011	To Landlord A/c	18,750	31.12.2011	By Profit and Loss A/c	18,750
31.12.2012	To Landlord A/c	15,000	31.12.2012	By Profit and Loss A/c	15,000
31.12.2013	To Landlord A/c	37,500	31.12.2013	By Profit and Loss A/c	37,500
31.12.2014	To Landlord A/c	11,250	31.12.2014	By Profit and Loss A/c	11,250

Tutorial Note : A limited company does not prepare a Manufacturing or a Trading Account separately. It prepares only a Profit and Loss Account. Therefore, all royalties are to be transferred to Profit and Loss Account.

Dr. **Shortworkings Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2009	To Landlord A/c	7,500	31.12.2009	By Balance c/d	7,500
1.1.2010	To Balance b/d	7,500			
31.12.2010	To Landlord A/c	6,000	31.12.2010	By Balance c/d	13,500
		13,500			13,500
1.1.2011	To Balance b/d	13,500	31.12.2011	By Landlord A/c	3,750
			31.12.2011	By Profit and Loss A/c	3,750
			31.12.2011	By Balance c/d	6,000
		13,500			13,500
1.1.2012	To Balance b/d	6,000	31.12.2012	By Profit and Loss A/c	6,000

Dr. **Landlord Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2009	To Bank A/c	15,000	31.12.2009	By Royalties A/c	7,500
			31.12.2009	By Shortworkings A/c	7,500
		15,000			15,000
31.12.2010	To Bank A/c	15,000	31.12.2010	By Royalties A/c	9,000
			31.12.2010	By Shortworkings A/c	6,000
		15,000			15,000
31.12.2011	To Bank A/c	15,000	31.12.2011	By Royalties A/c	18,750
31.12.2011	To Shortworkings A/c	3,750			
		18,750			18,750
31.12.2012	To Bank A/c	15,000	31.12.2012	By Royalties A/c	15,000
31.12.2013	To Bank A/c	37,500	31.12.2013	By Royalties A/c	37,500
31.12.2014	To Bank A/c	11,250	31.12.2014	By Royalties A/c	11,250

Illustration 3

Raniganj Ltd. took a mine on lease from Sri Bharatia, the landlord, at a given rate of royalty with a minimum rent of ₹ 60,000 per year. Each year's excess of minimum rent over royalties is recoverable out of the royalties for the next two years. In the event of a strike and the minimum rent not being reached, it was provided that the actual royalties earned for the year would be the full royalty obligation for the year. The actual royalties were as follows:

First year — Nil; Second year — ₹ 18,000; Third year (strike) — ₹ 45,000; Fourth year — ₹ 70,000; Fifth year — ₹ 80,000. Draw up Shortworkings, Sri Bharatia, Minimum Rent and Royalties Accounts.

Solution

Working Notes : Analysis of Royalties Payable [All figures in ₹]

Year	Actual Royalties	Minimum Rent	Excess Workings	Shortworkings				Amount Payable
				Suffered	Recouped	Written-off	C/F	
1st	Nil	60,000	—	60,000	—	—	60,000	60,000
2nd	18,000	60,000	—	42,000	—	—	1,02,000	60,000
3rd	45,000	45,000	—	—	—	*60,000	42,000	60,000
4th	70,000	60,000	10,000	—	10,000	**32,000	—	60,000
5th	80,000	60,000	20,000	—	—	—	—	80,000

*As per the lease agreement, each year's shortworkings are recoverable out of the excess workings of the next two years. In the first year, the shortworkings are ₹ 60,000. The shortworkings for the 1st year can be recouped within third year. In the third year there is no excess workings. Therefore, the whole amount of ₹ 60,000 is to be written-off in the third year.

** In the second year, the shortworkings are ₹ 42,000. The last year for recoupment was 4th year. In the 4th year, there are excess workings of ₹ 10,000. Therefore, the balance of ₹ 32,000 (₹ 42,000 – ₹ 10,000) is to be written-off in the 4th year.

In the books of Raniganj Ltd.

Dr. Minimum Rent Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1st Year	To Sri Bhartia A/c	60,000	1st Year	By Shortworkings A/c	60,000
2nd Year	To Sri Bhartia A/c	60,000	2nd Year	By Royalties A/c	18,000
			"	By Shortworkings A/c	42,000
		60,000			60,000
3rd Year	To Sri Bhartia A/c	45,000	3rd Year	By Royalties A/c	45,000

Dr. Sri Bhartia Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1st Year	To Bank A/c	60,000	1st Year	By Minimum Rent A/c	60,000
2nd Year	To Bank A/c	60,000	2nd Year	By Minimum Rent A/c	60,000
3rd Year	To Bank A/c	45,000	3rd Year	By Minimum Rent A/c	45,000
4th Year	To Shortworkings A/c	10,000	4th Year	By Royalties A/c	70,000
"	To Bank A/c	60,000			
		70,000			70,000
5th Year	To Bank A/c	80,000	5th Year	By Royalties A/c	80,000

Dr. Royalties Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2nd Year	To Minimum Rent A/c	18,000	2nd Year	By Profit and Loss A/c	18,000
3rd Year	To Minimum Rent A/c	45,000	3rd Year	By Profit and Loss A/c	45,000
4th Year	To Sri Bhartia A/c	70,000	4td Year	By Profit and Loss A/c	70,000
5th Year	To Sri Bhartia A/c	80,000	5th Year	By Profit and Loss A/c	80,000

Dr. Shortworkings Account Cr.

Date	Particulars	₹	Date	Particulars	₹
1st Year	To Minimum Rent A/c	60,000	1st Year	By Balance c/d	60,000
2nd Year	To Balance b/d	60,000	2nd Year	By Balance c/d	1,02,000
"	To Minimum Rent A/c	42,000			
		1,02,000			1,02,000

3rd Year	To Balance b/d	1,02,000	3rd Year	By Profit and Loss A/c	60,000
			"	By Balance c/d	42,000
		1,02,000			1,02,000
4th Year	To Balance b/d	42,000	4th Year	By Sri Bhartia A/c	10,000
			"	By Profit and Loss A/c	32.000
		42,000			42,000

Illustration 4

PQR Limited is engaged in the manufacturing of magnifying glasses. The company leased a machine from WXY Limited on 1.1.2010 for this purpose.

The terms of the lease are as follows:

(1) The lessee should pay ₹ 5 for every magnifying glass produced.
(2) The minimum rent shall be ₹ 10,000 p.a.
(3) The lessee may recover any shortworkings in the first year of operation out of the excess workings in the next two following years. Shortworkings in the second or subsequent years may be recovered out of any excess in the year next following that in which the shortworking arose.
(4) The royalties are payable on 31 December of each year.

Details of magnifying glasses produced are :

Year	2010	2011	2012	2013	2014
Units	1,600	1,900	2,460	1,840	2,720

You are required to prepare necessary ledger accounts in the books of PQR Limited for the five years ended 31.12.2014.

Solution

Working Notes : **Analysis of Royalties Payable** **[All figures in ₹]**

Year	Output (Units)	Actual Royalties	Minimum Rent	Excess Workings	Shortworkings				Amount Payable
					Suffered	Recouped	Written-off	C/F	
2010	1,600	8,000	10,000	—	2,000	—	—	2,000	10,000
2011	1,900	9,500	10,000	—	500	—	—	2,500	10,000
2012	2,460	12,300	10,000	2,300	—	2,300	200	—	10,000
2013	1,840	9,200	10,000	—	800	—	—	800	10,000
2014	2,720	13,600	10,000	3,600	—	800	—	—	12,800

In the books of PQR Ltd

Dr. **Royalties Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2010	To WXY Ltd A/c	8,000	31.12.2010	By Profit and Loss A/c	8,000
31.12.2011	To WXY Ltd A/c	9,500	31.12.2011	By Profit and Loss A/c	9,500
31.12.2012	To WXY Ltd A/c	12,300	31.12.2012	By Profit and Loss A/c	12,300
31.12.2013	To WXY Ltd A/c	9,200	31.12.2013	By Profit and Loss A/c	9,200
31.12.2014	To WXY Ltd A/c	13,600	31.12.2014	By Profit and Loss A/c	13,600

Dr. **Shortworkings Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2010	To WXY Ltd A/c	2,000	31.12.2010	By Balance c/d	2,000
1.1.2011	To Balance b/d	2,000	31.12.2011	By Balance c/d	2,500
31.12.2011	To WXY Ltd A/c	500			
		2,500			2,500
1.1.2012	To Balance b/d	2,500	31.12.2012	By WXY Ltd A/c	2,300
			31.12.2012	By Profit and Loss A/c	200
		2,500			2,500
31.12.2013	To WXY Ltd A/c	800	31.12.2013	By Balance c/d	800
1.1.2014	To Balance b/d	800	31.12.2014	By WXY Ltd A/c	800

Dr. **WXY Ltd Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2010	To Bank A/c	10,000	31.12.2010	By Royalties A/c	8,000
			31.12.2010	By Shortworkings A/c	2,000
		10,000			10,000
31.12.2011	To Bank A/c	10,000	31.12.2011	By Royalties A/c	9,500
			31.12.2011	By Shortworkings A/c	500
		10,000			10,000
31.12.2012	To Shortworkings A/c	2,300	31.12.2012	By Royalties A/c	12,300
31.12.2012	To Bank A/c	10,000			
		12,300			12,300
31.12.2013	To Bank A/c	10,000	31.12.2013	By Royalties A/c	9,200
			31.12.2013	By Shortworkings A/c	800
		10,000			10,000
31.12.2014	To Shortworking A/c	800	31.12.2014	By Royalties A/c	13,600
31.12.2014	To Bank A/c	12,800			
		13,600			13,600

Illustration 5

Business Texts is a small publishing firm. It has commissioned Prof. A.K. Ahuja to write a book. The initial sales of this book are not expected to be good, although demand is likely to increase as time passes. Ahuja's contract states that his royalties will be calculated as follows:

(1) He will receive a basic payment of ₹ 20 for every book sold.
(2) The minimum payment during each of the first two years will be ₹ 20,000. The publisher is entitled to recover any payment additional to royalties earned made because of this clause, from the royalties of the third and fourth years. The maximum amount which can be recovered during any given year is, however, limited to 25% of that year's royalties.
(3) There are no minimum royalties from year three onwards.
(4) All royalties are to be paid on 31st December, the last day of the firm's accounting year.
(5) The book was published during 2011. The number of copies sold in each of the first four years were as follows: 2011 — 400; 2012 — 450; 2013 — 700; 2014 — 900.

You are required to prepare necessary ledger accounts in the books of Business Texts.

Solution

Working Notes : **Analysis of Royalties Payable** **[All figures in ₹]**

Year	Number of Books	Actual Royalties	Minimum Royalty	Excess Workings	Shortworkings				Amount Payable
					Suffered	Recouped	Written-off	C/F	
2011	400	8,000	20,000	—	12,000	—	—	12,000	20,000
2012	450	9,000	20,000	—	11,000	—	—	23,000	20,000
2013	700	14,000	—	—	—	*3,500	—	19,500	10,500
2014	900	18,000	—	—	—	4,500	**15,000	—	13,500

* As per lease agreement, shortworkings of 1st year and 2nd year can be recouped from the royalties of 3rd and 4th year subject to maximum of 25% of that year's royalties. In 2013, carried forward balance of shortworkings was ₹ 23,000. Actual royalty of 2013 is ₹ 14,000. Therefore, only ₹ 3,500 (25% of ₹ 14,000) can be recouped in 2013.

** In 2014, carried forward balance of shortworkings was ₹ 19,500. Actual royalty of 2014 is ₹ 18,000. Therefore, only ₹ 4,500 (25% of ₹ 18,000) can be recouped in 2014. However, balance ₹ 15,000 (₹ 19,500 – 4,500) is to be written off in 2014 being the last year for recoupment of shortworkings.

In the books of Business Texts

Dr. **Royalties Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2011	To A. K. Ahuja A/c	8,000	31.12.2011	By Profit and Loss A/c	8,000
31.12.2012	To A. K. Ahuja A/c	9,000	31.12.2012	By Profit and Loss A/c	9,000
31.12.2013	To A. K. Ahuja A/c	14,000	31.12.2013	By Profit and Loss A/c	14,000
31.12.2014	To A. K. Ahuja A/c	18,000	31.12.2014	By Profit and Loss A/c	18,000

Dr. **Shortworkings Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2011	To A. K. Ahuja A/c	12,000	31.12.2011	By Balance c/d	12,000
1.1.2012	To Balance b/d	12,000	31.12.2012	By Balance c/d	23,000
31.12.2012	To A. K. Ahuja A/c	11,000			
		23,000			23,000
1.1.2013	To Balance b/d	23,000	31.12.2013	By A. K. Ahuja A/c	3,500
			31.12.2013	By Balance c/d	19,500
		23,000			23,000
1.1.2014	To Balance b/d	19,500	31.12.2014	By A. K. Ahuja A/c	4,500
			31.12.2014	By Profit and Loss A/c	15,000
		19,500			19,500

Dr. **A K Ahuja Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2011	To Bank A/c	20,000	31.12.2011	By Royalties A/c	8,000
			31.12.2011	By Shortworkings A/c	12,000
		20,000			20,000
31.12.2012	To Bank A/c	20,000	31.12.2012	By Royalties A/c	9,000
			31.12.2012	By Shortworkings A/c	11,000
		20,000			20,000
31.12.2013	To Shortworkings A/c	3,500	31.12.2013	By Royalties A/c	14,000
31.12.2013	To Bank A/c	10,500			
		14,000			14,000
31.12.2014	To Shortworkings A/c	4,500	31.12.2014	By Royalties A/c	18,000
31.12.2014	To Bank A/c	13,500			
		18,000			18,000

Illustration 6

X, who had patented a vacuum cleaner, granted ABC Ltd a licence for 5 years to manufacture and sale the cleaner on the following terms :

(1) ABC Ltd to pay a royalty of ₹ 100 for every cleaner sold with a minimum payment of ₹ 2,50,000 p.a.

(2) If, for any year, the royalties calculated on cleaners sold amount to less than ₹ 2,50,000, ABC Ltd may set off the deficiency against royalties payable in excess of the sum as under —
(i) 50% in the next year; and (ii) the balance in the next following year.

(3) As from the commencement of the third year, the agreement was varied and ₹ 2,00,000 was substituted for ₹ 2,50,000, stated above — the other terms of the agreement remaining unchanged.
The number of cleaners sold was : 2010 — 2,000; 2011 — 2,200; 2012 — 2,300; 2013 — 2,100; 2014 — 1,800.

You are required to prepare necessary ledger accounts in the books of ABC Ltd.

Solution

Working Notes : **Analysis of Royalties Payable** **[All figures in ₹]**

Year	Units Sold	Actual Royalties	Minimum Rent	Excess Workings	Shortworkings				Amount Payable
					Suffered	Recouped	Written-off	C/F	
2010	2,000	2,00,000	2,50,000	—	50,000	—	—	50,000	2,50,000
2011	2,200	2,20,000	2,50,000	—	30,000	—	*25,000	55,000	2,50,000
2012	2,300	2,30,000	2,00,000	30,000	—	30,000	**10,000	15,000	2,00,000
2013	2,100	2,10,000	2,00,000	10,000	—	10,000	***5,000	—	2,00,000
2014	1,800	1,80,000	2,00,000	—	20,000	—	****20,000	—	2,00,000

* As per lease agreement, 50% shortworkings can be adjusted in the next year and the balance in the next following year. In 2010, shortworkings were ₹ 50,000. 50%, i.e., ₹ 25,000 can be adjusted in 2011 and ₹ 25,000 can be adjusted in 2012. In 2011, there is no excess workings. Therefore, ₹ 25,000 is to be written off in 2011.

** In 2011, shortworkings were ₹ 30,000. ₹ 15,000 can be adjusted in 2012 and the balance ₹ 15,000 in 2013. In 2012, excess workings are ₹ 30,000. Out of this ₹ 30,000, ₹ 25,000 (related to 2010) is to be adjusted first and the balance ₹ 5,000 is to be adjusted against the shortworkings of 2011. Therefore, ₹ 10,000 (₹ 15,000 – 5,000) shortworkings of 2011 is to be written off in 2012.

*** In 2013, excess workings were ₹ 10,000. Shortworkings of 2011 carried forward ₹ 15,000. Only ₹ 10,000 can be adjusted in 2013 and the balance ₹ 5,000 is to be written off in 2013.

**** 2014 is the last year of lease. Therefore, any shortworkings arising in that year is to be written off immediately.

In the books of ABC Ltd

Royalties Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
31.12.2010	To X A/c	2,00,000	31.12.2010	By Profit and Loss A/c	2,00,000
31.12.2011	To X A/c	2,20,000	31.12.2011	By Profit and Loss A/c	2,20,000
31.12.2012	To X A/c	2,30,000	31.12.2012	By Profit and Loss A/c	2,30,000
31.12.2013	To X A/c	2,10,000	31.12.2013	By Profit and Loss A/c	2,10,000
31.12.2014	To X A/c	1,80,000	31.12.2014	By Profit and Loss A/c	1,80,000

Shortworkings Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
31.12.2010	To X A/c	50,000	31.12.2010	By Balance c/d	50,000
1.1.2011	To Balance b/d	50,000	31.12.2011	By Profit and Loss A/c	25,000
31.12.2011	To X A/c	30,000	31.12.2011	By Balance c/d	55,000
		80,000			80,000
1.1.2012	To Balance b/d	55,000	31.12.2012	By X A/c	30,000
			31.12.2012	By Profit and Loss A/c	10,000
			31.12.2012	By Balance c/d	15,000
		55,000			55,000
1.1.2013	To Balance b/d	15,000	31.12.2013	By X A/c	10,000
			31.12.2013	By Profit and Loss A/c	5,000
		15,000			15,000
31.12.2014	To X A/c	20,000	31.12.2014	By Profit and Loss A/c	20,000

X Account

Dr. Date	Particulars	₹	Date	Particulars	Cr. ₹
31.12.2010	To Bank A/c	2,50,000	31.12.2010	By Royalties A/c	2,00,000
			31.12.2010	By Shortworkings A/c	50,000
		2,50,000			2,50,000
31.12.2011	To Bank A/c	2,50,000	31.12.2011	By Royalties A/c	2,20,000
			31.12.2011	By Shortworkings A/c	30,000
		2,50,000			2,50,000
31.12.2012	To Shortworkings A/c	30,000	31.12.2012	By Royalties A/c	2,30,000
31.12.2012	To Bank A/c	2,00,000			
		2,30,000			2,30,000
31.12.2013	To Shortworkings A/c	10,000	31.12.2013	By Royalties A/c	2,10,000
31.12.2013	To Bank A/c	2,00,000			
		2,10,000			2,10,000
31.12.2014	To Bank A/c	2,00,000	31.12.2014	By Royalties A/c	1,80,000
			31.12.2014	By Shortworkings A/c	20,000
		2,00,000			2,00,000

Illustration 7

Prof P Ali wrote a book and authorised ABC Publishing Co Ltd to publish the book.

The book was published on 1.10.2011. The amount of royalty is paid on 31st December every year when the books of accounts of the publishers are closed. The shortworkings for any accounting period can be recouped in the following year only.

The royalty is to be calculated on the printed price of book, based on the number of copies sold. The rate of royalty is as under :

1 to 5,000 copies	10%	[See Note below]
5,001 to 10,000 copies	12.5%	
10,001 copies and above	15%	

[Note : Not to be calculated in a given accounting year but, on the life of the book.]

The minimum amount payable per annum is to be calculated on a time basis and is as under :

2011: ₹ 1,00,000; 2012: ₹ 1,20,000; 2013: ₹ 1,40,000; 2014 and afterwards ₹ 1,50,000.

The following additional information is provided :

	2011	2012	2013	2014
(a) Year	**2011**	**2012**	**2013**	**2014**
Copies printed (Nos.)	3,000	7,000	10,000	12,000
Printed price (₹.)	100	120	140	150
(b) Year ended 31st December	**2011**	**2012**	**2013**	**2014**
Copies sold (Nos.)	2,000	7,000	8,000	13,000

Prepare necessary ledger accounts in the books of ABC Publishing Co Ltd for the 4 accounting periods ended on 31.12.2014.

Solution

Working Notes : **(1) Analysis of Royalties Payable** **[All figures in ₹]**

Year	Actual Royalties	Minimum Royalty	Excess Workings	Shortworkings				Amount Payable
				Suffered	Recouped	Written-off	C/F	
2011	20,000	$25,000	—	5,000	—	—	5,000	25,000
2012	94,000	1,20,000	—	26,000	—	5,000	26,000	1,20,000
2013	1,62,000	1,40,000	22,000	—	22,000	4,000	—	1,40,000
2014	2,88,000	1,50,000	1,38,000	—	—	—	—	2,88,000

(2) Calculation of Actual Royalties

Year	Copies Sold	Break-up	Printed Price (₹)	Royalty (%)	Royalty Per Copy (₹)	Total Royalties (₹)
2011	2,000	2,000 (2011 Ed.)	100	10.0%	10.00	20,000
2012	7,000	1,000 (2011 Ed.)	100	10.0%	10.00	10,000
		2,000 (2012 Ed.)	120	10.0%	12.00	24,000
		4,000 (2012 Ed.)	120	*12.5%	15.00	60,000
						94,000
2013	8,000	1,000 (2012 Ed.)	120	12.5%	15.00	15,000
		7,000 (2013 Ed.)	140	**15.0%	21.00	1,47,000
						1,62,000
2014	13,000	3,000 (2013 Ed.)	140	15.0%	21.00	63,000
		10,000 (2014 Ed.)	150	15.0%	22.50	2,25,000
						2,88,000

* Above 5,000 copies (cumulative) @ 12.5%   ** above10,000 copies (cumulative) @ 15%

$ For 3 months (₹ 1,00,000/12 × 3) = ₹ 25,000.

In the books of ABC Publishing Co Ltd

Dr. **Royalties Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2011	To P Ali A/c	20,000	31.12.2011	By Profit and Loss A/c	20,000
31.12.2012	To P Ali A/c	94,000	31.12.2012	By Profit and Loss A/c	94,000
31.12.2013	To P Ali A/c	1,62,000	31.12.2013	By Profit and Loss A/c	1,62,000
31.12.2014	To P Ali A/c	2,88,000	31.12.2014	By Profit and Loss A/c	2,88,000

Dr. **Shortworkings Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2011	To P Ali A/c	5,000	31.12.2011	By Balance c/d	5,000
1.1.2012	To Balance b/d	5,000	31.12.2012	By Profit and Loss A/c	5,000
31.12.2012	To P Ali A/c	26,000	31.12.2012	By Balance c/d	26,000
		31,000			31,000
1.1.2013	To Balance b/d	26,000	31.12.2013	By P Ali A/c	22,000
			31.12.2013	By Profit and Loss A/c	4,000
		26,000			26,000

Dr. **P. Ali Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2011	To Bank A/c	25,000	31.12.2011	By Royalties A/c	20,000
			31.12.2011	By Shortworkings A/c	5,000
		25,000			25,000

31.12.2012	To Bank A/c	1,20,000	31.12.2012	By Royalties A/c	94,000
			31.12.2012	By Shortworkings A/c	26,000
		1,20,000			1,20,000
31.12.2013	To Shortworkings A/c	22,000	31.12.2013	By Royalties A/c	1,62,000
31.12.2013	To Bank A/c	1,40,000			
		1,62,000			1,62,000
31.12.2014	To Bank A/c	2,88,000	31.12.2014	By Royalties A/c	2,88,000

Illustration 8

The Eastern Colleries Ltd. leased a coalfield from C Ltd. at a royalty of ₹ 6 per ton with a minimum rent of ₹ 8,000 per annum and power to recoup each year's shortworkings out of the royalties of next 3 years.

In the event of a strike, it was decided that shortworkings, if any, would stand reduced proportionately to time actually worked.

The annual outputs (in tonnes) were as follows:

2009 — 600; 2010 — 1,250; 2011 — 1,500; 2012 — 1,800; 2013 (strike for 3 months) — 800; 2014 — 1,600.

Write up the Royalties, Shortworkings and C Ltd. Accounts.

Solution

Working Notes : **Analysis of Royalties Payable** **[All figures in ₹]**

Year	Output (Tonnes)	Actual Royalties	Minimum Rent	Excess Workings	Shortworkings				Amount Payable
					Suffered	Recouped	Written-off	C/F	
2009	600	3,600	8,000	—	4,400	—	—	4,400	8,000
2010	1,250	7,500	8,000	—	500	—	—	4,900	8,000
2011	1,500	9,000	8,000	1,000	—	1,000	—	3,900	8,000
2012	1,800	10,800	8,000	2,800	—	2,800	600	500	8,000
2013	800	4,800	*7,200	—	*2,400	—	500	2,400	7,200
2014	1,600	9,600	8,000	1,600	—	1,600	—	800	8,000

*Actual shortworkings are ₹ 3,200 (₹ 8,000 – ₹ 4,800). But it is reduced to 75% (9 months), i.e., ₹ 2,400. Therefore, minimum rent is adjusted accordingly (₹ 4,800 + ₹ 2,400 = ₹ 7,200).

In the books of Eastern Colleries Ltd.

Dr. **Royalties Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2009	To C Ltd. A/c	3,600	31.12.2009	By Profit and Loss A/c	3,600
31.12.2010	To C Ltd. A/c	7,500	31.12.2010	By Profit and Loss A/c	7,500
31.12.2011	To C Ltd. A/c	9,000	31.12.2011	By Profit and Loss A/c	9,000
31.12.2012	To C Ltd. A/c	10,800	31.12.2012	By Profit and Loss A/c	10,800
31.12.2013	To C Ltd. A/c	4,800	31.12.2013	By Profit and Loss A/c	4,800
31.12.2014	To C Ltd. A/c	9,600	31.12.2014	By Profit and Loss A/c	9,600

Dr. **Shortworkings Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2009	To C Ltd. A/c	4,400	31.12.2009	By Balance c/d	4,400
1.1.2010	To Balance b/d	4,400	31.12.2010	By Balance c/d	4,900
31.12.2010	To C Ltd. A/c	500			
		4,900			4,900
1.1.2011	To Balance b/d	4,900	31.12.2011	By C Ltd. A/c	1,000
			"	By Balance c/d	3,900
		4,900			4,900
1.1.2012	To Balance b/d	3,900	31.12.2012	By C Ltd. A/c	2,800
			"	By Profit and Loss A/c	600
			"	By Balance c/d	500
		3,900			3,900
1.1.2013	To Balance b/d	500	31.12.2013	By Profit and Loss A/c	500
31.12.2013	To C Ltd. A/c	2,400	"	By Balance c/d	2,400
		2,900			2,900
1.1.2014	To Balance b/d	2,400	31.12.2014	By C Ltd. A/c	1,600
			"	By Balance c/d	800
		2,400			2,400

Dr. C Ltd. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2009	To Bank A/c	8,000	31.12.2009	By Royalties A/c	3,600
			31.12.2009	By Shortworkings A/c	4,400
		8,000			8,000
31.12.2010	To Bank A/c	8,000	31.12.2010	By Royalties A/c	7,500
			31.12.2010	By Shortworkings A/c	500
		8,000			8,000
31.12.2011	To Shortworkings A/c	1,000	31.12.2011	By Royalties A/c	9,000
31.12.2011	To Bank A/c	8,000			
		9,000			9,000
31.12.2012	To Shortworkings A/c	2,800	31.12.2012	By Royalties A/c	10,800
31.12.2012	To Bank A/c	8,000			
		10,800			10,800
31.12.2013	To Bank A/c	7,200	31.12.2013	By Royalties A/c	4,800
			31.12.2013	By Shortworkings A/c	2,400
		7,200			7,200
31.12.2014	To Shortworkings A/c	1,600	31.12.2014	By Royalties A/c	9,600
31.12.2014	To Bank A/c	8,000			
		9,600			9,600

2. Where no minimum rent exists

In certain cases, the lease agreement may not contain any clause for minimum rent. Therefore, the question of shortworkings does not arise. The landlord is entitled to get only the actual royalties. In this situation, the accounting entries are very simple and are as under:

(i) Royalties (Payable) Account Dr. [Actual royalties for the period]
  To Landlord Account
(ii) Landlord Account Dr.
  To Bank Account
  To Income Tax Payable Account
(iii) Manufacturing/Profit and Loss Account Dr.
  To Royalties (Payable) Account

Illustration 9

The Bengal Coal Co. Ltd. is the lessee of a mine on a royalty of Re 1 per ton of coal raised, without any minimum rent. The output (in tons) for the first 3 years were as : 2012 — 10,000; 2013 — 50,000; and 2014 — 75,000.

Pass necessary Journal Entries and show the necessary Ledger Accounts in the books of The Bengal Coal Co Ltd.

Solution **In the books of The Bengal Coal Co. Ltd.**

Journal

Date	Particulars		Dr. ₹	Cr. ₹
2012 Dec 31	Royalties A/c	Dr.	10,000	
	To Landlord A/c			10,000
	(Being royalties @ Re 1 per ton on 10,000 tons)			
"	Landlord A/c	Dr.	10,000	
	To Bank A/c			10,000
	(Being the amount paid in respect of royalties)			
"	Profit and Loss A/c	Dr.	10,000	
	To Royalties A/c			10,000
	(Being the transfer of Royalties Account to Profit and Loss Account)			
2013 Dec 31	Royalties A/c	Dr.	50,000	
	To Landlord A/c			50,000
	(Being royalties @ Re 1 per ton on 50,000 tons)			
"	Landlord A/c	Dr.	50,000	
	To Bank A/c			50,000
	(Being the amount paid in respect of royalties)			

	Profit and Loss A/c To Royalties A/c (Being the transfer of Royalties Account to Profit and Loss Account)	Dr.	50,000	50,000
2014 Dec 31	Royalties A/c To Landlord A/c (Being royalties @ Re 1 per ton on 75,000 tons)	Dr.	75,000	75,000
"	Landlord A/c To Bank A/c (Being the amount paid in respect of royalties)	Dr.	75,000	75,000
"	Profit and Loss A/c To Royalties A/c (Being the transfer of Royalties Account to Profit and Loss Account)	Dr.	75,000	75,000

Dr. **Royalties Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Landlord A/c	10,000	31.12.2012	By Profit and Loss A/c	10,000
31.12.2013	To Landlord A/c	50,000	31.12.2013	By Profit and Loss A/c	50,000
31.12.2014	To Landlord A/c	75,000	31.12.2014	By Profit and Loss A/c	75,000

Dr. **Landlord Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Bank A/c	10,000	31.12.2012	By Royalties A/c	10,000
31.12.2013	To Bank A/c	50,000	31.12.2013	By Royalties A/c	50,000
31.12.2014	To Bank A/c	75,000	31.12.2014	By Royalties A/c	75,000

Accounting Entries in the Books of Landlord [Lessors / Authors / Patent owner]

*(a) Where the royalty is **less** than the minimum rent*

(i) Lessee/Licencee/Publisher Account Dr. [Minimum rent]
To Royalties (Receivable) Account [Actual royalties for the period]
To Royalty Suspense / Shortworkings Allowable Account [Amount by which the royalties fall short]

(ii) Bank Account Dr. [Net amount received]
Tax Deducted at Source Account Dr. [Tax deducted at source]
To Lessee/Licencee/Publisher Account [Minimum rent]

(iii) Royalties (Receivable) Account Dr.
To Profit and Loss Account

*(b) Where the royalty is **more** than the minimum rent*

(i) Lessee/Licencee/Publisher Account Dr. [Actual royalties for the period]
To Royalties (Receivable) Account

(ii) Royalty Suspense / Shortworkings Allowable Account Dr. [Shortworkings, if any, recouped during the period]
To Lessee/Licencee/Publisher Account

(iii) Bank Account Dr.
Tax Deducted at Source Account Dr.
To Lessee/Licencee/Publisher Account

(iv) Royalty Suspense / Shortworkings Allowable Account Dr. [Shortworkings which cannot be recouped]
To Profit and Loss Account

(v) Royalties (Receivable) Account Dr. [Transfer]
To Profit and Loss Account

Illustration 10

The facts are the same as in the ***Illustration 1*** (except last para). You are required to pass necessary Journal Entries in the books of Ram and also post and balance the appropriate accounts in the ledger.

Solution

Working Notes : **Analysis of Royalties Receivable** **[All figures in ₹]**

Year	Output (Tons)	Actual Royalties	Minimum Rent	Excess Workings	Royalty Suspense				Amount Receivable
					Occured	Adjusted	Credited to P/L	C/F	
2011	10,000	5,000	30,000	—	25,000	—	—	25,000	30,000
2012	70,000	35,000	30,000	5,000	—	5,000	—	20,000	30,000
2013	80,000	40,000	30,000	10,000	—	10,000	10,000	—	30,000
2014	1,20,000	60,000	30,000	30,000	—	—	—	—	60,000

In the books of Ram
Journal

Date	Particulars		Dr. ₹	Cr. ₹
2011 Dec 31	The Raniganj Coal Co. Ltd. A/c	Dr.	30,000	
	To Royalties (Receivable) A/c			5,000
	To Royalty Suspense / Shortworkings Allowable A/c			25,000
	(Being the royalties @ 50 paise per ton on 10,000 tons subject to a minimum rent of ₹ 30,000)			
"	Bank A/c	Dr.	30,000	
	To The Raniganj Coal Co. Ltd. A/c			30,000
	(Being the amount received on account of royalties)			
"	Royalties (Receivable) A/c	Dr.	5,000	
	To Profit and Loss A/c			5,000
	(Being the transfer of Royalties (Receivable) Account to Profit and Loss Account)			
2012 Dec. 31	The Raniganj Coal Co. Ltd. A/c	Dr.	35,000	
	To Royalties (Receivable) A/c			35,000
	(Being the royalties @ 50 paise per ton on 70,000 tons)			
"	Royalty Suspense / Shortworkings Allowable A/c	Dr.	5,000	
	To The Raniganj Coal Co. Ltd. A/c			5,000
	(Being the adjustment of excess workings against Shortworkings Allowable Account)			
"	Bank A/c	Dr.	30,000	
	To The Raniganj Coal Co. Ltd. A/c			30,000
	(Being the amount received on account of royalties)			
"	Royalties (Receivable) A/c	Dr.	35,000	
	To Profit and Loss A/c			35,000
	(Being the transfer of Royalties (Receivable) Account to Profit and Loss Account)			
2013 Dec 31	The Raniganj Coal Co. Ltd. A/c	Dr.	40,000	
	To Royalties (Receivable) A/c			40,000
	(Being the royalties @ 50 paise per ton on 80,000 tons)			
"	Royalty Suspense / Shortworkings Allowable A/c	Dr.	10,000	
	To The Raniganj Coal Co. Ltd. A/c			10,000
	(Being the adjustment of excess workings against Shortworkings Allowable Account)			
"	Shortworkings Allowable A/c	Dr.	10,000	
	To Profit and Loss A/c			10,000
	(Being the transfer of lapsed shortworkings to Profit and Loss Account)			
"	Bank A/c	Dr.	30,000	
	To The Raniganj Coal Co. Ltd. A/c			30,000
	(Being the amount received on account of royalties)			
"	Royalties (Receivable) A/c	Dr.	40,000	
	To Profit and Loss A/c			40,000
	(Being the transfer of Royalties (Receivable) Account to Profit and Loss Account)			
2014 Dec. 31	The Raniganj Coal Co. Ltd. A/c	Dr.	60,000	
	To Royalties (Receivable) A/c			60,000
	(Being the royalties @ 50 paise per ton on 1,20,000 tonns)			
"	Bank A/c	Dr.	60,000	
	To The Raniganj Coal Co. Ltd. A/c			60,000
	(Being the amount received on account of royalties)			
"	Royalties (Receivable) A/c	Dr.	60,000	
	To Profit and Loss A/c			60,000
	(Being the transfer of Royalties (Receivable) Account to Profit and Loss Account)			

Ledger

Dr. The Raniganj Coal Co Ltd. Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2011	To Royalties (Receivable) A/c	5,000	31.12.2011	By Bank A/c	30,000
31.12.2011	To Royalty Suspense A/c	25,000			
		30,000			30,000
31.12.2012	To Royalties (Receivable) A/c	35,000	31.12.2012	By Royalty Suspense A/c	5,000
			31.12.2012	By Bank A/c	30,000
		35,000			35,000
31.12.2013	To Royalties (Receivable) A/c	40,000	31.12.2013	By Royalty Suspense A/c	10,000
			31.12.2013	By Bank A/c	30,000
		40,000			40,000
31.12.2014	To Royalties (Receivable) A/c	60,000	31.12.2014	By Bank A/c	60,000

Dr. Royalties (Receivable) Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2011	To Profit and Loss A/c	5,000	31.12.2011	By The Raniganj Coal Co Ltd. A/c	5,000
31.12.2012	To Profit and Loss A/c	35,000	31.12.2012	By The Raniganj Coal Co Ltd. A/c	35,000
31.12.2013	To Profit and Loss A/c	40,000	31.12.2013	By The Raniganj Coal Co Ltd. A/c	40,000
31.12.2014	To Profit and Loss A/c	60,000	31.12.2014	By The Raniganj Coal Co Ltd. A/c	60,000

Dr. Royalty Suspense / Shortworkings Allowable Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2011	To Balance c/d	25,000	31.12.2011	By The Raniganj Coal Co Ltd. A/c	25,000
31.12.2012	To The Raniganj Coal Co Ltd. A/c	5,000	1.1.2012	By Balance b/d	25,000
"	To Balance c/d	20,000			
		25,000			25,000
31.12.2013	To The Raniganj Coal Co Ltd.	10,000	1.1.2013	By Balance b/d	20,000
"	To Profit and Loss A/c	10,000			
		20,000			20,000

Illustration 11

M owned the patent of a folding chair. On 1.1.2010, he granted N a licence for 5 years to manufacture and sell the chair on the following terms :

(a) Royalty of ₹ 10 per chair sold;
(b) Minimum rent of ₹ 15,000 p.a.;
(c) Shortworkings could be recouped only within 2 years following the year in which the shortworking occurs subject to a maximum of ₹ 3,500 p.a.; and
(d) If in any year normal sale was not attained due to strike, the minimum rent was to be regarded as having been reduced proportionately having regard to the length of the stoppage.

The number of chairs sold during the lease period was as follows :

Year	2010	2011	2012	2013	2014
Sold	900	1,300	2,000	1,100	1,400

During the year 2013, there was a stoppage due to strike lasting 4 months.

You are required to show : (i) Royalties Receivable Account; (ii) Royalties Suspense Account; and (iii) N Account in the books of M for each of the above years.

Solution

Working Notes : Analysis of Royalties Receivable [All figures in ₹]

Year	Units Sold	Actual Royalties	Minimum Royalty	Excess Workings	Shortworkings				Amount Receivable
					occured	Adjusted	Credited to P/L	C/F	
2010	900	9,000	15,000	—	6,000	—	—	6,000	15,000
2011	1,300	13,000	15,000	—	2,000	—	—	8,000	15,000
2012	2,000	20,000	15,000	5,000	—	3,500	*2,500	2,000	16,500
2013	1,100	11,000	10,000	1,000	—	1,000	**1,000	—	10,000
2014	1,400	14,000	15,000	—	1,000	—	***1,000	—	15,000

* As per lease agreement, shortworkings can be adjusted within two years following the year in which shortworkings occurred but maximum of ₹ 3,500 can be adjusted in a particular year. In 2010, shortworkings were ₹ 6,000. Last year for adjustment of this shortworkings is 2012. In 2012, excess workings were ₹ 5,000 but maximum ₹ 3,500 can be adjusted. Therefore, ₹ 2,500 (₹ 6,000 – ₹ 3,500) is to be credited to Profit and Loss Account of 2012.

** Shortworkings in 2011 were ₹ 2,000. Last year for adjustment is 2013. In 2013, excess workings were ₹ 1,000 only. Therefore, the balance (₹ 2,000 – ₹ 1,000) of ₹ 1,000 is to be credited to Profit and Loss Account of 2013.

*** In 2014 shortworkings were ₹ 1,000. No further adjustment of shortworking will be allowed since the lease is for a period of 5 years. Therefore, shortworking cannot be carried forward to next year.

In the books of M

Dr. Royalties Receivable Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2010	To Profit and Loss A/c	9,000	31.12.2010	By N A/c	9,000
31.12.2011	To Profit and Loss A/c	13,000	31.12.2011	By N A/c	13,000
31.12.2012	To Profit and Loss A/c	20,000	31.12.2012	By N A/c	20,000
31.12.2013	To Profit and Loss A/c	11,000	31.12.2013	By N A/c	11,000
31.12.2014	To Profit and Loss A/c	14,000	31.12.2014	By N A/c	14,000

Dr. Royalties Suspense Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2010	To Balance c/d	6,000	31.12.2010	By N A/c	6,000
31.12.2011	To Balance c/d	8,000	1.1.2011	By Balance b/d	6,000
			31.12.2011	By N A/c	2,000
		8,000			8,000
31.12.2012	To N A/c	3,500	1.1.2012	By Balance b/d	8,000
31.12.2012	To Profit and Loss A/c	2,500			
31.12.2012	To Balance c/d	2,000			
		8,000			8,000
31.12.2013	To N A/c	1,000	1.1.2013	By Balance b/d	2,000
31.12.2013	To Profit and Loss A/c	1,000			
		2,000			2,000
31.12.2014	To Profit and Loss A/c	1,000	31.12.2014	By N A/c	1,000

Dr. N Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2010	To Royalties Receivable A/c	9,000	31.12.2010	By Bank A/c	15,000
31.12.2010	To Royalties Suspense A/c	6,000			
		15,000			15,000
31.12.2011	To Royalties Receivable A/c	13,000	31.12.2011	By Bank A/c	15,000
31.12.2011	To Royalties Suspense A/c	2,000			
		15,000			15,000
31.12.2012	To Royalties Receivable A/c	20,000	31.12.2012	By Royalties Suspense A/c	3,500
			31.12.2012	By Bank A/c	16,500
		20,000			20,000
31.12.2013	To Royalties Receivable A/c	11,000	31.12.2013	By Royalties Suspense A/c	1,000
			31.12.2013	By Bank A/c	10,000
		11,000			11,000
31.12.2014	To Royalties Receivable A/c	14,000	31.12.2014	By Bank A/c	15,000
31.12.2014	To Royalties Suspense A/c	1,000			
		15,000			15,000

Illustration 12

X, who has patented a vacuum cleaner, granted PQR Ltd., a licence for 10 years to manufacture and sell the cleaner on the following terms:

(a) PQR Ltd. to pay a royalty of ₹ 1 for every cleaner sold with a minimum payment of ₹ 25,000 p.a. Calculations to be made annually on 31st March and payment to be made on 30th April.

(b) If, for any year, the royalties calculated on cleaners sold amount to less than ₹ 25,000, PQR Ltd. may set off the deficiency against royalties payable in excess of that sum in the next two years.

As from the commencement of the third year the agreement was revised and a minimum annual payment of ₹ 20,000 was substituted for ₹ 25,000, the other terms of the agreement remaining unchanged. The number of cleaners sold was (year ended 31st March): 2011 — 10,000; 2012 — 20,000; 2013 — 30,000; 2014 — 25,000.

You are required to prepare the following Ledger Accounts recording the above transactions in respect of royalties in the books of X, which are closed annually on 31st March: (i) Royalties (Receivable) Account; (b) Shortworkings Allowable Account; (iii) the account of PQR Ltd.

Solution

Working Notes : **Analysis of Royalties Receivable** **[All figures in ₹]**

Year	Units Sold	Actual Royalties	Minimum Rent	Excess Workings	Royalty Suspense				Amount Receivable
					Occured	Adjusted	Credited to P/L	C/F	
2011	10,000	10,000	25,000	—	15,000	—	—	15,000	25,000
2012	20,000	20,000	25,000	—	5,000	—	—	20,000	25,000
2013	30,000	30,000	20,000	10,000	—	10,000	5,000	5,000	20,000
2014	25,000	25,000	20,000	5,000	—	5,000	—	—	20,000

In the books of X

Dr. **Royalties (Receivable) Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2011	To Profit and Loss A/c	10,000	31.3.2011	By PQR Ltd. A/c	10,000
31.3.2012	To Profit and Loss A/c	20,000	31.3.2012	By PQR Ltd. A/c	20,000
31.3.2013	To Profit and Loss A/c	30,000	31.3.2013	By PQR Ltd. A/c	30,000
31.3.2014	To Profit and Loss A/c	25,000	31.3.2014	By PQR Ltd. A/c	25,000

Dr. **Shortworkings Allowable Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2011	To Balance c/d	15,000	31.3.2011	By PQR Ltd. A/c	15,000
31.3.2012	To Balance c/d	20,000	1.4.2011	By Balance b/d	15,000
			31.3.2012	By PQR Ltd. A/c	5,000
		20,000			20,000
31.3.2013	To PQR Ltd. A/c	10,000	1.4.2012	By Balance b/d	20,000
31.3.2013	To Profit and Loss A/c	5,000			
31.3.2013	To Balance c/d	5,000			
		20,000			20,000
31.3.2014	To PQR Ltd. A/c	5,000	1.4.2013	By Balance b/d	5,000

Dr. **PQR Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.2011	To Royalties (Receivable) A/c	10,000	31.3.2011	By Balance c/d	25,000
31.3.2011	To Shortworkings Allowable A/c	15,000			
		25,000			25,000
1.4.2011	To Balance b/d	25,000	30.4.2011	By Bank A/c	25,000
31.3.2012	To Royalties (Receivable) A/c	20,000	31.3.2012	By Balance c/d	25,000
31.3.2012	To Shortworkings Allowable A/c	5,000			
		50,000			50,000
1.4.2012	To Balance b/d	25,000	30.4.2012	By Bank A/c	25,000
31.3.2013	To Royalties (Receivable) A/c	30,000	31.3.2013	By Shortworkings Allowable A/c	10,000
			31.3.2013	By Balance c/d	20,000
		55,000			55,000
1.4.2013	To Balance b/d	20,000	30.4.2013	By Bank A/c	20,000
31.3.2014	To Royalties (Receivable) A/c	25,000	31.3.2014	By Shortworkings Allowable A/c	5,000
			31.3.2014	By Balance c/d	20,000
		45,000			45,000

General Illustrations

Illustration 13

XY & Co. raises minerals from the mines, then incurs some processing costs and sells the product. Royalty is payable to landlord at 20% of the cost of material, being the cost including the royalty but before incurring the processing costs. Processing cost is 20% of selling price and profit on sale is 30% of the selling price. Stock is valued at total cost (including the processing cost). The sales and stock at close of the respective years were as follows:

Sales : 2012 — ₹ 12,00,000; 2013 — ₹ 14,00,000; and 2014 — ₹ 13,00,000.

Closing Stock : 2012 — ₹ 14,000; 2013 — ₹ 21,000; and 2014 — ₹ 70,000.

Minimum annual rent payable is ₹ 1,35,000. Shortworkings can be recovered anytime in first three years starting from 2012 and not thereafter. Show necessary Ledger Accounts in the books of the lessee.

Solution

Working Notes :

Relationship between Royalty and Total Cost	₹	Relationship between Royalty and Selling Price	₹
Let, Selling price	100	Let, Selling price	*100
Less: Profit (30% of Sales)	30	*Less*: Profit (30% of Sales)	30
Total cost of Production	*70	Total cost of Production	70
Less: Processing cost (20% of Sales)	20	*Less*: Processing cost (20% of Sales)	20
Total cost of materials (including royalty)	50	Total cost of materials (including royalty)	50
Royalty (20% of ₹ 50 above)	*10	Royalty (20% of ₹ 50 above)	*10
Other cost on materials	40	Other cost on materials	40
*Where total cost is ₹ 70., royalty = ₹ 10 i.e. 10/70 or 1/7 of total cost of production will be the royalty.		*where , Sales is ₹ 100, royalty = ₹ 10 i.e. 10/100 or 1/10 of Sales will be the royalty.	

Calculation of Actual Royalty Payable **[All figures in ₹]**

Year	Cost of Sales (Selling Price — 30%)	Total Cost of Production (Cost of Sales + Closing Stock – Opening Stock)	Royalty 1/7 of total cost of production
2012	12,00,000 – 3,60,000 = 8,40,000	8,40,000 + 14,000 – nil = 8,54,000	1,22,000
2013	14,00,000 – 4,20,000 = 9,80,000	9,80,000 + 21,000 – 14,000 = 9,87,000	1,41,000
2014	13,00,000 – 3,90,000 = 9,10,000	9,10,000 + 70,000 – 21,000 = 9,59,000	1,37,000

Alternatively,

Year	Sales	Stock (converted into selling price)	Selling Price of Production	Royalty @ 10% of Sales
2012	12,00,000	100/70 x 14,000 = ₹ 20,000	12,00,000 + 20,000 – nil = 12,20,000	1,22,000
2013	14,00,000	100/70 x 21,000 = ₹ 30,000	14,00,000 + 30,000 – 20,000 = 14,10,000	1,41,000
2014	13,00,000	100/70 x 70,000 = ₹ 1,00,000	13,00,000 + 1,00,000 – 30,000 = 13,70,000	1,37,000

Analysis of Royalties Payable **[All figures in ₹]**

Year	Actual Royalties	Minimum Rent	Excess Workings	Shortworkings				Amount Payable
				Suffered	Recouped	Written-off	C/F	
2012	1,22,000	1,35,000	—	13,000	—	—	13,000	1,35,000
2013	1,41,000	1,35,000	6,000	—	6,000	—	7,000	1,35,000
2014	1,37,000	1,35,000	2,000	—	2,000	5,000	—	1,35,000

In the books of XY & Co.

Dr. **Royalties Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Landlord A/c	1,22,000	31.12.2012	By Manufacturing A/c	1,22,000
31.12.2013	To Landlord A/c	1,41,000	31.12.2013	By Manufacturing A/c	1,41,000
31.12.2014	To Landlord A/c	1,37,000	31.12.2014	By Manufacturing A/c	1,37,000

Tutorial Note : Here, royalty is a part of the cost of the materials consumed in the process of production. Therefore, royalty should be charged to Manufacturing Account.

Dr. Shortworkings Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Landlord A/c	13,000	31.12.2012	By Balance c/d	13,000
1.1.2013	To Balance b/d	13,000	31.12.2013	By Landlord A/c	6,000
			31.12.2013	By Balance c/d	7,000
		13,000			13,000
1.1.2014	To Balance b/d	7,000	31.12.2014	By Landlord A/c	2,000
			31.12.2014	By Profit and Loss A/c	5,000
		7,000			7,000

Dr. Landlord Account Cr.

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Bank A/c	1,35,000	31.12.2012	By Royalties A/c	1,22,000
			31.12.2012	By Shortworkings A/c	13,000
		1,35,000			1,35,000
31.12.2013	To Shortworkings A/c	6,000	31.12.2013	By Royalties A/c	1,41,000
31.12.2013	To Bank A/c	1,35,000			
		1,41,000			1,41,000
31.12.2014	To Shortworkings A/c	2,000	31.12.2014	By Royalties A/c	1,37,000
31.12.2014	To Bank A/c	1,35,000			
		1,37,000			1,37,000

Illustration 14

Menthol India Ltd., entered into a collaboration agreement with Menthol U.K. Ltd., under which the Indian company is to pay the London company, commencing with the date of start of production in the Indian factory, a royalty at 1% of sales during each quarter, subject to deduction of income-tax at 30%, so that the remittance in any quarter should not be less than £ 400. Shortworkings are recoupable from out of royalty payable in subsequent quarters within the same calendar year and not beyond.

Sales of each quarters are given below:

30.9.2013 — ₹ 4,00,000; 31.12.2013 — ₹ 6,00,000; 31.3.2014 — ₹ 10,00,000; 30.6.2014 — ₹ 16,00,000; 30.9.2014 — ₹ 10,00,000; and 31.12.2014 — ₹ 14,00,000.

Production commenced on 1st July 2013. Rate of exchange to be adopted for remittances will be £1 = ₹ 20 for 2013 payments and £1 = ₹ 22 for 2014 payments. Remittance of each quarter's royalty was made within 30 days of the end of the quarter. Draw Royalty Account, Shortworkings Account and Menthol U.K. Ltd. Account in the books of Menthol India Ltd. for all the years.

Solution

Working Notes : Analysis of Royalties Payable [All figures in ₹]

Quarter ending	Sales	Actual Royalties#	Minimum Rent	Excess Workings	Shortworkings				Amount Payable
					Suffered	Recouped	Written-off	C/F	
30.9.2013	4,00,000	4,000	*11,429	—	7,429	—	—	7,429	11,429
31.12.2013	6,00,000	6,000	11,429	—	5,429	—	**12,858	—	11,429
31.3.2014	10,00,000	10,000	12,571	—	2,571	—	—	2,571	12,571
30.6.2014	16,00,000	16,000	12,571	3,429	—	2,571	—	—	13,429
30.9.2014	10,00,000	10,000	12,571	—	2,571	—	—	2,571	12,571
31.12.2014	14,00,000	14,000	12,571	1,429	—	1,429	1,142	—	12,571

@ 1% of sales.

* Minimum royalty to be paid to Menthol U.K. Ltd. is £ 400 after tax. The value of one pound in 2013 was ₹ 20. Royalty to be paid in Indian ₹ = 400 x ₹ 20 = ₹ 8,000 (after tax). Rate of tax is 30%. Therefore, in 2013 the minimum rent will be ₹ 8,000/70% = ₹ 11,429 (approx.).

Similarly for 2014, the minimum rent will be (400 x ₹ 22) / 70% = ₹ 12,571 (approx.).

** As per lease agreement, shortworkings are recoupable by next quarter of the same calendar year. For quarter ending on 30.9.2013, there were shortworkings of ₹ 7,429 and for quarter ending on 31.12.2013 again there were shortworkings of ₹ 5,429. At the end of 2013 total shortworkings were ₹ 12,858. In 2013 the full amount of ₹ 12,858 is to be written-off.

In the books of Menthol India Ltd.

Dr. **Royalty Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
30.9.2013	To Menthol U.K. Ltd. A/c	4,000	31.12.2013	By Profit and Loss A/c	10,000
31.12.2013	To Menthol U.K. Ltd. A/c	6,000			
		10,000			10,000
31.3.2014	To Menthol U.K. Ltd. A/c	10,000	31.12.2014	BY Profit and Loss A/c	50,000
30.6.2014	To Menthol U.K. Ltd. A/c	16,000			
30.9.2014	To Menthol U.K. Ltd. A/c	10,000			
31.12.2014	To Menthol U.K. Ltd. A/c	14,000			
		50,000			50,000

Dr. **Shortworkings Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
30.9.2013	To Menthol U.K. Ltd. A/c	7,429	31.12.2013	By Profit and Loss A/c	12,858
31.12.2013	To Menthol U.K. Ltd. A/c	5,429			
		12,858			12,858
31.3.2014	To Menthol U.K. Ltd. A/c	2,571	30.6.2014	By Menthol U.K. Ltd. A/c	2,571
30.9.2014	To Menthol U.K. Ltd. A/c	2,571	31.12.2014	By Menthol U.K. Ltd. A/c	1,429
			31.12.2014	By Profit and Loss A/c	1,142
		5,142			5,142

Dr. **Menthol U.K. Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.10.2013	To Bank A/c	8,000	30.9.2013	By Royalty A/c	4,000
31.10.2013	To Income Tax Payable A/c	3,429	30.9.2013	By Shortworkings A/c	7,429
31.12.2013	To Balance c/d	11,429	31.12.2013	By Royalty A/c	6,000
			31.12.2013	By Shortworkings A/c	5,429
		22,858			22,858
31.1.2014	To Bank A/c	8,000	1.1.2014	By Balance b/d	11,429
31.1.2014	To Income Tax Payable A/c	3,429	31.3.2014	By Royalty A/c	10,000
30.4.2014	To Bank A/c	8,800	31.3.2014	By Shortworkings A/c	2,571
30.4.2014	To Income Tax Payable A/c	3,771	30.6.2014	By Royalty A/c	16,000
30.6.2014	To Shortworkings A/c	2,571	30.9.2014	By Royalty A/c	10,000
31.7.2014	To Bank A/c	9,400	30.9.2014	By Shortworkings A/c	2,571
31.7.2014	To Income Tax Payable A/c	4,029	31.12.2014	By Royalty A/c	14,000
31.10.2014	To Bank A/c	8,800			
31.10.2014	To Income Tax Payable A/c	3,771			
31.12.2014	To Shortworkings A/c	1,429			
31.12.2014	To Balance c/d	12,571			
		66,571			66,571

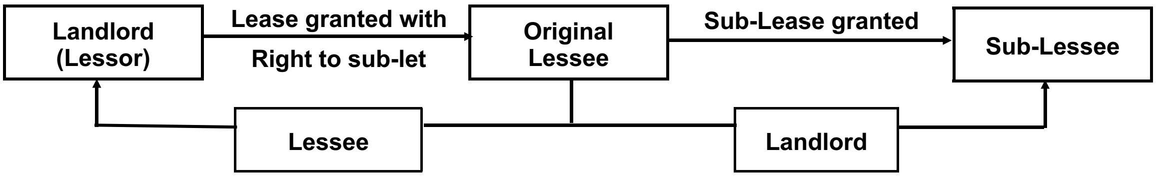
Sub-Lease

If the lease agreement contains a provision for sub-lease, the original lessee may grant a sub-lease to another person either of the whole or a part of the mine (or any other right), generally at an increased royalty. In the sub-lease, the original lessee takes the place of the landlord. Thus a third party becomes involved.

In this case, the original lessee is liable to the landlord for the agreed royalty on the total output/sale (own + sub-lessee) irrespective of the terms and conditions of the agreement made between the original lessee and the sub-lessee. The original lessee has two sets of relationship:

(a) he is a lessee of the original landlord, and

(b) he is a landlord of the sub-lessee.



Accounting Arrangements

(a) In the books of the original lessee

The lessee will maintain the following accounts in his book:

In respect of his Landlord	In respect of his Sub-Lessee
1. Royalty Payable Account	1. Royalty Receivable Account
2. Shortworkings Recoupable Account	2. Royalty Suspense Account/Shortworkings Allowable Account
3. Landlord's Account	3. Sub-Lessee's Account

Royalty Payable Account : This account is debited with the total amount of royalties (own + sub-lessee) payable to the landlord and is credited by (i) Manufacturing/Profit and Loss Account (in respect of royalty on own production/sale) (ii) Royalty Receivable Account (in respect of sub-lessee's production/sale).

Royalty Receivable Account : This account is debited with the amount of royalties on sub-lessee's production/sale (calculated at the rate of original lease) and is Credited with the amount of royalties earned (calculated as per sub-lease agreement). The balance at the year end is transferred to Profit and Loss Account (being profit or loss on sub-lease).

Shortworkings Recoupable Account : This account is opened when minimum rent (as agreed with the landlord) is more than the total amount of royalties payable. It is debited with the difference between minimum rent and total royalties payable. At the end of the year it is carried forward to next period for recoupment and it will appear in the Balance Sheet as an asset. In the subsequent years, this account is credited with (i) shortworkings recouped (when there is excess working); and (ii) shortworkings lapsed.

Royalty Suspense Account/Shortworkings Allowable Account: This account is opened when minimum rent (as agreed with the sub- lessee) is more than the royalties receivable from the sub- lessee. It is credited with the difference between minimum rent and actual royalty receivable. At the end of the year it is carried forward to next period for adjustment against excess workings of the sub-lessee. It will appear in the Balance Sheet as a liability. In the subsequent years, it is debited with (i) excess workings adjusted by the sub-lessee; and (ii) the amount lapsed.

Landlord Account : This account is maintained in the similar manner as we do in case of original lease. It is debited with the amount of minimum rent or actual royalties (on all production/sale) whichever is higher and is credited with the amount of actual royalty and shortworkings recoupable.

Sub-lessee Account : This account is debited with the amount of actual royalty receivable and shortworkings allowable and is credited with the amount of minimum rent or actual royalty receivable whichever is higher.

In order to facilitate the entries, the original lessee will prepare two analytical tables — (i) in respect of royalties payable to the landlord; and (ii) in respect of royalties receivable from the sub-lessee.

(b) In the books of the landlord : The accounting entries are made in the similar manner as we do in case of original lease (explained earlier).

(c) In the books of the sub-lessee : The accounting entries are made in the similar manner as we do in case of original lease (assuring that sub-lessee is taking the place of lessee).

Accounting Entries

When a minimum rent exists with right to recoup shortworkings

(a) ***Where the actual royalty (own + sub-lessee) is less than the minimum rent***

(i) Royalties Payable Account Dr. [Actual royalties (own + sub-lessee)]
  Shortworkings Recoupable Account Dr. [Minimum rent – actual royalties]
    To Landlord Account [Minimum rent]
  (Being royalties payable to landlord on total production subject to a minimum rent of ₹ . . .)

(ii) Landlord Account Dr. [Minimum rent]
    To Bank Account [Net amount paid]
    To Income Tax Payable Account [Tax deducted at source]
  (Being the amount paid to landlord after deducting tax)

(iii) Sub-lessee Account Dr. [Minimum rent applicable for sub-lessee]
    To Royalties Receivable Account [Actual royalties from sub-lessee]
    To Royalties Suspense Account [Minimum rent – actual royalties]
  (Being royalties receivable from sub-lessee subject to minimum rent of ₹ . . .]

(iv) Bank Account Dr. [Actual amount received]
  Tax Deducted at Source Account Dr. [Tax deducted by the sub-lessee]
    To Sub-lessee Account
  (Being the amount received from sub-lessee after tax deducted at source]

(v) Royalties Receivable Account Dr. [Royalties received from sub-lessee]
    To Royalties Payable Account [Royalties on production/sales of the sub-lessee]
    To Profit and Loss Account [Profit on sub-lease]
  (Being royalties on the production/sales of the sub-lessee adjusted against Royalties Payable Account and profit on sub-lease credited to Profit and Loss Account)

(vi) Manufacturing Account Dr. [Royalties payable on own production / sale]
  Or, Profit and Loss Account Dr.
    To Royalties Payable Account
  (Being royalties on own production/sales transferred to Manufacturing / Profit and Loss Account)

(b) ***Where the actual royalty (own + sub-lease) is more than the minimum rent***

(i) Royalties Payable Account Dr. [Actual royalties (own + sub-lessee)]
    To Landlord Account
  (Being royalties payable on total production)

(ii) Landlord Account Dr. [Shortworking recouped during the year]
    To Shortworkings Recoupable Account
  (Being shortworkings recouped during the year)

(iii) Landlord Account Dr.
    To Bank Account
    To Tax Deducted at Source Account
  (Being the amount paid to landlord)

(iv) Profit and Loss Account Dr. [Shortworkings could not be recouped]
    To Shortworkings Recoupable Account
  (Being shortworkings lapsed and debited to Profit and Loss Account)

(v) Sub-lessee Account Dr. [Actual royalties receivable from sub-lessee]
    To Royalties Receivable Account

(vi) Royalties Suspense Account Dr. [Recoupment of shortworkings by the sub-lessee]
To Sub-lessee Account
To Profit and Loss Account [Shortworkings could not be recouped by the sub-lessee]
(Being the amount adjusted by the sub-lessee in respect of previous shortworkings. Amount could not be adjusted by the sub-lessee, credited to Profit and Loss Account)

(vii) Royalties Receivable Account Dr. [Royalties received from sub-lessee]
To Royalties Payable Account [Royalties of the sub-lessee]
To Profit and Loss Account [Profit on sub-lease]
(Being adjustment of royalties receivable against royalties payable in respect of sub-lessee's production. Profit on sub-lease credited to Profit and Loss Account)

(viii) Bank Account Dr.
Tax Deducted at Source Account Dr.
To Sub-lessee Account
(Being the amount received from sub-lessee after tax deducted at source)

Illustration 15

A Ltd. holds a lease of coal mine from B Ltd. at a royalty of ₹ 2 per ton of coal produced with a minimum rent of ₹ 4,000 p.a., the shortworkings being recoverable out of the royalties of the next two years.

After working the mine for two years A Ltd. sublets part of the mine to X Ltd. at a royalty of ₹ 2.50 per ton with a minimum rent of ₹ 2,000 p.a.. X Ltd. has right to recover shortworkings during the first three years of the sub-lease.

Annual production (in tonnes)

	2010	2011	2012	2013	2014
A Ltd.	1,200	1,400	1,900	2,000	2,000
X Ltd.	—	—	700	800	900

Pass necessary Journal Entries and prepare necessary accounts in the books of A Ltd. for the period from 2010 to 2014.

Solution

Working Notes : **(1) Analysis of Royalties Payable** **[All figures in ₹]**

Year	Total Output (Tons)	Actual Royalties	Minimum Rent	Excess Workings	Shortworkings				Amount Payable
					Suffered	Recouped	Written-off	C/F	
2010	1,200	2,400	4,000	—	1,600	—	—	1,600	4,000
2011	1,400	2,800	4,000	—	1,200	—	—	2,800	4,000
2012	2,600	5,200	4,000	1,200	—	1,200	400	1,200	4,000
2013	2,800	5,600	4,000	1,600	—	1,200	—	—	4,400
2014	2,900	5,800	4,000	1,800	—	—	—	—	5,800

(2) Analysis of Royalties Receivable **[All figures in ₹]**

Year	Output of Sub-lessee (Tons)	Actual Royalties	Minimum Rent	Excess Workings	Royalty Suspense				Amount Receivable
					Occured	Adjusted	Credited to P/L	C/F	
2012	700	1,750	2,000	—	250	—	—	250	2,000
2013	800	2,000	2,000	—	—	—	—	250	2,000
2014	900	2,250	2,000	250	—	250	—	—	2,000

In the books of A Ltd

Journal **Dr.** **Cr.**

Date	Particulars		₹	₹
2010 Dec. 31	Royalties Payable A/c	Dr.	2,400	
	Shortworkings Recoupable A/c	Dr.	1,600	
	To B Ltd A/c			4,000
	(Being royalties payable @ ₹ 2 per ton on 1,200 tons subject to a minimum rent of ₹ 4,000)			

Date	Particulars		Dr. (₹)	Cr. (₹)
	B Ltd A/c To Bank A/c (Being the amount paid in respect of royalties)	Dr.	4,000	 4,000
	Profit and Loss A/c To Royalties Payable A/c (Being the transfer of Royalties Payable Account to Profit and Loss Account)	Dr.	2,400	 2,400
2011 Dec. 31	Royalties Payable A/c Shortworkings Recoupable A/c To B Ltd A/c (Being royalties payable @ ₹ 2 per ton on 1,400 tons subject to a minimum rent of ₹ 4,000)	Dr. Dr.	2,800 1,200	 4,000
	B Ltd A/c To Bank A/c (Being the amount paid in respect of royalties)	Dr.	4,000	 4,000
	Profit and Loss A/c To Royalties Payable A/c (Being the transfer of Royalties Payable Account to Profit and Loss Account)	Dr.	2,800	 2,800
2012 Dec. 31	Royalties Payable A/c To B Ltd A/c (Being royalties payable @ ₹ 2 per ton on 2,600 tons)	Dr.	5,200	 5,200
	B Ltd A/c To Shortworkings Recoupable A/c (Being ₹ 1,200 recovered against shortworkings of 2010)	Dr.	1,200	 1,200
	B Ltd A/c To Bank A/c (Being the amount paid in respect of royalties)	Dr.	4,000	 4,000
	Profit and Loss A/c To Shortworkings Recoupable A/c (Being the shortworkings lapsed for 2010 written off)	Dr.	400	 400
	X Ltd A/c To Royalties Receivable A/c To Royalties Suspense A/c (Being royalties receivable @ ₹ 2.50 per ton on 700 tons subject to a minimum rent of ₹ 2,000)	Dr.	2,000	 1,750 250
	Bank A/c To X Ltd A/c (Being the amount received in respect of royalties)	Dr.	2,000	 2,000
	Royalties Receivable A/c To Royalties Payable A/c To Profit and Loss A/c (Being the adjustment of royalties paid on sub-lessee's production @ ₹ 2 per ton on 700 tons. Profit on sub-lease @ Re 0.50 per ton on 700 tons credited to Profit and Loss Account)	Dr.	1,750	 1,400 350
	Profit and Loss A/c To Royalties Payable A/c (Being royalties paid on own production @ ₹ 2 per ton on 1,900 tons debited to Profit and Loss Account)	Dr.	3,800	 3,800
2013 Dec. 31	Royalties Payable A/c To B Ltd A/c (Being royalties payable @ ₹ 2 per ton on 2,800 tons)	Dr.	5,600	 5,600
	B Ltd A/c To Shortworkings Recoupable A/c (Being ₹ 1,200 recovered against shortworkings of 2011)	Dr.	1,200	 1,200
	B Ltd A/c To Bank A/c (Being the amount paid in respect of royalties)	Dr.	4,400	 4,400
	X Ltd A/c To Royalties Receivable A/c (Being royalties receivable @ ₹ 2.50 per ton on 800 tons)	Dr.	2,000	 2,000
	Royalties Receivable A/c To Royalties Payable A/c To Profit and Loss A/c (Being the adjustment of royalties paid on sub-lessee's production @ ₹ 2 per ton on 800 tons. Profit on sub-lease @ Re 0.50 per ton on 800 tons credited to Profit and Loss Account)	Dr.	2,000	 1,600 400

			Dr.	Cr.
	Bank A/c	Dr.	2,000	
	To X Ltd A/c			2,000
	(Being the amount received from X Ltd)			
	Profit and Loss A/c	Dr.	4,000	
	To Royalties Payable A/c			4,000
	(Being royalties paid on own production @ ₹ 2 per ton on 2,000 tons debited to Profit and Loss Account)			
2014 Dec. 31	Royalties Payable A/c	Dr.	5,800	
	To B Ltd A/c			5,800
	(Being royalties payable @ ₹ 2 per ton on 2,900 tons)			
	B Ltd A/c	Dr.	5,800	
	To Bank A/c			5,800
	(Being the amount paid in respect of royalties)			
	X Ltd A/c	Dr.	2,250	
	To Royalties Receivable A/c			2,250
	(Being royalties receivable @ ₹ 2.50 per ton on 900 tons)			
	Royalties Receivable A/c	Dr.	2,250	
	To Royalties Payable A/c			1,800
	To Profit and Loss A/c			450
	(Being the adjustment of royalties paid on sub-lessee's production @ ₹ 2 per ton on 900 tons. Profit on sub-lease @ Re 0.50 per ton on 900 tons credited to Profit and Loss Account)			
	Royalty suspense A/c	Dr.	250	
	To X Ltd A/c			250
	(Being the shortworkings recouped by the sub-lessee)			
	Bank A/c	Dr.	2,000	
	To X Ltd A/c			2,000
	(Being the amount received from X Ltd)			
	Profit and Loss A/c	Dr.	4,000	
	To Royalties Payable A/c			4,000
	(Being royalties paid on own production @ ₹ 2 per ton on 2,000 tons debited to Profit and Loss Account)			

Ledger of A Ltd.

Dr. **Royalties Payable Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2010	To B Ltd. A/c	2,400	31.12.2010	By Profit and Loss A/c	2,400
31.12.2011	To B Ltd. A/c	2,800	31.12.2011	By Profit and Loss A/c	2,800
31.12.2012	To B Ltd. A/c	5,200	31.12.2012	By Royalty Receivable A/c (₹ 2 x 700)	1,400
			31.12.2012	By Profit and Loss A/c	3,800
		5,200			5,200
31.12.2013	To B Ltd. A/c	5,600	31.12.2013	By Royalty Receivable A/c (₹ 2 x 800)	1,600
			31.12.2013	By Profit and Loss A/c	4,000
		5,600			5,600
31.12.2014	To B Ltd. A/c	5,800	31.12.2014	By Royalty Receivable A/c (₹ 2 x 900)	1,800
			31.12.2014	By Profit and Loss A/c	4,000
		5,800			5,800

Dr. **Shortworkings Recoupable Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2010	To B Ltd. A/c	1,600	31.12.2010	By Balance c/d	1,600
1.1.2011	To Balance b/d	1,600	31.12.2011	By Balance c/d	2,800
31.12.2011	To B Ltd. A/c	1,200			
		2,800			2,800
1.1.2012	To Balance b/d	2,800	31.12.2012	By B Ltd. A/c	1,200
			31.12.2012	By Profit and Loss A/c (lapsed)	400
			31.12.2012	By Balance c/d	1,200
		2,800			2,800
1.1.2013	To Balance b/d	1,200	31.12.2013	By B Ltd. A/c	1,200

Dr. **B Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2010	To Bank A/c	4,000	31.12.2010	By Royalty Payable A/c	2,400
			31.12.2010	By Shortworkings Recoupable A/c	1,600
		4,000			4,000
31.12.2011	To Bank A/c	4,000	31.12.2011	By Royalty Payable A/c	2,800
			31.12.2011	By Shortworkings Recoupable A/c	1,200
		4,000			4,000
31.12.2012	To Shortworkings Recoupable A/c	1,200	31.12.2012	By Royalty Payable A/c	5,200
31.12.2012	To Bank A/c	4,000			
		5,200			5,200
31.12.2013	To Shortworkings Recoupable A/c	1,200	31.12.2013	By Royalty Payable A/c	5,600
31.12.2013	To Bank A/c	4,400			
		5,600			5,600
31.12.2014	To Bank A/c	5,800	31.12.2014	By Royalty Payable A/c	5,800

Dr. **Royalty Receivable Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Royalty Payable A/c	1,400	31.12.2012	By X Ltd. A/c	1,750
31.12.2012	To Profit and Loss A/c	350			
		1,750			1,750
31.12.2013	To Royalty Payable A/c	1,600	31.12.2013	By X Ltd. A/c	2,000
31.12.2013	To Profit and Loss A/c	400			
		2,000			2,000
31.12.2014	To Royalty Payable A/c	1,800	31.12.2014	By X Ltd. A/c	2,250
31.12.2014	To Profit and Loss A/c	450			
		2,250			2,250

Dr. **Royalty Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Balance c/d	250	31.12.2012	By X Ltd. A/c	250
31.12.2013	To Balance c/d	250	1.1.2013	By Balance b/d	250
31.12.2014	To X Ltd. A/c	250	1.1.2014	By Balance b/d	250

Dr. **X Ltd. Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Royalty Receivable A/c	1,750	31.12.2012	By Bank A/c	2,000
31.12.2012	To Royalty Suspense A/c	250			
		2,000			2,000
31.12.2013	To Royalty Receivable A/c	2,000	31.12.2013	By Bank A/c	2,000
31.12.2014	To Royalty Receivable A/c	2,250	31.12.2014	By Royalty Suspense A/c	250
			31.12.2014	By Bank A/c	2,000
		2,250			2,250

Tutorial Note : A Ltd. is a limited company. Therefore, royalty on own production should be charged to Profit and Loss Account (production account section). The royalty on sub-lessee's production is adjusted against the Royalty Receivable Account.

Illustration 16

Bharat Ltd. took a licence for production of electronic machines from Hindusthan Ltd. Royalty is payable @ ₹ 20 per electronic machine produced.

Bharat Ltd. issued a sub-licence to Bengal Ltd. on the basis of a royalty payment of ₹ 25 per machine sold.

Minimum royalty payable by Bengal Ltd. was fixed at ₹ 30,000 per annum with a right to recoup shortworkings in the following year.

From the following details show Royalty Payable Account, Royalty Receivable Account, Shortworking Account and Shortworking Suspense Account in the books of Bharat Ltd.

	Bharat Ltd.		Bengal Ltd.	
Year	Sales (No. of Units)	Closing Stock (No. of Units)	Production (No. of Units)	Closing Stock (No. of Units)
2012	4,000	1,000	400	200
2013	5,000	2,000	2,000	400
2014	9,000	3,000	3,000	900

Solution

Calculation of Production in Units

Bharat Ltd.	2012	2013	2014
Sales	4,000	5,000	9,000
Add: Closing Stock	1,000	2,000	3,000
	5,000	7,000	12,000
Less: Opening Stock	Nil	1,000	2,000
Production	5,000	6,000	10,000

Calculation of Sales in Units

Bengal Ltd.	2012	2013	2014
Production	400	2,000	3,000
Add: Opening Stock	Nil	200	400
	400	2,200	3,400
Less: Closing Stock	200	400	900
Sales	200	1,800	2,500

(1) Analysis of Royalties Payable **[All figures in ₹]**

Year	Total Production	Actual Royalties	Minimum Rent	Excess Workings	Shortworkings				Amount Payable
					Suffered	Recouped	Written-off	C/F	
2012	5,400	1,08,000	Nil	—	—	—	—	—	1,08,000
2013	8,000	1,60,000	Nil	—	—	—	—	—	1,60,000
2014	13,000	2,60,000	Nil	—	—	—	—	—	2,60,000

(2) Analysis of Royalties Receivable **[All figures in ₹]**

Year	Sales Units	Actual Royalties	Minimum Rent	Excess Workings	Shortworking Suspense				Amount Receivable
					Occured	Adjusted	Written-off	C/F	
2012	200	5,000	30,000	—	25,000	—	—	25,000	30,000
2013	1,800	45,000	30,000	15,000	—	15,000	10,000	—	30,000
2014	2,500	62,500	30,000	32,500	—	—	—	—	62,500

In the books of Bharat Ltd.

Dr. **Royalties Payable Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Hindusthan Ltd. A/c	1,08,000	31.12.2012	By Royalty Receivable A/c	8,000
			31.12.2012	By Profit and Loss A/c (Note 1)	1,00,000
		1,08,000			1,08,000
31.12.2013	To Hindusthan Ltd. A/c	1,60,000	31.12.2013	BY Royalty Receivable A/c	40,000
			31.12.2013	By Profit and Loss A/c	1,20,000
		1,60,000			1,60,000
31.12.2014	To Hindusthan Ltd. A/c	2,60,000	31.12.2014	By Royalty Receivable A/c	60,000
			31.12.2014	By Profit and Loss A/c	2,00,000
		2,60,000			2,60,000

Tutorial Note : 1. Bharat Ltd. is a limited company. Therefore, royalty on own production to be charged to Profit and Loss Account (production account section). The royalty on sub-lessee's production is adjusted against the royalty receivable account.

Dr. **Royalty Receivable Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Royalty Payable A/c	8,000	31.12.2012	By Bengal Ltd. A/c	5,000
			31.12.2012	By Profit and Loss A/c	3,000
		8,000			8,000
31.12.2013	To Royalty Payable A/c	40,000	31.12.2013	By Bengal Ltd. A/c	45,000
31.12.2013	To Profit and Loss A/c	5,000			
		45,000			45,000

31.12.2014	To Royalty Payable A/c	60,000	31.12.2014	By Bengal Ltd. A/c	62,500
31.12.2014	To Profit and Loss A/c	2,500			
		62,500			62,500

Dr. **Shortworkings Suspense Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Balance c/d	25,000	31.12.2012	By Bengal Ltd. A/c	25,000
31.12.2013	To Bengal Ltd. A/c	15,000	31.12.2013	By Balance b/d	25,000
31.12.2013	To Profit and Loss A/c	10,000			
		25,000			25,000

***Alternative solution*:**

***It may be quite appropriate to carry down a balance in the Royalty Payable Account equal to the royalty on production of Bengal Ltd. not yet sold. In such a situation the accounts will appear as follows*:**

Dr. **Royalty Payable Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Hindusthan Ltd. A/c	1,08,000	31.12.2012	By Royalty Receivable A/c	4,000
			31.12.2012	By Profit and Loss A/c	1,00,000
			31.12.2012	By Balance c/d (Note 1)	4,000
		1,08,000			1,08,000
1.1.2013	To Balance b/d	4,000	31.12.2013	By Royalties Receivable A/c	36,000
31.12.2013	To Hindusthan Ltd. A/c	1,60,000	31.12.2013	By Profit and Loss A/c	1,20,000
			31.12.2013	By Balance c/d (Note 2)	8,000
		1,64,000			1,64,000
1.1.2014	To Balance b/d	8,000	31.12.2014	By Royalties Receivable A/c	50,000
31.12.2014	To Hindusthan Ltd. A/c	2,60,000	31.12.2014	By Profit and Loss A/c	2,00,000
			31.12.2014	By Balance c/d (Note 3)	18,000
		2,68,000			2,68,000

Dr. **Royalty Receivable Account** **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.12.2012	To Royalty Payable A/c	4,000	31.12.2012	By Bengal Ltd. A/c	5,000
31.12.2012	To Profit and Loss A/c (Note 1)	1,000			
		5,000			5,000
31.12.2013	To Royalty Payable A/c	36,000	31.12.2013	By Bengal Ltd. A/c	45,000
31.12.2013	To Profit and Loss A/c (Note 2)	9,000			
		45,000			45,000
31.12.2014	To Royalty Receivable A/c	50,000	31.12.2014	By Bengal Ltd. A/c	62,500
31.12.2014	To Profit and Loss A/c	12,500			
		62,500			62,500

Tutorial Note:

1. In 2012, the production of sub-lessee was 400 units and royalty paid on that production was ₹ 8,000. Out of 400 units only 200 units were sold in 2012. Therefore, royalty paid on (400 – 200) = 200 units @ ₹ 20 = ₹ 4,000 is to be carried forward to 2013. Profit on sub-lease ₹ 5 (₹ 25 – ₹ 20) per unit sold. In 2012, 200 units were sold. Therefore, profit of ₹ 5 x 200 = ₹ 1,000 is to be transferred to Profit and Loss Account of 2012.
2. In 2013, the production of sub-lessee was 2,000 units and royalty paid on that production was ₹ 40,000. Out of 2,000 units only 1,600 units were sold (total units sold were 1,800 but 200 from opening stock) in 2013. Therefore, royalty paid on (2,000 – 1,600) = 400 units @ ₹ 20 = ₹ 8,000 is to be carried forward to 2014. Profits on sub-lease is ₹ 5 x 1,800 = ₹ 9,000.
3. In 2014, the production sub-lessee was 3,000 units and royalty paid on that production was ₹ 60,000. Out of 3,000 units only 2,100 units were sold (total units sold were 2,500 but 400 units from opening stock) in 2014. Therefore, royalty paid on (3,000 – 2,100) = 900 units @ ₹ 20 = ₹ 1,800 to be carried forward to 2015. Profit on sub-lease is ₹ 5 x 2,500 = ₹ 12,500.

Key Points

- the landlord and the lessee agree upon a minimum periodical amount that the landlord will receive from the lessee, even if the actual royalty as calculated on the basis of actual production or sale is less than such minimum amount. This assured and mutually agreed periodical minimum amount is known as "***Minimum Rent***".
- Shortworkings is the amount by which the minimum rent exceeds the actual royalty.
- Generally the royalty agreement contains a provision for carrying forward of shortworkings with a view to adjust it in the future. In the subsequent years, such shortworking is adjusted against the surplus royalty. This process of adjustment is called ***recoupment of shortworkings***.
- In the event of a strike or lockout, the minimum rent can be reduced if there is an agreement between the parties.

THEORETICAL QUESTIONS

1. What do you mean by (i) Minimum Rent; and (ii) Surface Rents ?
2. State the importance of minimum rent in lease agreeement.
3. Write short notes on: (a) Dead Rent; (b) Royalty Suspense; and (c) Shortworkings.
4. What do you mean by Royalty? Why the Minimum Rent Account is opened in the books of the lessee?

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below :

1. Recoupable shortworkings are shown in the Balance Sheet as a
   A current asset
   B fixed asset
   C none of these.
2. Income tax to be deposited to the credit of the Central Government within a specified time for royalty by the
   A payee
   B payer
   C none of these.
3. The landlord receives a minimum rent as royalty
   A periodically
   B at a time
   C none of these.
4. The dead rent or the actual royalty shall have to be paid by the lessee, whichever is
   A lower
   B higher
   C none of these.
5. The owner of an asset may allow another party the right to use that asset against some consideration to be
   A paid
   B received
   C none of these.

PRACTICAL QUESTIONS

1. On 1.1.2011, X acquired on lease from Mr Landlord, certain mica fields at a minimum rent of ₹ 48,000 p.a., merging into a royalty of Re 1 per ton of mica ore raised. The shortworkings were recovered in next two years of such shortworkings only, but on condition that if full shortworkings could not be recovered in the next year, X would lose his right to recover 50% of the unrecovered balance of shortworkings.
   The output of the first four years were (figures in tons): 2011 — 12,000; 2012 — 30,000; 2013 — 60,000; 2014 — 56,000. Prepare necessary ledger accounts in the books of X.
2. A Ltd. obtained from B. S. Ltd. a lease of some coal bearing land, the terms being a royalty of ₹ 15 per ton of coal raised subject to minimum rent of ₹ 75,000 per annum with a right of recoupment of shortworkings over the first four years of the lease. From the following details show (i) Royalties Account; (ii) Shortworkings Account; and (iii) B.S. Ltd. Account in the books of A Ltd.

Year	2010	2011	2012	2013	2014
Sales (Tonnes) Closing Stock (Tonnes)	2,000 300	3,500 400	4,800 600	5,600 500	8,000 800

3. Prof. P. Sen wrote a book of Accountancy. He gave Standard Publishers the right to publish the book. The stipulated terms with effect from 1.1.2010 were as follows:
   (a) Royalties @ 10% on published price of the copies sold.
   (b) Minimum payment ₹ 6,000 in the first year and ₹ 10,000 p.a. thereafter.
   (c) The right to deduct in following two years any excess of minimum payment over the calculated royalties in any year.
   (d) Revision of books by the author on request and to pay ₹ 600 per month to Standard Publishers for every month of delay after six months of request made by Standard Publishers.
   (e) In the event of delay, the condition of minimum amount payable to Prof. Sen was not to apply. At the end of third year Prof. Sen was requested to revise the book. The revised manuscripts reached Standard Publishers on 1st November of fourth year. Show the Journal Entries in the books of Standard Publishers and draw up the record of following particulars:

Years	1	2	3	4	5
Copies sold (Nos.) Published price (₹)	1,500 20	4,900 20	5,000 25	4,000 25	5,000 25

4. Mr Raman, a scientist owned a patent for the manufacture of electric blanket. In 2011, he allowed Hindusthan Manufacturers Ltd., the use of the patent on the terms that he would receive a royalty of ₹ 10 per blanket manufactured subject to a minimum of ₹ 12,000 in 2011, ₹ 16,000 in 2012 and thereafter ₹ 30,000 every year. Any shortworkings is recoverable out of the royalties of the two years subsequent to the year in which shortworkings may arise.
   The actual output is as follows: 2011 — 1,000; 2012 — 1,200; 2013 — 3,200; and 2014 — 3,200.
   Income tax was deducted at source @ 20% every year before actual payment of royalty. You are required to show (i) Royalties Account; (ii) Shortworkings Account; and (iii) Mr. Raman Account from 2011 to 2014.
5. East India Machine Distributors Ltd., leased out three machines for manufacturing burners to Calcutta Stove Manufacturers in three successive years. The terms of lease for the machines were as follows:
   (i) The lessee would pay a royalty of 50 paise for every 10 burners produced subject to a minimum payment of ₹ 500 per annum for every machine.
   (ii) The lessee could recoup any shortworkings arising in the first year of the leased machine in the second year only, but not afterwards.
   Details of three machines on lease are given below:

	Machine No. 1	Machine No. 2	Machine No. 3
Date of Commencement of lease	1.1.2011	1.1.2012	1.1.2013
Production of burners for the year ended 31st December	Nos.	Nos.	Nos.
2011	8,000	—	—
2012	15,000	10,000	—
2013	17,400	9,600	8,000
2014	18,000	12,400	7,400

   You are required to show the Ledger Accounts giving effect to the above transactions in the books of Calcutta Stove Manufacturers. (Details of calculations to be separately shown).
6. On 1st January 2010, Bright Limited, patentees of a new type of gas-burner, issued a licence to Popular Limited for the manufacture and sale of burners for 5 years on the following terms and conditions.
   (a) Popular Limited to pay a royalty of ₹ 100 for every burner manufactured subject to a minimum rent of ₹ 50,000 p.a.
   (b) If, for any year, the royalties calculated on burners manufactured amount to less than minimum rent, Popular Limited may recoup the shortworkings against royalties payable in excess of the minimum rent in the next year only, but not afterwards.
   (c) Payment should be made on 31st December.
   Sales and closing stock of burners for five years wer

Years	2010	2011	2012	2013	2014
Sales (Units)	200	400	600	550	230
Closing Stock (Units)	50	100	70	150	20

   You are required to show the (i) Royalties Account; (ii) Shortworkings Account; and (iii) Bright Limited Account in the books of Popular Limited who close their accounts on 31st December in each year.

7. Mining Corporation Ltd. obtained a lease of field for 99 years from Mr Landlord on the following terms from 01.01. 2011.
   (a) Mining Corporation Ltd. will develop the land and will bear the cost of development.
   (b) Royalties will be ₹ 2 per tonne of coal raised during the period.
   (c) Minimum rent will be ₹ 10,000 for the first year with an annual increase of ₹ 1,000 till it reaches ₹ 15,000.
   (d) Shortworkings, if any, are recoverable within 3 years only.

   Mining Corporation Ltd. developed the land at the cost of ₹ 2 crores and estimated coal deposit of 20 lacs tonnes. It was decided to depreciate this expenditure on depletion method of depreciation. The coal raised in tonnes by Mining Corporation Ltd. is as: 2011 — 1,000; 2012 — 2,000; 2013 — 10,000; and 2014 — 15,000.

   You are required to show: (i) Royalties Account; (ii) Mr Landlord Account; (iii) Shortworkings Account; and (iv) Land Development Account in the books of Mining Corporation Ltd.

8. M owned certain patent rights. He granted a licence to N to use such rights on royalty basis. The following are the relevant particulars:

Years	1st	2nd	3rd	4th (strike)	5th
Actual Royalties (₹)	5,000	10,000	8,000	8,000	14,000
Minimum Rent (₹)	8,000	9,000	10,000	12,000	13,000

   The deficiency of any year is to be set off against royalties payable in excess of the minimum rent in two following years. In the event of a strike and the minimum rent not being realised, it was provided that the actual royalties earned for the year would be the full royalty obligation for the year.

   You are required to show the Royalties Account, M Account and Shortworkings Account in the books of N.

9. Landlord Ltd gave the lease of a mine to the Mining Co Ltd for a period of 20 years from 1.4.2011 on the following terms and conditions :
   (a) A royalty of Re 0.50 per metric tonne of production to be paid, subject to a minimum rent of ₹ 12,000 p.a.
   (b) Each year's excess of minimum rent over the actual royalty (shortworking) can be recovered during the subsequent two years.
   (c) In the event of a strike and the minimum rent not being reached, the minimum rent is to be reduced by 1/3rd of minimum rent given in (a) above.
   (d) The following details are available from accounting records —

Year ended	Opening Stock (in M.T.)	Sales (in M.T.)	Closing Stock (in M.T.)
31.3.2012	Nil	12,000	2,000
31.3.2013	2,000	16,000	4,000
31.3.2014	4,000	32,000	2,000
31.3.2015	2,000	20,000	4,000

   (Strike for 3 months in 2014-15)

   Write up the Royalties, Shortworkings and Landlord Accounts for 4 years in the books of Mining Co. Ltd.

10. ABC Limited has been given sole manufacturing and selling rights for a patented product by XYZ Limited. The agreement is that 50 paise will be paid to XYZ Limited for each unit sold during the year (1 October to 30 September) subject to a minimum payment of ₹ 5,000 each year. These royalty payments are to be made at the end of each quarter and any shortfall below ₹ 5,000 for the year made up to ₹ 5,000 and included with the September payment. Such shortfall payments cannot be recovered later.

    The number of units sold were :

    October to December, 2013 — 1,000; January to March, 2014 — 1,200; April to June, 2015 — 1,800.

    A market for the product is gradually being established and it is expected that about 2,400 units will be sold in the next quarter.

    You are required to prepare necessary ledger accounts for the year ended 30.6.2014 in the books of ABC Limited.

11. Mahesh wrote a boook on Accountancy and got it published from Singh on the terms that royalty will be 15% on the published price of the copies sold with a minimum payment of ₹ 20,000 every year. Mahesh agreed to revise the book at the end of 3 years, within 6 months of request made by Singh. In the event of delay, the condition of minimum payment was not to apply.

Year	Copies sold	Published price (₹)
1	4,000	20
2	10,000	22
3	11,000	25
4	4,000	25

The revision of the book took 9 months. Pass Journal Entries in the books of both the parties, assuming that Mahesh has the right to recoup shortworkings in first 3 years.

12. Jaya Ltd., owned the patent of safety locks. It granted, to X and Company, a licence for seven years to manufacture locks on the following terms :
    (1) X and Company to pay Jaya Ltd., a royalty of ₹ 5 for each lock sold with a minimum annual payment of ₹ 50,000. Accounts to be settled annually on 31st December.
    (2) If in any year royalty calculation locks sold amounted to less than ₹ 50,000 X and Company to have the right to deduct the deficiency from the royalty payable in excess of that sum in the two following years.
    The number of locks sold was as follows :
    Year ended 31.12.2011 — 8,000;
    Year ended 31.12.2013 — 11,000;
    Year ended 31.12.2012 — 9,000;
    Year ended 31.12.2014 — 18,000

    You are required to show the Ledger Accounts necessary to record the above royalty transactions in the books of X and Company which are closed annually on 31st December.
13. Show your understanding of each of the following Journal Entries in the books of the Bharat Coking Coal Ltd. (royalties payable at 50 paise per ton as per lease agreement).

Journal **Dr.** **Cr.**

Date	Particulars		₹	₹
2013	Royalties A/c	Dr.	17,000	
Dec 31	Shortworkings A/c	Dr.	8,000	
	To Eastern Colliery Co Ltd. A/c			25,000
2014	Royalties A/c	Dr.	30,000	
Dec 31	To Eastern Colliery Co Ltd. A/c			30,000
"	Eastern Colliery Co Ltd. A/c	Dr.	30,000	
	To Shortworkings A/c			5,000
	To Bank A/c			25,000
"	Profit and Loss A/c	Dr.	33,000	
	To Shortworkings A/c			3,000
	To Royalties A/c			30,000

14. Sri K. Roy, leased out the mining rights over property to Bose Co. Ltd. for a period of 20 years from 1st January 2010. The minimum rent was agreed at ₹ 30,000 a year merging in a royalty of ₹ 2 per ton payable in each year. It was agreed that each year's shortworkings, if any, was to be recouped only out of excess royalties in the next year but not later.
    The following was the result of working in the property (in tonnes):
    2010 — 15,000; 2011 — 37,500; 2012 — 20,000; 2013 — 35,000; and 2014 — 32,500.
    Prepare necessary Ledger Accounts in the books of Bose Co. Ltd.
15. P. Co. Ltd. took a mine on lease from A at an agreed rate of royalty with a minimum rent of ₹ 20,000 a year. Each year's excess of minimum rent over royalties is recoverable out of the royalties of the next year only. In the event of a strike and the minimum rent not being realised, it was provided that the actual royalties earned for that year would be the full royalty obligation for the year.
    The actual royalties were calculated as follows:
    2011 — Nil; 2012 — ₹ 24,000; 2013 — ₹ 16,000; 2014 — ₹ 18,000.
    The reason for the fall in the amount of royalties for 2012 was a strike lasting over a period of three months.
    Prepare necessary Ledger Accounts in the books of P. Co. Ltd. recording the above transactions for all the years.
16. Minerals Ltd. leased a property from Shri B. Sarkar at a royalty of ₹ 1.50 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 next five years. In the event of a strike and the minimum rent not being reached, the lease provided that the actual royalties earned for the year discharged all rental obligations for the year.
    The results of working of the property are given below: (actual royalty)
    2007— Nil; 2008 — ₹ 3,300; 2009 — ₹ 9,000; 2010 — ₹ 11,100; 2011 — ₹ 14,000; 2012 — ₹ 15,000; 2013 (strike year) — ₹ 8,000; 2014 — ₹ 15,200.
    Write up the Minimum Rent Account and Royalties Account showing the amount charged to Profit and Loss Account each year.

17. Coal Ltd. leased land from Sunil Kumar at a royalty of Re 0.25 per tonne of coal raised. The minimum rent was ₹ 24,000. Shortworkings were to be recouped during the first 4 years. The coal raised in the first 4 years was as follows (in tonnes): 2011 — 80,000; 2012 — 90,000; 2013 — 60,000 (strike for three months); 2014 — 1,20,000. There was a provision for proportionate reduction in the minimum rent in case of stoppage of work by strike, lock-out, accident, etc. Show the relevant Ledger Accounts in the books of Coal Ltd.
18. P owned the patent of a new type of electrical fan. He granted Q a licence for five years as on 1.1.2010. The licence provided for the payment of royalty of ₹ 2 for each fan manufactured subject to a minimum annual payment of ₹ 6,000 for 2010 increasing by ₹ 400 a year. If in any year the royalties, calculated on the fans manufactured, be less than the minimum payment, the deficiency could be set off against royalties in excess of the minimum during the following two years, but not afterwards. The accounts were to be settled annually on December 31.
    The number of fans manufactured for the five years was as follows:
    2010 — 800; 2011 — 600; 2012 — 5,400; 2013 — 3,600; 2014 — 3,200.
    You are required to show the (a) Royalties; (b) Shortworkings; and (c) P's Accounts in the books of Q which are closed annually on December 31.
19. Magickey Limited took certain lands on lease from Manganese Estates Limited for a period of 15 years for mining of manganese ore with a stipulated royalty of ₹ 1.50 per ton and a minimum rent of ₹ 21,000 with a clause to recoup shortworkings over three subsequent years.
    The actual working results were:

Year	2010	2011	2012	2013	2014
Output (in tonnes)	8,000	16,000	13,000	17,000	43,800

    You are required to show the necessary Ledger Accounts in the books of Magickey Limited.
20. G, a scientist holds a patent for the manufacture of a certain electrical appliance. He allows the Electricals Limited to use the patent on the terms that he will receive a royalty of ₹ 10 per electrical appliance manufactured subject to the minimum of ₹ 6,000 in the first year and thereafter ₹ 10,000 per year. Any shortworkings is recoverable within 3 years of the contract date. The number of appliances manufactured are: 1st year — 200; 2nd year — 500; 3rd year — 1,300; and 4th year — 2,000. The payments are duly made to the patentee every year. Show the necessary Ledger Accounts in the books of both the parties.
21. X has taken on lease coal fields from Y on the following terms:
    (i) Lease is for 99 years;
    (ii) Lease rent is to be 50 paise p.a. for every ton of coal raised;
    (iii) Minimum royalty per annum to be ₹ 30,000, the lease has a right to recoup any shortworkings within a period of three years for which the excess payment was made;
    (iv) In case the working of the mines was affected by any strike or riot and there is no raisings, then the minimum rent payable would abate proportionately;
    (v) The raisings of the different years were (in tonnes): 2009 — 20,000; 2010 — 35,000; 2011 — 30,000 (there was a strike for 3 months during which no coal was mined); 2012 — 70,000; 2013 — 80,000; and 2014 — 1,00,000.

    You are required to show the Royalties Account; Shortworkings Account and Y Account in the books of X.
22. Agro (India) Ltd. Madras, entered into a collaboration agreement with Agro (U.K.) Ltd., Birmingham, under which the former was to pay the latter, commencing with the date on which they started production, a royalty @ 5% of sales during each quarter of the calendar year, subject to deduction of tax in India (which may be assumed @ 50%) subject to the condition that the remittance in any such quarter should not be less than £ 500, the shortworkings being recoupable from out of royalty payable in subsequent quarters during the same calendar year but not beyond.
    The following are the sales figures of Agro (India) Ltd.: 30.9.2013 — ₹ 1,00,000; 31.12.2013 — ₹ 2,00,000; 31.3.2014 — ₹ 5,00,000; 30.6.2014 — ₹ 3,36,000; 30.9.2014 — ₹ 6,00,000; 31.12.2014 — 12,00,000
    The production had begun on 1.7.2013. The rate of exchange may be taken at £ 1 = ₹ 13.33 for remittances up to 6.6.2014 and thereafter at £ 1 = ₹ 21. The remittance has been made in each case within one month from the end of the relevant quarters. Show Royalty Account, Agro (U.K.) Account and Shortworkings Account.
23. MMC Ltd. obtained a lease from EC Ltd., for a coal mine on 1st January 2009 on the following terms and conditions:
    (a) Royalty @ ₹ 10 per tonne raised.
    (b) Minimum rent ₹ 1,20,000 p.a.
    (c) Recoupment of shortworkings of each year during three years following, subject to a maximum of ₹ 25,000 p.a.
    (d) In the event of strike the minimum rent would be taken pro-rata on the basis of actual working days, but in the event of lockout, the lessee would enjoy a concession in respect of minimum rent for 50% of the period of lockout.
    Besides the above, MMC Ltd. have been granted a cash subsidy equal to 25% of the unrecoupable shortworkings by the Central Govt. up to the first 5 years of the lease.

(e) The actual royalties of the first 6 years are as follows: 2009 — ₹ 70,000; 2010 — ₹ 1,02,000; 2011 — ₹ 1,61,000; 2012 — ₹ 1,36,000; 2013 — ₹ 1,08,000 (strike 73 days); 2014 — ₹ 97,000 (lockout for 4 months).

You are required to show Royalties Account; Shortworkings Account; EC Ltd. Account in the books of MMC Ltd.

24. P took a lease of mines from N w.e.f. January 1, 2002 for 20 years. The terms provided for the royalty payment @ ₹ 6 per ton raised, subject to a minimum rent of ₹ 1,20,000 p.a. with a right to recoup shortworkings within next 3 years. It was also agreed that the minimum rent should be reduced proportionately in case of strikes or lock-outs in any year. The following are the details of the output in tons: 2009 — 23,000; 2010 — 18,700; 2011 — 15,400 (strike for 3 months); 2012 — 19,000; 2013 — 20,600; 2014 — 22,600. The balance in Shortworkings Account as on January 1 2009, was ₹ 49,000, of which ₹ 22,000 arose in 2006 and the balance in 2007.

Show the Royalties Account; Shortworkings Account and N Account in the books of P for all the above 6 years.

25. The following information has been obtained from the books of a lessee relating to the years 2009-10 to 2012-13 (all figures in ₹):

Year	Payments to Landlord After Deduction of Tax @ 20%	Shortworkings Recovered	Shortworkings Lapsed
2009-10	12,000	—	800
2010-11	12,000	2,500	—
2011-12	12,000	1,000	500
2012-13	19,200	—	—

Shortworkings Account balance brought forward on 1.4.2009 was ₹ 800 (which arose in 2007-08).

According to the terms of agreement, shortworkings are recoverable within the next two years following the year in which shortworking arises.

You are required to prepare Royalties Account and Shortworkings Account for the four years ended 31.3.2013.

26. The following balances appeared in the books of a Lessee as on January 1, 2009: Landlord's Account (Cr.) ₹ 28,000; Shortworkings Account (Dr.) ₹ 6,000 (out of which ₹ 3,000 arose in 2008, ₹ 2,000 in 2007 and the rest in 2006).

The agreement of royalty provided the following:

(a) Minimum rent ₹ 56,000 p.a.

(b) The power to recoup shortworkings within 3 years immediately following the year in which it arises.

(c) Payments to the landlord to be made as under:

50% of the amount is payable in the year in which it becomes due and the balance of 50% in the next year.

You are given the following particulars from 2009 to 2012:

Year	Payments to Landlord (₹)	Shortworkings (₹)	Shortworkings Recouped (₹)
2009	56,000	—	800
2010	58,000	—	5,000
2011	58,000	2,000	—
2012	60,000	—	2,000

Show the Royalty Account, Shortworkings Account and the Landlord's Account in the books of the lessee from 2009 to 2012. *[I.C.W.A. (Inter) — Adapted]*

SUB-LEASE

27. Das obtained on 1.1.2010 from Jalan a lease of some coal bearing land, the terms being a royalty of ₹ 10 per ton of coal raised subject to a minimum rent of ₹ 40,000 p.a. with a right of recoupment of shortworkings over the first four years of the lease. On the same date Das granted a sub lease of part of the land to Raghunath on a royalty of ₹ 15 per ton merging into a minimum rent of ₹ 20,000 per annum with a right of recoupment of shortworkings during the next two years following. The output for the first five years were as follows : (in tons)

Year	2010	2011	2012	2013	2014
Das	2,200	2,320	2,600	2,800	3,600
Raghunath	800	1,080	1,400	1,800	2,400
Total	3,000	3,400	4,000	4,600	6,000

Show Ledger Accounts in the books of Das.

28. M/s Coal Extractors Ltd. took lease of a coal mine from M/s Coal Mines Ltd. at an annual dead rent of ₹ 10,000 subject to a royalty payable @ ₹ 2 per ton extracted. Shortworkings are recoupable one year after they arise.

Coal Extractors Ltd. sub-leased a part of the mine to Miners' Co-operative at an annual dead rent of ₹ 5,000 subject to a royalty payable @ Re 1 per ton extracted. The right to recoup shortworkings arise one year after they take place. However, such right lapses at the end of the year in which shortworkings become recoupable.

Details of extraction (in tonnes) are as follows:

	2011	2012	2013	2014
Coal Extractors Ltd.	2,000	3,000	4,000	5,000
Miners' Co-operative	2,000	3,000	4,000	5,000

In 2014 the whole mine was closed for 6 months due to a mine collapse.

Show Royalty Payable Account, Shortworkings Repayable Account, Coal Mines Ltd. Account and Miners' Co-operative Account in the books of Coal Extractors Ltd.

29. West Bengal Coal Co. obtained the lease (with powers to sub- lease) of a coal mine from K. Roy for a period of 30 years from 1st January, 2011. The terms of the lease contained, amongst others, the following provisions:
(a) Minimum rent payable is ₹ 20,000 merging into a royalty of Re 1 per ton of coal raised in any year.
(b) Shortworking is recoverable throughout the term of the lease.
(c) West Bengal Coal Co. granted sub-lease of a portion of the colliery on 1st January, 2012 for a period 15 years to Coal Syndicate on the following terms: (i) Minimum rent payable is ₹ 12,500 merging into a royalty of ₹ 1.50 per ton of coal raised in any year; and (ii) Shortworking is recoverable during the first three years of the lease. In the first 4 years the raisings were as follows:

Year	By West Bengal Coal (Tons)	By Coal Syndicate (Tons)
2011	7,000	—
2012	8,000	5,000
2013	12,000	8,000
2014	15,000	10,000

You are required to show: (i) Royalties Payable Account; (ii) Royalties Receivable Account; (iii) Shortworkings Recoupable Account; (iv) Royalties Suspense Account; and (v) Coal Syndicate Account in the books of West Bengal Coal Co.

30. Alpha Co. Ltd. holds a lease of mines from Sri A Shah for a period of 30 years from 1st July, 2012. Under the lease, royalty of 50 paise per ton merging in a minimum rent of ₹ 20,000 a year is payable half-yearly on 30th June and on 31st December, 2012. They granted a sub-lease for 20 years from 1st December, 2012 to Neera Co. Ltd. of one half of the area for a royalty of 75 paise a ton merging in a minimum rent of ₹ 15,000 a year payable half yearly on 30th June and 31st December. Alpha Co. Ltd. is entitled under the lease from the landlord to recoup shortworkings out of subsequent excess workings without any limitation of period but Neera Co. Ltd. under the sublease is allowed to recoup shortworkings out of excess working in any of the three years immediately following that in which the shortworkings accrued.
Minerals raised were as following:

	By Alpha Co Ltd.	By Neera Co Ltd.
Half year ended 31st Dec, 2012	8,000	—
Half year ended 30th June, 2013	10,000	10,000
Half year ended 31st Dec, 2013	15,000	16,000
Half year ended 30th June, 2014	20,000	25,000
Half year ended 31st Dec, 2014	30,000	10,000

Show the necessary Ledger Accounts in the books of Alpha Co. Ltd.

31. On 1.1.2010, A obtained a mining lease and from that date he sub-leased a part of the mine to B. Show Ledger Accounts in A's books from the following data:

Year	2010	2011	2012	2013	2014	Royalty per ton	Dead rent p.a.	Shortworkings Recoverable
Lease (tons)	1,000	3,000	12,000	9,000	5,000	₹ 2	₹ 15,000	3 years
Sub-Lease (tons)	1,000	2,000	5,000	2,000	12,000	₹ 3	₹ 10,000	2 years

There was a strike in the year, 2013. In case of strike, royalty earned will discharge all liabilities for the year only.

32. Iron Ore Limited leased its mines to Digwell Limited on the following terms: (1) Royalty will be payable at ₹ 2 per tonne of raising, with a minimum of ₹ 4,000 per annum; (2) Shortworking can be recouped within the first 3 years and not thereafter.
Digwell Limited with permission from Iron Ore Limited sub-leased a part of the mine to Dowell Limited on the following terms:
(1) Royalty will be payable at ₹ 3 per tonne of raising, with a minimum of ₹ 2,400 per annum;
(2) Shortworking can be recouped within the first 3 years and not thereafter.

Raising (in tonnes) are :

Year	Digwell Limited	Dowell Limited	Total
1	1,000	500	1,500
2	1,100	600	1,700
3	1,400	400	1,800
4	1,800	700	2,500

Show how the relevant items will appear in the Manufacturing Account, Profit and Loss Account and the Balance Sheet, in the Annual Accounts, for each of the 4 years of Digwell Limited.

33. SN took on lease mining rights in an area of 100 square miles for a period of 33 years from 1st January 2012. Under the terms of the lease, a royalty of Re 1 per tonne is payable merging in a minimum rent of ₹ 40,000 per annum payable half yearly on 1st January and 1st July every year.
SN granted a sub-lease for 20 years of a portion of the above area measuring 50 square miles to KS from 1st July 2012 in terms of which a royalty of ₹ 1.50 per tonne merging in a minimum rent of ₹ 39,000 per annum was payable again in equal instalments on every 1st January or 1st July.
SN can recoup shortworkings throughout the period of lease whereas the sub-lease provides that any shortworkings could be recouped only out of excess workings in any of the three half years immediately following that in which the shortworkings accrued. Details for minerals obtained were: (figures in tons)

	30.6.2012	31.12.2012	30.6.2013	31.12.2013	30.6.2014	31.12.2014
SN	12,000	10,000	28,000	18,000	24,000	30,000
KS	—	8,000	10,000	12,000	15,000	20,000

Show the necessary accounts in the books of SN who close their books on a calendar year basis.

34. A leased a colliery on 1.1.2012 on a royalty of 50 paise per tonne with minimum rent of ₹ 15,000 p.a. He sub-leased a portion on 1.7.2012 to B at a royalty of Re 1 per tonne with a minimum rent of ₹ 10,000 per half year. Under this agreement A could recoup shortworkings throughout the lease. B could only adjust it within three half years following the year in which the shortworkings occurred. In case of strikes or other unforeseen major event the royalty earned discharged all liabilities for the period. From the following show the Royalties Payable Account and also show accounts for exhibiting the rights of B to adjust his shortworkings in A's books for all the three years. A closes his books on December 31, in each year. Production in tons is as follows:

Period ending	30.6.2012	31.12.2012	30.6.2013	31.12.2013	30.6.2014	31.12.2014
A	10,000	15,000	18,000	9,000	*15,000	20,000
B	Nil	5,000	9,000	10,000	*3,000	30,000

*Strike

35. Miners Ltd. holds a lease of a mine from Mr Landlord from January 1, 2012. The royalty, payable under this lease is Re 1 a tonne, the minimum rent being ₹ 40,000 a year. The royalty was payable half-yearly on June 30 and December 31. With effect from July 1, 2012 they granted a sub-lease to Mr Industrious of one-half of the area for a royalty of ₹ 1.50 a tonne, the minimum rent being ₹ 30,000 a year, payable half-yearly on June 30 and December 31. Miners Ltd. is entitled under the lease from Mr Landlord to recoup shortworkings out of subsequent excess workings throughout the term of the lease. Mr Industrious, however, is entitled to recoup shortcomings out of excess workings in any of the three half-years immediately following that in which the shortworkings accrued.
The minerals raised in tonnes are as follows:

Half-yearly ending	30.6.2012	31.12.2012	30.6.2013	31.12.2013	30.6.2014
Computed Total	5,000	5,000	20,000	30,000	25,000
By Mr Industrious	—	5,000	6,000	6,000	12,000

Show the Royalties Accounts and the Shortworkings Accounts in the books of Miners Ltd. both under the lease from Mr Landlord and the sub-lease to Mr Industrious. The books of Miners Ltd. are balanced yearly on June 30.

36. Dobsons Ltd. took a licence for production of a foreign medicine from Johnson Ltd. at royalty of Re 1 per bottle produced.
Dobsons Ltd. issued a sub-licence to Medico Ltd. on the basis of a royalty payment of ₹ 1.25 per bottle sold. Minimum royalty payable to Medico Ltd. was fixed at ₹ 15,000 per annum with a right to recoup shortworkings in the following year.

From the following details show Royalty Receivable Account, Royalty Payable Account and Shortworkings Account, in the books of Dobsons Ltd.

	Dobsons Ltd.		Medico Ltd.	
	Sales	Closing Stock	Production	Closing Stock
1st Year	50,000	5,000	10,000	2,000
2nd Year	70,000	8,000	18,000	4,000
3rd Year	1,00,000	10,000	25,000	5,000

37. P Co Ltd took lease of a colliery from a landlord of Jharia for a period of 30 years from 1.1.2013 with a power to sub-lease the property.
Under the terms of this lease, a royalty of Re 1 per tonne is payable, minimum rent being ₹ 14,000 a year, payable half yearly on 30th of June and 31st December.
P Co Ltd are entitled under the lease to recoup shortworkings from the landlord out of excess working throughout the term of the lease. P Co Ltd granted a sub-lease of a part of the property to Q Co Ltd from 1.7.2013 for a royalty of ₹ 1.50 per tonne merging into a minimum rent of ₹ 21,000 per year payable half yearly on 30th June and 31st December.
The sub-lessee, Q Co Ltd, are entitled to recoup shortworkings only out of the excess workings in any of the three half years immediately following that in which the shortworkings occurs. The output was as follows :

Half Year ended	30.6.2013	31.12.2013	30.6.2014	31.12.2014	30.6.2015
P Co Ltd (Tonnes)	7,000	7,000	28,000	42,000	35,000
Q Co Ltd (Tonnes)	—	7,000	8,400	8,400	16,800

Show necessary accounts in the books of P Co Ltd, whose books are closed on 30th June each year.

38. Homeo Research Laboratories (P) Ltd developed Soft Skinobit, a new cosmetic and got it patented.
On 1.3.2011 it issued a licence to M/s M Bhattacharya & Sons for commercial production and sale of the product. Later in the day, M Bhattacharya & Sons granted a sub-licence to Chowdhury Bros for the same purpose.
The terms are stated below :
Licence : Royalty ₹ 5 per unit produced ; Minimum Rent ₹ 36,000 p.a
.Sub-licence: Royalty ₹ 7.50 per unit sold ; Minimum Rent ₹ 14,000 p.a.
Recoupment of shortworkings : If the royalty for any year falls short of the minimum rent, the shortworkings can be recouped out of royalties in excess of the minimum rent for either of the two immediately following years (applicable to both parties).
From the following particulars prepare Royalty Accounts and Shortworkings Accounts in the books of M/s M Bhattacharya & Sons for the entire period :

	M/s M Bhattacharya & Sons		Chowdhury Bros	
	Sales (Units)	Closing Stock (Units)	Production (Units)	Closing Stock (Units)
Year I	2,500	500	2,100	200
Year II	5,800	600	1,800	400
Year III	4,800	1,000	2,000	700

39. On 1.1.2011, Hari obtained a mining lease on a term that for every ton of output a royalty of 50 paise is payable subject to a minimum rent of ₹ 12,000 p.a. On 1.7.2012, Hari granted a sub- lease of part of this mine to Ram on the basis that a royalty of 75 paise per ton of output merging into a minimum of ₹ 5,000 p.a.
The recoupment of shortworkings was limited under the principal lease to a period of first three years of lease and under the sub-lease to a period up to 31.12.2013.
From the following information, you are required to show ledger accounts in the books of Hari: (output in tons)

	2011	2012	2013	2014
Own	18,000	16,000	18,000	15,000
Sub-lease	—	3,000	9,000	10,000

40. On 1.1.2010, Sudarshan Sinha obtained a mining lease and from that date he sub-leased a part of the mine to Sujit Saha. Show ledger accounts in the books of Sudarshan Sinha from the following data :

Year	Lease (tons)	Sub-lease (tons)
2010	1,500	1,000
2011	4,000	4,500
2012	18,000	10,000

2013	15,000	(strike) 3,000
2014	8,000	15,000
Royalty per ton	₹ 3.00	₹ 4.00
Minimum rent p.a.	₹ 35.000	₹ 25,000
Shortworkings recoverable in following	3 years	2 years

In the event of a strike and the minimum rental not being reached, the lease provided that the actual royalties earned for the year discharged all rental obligations for the year.

Guide to Answers

Multiple Choice

1. A; 2. B; 3. A; 4. B; 5. B.

Practical Questions

1. **2011 : Shortworkings ₹ 36,000; 2012 : Shortworings written-off ₹ 18,000; 2013 : Shortworkings recouped ₹ 12,000 and written-off ₹ 15,000; 2014 : Shortworkings recouped ₹ 8,000 and written-off ₹ 1,000.**
2. **Production (tonnes) — 2010 : 2,300; 2011 : 3,600; 2012 : 5,000; 2013 : 5,500; 2014 : 8,300.**
   2010 : Shortworkings ₹ 40,500; 2011 : Shortworings : ₹ 21,000; 2013 : Shortworkings recouped ₹ 7,500 and written-off ₹ 5,400.
3. **Year 1 — Shortworkings : ₹ 3,000; Year 2 — Shortworkings : ₹ 200; Year 3 — Shortworkings recouped : ₹ 2,500 and written-off ₹ 500; Year 4 — Shortworkings written-off ₹ 200; Year 5 — Excess workings : ₹ 2,500.**
4. **2011 : Shortworkings ₹ 2,000; 2012 : Shortworings ₹ 4,000; 2013 : Shortworkings recouped ₹ 2,000; 2014 : Shortworkings recouped ₹ 2,000 and written-off ₹ 2,000.**
5. **2011 : Shortworkings ₹ 200; 2012 : Shortworings recouped ₹ 100; 2013 : Shortworkings ₹ 20 (Machine 2) and ₹ 100 (Machine 3) , Shortworkings written-off ₹ 20 (Machine 2); 2014 : Shortworkings ₹ 300 (Machine 3) and Shortworkings written-off ₹ 230 (Machine 3).**
6. **Production (unit) — 2010 : 250; 2011 : 450; 2012 : 570; 2013 : 630; 2014 : 100.**
   2010 : Shortworkings ₹ 25,000; 2011 : Shortworings : ₹ 5,000 and written-off ₹ 25,000; 2012 : Shortworkings recouped ₹ 5,000; 2014 : Shortworkings written-off ₹ 40,000 (of 2014).
7. **2011 : Shortworkings ₹ 8,000; 2012 : Shortworings ₹ 7,000; 2013 : Shortworkings recouped ₹ 8,000 and written-off ₹ 7,000; 2014 : Amount paid ₹ 30,000.**
8. **1st year — Shortworkings : ₹ 3,000; 2nd year — Shortworkings recouped : ₹ 1 ,000; 3rd year — Shortworkings lapsed : ₹ 2,000; 5th year — Shortworkings recouped : ₹ 1,000; and Shortworkings lapsed : ₹ 1,000.**
   Amount paid : 1st year } ₹ 8,000; 2nd year } ₹ 9,000; 3rd year } ₹ 10,000; 4th year } ₹ 8,000; 5th year — ₹ 13,000.
9. **31.3.2012 — Shortworkings : ₹ 5,000; 31.3.2013 — Shortworkings : ₹ 3,000; 31.3.2014 — Shortworkings recouped : ₹ 3,000; Shortworkings lapsed — ₹ 2,000; 31.3.2015 — Shortworkings recouped : ₹ 3,000.**
   Amount paid : 31.3.2012 — ₹ 12,000; 31.3.2013 — ₹ 12,000; 31.3.2014 — ₹ 12,000; 31.3.2015 — ₹ 8,000.
10. **Amount paid : October to December, 2013 — ₹ 500; January to March, 2014 — ₹ 600; April to June, 2014 — ₹ 900 and July to September, 2014 — ₹ 3,000.**
11. **1st year — Shortworkings : ₹ 8,000; 2nd year — Shortworkings recouped : ₹ 8,000. Amount paid : 1st year : ₹ 20,000; 2nd year : ₹ 25,000; 3rd year : ₹ 41,250; 4th year : ₹ 15,000.**
12. **2011 — Shortworkings : ₹ 10,000; 2012 — Shortworkings : ₹ 5,000; 2013 — Shortworkings recouped : ₹ 5,000 and Shortworkings lapsed : ₹ 5,000; 2014 — Shortworkings recouped : ₹ 5,000.**
13. **2013 — Actual royalties : ₹ 17,000; Minimum rent : ₹ 25,000; and Shortworkings : ₹ 8,000.**
    2014 — Actual royalties : ₹ 30,000; Shortworkings recouped : ₹ 5,000; and Shortworkings lapsed : ₹ 3,000.
    Shortworkings can be recouped within next year.
14. **Actual royalty — 2010 : ₹ 30,000; 2011 : ₹ 75,000; 2012 : ₹ 40,000; 2013 : ₹ 70,000; 2014 : ₹ 65,000. As the minimum rent is equal to or lower than the actual royalties, the question of shortworking does not arise. Hence, there is no question of shortworking recovery or shortworking lapse.**
15. **2011 — Shortworkings : ₹ 20,000; 2012 : Shortworkings recouped : ₹ 4,000; Shortworkings lapsed : ₹ 16,000; 2014 — Shortworkings : ₹ 2,000.**
16. **Amount charged to each year's Profit and Loss Account — 2007 : Nil; 2008 : ₹ 3,300; 2009 : ₹ 9,000; 2010 : ₹ 11,100; 2011: ₹ 14,000; 2012 : ₹ 15,000; 2013 : ₹ 14,600; 2014 : ₹ 15,200, Shortworkings lapsed in 2013 : ₹ 6,600.**
17. **2011 : Shortworkings — ₹ 4,000; 2012 : Shortworkings — ₹ 1,500; 2013 : Shortworkings : ₹ 3,000; 2014 : Shortworkings recouped : ₹ 6,000 and Shortworkings lapsed : ₹ 2,500.**
18. **2010 : Shortworkings — ₹ 4,400; 2011 : Shortworkings — ₹ 5,200; 2012 : Shortworkings recouped — ₹ 4,800; 2013 : Shortworkings lapsed — ₹ 4,800; 2014 — Shortworkings : ₹ 1,200.**
19. **2010 : Shortworkings — ₹ 9,000; 2011 : Shortworkings recouped : ₹ 3,000; 2012 : Shortworkings — ₹ 1,500; 2013 : Shortworkings recouped : ₹ 4,500 and Shortworkings lapsed : ₹ 1,500; 2014 : Shortworkings recouped — ₹ 1,500.**
20. **1st year's Shortworkings : ₹ 4,000; 2nd year's Shortworkings : ₹ 5,000; 3rd year's Shortworkings recouped : ₹ 3,000 and Shortworkings lapsed : ₹ 3,000.**

21. **2009 : Shortworkings : ₹ 20,000; 2010 : Shortworkings : ₹ 12,500; 2011 : Shortworkings : ₹ 7,500; 2012 : Shortworkings recouped : ₹ 5,000 and amount written-off : ₹ 15,000; 2013 : Shortworkings recouped : ₹ 10,000 and Shortworkings written-off: ₹ 2,500; 2014 : Shortworkings recouped — ₹ 7,500.**

22. **2014 — Shortworkings : ₹ 11,666.**

23. **2009 : Shortworkings : ₹ 50,000; 2010 : Shortworkings : ₹ 18,000; 2011 : Shortworkings recouped — ₹ 25,000; 2012 : Shortworkings recouped — ₹ 16,000 and written-off ₹ 6,750; Subsidy — ₹ 2,250; 2013 : Shortworkings recouped — ₹ 12,000; written-off — ₹ 4,500; Subsidy — ₹ 1,500.**

24. **2009 : Shortworkings recouped — ₹ 18,000 and written-off ₹ 4,000. 2010 : Shortworking written-off — ₹ 27,000.**
2011 : Shortworking recouped ₹ 2,400. 2013 : Shortworkings recouped ₹ 3,600 and written-off ₹ 1,800.
2014 : Shortworkings recouped ₹ 6,000.

25. **2009-10 : Shortworkings suffered ₹ 4,000 and written-off ₹ 800. 2010-11 Shortworkings recouped ₹ 2,500. 2011-12 : Shortworkings recouped ₹ 1,000 and written-off ₹ 500.**

26. **Actual royalty payable in 2009 — ₹ 56,800 (₹ 56,000 + ₹ 800)**
Actual royalty payable in 2010 — ₹ 65,000 (₹ 60,000 + ₹ 5,000)
Actual royalty payable in 2011 — ₹ 54,000 (₹ 56,000 – ₹ 2,000)
Actual royalty payable in 2012 — ₹ 66,000 (₹ 64,000 + ₹ 2,000)

27. **Royalty payable — 2010 : Shortworkings : ₹ 10,000; 2011 : ₹ 6,000; 2013 : Shortworkings recouped — ₹ 6,000; written-off ₹ 10,000.**
Royalty receivable — 2010 : Shortworkings suspense : ₹ 8,000; 2011 : ₹ 3,800; 2012 : ₹ 1,000 (adjusted) and ₹ 7,000 credited to Profit and Loss Account; 2013 : ₹ 3,800 (adjusted).

28. **Royalty payable — 2011 : Shortworkings : ₹ 2,000; 2012 : Shortworkings recouped — ₹ 2,000;**
Excess working — 2013 : ₹ 6,000; 2014 : ₹ 15,000.
Royalty receivable — 2011 : Shortworkings suspense : ₹ 3,000; 2012 : Shortworkings suspense ₹ 2,000 and credited to Profit and Loss Account; 2013 : Shortworkings suspense ₹ 1,000 and credited to Profit and Loss Account ₹ 2,000; 2014 : ₹ 1,000 (adjusted).

29. **Royalty payable — 2011 : Shortworkings : ₹ 13,000; 2012 : ₹ 7,000; 2014 : Shortworkings recouped — ₹ 5,000.**
Royalty receivable — 2012 : Shortworkings suspense : ₹ 5,000; 2013 : ₹ 5,000; 2014 : ₹ 2,500 (adjusted).

30. **Royalty payable — 31.12.2012 : Shortworkings : ₹ 16,000; 30.06.2013 : ₹ 10,000; 31.12.2013 : ₹ 4,500;**
30.06.2014 Shortworkings recouped : ₹ 2,500.
Royalty receivable : 30.06.2013 : Shortworkings suspense : ₹ 7,500; 31.12.2013 : ₹ 3,000;
30.06.2014 : ₹ 3,750 (adjusted); 31.12.2014 : ₹ 7,500 (surplus).

31. **Royalty payable — 2010 : Shortworkings : ₹ 11,000; 2011 : ₹ 5,000; 2012 : ₹ 16,000 (recouped).**
Royalty receivable — 2010 : Shortworkings suspense : ₹ 7,000; 2011 : ₹ 4,000;
Shortworking suspense lapsed : ₹ 7,000; 2012 : ₹ 4,000 (surplus adjusted).

32. **Royalty payable : First year : Shortworkings : ₹ 1,000; Second year : Shortworkings : ₹ 600; Third year : Shortworkings: ₹ 400 and Shortworkings written-off : ₹ 1,600.**
Royalty receivable : First year : Shortworkings suspense : ₹ 900; Second year : Shortworkings suspense : ₹ 600; Third year: Shortworkings suspense : ₹ 1,200; and shortworkings suspense lapsed (credited to Profit and Loss Account) : ₹ 2,400; Fourth year : Shortworkings suspense : ₹ 300 and shortworkings suspense lapsed (credited to Profit and Loss Account) : ₹ 300.

33. **Royalty payable : 30.06.2012 : Shortworkings : ₹ 8,000; 31.12.2012 : Shortworkings : ₹ 2,000;**
30.06.2013 : Shortworkings recouped : ₹ 10,000.
Royalty receivable : 31.12.2012 : Shortworkings suspense : ₹ 7,500; 30.06.2013 : Shortworkings suspense : ₹ 4,500;
31.12.2013: Shortworkings suspense : ₹ 1,500; 30.06.2014 : Shortworkings suspense adjusted : ₹ 3,000;
and Shortworkings suspense lapsed — ₹ 4,500 (credited to Profit and Loss Account);
31.12.2014 : Shortworkings suspense adjusted : ₹ 6,000.

34. **Royalty payable : 30.06.2012 : Shortworkings : ₹ 10,000; 31.12.2012 : Shortworkings : ₹ 5,000;**
30.06.2013 : Shortworkings: ₹ 15,000; 31.12.2013 : Shortworkings : ₹ 5,500;
31.12.2014 : Shortworkings recouped : ₹ 10,000 and carried forward : ₹ 12,000
(assuming lapse period will expire in future).
Royalty receivable : 31.12.2012 : Shortworking surplus : ₹ 5,000; 30.06.2013 : Shortworkings suspense : ₹ 1,000;
30.06.2014: Shortworkings surplus lapsed : ₹ 5,000 and credited to Profit and Loss Account;
30.06.2014 : Shortworkings surplus adjusted: ₹ 1,000.

35. **Royalty payable : 30.06.2013 : Shortworkings : ₹ 7,500; 31.12.2013 : ₹ 7,500;**
30.12.2014 : Shortworkings recouped : ₹ 5,000; 30.06.2015 : ₹ 2,000.
Royalty receivable : 30.12.2013 : Shortworkings suspense : ₹ 3,750; 30.06.2014 : ₹ 3,000; 30.12.2014 : ₹ 3,000;
30.06.2015: ₹ 1,500 (adjusted).

36. **Total production (including sub-lease) : 1st year : ₹ 65,000 bottles; 2nd year : 91,000 bottles; 3rd year : 1,27,000 bottles.**
Royalty payable by Micado Ltd. : 1st year : ₹ 10,000 2nd year : ₹ 20,000; 3rd year : ₹ 30,000.

37. Royalty payable : 30.6.2013 — ₹ 7,000; 31.12.2013 — ₹ 14,000; 30.6.2014 — ₹ 36,400; 31.12.2014 — ₹ 50,400; 30.6.2015 — ₹ 51,800. (There is no shortcomings in any year.)
Royalty receivable : 31.12.2013 — ₹ 10,500; 30.6.2014 — ₹ 12,600; 31.12.2014 — ₹ 12,600; 30.6.2015 — ₹ 25,200.
Profit on sub-lease : 2013-2014 — ₹ 7,700; 2014-15 — ₹ 12,600.

38. Royalty payable: 1st year — Shortworkings ₹ 10,500; 2nd year — Shortworkings recouped ₹ 2,500; 3rd year — Shortworkings lapsed ₹ 8,000.
Royalty receivable : 2nd year — Shortworkings Suspense ₹ 2,000; 3rd year – Shortworkings Suspense ₹ 1,250.

39. Royalty payable : 30.6.2014 — Shortworkings ₹ 5,000; 30.6.2015 — Shortworkings recouped ₹ 5,000; 31.12.2015 — Shortworkings ₹ 1,000; 30.6.2016 — Shortworkings recouped ₹ 1,000.
Royalty receivable : 31.12.2014 — Shortworkings Suspense ₹ 7,500; 30.6.2015 — Shortworkings Suspense ₹ 6,000; 31.12.2015 — Shortworkings Suspense ₹ 6,000; 30.6.2016 — Adjusted ₹ 3,000 and credited to Profit and Loss Account ₹ 4,500.
Profit on Sub-lease : 30.6.2015 — ₹ 5,500; 30.6.2016 — ₹ 9,000.

40. Royalty payable : 2010 — Shortworkings ₹ 27,500; 2011 — Shortworkings ₹ 9,200; 2012 — Shortworkings recouped ₹ 37,000.
Royalty receivable : 2010 — Shortworkings Suspense ₹ 21,000; 2011 — Shortworkings Suspense ₹ 7,000; 2012 — ₹ 15,000 (adjusted) ₹ 6,000 credited to Profit and Loss Account; 2013 — ₹ 7,000 credited to Profit and Loss Account.

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Packages and Containers

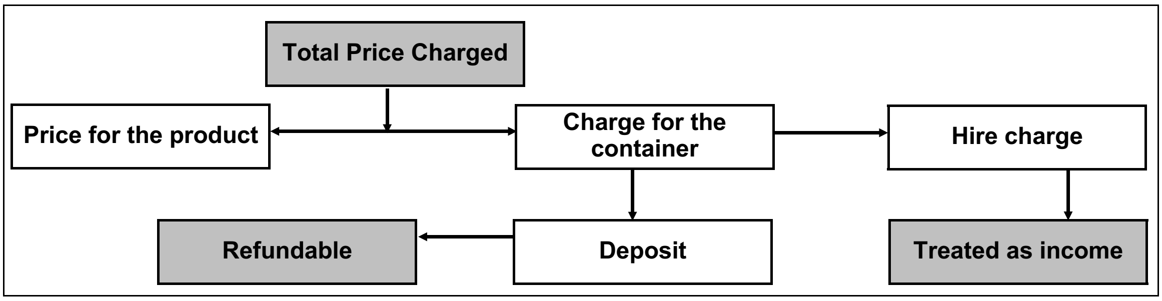
A container is anything in which goods are packed for sale. For most products some sort of packing is essential inasmuch as they cannot be sold without a container (e.g., soft drinks, ink, milk, etc.) or by their very nature, cannot be conveniently supplied in a loose form (e.g., cigarettes, potato chips, etc).

Containers of small values as compared to these of the product are generally non-returnable, and are passed on to the customers as part of the total price of the finished product. This is because these types of containers cannot be re-used and are thrown away by the customer when the product is used up. Obviously, the sale price covers both the contained, i.e., the product, and the container. When the container price is just a small fraction of the total costs, it is ignored by the customer. The price he pays is thought to be the price of the product alone. In these cases, no separate accounting treatment is required for containers since these are treated as a part of the total cost of product. But when the cost of the container is a significant portion of the total cost, the charge for the container is separated from the price of the product with a view to compete with sellers of similar other products. Containers of these types can usually be re-used and are returnable to the seller when empty. Bottled soft drinks are a case in point. Normally, a major portion of the charge for the container is refunded to the customers if the container is returned within a specified time (in proper condition, of course). The difference between the charge out price and the refund is treated as hire charge. For example, if the charge out price of a container is ₹ 15 and the refund is ₹ 12, then ₹ 3 represent the ***hire charge***.

The total price charge for the product sold in container has two elements:

(i) price for the product itself, which is actually sold, and

(ii) charge for the container (major portion of which is held as deposit and is refunded when the container is returned, the remaining portion being treated as hire charges).



The refundable price is generally set higher than the cost price of the container to encourage the customers to return it. If only the cost price is charged, which is essentially lower than the retail price, many customers may not be induced to return the container. If a higher price is charged, the consumer will be eager to return the container within the stipulated time.

Meaning of Important Terms/Expressions

Cost Price : It is the purchase price of the container

Charge out Price : It is the price charged to the customers for the container.

Returnable Price : It is the amount refunded when container is returned within a stipulated time.

Hire Charge : It is the difference between charge out price and returnable price.

Containers Retained (sold) : When containers are not returned within the specified time, these are treated as sold or retained by the customers.

Returnable Containers : These containers are lying with the customers on the closing date of the accounting period but the time limit for returning these has not yet expired.

Objectives of Keeping Separate Accounts for Containers

Returnable containers necessitate keeping separate accounts for the following reasons :

1. To ascertain the profit or loss arising out of containers.
2. To exercise control over the movement of containers. There is a regular inflow and outflow of containers, which demands reconciliation.
3. A substantial amount is involved in the investment for containers.

Income from Containers

1. Income from hire charges, which is ascertained as under:
   Number of containers sent out x (Charge out price – Returnable price)
2. Income from retained containers, which is ascertained as under:
   Number of containers retained x (Returnable price – Cost price)
3. Sale of scrap/insurance claim.

Important points to note:

(i) Income from hire charges arises in the accounting year when they are sent out, and has nothing to do with whether containers are retained or returned.

(ii) The income from retained containers is over and above the hire charges. It arises when the mandatory time limit expires, which may be in a different accounting period. In other words, containers may be sent out to customers and hire charges taken as income in one accounting period, while the profit on the retained containers may fall in another accounting period.

Expenses/Losses on Containers

1. Depreciation of the containers — It is the difference between the opening and closing values.
2. Containers scrapped — It is the cost price of the containers.
3. Repairs — It is the actual cost of repairs.

Accounting Arrangements in the Books of the Seller

Accounting treatment of non-returnable containers of a small value is different from the treatment of returnable containers. It is, therefore, convenient to discuss the matter separately.

1. Non-returnable Containers

In case of non-returnable containers, the charge is included in the total price of the finished product, and any profit made on the containers is automatically included in the profit on the sale of finished product.

2. Returnable Containers

In case of returnable containers, charge for containers is separated from the price of the product. For proper accounting, different methods of accounts are followed. Some of these are given below:

Method-1 [Stock and Trading Method]

Under this method, the following accounts should be opened.

1. Containers Stock Account.
2. Containers Trading Account.
3. Containers Deposit/Suspense/Reserve/Provision Account.
4. Containers Debtors Account.

1. Containers Stock Account

A Containers Stock Account is opened in the General Ledger to exercise greater control over the containers. It is ruled to record number, rate and value. All entries are made in this account at cost price (or lower stock-taking price).

This account is debited with the cost or lower stock-taking price of containers in hand and with customers at the beginning of the period. Containers purchased during the period are also debited to this account at ***purchase price***.

This account is credited with the (i) cost (or lower stock-taking price) of containers retained by customers, and (ii) containers destroyed or scrapped during the period. The depreciation on containers is also credited to this account. At the end of the accounting period, containers in hand and with customers are carried down at cost or lower stock-taking price, thus balancing both the monetary and unit columns. This account does not disclose any profit or loss on containers. The closing balance is shown in the Balance Sheet on the assets side. In the Containers Stock Account, no entry is passed for containers sent out to the customers and containers returned by the customers.

In the books of ...

Dr. Containers Stock Account Cr.

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
	To Balance b/d: In hand With customers To Bank A/c (Purchases)					By Containers Trading A/c (Cost of containers retained) By Containers Trading A/c (Depreciation) By Balance c/d In hand (new) With customers (old)			

2. Containers Trading Account

A Containers Trading Account is opened in the General Ledger to determine the profit or loss on returnable containers. It is a Nominal Account to record number, rate and value. This account is debited with the amount transferred from Containers Stock Account in respect of: (i) Containers retained by customers; (ii) Containers scrapped; (iii) Containers destroyed ; and (iv) Depreciation on the containers, etc. This account is also debited with the amount spent for repairs of containers.

This account is credited with (i) Hire charges on containers sent out; (ii) Sale of scrap; and (iii) Returnable price on retained containers. The balance of this account represents profit or loss on containers and it is transferred to the Profit and Loss Account.

Dr. Containers Trading Account Cr.

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
	To Containers Stock A/c (Cost of containers retained) To Containers Stock A/c (Cost of containers scrapped) To Profit & Loss A/c - Profit					By Hire Charges A/c By Containers Deposit A/c (Containers retained) By Bank A/c (Sale of scrap) By Profit & Loss A/c (Acc. loss)			

3. Containers Deposit/Suspense/Provision/Reserve Account

Containers Deposit Account records (at returnable price) opening and closing refundable deposits, containers sent out to customers and these returned or retained by them. This account always shows a credit opening balance equal to refundable deposits (containers with customers at the beginning *multiplied by* returnable price). It is credited by the amount of deposits on containers sent out to customers during the year.

This account is debited by the amount of deposits on containers returned and deposits no longer refundable for retained (sold) containers. The balance of this account represents deposit on returnable containers at the year end. The closing balance of refundable deposits on containers with customers is shown in the Balance Sheet as a deduction from Containers Debtors Account.

Dr. **Containers Deposit Account** **Cr.**

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
	To Containers Debtors A/c (Refund of deposit on containers returned)					By Balance b/d			
	To Containers Trading A/c (Deposit on containers retained)					By Containers Debtors A/c (Deposit on containers sent out)			
	To Balance c/d: (Deposit on containers still returnable)								

4. Containers Debtors Account

Containers Debtors Account is a Personal Account. This account shows a debit balance at the beginning of the year with amount due from customers in respect of containers. It is debited with the amount of deposits on containers sent out during the year and hire charges on such containers.

This account is credited with the deposits on containers returned and payments made during the year. The balance represents the amount due from customers in respect of the containers. This balance is shown in the Balance Sheet after deducting the balance of Containers Deposit Account.

Dr. **Containers Debtors Account** **Cr.**

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
	To Balance b/d					By Containers Deposit A/c (Refund of deposit)			
	To Containers Deposit A/c (Deposit on sent out containers					By Bank A/c (Balancing figure)			
	To Hire Charges A/c								

Accounting Entries

1. For purchase of containers

Containers Stock Account	Dr.	[Cost price]
To Cash/Bank/Sundry Creditors Account		

2. For containers sent out to customers

Containers Debtors Account	Dr.	[Charge out price]
To Hire Charges Account		[Hire charges]
To Containers Suspense/Deposit Account		[Returnable price]

3. For containers returned by customers

Containers Suspense/Deposit Account	Dr.	[Returnable price]
To Containers Debtors Account		

4. For containers retained (sold) by customers

(i) Containers Trading Account	Dr.	[Cost/lower stock-taking price]
To Containers Stock Account		
(ii) Containers Suspense/Deposit Account	Dr.	[Returnable price]
To Containers Trading Account		

5. For containers scrapped

(i) Containers Trading Account	Dr.	[Cost/lower stock-taking price]
To Containers Stock Account		
(ii) Cash/Bank Account	Dr.	[Sale proceeds]
To Containers Trading Account		

6. For repairing of containers

Containers Trading Account	Dr.	[Actual expenses]
To Bank Account		

7. For accidental loss of containers

(i) Accidental Loss Account	Dr.	[Cost or lower stock-taking price]
To Containers Stock Account		
(ii) Bank Account	Dr.	[Insurance claim received]
Profit and Loss Account	Dr.	[Loss]
To Accidental Loss Account		[Cost or lower stock-taking price]
Alternatively,		
Bank Account	Dr.	[Insurance claim received]
Profit and Loss Account	Dr.	[Loss]
To Containers Stock Account		[Cost or lower stock-taking price]

8. For depreciation on containers

Containers Trading Account	Dr.	[Cost — Stock-taking price]
To Containers Stock Account		

9. For transfer of hire charges

Hire Charges Account	Dr.	
To Containers Trading Account		

10. At the end of the accounting period :

(i) The containers in hand as well as with the customers (returnable) are valued at cost or lower stock-taking price and these are carried forward as a debit balance on Containers Stock Account.

(ii) The balance of Containers Trading Account represents profit or loss on containers and it is transferred to Profit and Loss Account.

(iii) The credit balance of Containers Suspense / Deposit Account is carried forward to the next period.

(iv) The debit balance of Containers Debtors Account is also carried forward to next period. For Balance Sheet purposes the credit balance of the Containers Suspense Account is set-off against Containers Debtors Account debit balance.

The above related matters are shown in the Balance Sheet as follows:

Balance Sheet as at ..... [Extract]

Liabilities	₹	₹	Assets	₹	₹
			Current Assets, Loans & Advances		
			Stock of Containers:		
			— in hand	***	
			— with customers	***	***
			Containers Debtors	***	
			Less: Containers Suspense	***	***
					***

In solving a practical question, certain workings are necessary to find out the missing information. These can be done in the following manner:

Inflow → **Containers in Hand** → **Outflow**

Containers in Hand

	Nos.		Nos.
Opening balance		Sent out to customers	
Purchased		Containers scrapped	
Returned by customers		Containers sold	
		Containers lost	
		Closing balance	

Inflow → **Containers with Customers** → **Outflow**

Containers with Customers

	Nos.		Nos.
Opening balance		Returned by customers	
Sent out to customers		Retained by customers	
		Closing balance	

What comes into the business → **Reconciliation of Stock (as a whole)** → **What goes out of the business for ever**

Reconciliation of Stock (as a whole)

	Nos.		Nos.
Opening balance		Retained by customers	
— in hand		Containers scrapped	
— with customers		Containers lost	
Purchased		Containers sold	
		Closing balance	
		— in hand	
		— with customers	

Alternatively,

Containers in Hand

	Nos.
Opening balance	***
Add: Purchased	***
Add: Returned by customers	***
	***
Less: Sent out to customers	***
Less: Sold	***
Less: Scrapped	***
Less: Destroyed	***
Closing balance	***

Containers with Customers

	Nos.
Opening balance	***
Add: Sent out	***
	***
Less: Returned by customers	***
Less: Retained by customers (sold)	***
Closing balance	***

Important points

(i) **Sent out** → **Charge out Price** → *Debited* **to Containers Debtors Account**

Charge out Price → **Hire charges** → *Credited* **to Hire Charges Account**

Charge out Price → **Deposit** → *Credited* **to Depost/Suspense/Provision Account**

(ii) **Returned** → **Returnable Price** → *Debited* **to Deposit/Suspense/ Provision Account**

↓

Credited **to Containers Debtor Account**

(iii) **Retained** → **Returnable Price** → *Debited* **to Deposit/Suspense/ Provision Account**

↓

Credited **to Containers Trading Account**

At the end of the year:

Hire charges are credited to Containers Trading Account separately (when stock and trading method is followed). It is credited to Container Stock Account (when stock and suspense method is followed).

The word "Containers" may be substituted for "Drums", "Boxes", "Packages", "Cases", "Crates", "Bottles" and "Barrels", etc. in appropriate situations.

Illustration 1

Chandra sells its goods in special packages costing ₹ 20 each. Packages are charged out at ₹ 28 each to the customers and credited at ₹ 18 each if returned in good condition within 3 months. For stock taking purposes, all the packages are valued at ₹ 15 each. From the following particulars, show (i) Packages Stock Account; and (ii) Packages Trading Account.

	Nos.		Nos.
Number of packages as on 1.1.2014			
— in hand	3,000	Sent to the customers during the year	9,000
— with customer	2,000	Returned by the customers during the year	6,000
Purchased during the year	5,000	Packages retained by the customers	2,200

Solution

Working Notes:

			₹
(1) Charge out price (₹)	28	**(2) Total Hire Charges**	
Less: Returnable price (₹)	18	Number of packages sent out x Hire charges per unit	
Hire charges per unit (₹)	10	(9,000 x ₹ 10)	90,000

(3) Packages in hand				**(4) Packages with customers**			
Particulars	Nos.	Particulars	Nos.	Particulars	Nos.	Particulars	Nos.
Opening balance	3,000	Sent out	9,000	Opening balance	2,000	Returned	6,000
Purchased	5,000	Closing balance	5,000	Sent out	9,000	Retained (sold)	2,200
Returned	6,000					Closing balance	2,800
	14,000		14,000		11,000	(Balancing figure)	11,000

(5) Depreciation on packages = 5,000 × ₹ 5 (₹ 20 – ₹ 15) = ₹ 25,000. No depreciation has been charged on old packages because their opening stock price and closing stock price are the same.

In the books of Chandra

Dr. Packages Stock Account Cr.

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Balance b/d:				2014	By Packages Trading A/c			
Jan. 1	— in hand	3,000	15	45,000	Dec. 31	(Cost of packages retained)	2,200	15	33,000
	— with customers	2,000	15	30,000	"	By Packages Trading A/c			
Dec. 31	To Bank A/c (purchases)	5,000	20	1,00,000		(Depreciation - Note 5)			25,000
					"	By Balance c/d			
						— in hand (new)	5,000	15	75,000
						— with customers (old)	2,800	15	42,000
		10,000		1,75,000			10,000		1,75,000

Dr. **Packages Trading Account** **Cr.**

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Packages Stock A/c				2014	By Packages Deposit A/c			
Dec. 31	(Cost of packages retained)	2,200	15	33,000	Dec. 31	(Deposit on pack. retained)	2,200	18	39,600
Dec. 31	To Packages Stock A/c					By Hire Charges A/c			90,000
	(Depreciation)	—		25,000					
	To Profit & Loss A/c	—		71,600					
		2,200		1,29,600			2,200		1,29,600

Illustration 2

X Company delivers oil to their customers in drums costing ₹ 60 each but charging them out at ₹ 100 each and crediting them at ₹ 80 each, if returned within three months.

On 1st January, 2014, there were 2,500 drums in the godown of the company and 5,000 returnable drums in the hands of the customers. During the year ending 31st December, 2014, 4,000 drums were purchased @ ₹ 75 each. 10,000 drums were sent out to customers. 7,000 drums were returned by the customers throughout the year. 100 drums from the old lot were completely destroyed by fire in the godown and 150 drums from the old lot were damaged and were sold as scrap for ₹ 20 each. On 31st December, 2014, 3,000 returnable drums were with customers. The drums are valued at their cost price for stock taking purposes.

Show the Drums Stock Account and Drums Trading Account in the ledger of the company.

Solution

Working Notes:

(1) Charge out price (₹)	100	**(2) Total Hire Charges**	₹
Less : Returnable Price (₹)	80	Number of drums sent out x Hire charges per Unit	
Hire Charges per Unit	20	10,000 x ₹ 20	2,00,000

(3) Drums in hand				**(4) Drums with customers**			
Particulars	Nos.	Particulars	Nos.	Particulars	Nos.	Particulars	Nos.
Opening balance	2,500	Sent out	10,000	Opening balance	5,000	Returned	7,000
Purchased	4,000	Destroyed by fire	100	Sent out	10,000	Retained (Sold)	5,000
Returned	7,000	Damaged	150			Closing balance	3,000
		Closing balance	3,250				
	13,500		13,500		15,000		15,000

In the books of X Company

Dr. **Drums Stock Account** **Cr.**

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Balance b/d :				2014	By Drums Trading A/c	5,000	60	3,00,000
Jan. 1	In hand	2,500	60	1,50,000	Dec. 31	(Cost of drums retained)			
	With customers	5,000	60	3,00,000		By Profit and Loss A/c			
Dec. 31	To Bank A/c (Purchases)	4,000	75	3,00,000		(Cost of drums destroyed)	100	60	6,000
						By Drums Trading A/c			
						(Cost of drums sold			
						as scrap)	150	60	9,000
						By Balance c/d			
						In hand (all new)	*3,250	75	2,43,750
						With customers (new)	750	75	56,250
						With customers (old)	2,250	60	1,35,000
		11,500		7,50,000			11,500		7,50,000

* It is assumed that all drums in hand are new.

Dr. **Drums Trading Account** **Cr.**

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Drums Stock A/c				2014	By Hire Charges A/c (Note 2)			2,00,000
Dec. 31	(Cost of drums retained)	5,000	60	3,00,000	Dec. 31	By Drums Deposit A/c			
	To Drums Stock A/c					(Drums retained)	5,000	80	4,00,000
	(Cost of drums sold					By Bank A/c			
	as scrap)	150	60	9,000		(Sale of scrap)	150	20	3,000
	To Profit and Loss A/c			2,94,000					
		5,150		6,03,000			5,150		6,03,000

Illustration 3

B Co. Ltd delivers goods to their customers in packages costing ₹ 6 each but charging them out at ₹ 12 each and crediting them at ₹ 8 each, if returned within three months.

On 1st January, 2014 there were 1,000 packages in the godown of the company and 2,100 returnable packages in the hands of the customers. During the year ending 31st December 2014, 1,500 packages were purchased at ₹ 10 each, 3,200 packages were sent out to customers. 2,300 packages were returned by the customers throughout the year. 30 packages from the old lot were completely destroyed by fire in the warehouse and another 50 packages from the old lot were accidentally broken and were sold as scrap for ₹ 4 each.

On 31st December 2014, 1,900 returnable packages from the old lot were with customers and stock in godown included all the new packages besides the old ones. The packages are valued at their cost price for stock-taking purposes.

Show the Packages Stock Account and Packages Trading Account in the ledger of the company.

Solution

Working Notes:

(1) Charge out price (₹)	12	**(2) Total Hire Charges**	₹
Less: Returnable price (₹)	8	Number of packages sent out x Hire charges per unit	
Hire charges per unit (₹)	4	(3,200 x ₹ 4)	12,800

(3) Packages in hand				**(4) Packages with customers**			
Particulars	Nos.	Particulars	Nos.	Particulars	Nos.	Particulars	Nos.
Opening balance	1,000	Sent out	3,200	Opening balance	2,100	Returned	2,300
Purchased	1,500	Destroyed	30	Sent out	3,200	Retained	1,100
Returned	2,300	Scrapped	50			(Balancing figure)	
		Closing balance	1,520			Closing balance	1,900
	4,800		4,800		5,300		5,300

In the books of B. Co. Ltd.

Dr. Packages Stock Account Cr.

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Balance b/d:				2014	By Packages Trading A/c			
Jan. 1	— in hand	1,000	6	6,000	Dec. 31	(Cost of packages retained)	1,100	6	6,600
	— with customers	2,100	6	12,600		By Profit & Loss A/c (Cost of			
Dec. 31	To Bank A/c (Purchases)	1,500	10	15,000		packages destroyed by fire)	30	6	180
						By Packages Trading A/c			
						(Cost of packages	50	6	300
						accidentally broken)			
						By Balance c/d:			
						— in hand (old)	20	6	120
						— in hand (new)	1,500	10	15,000
						— with customers (old)	1,900	6	11,400
		4,600		33,600			4,600		33,600

Dr. Packages Trading Account Cr.

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Packages Stock A/c				2014	By Hire Charges A/c (Note 2)	—	—	12,800
Dec. 31	(Cost of packages retained)	1,100	6	6,600	Dec. 31	By Packages Deposit A/c			
Dec. 31	To Packages Stock A/c					(Packages retained)	1,100	8	8,800
	(Cost of packages scrapped)	50	6	300		By Bank A/c (sale of scrap)	50	4	200
	To Profit & Loss A/c - Profit			15,000		By Profit & Loss A/c (Acc. loss)			100
		1,150		21,900			1,150		21,900

Tutorial Note: Packages accidentally broken should not be treated as normal loss and the difference between cost price and sale of scrap should be charged to Profit and Loss Account. However, if it is treated as a normal incident, then the profit will be ₹ 14,900.

Illustration 4

Baroda Chemicals Ltd. delivers goods to customers in drums (which are valued in books at ₹ 30) charging them out at ₹ 60 each. Customers are credited with ₹ 40 if the drums are returned within six weeks. The following information is supplied to you:

	Drums		Drums
Stock in hand on 1st January, 2014	2,000	Drums returned by customers	4,600
Drums with customers on 1st January, 2014 (still returnable)	4,200	Drums destroyed in an accident	60

Purchases at ₹ 50 each	3,000	Drums sold as scrap for ₹ 1,000	100
Drums sent out to customers	6,400	Repairs carried out to drums ₹ 2,500	

On 31st December 2014, 3,800 drums were with customers and may be returned within the following week. Show the relevant accounts in the books of the company to show profit or loss on this part of the company's business.

Solution

Working Notes:

(1) Charge out price (₹)	60	**(2) Total Hire Charges**	₹
Less: Returnable price (₹)	40	Number of drums sent out x Hire charges per drum	
Hire charges per unit (₹)	20	(6,400 x ₹ 20)	1,28,000

(3) Drums in hand				**(4) Drums with customers**			
Particulars	Nos.	Particulars	Nos.	Particulars	Nos.	Particulars	Nos.
Opening balance	2,000	Sent out	6,400	Opening balance	4,200	Returned	4,600
Purchased	3,000	Scrapped	100	Sent out	6,400	Retained	
Returned	4,600	Destroyed	60			(Balancing figure)	2,200
		Closing balance	3,040			Closing balance	3,800
	9,600		9,600		10,600		10,600

(5) Total drums in hand = 3,040. Out of these, 3,000 are assumed to be new and therefore valued @ ₹ 50 each.

In the books of Baroda Chemicals Ltd.

Dr. Drums Stock Account Cr.

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Balance b/d				2014	By Drums Trading A/c			
Jan. 1	— in hand	2,000	30	60,000	Dec. 31	(Cost of drums retained)	2,200	30	66,000
	— with customers	4,200	30	1,26,000		By Profit & Loss A/c			
Dec. 31	To Bank A/c (Purchases)	3,000	50	1,50,000		(Cost of drums destroyed)	60	30	1,800
						By Drums Trading A/c			
						(Cost of drums sold as scrap)	100	30	3,000
						By Balance c/d:			
						— in hand (old)	40	30	1,200
						— in hand (new)	3,000	50	1,50,000
						— with customers	3,800	30	1,14,000
		9,200		3,36,000			9,200		3,36,000

Dr. Drums Trading Account Cr.

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Drums Stock A/c				2014	By Hire Charges A/c (Note 2)			1,28,000
Dec. 31	(Cost of drums retained)	2,200	30	66,000	Dec. 31	By Drums Deposit A/c			
	To Drums Stock A/c					(Drums retained)	2,200	40	88,000
	(Cost of drums sold as scrap)	100	30	3,000		By Bank A/c (Sale of scrap)	100	—	1,000
	To Bank A/c (Repairs)	—	—	2,500					
	To Profit & Loss A/c (Profit)	—	—	1,45,500					
		2,300		2,17,000			2,300		2,17,000

Tutorial Note : For lack of information, no depreciation has been charged on new drums. If it is charged, then the profit will be ₹ 85,500.

Dr. Drums Deposit Account Cr.

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Drums Debtors A/c				2014				
Dec. 31	(Refund of deposit on				Jan. 1	By Balance b/d	4,200	40	1,68,000
	drums returned)	4,600	40	1,84,000	Dec. 31	By Drums Debtors A/c			
	To Drums Trading A/c					(Deposit on sent out drums)	6,400	40	2,56,000
	(Deposit on drums retained)	2,200	40	88,000					
	To Balance c/d: (Deposit on								
	drums still returnable)	3,800	40	1,52,000					
		10,600		4,24,000			10,600		4,24,000

Illustration 5

Reliance Ltd markets chemicals which is sold on drums. The drums are returnable, and are lent to the customers free of charge for three months, after which rental is charged of ₹ 5 per drum per month. Customers who advise that they do not propose to return the drum are charged ₹ 100 but credit is given for any rental charges already made.

For the year 2014, the following transactions apply :

	Nos.	Particulars	₹
1 January			
Drums on loan	230		
Drums on rental	140		
Drums in store	470		
	840	@ Cost less depreciation	33,600
31 December			
Bought in year	1,000	@ Cost	63,200
Rentals charged			9,500
Drums charged			9,000
Rentals Credited			2,200
Drums Scrapped	330	Realising	660
Repairs		Cost	4,900
	Nos.		
Drums on loan	280		
Drums in store	1,140		
	1,420	@ Cost less depreciation	?

Depreciation is charged @ 30% p.a. Purchases may be regarded as spread evenly throughout the year and disposes should be taken as from the drums in hand at 1 January.

You are required to prepare Drums Stock Account and Drums Trading Account.

Solution **In the books of Reliance Ltd**

Dr. **Drums Stock Account** **Cr.**

Date	Particulars	Nos.	₹	Date	Particulars	Nos.	₹
2014	To Balance b/d :			2014	By Drums Trading A/c	90	3,600
Jan. 1	On loan	230		Dec. 31	(Cost of drums not returned by the		
	On rental	140			customers — Note 1)		
	In store	470			By Drums Trading A/c	330	13,200
		840	33,600		(Cost of drums scrapped)		
Dec. 31	To Bank A/c (Purchases)	1,000	63,200		By Drums Trading A/c		14,520
					(Depreciation — Note 2)		
					By Balance c/d : (Note 3)		
					On loan 280		
					In store 1140	1,420	65,480
		1,840	96,800			1,840	96,800

Dr. **Drums Trading Account** **Cr.**

Date	Particulars	Nos.	₹	Date	Particulars	Nos.	₹
2014	To Drums Stock A/c	90	3,600	2014	By Customers A/c (Rental charged)		9,500
Dec. 31	(Cost of drums not returned)			Dec. 31	By Customers A/c (Drums charged)	90	9,000
	To Drums Stock A/c	330	13,200		By Bank A/c	330	660
	(Cost of drums scrapped)				(Proceeds of drums scrapped)		
	To Bank A/c (Repairs)		4,900		By Profit and Loss A/c (Loss)		19,260
	To Drums Stock A/c						
	(Depreciation — Note 2)		14,520				
	To Customers A/c (Rentals credited)		2,200				
		420	38,420			420	38,420

Working Notes :

(1) Written down value of each drum at the beginning = ₹ 33,600 / 840 = ₹ 40. Number of drums not returned by the customers = ₹ 9,000 / ₹ 100 = 90.

Cost of drums not yet returned by the customers = ₹ 40 × 90 = ₹ 3,600.

(2) Calculation of Depreciation

			₹
Opening stock		840 units at cost less depreciation	33,600
Less : Drum charged	90		
Scrapped	330	420	16,800
		420	16,800

(a) Depreciation on ₹ 16,800 for one year at 30% per annum is ₹ 5,040.

(b) During the year a further 1,000 drums are purchased for ₹ 63,200. Purchase of these regarded as spread evenly throughout the year, i.e., they have been owned on average, for 6 months. Depreciation, therefore, will be :
₹ 63,200 × 30% × 6/12 = ₹ 9,480. Total depreciation for the year = ₹ 5,040 (a) + ₹ 9,480 (b) = ₹ **14,520**.

(3) Written down value of closing stock

	₹	₹
(i) Opening stock	16,800	
Less : Depreciation (a)	5,040	11,760
(ii) Purchased during the year	63,200	
Less : Depreciation (b)	9,480	53,720
		65,480

Illustration 6

Madras Chemicals Ltd. supplies its products in returnable drums which are charged at ₹ 20 each. Customers returning the drums within a month are credited with ₹ 18. The company's procedure is to retain ₹ 18 in Deposit Account till the expiry of the option period for return of the drums.

The following particulars are available from the books:

	Nos.		Nos.
Returnable drums as on 1.1.2014	8,000	Drums returned by customers in 2014	2,88,000
Drums in stock as on 1.1.2014	16,000	Drums returnable on 31.12.2014	15,000
Drums purchased during 2014 at ₹ 15 per drum	20,000	Drums scrapped in 2014 sold for ₹ 10,000	2,000
Drums sent to customers during 2014	3,00,000		

All drums as on 31.12.2013 and 31.12.2014 are to be valued at ₹ 10 each. All the amounts due in respect of drums have been collected from the customers.

You are asked to show the Ledger Accounts for 2014 of:

(a) Drum Stock; (b) Drum Debtors; (c) Drum Deposits; and (d) Drum Trading.

Solution

Working Notes:

(1) Charge out price (₹)	20	**(2) Total Hire Charges**	₹
Less: Returnable price (₹)	18	Number of drums sent out x Hire charge per drum	
Hire charges per unit (₹)	2	(3,00,000 x ₹ 2) =	6,00,000

(3) Drums in hand				**(4) Drums with customers**			
Particulars	Nos.	Particulars	Nos.	Particulars	Nos.	Particulars	Nos.
Opening balance	16,000	Sent out	3,00,000	Opening balance	8,000	Returned	2,88,000
Purchased	20,000	Scrapped	2,000	Sent out	3,00,000	Retained (Bal. figure)	5,000
Returned	2,88,000	Closing balance	22,000			Closing balance	15,000
	3,24,000		3,24,000		3,08,000		3,08,000

(5) Depreciation on drums = ₹ 20,000 (15 – 10) = ₹ 1,00,000. No depreciation has been charged on old drums because their opening stock-taking price and closing stock-taking price are the same.

In the books of Madras Chemicals Ltd.

Dr. Drums Stock Account Cr.

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Balance b/d:				2014	By Drums Trading A/c			
Jan.1	— In hand	16,000	10	1,60,000	Dec. 31	(Cost of drums retained)	5,000	10	50,000
	— With customers	8,000	10	80,000		By Drums Trading A/c			
Dec. 31	To Bank A/c (Purchases)	20,000	15	3,00,000		(Cost of drums scrapped)	2,000	10	20,000
						By Drums Trading A/c			
						(Depreciation - Note 5)			1,00,000
						By Balance c/d:			
						— in hand	22,000	10	2,20,000
						— with customers	15,000	10	1,50,000
		44,000		5,40,000			44,000		5,40,000

Dr. Drums Trading Account Cr.

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Drums Stock A/c				2014	By Hire Charges (Note 2)			6,00,000
Dec. 31	(Cost of drums retained)	5,000	10	50,000	Dec. 31	By Drums Deposit A/c			
	To Drums Stock A/c					(Drums retained)	5,000	18	90,000

	(Cost of drums scrapped)	2,000	10	20,000		By Bank A/c (Sale of scrap)	2,000	5	10,000
	To Drums Stock A/c (Depreciation)			1,00,000					
	To Profit & Loss A/c - Profit			5,30,000					
		7,000		7,00,000			7,000		7,00,000

Dr. Drums Deposit Account Cr.

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014 Dec. 31	To Drums Debtors A/c (Refund of deposit)	2,88,000	18	51,84,000	2014 Dec. 31	By Balance b/d	8,000	18	1,44,000
	To Drums Trading A/c (Drums retained)	5,000	18	90,000		By Drums Debtors A/c (Dep. on sent out drums)	3,00,000	18	54,00,000
	To Balance c/d	15,000	18	2,70,000					
		3,08,000		55,44,000			3,08,000		55,44,000

Dr. Drums Debtors Account Cr.

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014 Jan. 1	To Balance b/d	8,000	20	1,60,000	2014 Dec. 31	By Drums Deposit A/c (Refund of deposit)	2,88,000	18	51,84,000
Dec. 31	To Drums Deposit A/c (Dep. on sent out drums)	3,00,000	18	54,00,000		By Drums retained	5,000		—
	To Hire Charges A/c			6,00,000		By Bank A/c (Bal. fig.)			6,76,000
						By Balance c/d	15,000	20	3,00,000
		3,08,000		61,60,000			3,08,000		61,60,000

Tutorial Note: Students should note that, Drums Deposit Account is maintained at "returnable price" whereas, Drums Debtors Account is maintained at "Charge out price". In the Balance Sheet "Drum Deposit Account" is shown as a deduction from "Drum Debtors Account".

Method - 2 [Stock and Suspense Method]

Under this method, Containers Trading Account is merged with the Containers Stock Account. The common entries between the two accounts are eliminated. The Containers Stock Account will disclose profit or loss on containers. Containers Deposit Account and Containers Debtors Account are prepared in the usual manner.

The following accounts should be opened:

1. Containers Stock Account
[Mixture of Containers Stock and Containers Trading Account of Method - 1]

2. Containers Deposit/Suspense/Reserve/Provision Account
[Similar to Method - 1]

3. Containers Debtors Account
[Similar to Method - 1]

Accounting Entries

1. For purchase of containers
Containers Stock Account Dr. [Cost price]
To Cash/Bank/Sundry Creditors Account

2. For containers sent out to customers
Containers Debtors Account Dr. [Charge out price]
To Hire Charges Account [Hire charges]
To Containers Suspense/Deposit Account [Returnable price]

3. For containers returned by customers
Containers Suspense/Deposit Account Dr. [Returnable price]
To Containers Debtors Account

4. For containers retained (sold) by customers
Containers Suspense/Deposit Account Dr. [Returnable price]
To Containers Stock Account

5. For containers scrapped
Cash/Bank Account Dr. [Sale proceeds]
To Containers Stock Account

6. For repairing of containers

Containers Stock Account	Dr.	[Actual expenditure]
To Bank/Cash Account		

7. For accidental loss of containers

Bank Account	Dr.	[Insurance claims received]
Profit and Loss Account	Dr.	[Loss]
To Containers Stock Account		

8. For depreciation on containers

No entry

9. For transfer of hire charges

Hire Charges Account	Dr.	[Hire charges]
To Containers Stock Account		

10. At the end of the accounting period

(i) The containers in hand as well as with customers (returnable) are valued at cost or lower stock-taking price and these are carried forward as a debit balance on Containers Stock Account.

(ii) The balance of Containers Stock Account represents profit or loss on containers and it is transferred to Profit and Loss Account.

(iii) The credit balance of Containers Suspense/Deposit Account is carried forward to the next period.

(iv) The debit balance of Containers Debtors Account is also carried forward to the next period.

In the Balance Sheet, all the relevant matters are shown in the similar manner as for Method - 1.

Illustration 7

Durgapur Chemicals Ltd. delivers goods to customers in drums (which are valued in books at ₹ 30 each) charging them out at ₹ 60 each. Customers are credited with ₹ 40 each if the drums are returned in time. Following are the details of drums:

	Drums		Drums
Stock in hand on 1st January, 2014	2,000	Drums returned by customers	4,600
Drums with customers on 1st January, 2014	4,200	Drums destroyed in an accident	60
Purchases at ₹ 50 each	3,000	Drums sold as scrap for ₹ 1,000	100
Drums sent out to customers	6,400	Drums with customers (returnable) as on 31.12.2014	3,800

Show the necessary Ledger Accounts in the books of the Company.

Solution

Working Notes:

(1) Charge out price (₹)	60	**(2) Total Hire Charges**	₹
Less: Returnable price (₹)	40	Number of drums sent out x Hire charges per unit	
Hire charges per unit (₹)	20	(6,400 x ₹ 20)	1,28,000

(3) Drums in hand				**(4) Drums with customers**			
Particulars	Nos.	Particulars	Nos.	Particulars	Nos.	Particulars	Nos.
Opening balance	2,000	Sent out	6,400	Opening balance	4,200	Returned	4,600
Purchased	3,000	Scrapped	100	Sent out	6,400	Retained (Bal. fig.)	2,200
Returned	4,600	Destroyed	60			Closing balance	3,800
		Closing balance	3,040				
	9,600		9,600		10,600		10,600

(5) Total drums in hand = 3,040. Out of these 3,000 drums are assumed to be new and are, therefore, valued @ ₹ 50 each.

This problem can be solved as follows: (a) Stock and Trading Method; as well as (b) Stock and Suspense Method. The profit to be disclosed under both the methods is the same.

The Accounts opened under these methods are:

(a) Stock and Trading Method	**(b) Stock and Suspense Method**
(i) Drums Stock Account →	(i) Drums Stock Account
(ii) Drums Trading Account	
(iii) Drums Deposit Account →	(ii) Drums Deposit Account

(a) Stock and Trading Method

In the books of Durgapur Chemicals Ltd.

Dr. **Drums Stock Account** **Cr.**

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Balance b/d:				2014	By Drums Trading A/c			
Jan. 1	— in hand	2,000	30	60,000	Dec. 31	(Cost of drums retained)	2,200	30	66,000
	— with customers	4,200	30	1,26,000		By Profit & Loss A/c			
Dec. 31	To Bank A/c (Purchases)	3,000	50	1,50,000		(Cost of drums destroyed)	60	30	1,800
						By Drums Trading A/c			
						(Cost of drums sold as scrap)	100	30	3,000
						By Balance c/d:			
						— in hand (old)	40	30	1,200
						— in hand (new)	3,000	50	1,50,000
						— with customers	3,800	30	1,14,000
		9,200		3,36,000			9,200		3,36,000

Dr. **Drums Trading Account** **Cr.**

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Drums Trading A/c				2014	By Hire Charges A/c			1,28,000
Dec. 31	(Cost of drums retained)	2,200	30	66,000	Dec. 31	By Drums Deposit A/c			
	To Drums Stock A/c					(Drums retained)	2,200	40	88,000
	(Cost of drums sold as scrap)	100	30	3,000		By Bank A/c (Sale of scrap)	100		1,000
	To Profit & Loss A/c - Profit			1,48,000					
		2,300		2,17,000			2,300		2,17,000

Tutorial Note : For lack of information, no depreciation has been charged on new drums. If it is charged, then the profit will ₹ 88,000.

Dr. **Drums Deposit Account** **Cr.**

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Drums Debtors A/c				2014				
Dec. 31	(Refund of deposit)	4,600	40	1,84,000	Jan. 1	By Balance b/d	4,200	40	1,68,000
	To Drums Trading A/c				Dec. 31	By Drums Debtors A/c			
	(Deposit on drums retained)	2,200	40	88,000		(Deposit on sent out drums)	6,400	40	2,56,000
	To Balance c/d	3,800	40	1,52,000					
		10,600		4,24,000			10,600		4,24,000

(b) Stock and Suspense Method

Under this method, no separate "Drums Trading Account" is opened. This account is merged with "Drums Stock Account". The common entries between "Drums Stock Account" and "Drums Trading Account" are eliminated automatically. The Drums Stock Account will show the profit or loss on drum trading. The students should carefully observe the following accounts. However, "Drums Deposit Account" will appear in the usual manner.

Dr. **Drums Stock Account** **Cr.**

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Balance b/d:				2014	By Profit & Loss A/c*			
Jan. 1	— in hand	2,000	30	60,000	Dec. 31	(Cost of drums destroyed)	60	30	1,800
	— with customers	4,200	30	1,26,000		By Hire Charges A/c			1,28,000
Dec. 31	To Bank A/c (Purchases)	3,000	50	1,50,000		By Drum Deposit A/c			
	To Profit & Loss A/c - Profit			1,48,000		(Drums retained)	2,200	40	88,000
						By Bank A/c (Sale of scrap)	100		1,000
						By Balance c/d:			
						— In hand (old)	40	30	1,200
						— In hand (new)	3,000	50	1,50,000
						— With customers	3,800	30	1,14,000
		9,200		4,84,000			9,200		4,84,000

* **Tutorial Note** : Alternatively, cost of drums destroyed can be debited to **Abnormal Loss Account**.

Dr. **Drums Deposit Account** **Cr.**

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Drums Debtors A/c				2014				
Dec. 31	(Refund of deposit)	4,600	40	1,84,000	Jan. 1	By Balance b/d	4,200	40	1,68,000
	To Drums Stock A/c	2,200	40	88,000	Dec. 31	By Drums Debtors A/c	6,400	40	2,56,000
	To Balance c/d	3,800	40	1,52,000					
		10,600		4,24,000			10,600		4,24,000

Illustration 8

M/s L & Co. deliver their products in drums which are returnable. The containers cost ₹ 100 each and are valued at that price for stock-taking purposes. They are charged to customers at ₹ 140 each and credited on return within 2 months at ₹ 120 each.

On 1st April 2014, there were 150 drums in stock and 360 with customers which were returnable within 2 months. During the 6 months ended 30th September 2014, 1,000 new drums were purchased, 4,800 were sent to customers and 4,300 were returned by them. Of the drums returned, 250 were sold at ₹ 25 each and 130 were destroyed. On 30th September 2014, there were 270 drums in stock and 660 returnable drums with customers, and the remaining were retained by the customers.

You are to record the above transactions in the Drums Stock Account and the Drums Suspense Account in the books of M/s L & Co.

Solution

Working Notes:

(1) Charge out price (₹)	140	**(2) Total Hire Charges**	₹
Less: Returnable price (₹)	120	Number of drums sent out x Hire charges per unit	
Hire charges per unit (₹)	20	(4,800 x ₹ 20)	96,000

(3) Drums in hand				**(4) Drums with customers**			
Particulars	Nos.	Particulars	Nos.	Particulars	Nos.	Particulars	Nos.
Opening balance	150	Sent out	4,800	Opening balance	360	Returned	4,300
Purchases	1,000	Scrapped	250	Sent out	4,800	Retained	200
Returned	4,300	Destroyed	130			Closing balance	660
		Closing balance	270				
	5,450		5,450		5,160		5,160

In the books of M/s. L & Co.

Dr. Drums Stock Account Cr.

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Balance b/d:				2014	By Drums Suspense A/c			
April 1	— in hand	150	100	15,000	Sept. 30	(Deposit on drums retained)	200	120	24,000
	— with customers	360	100	36,000		By Hire Charges A/c			96,000
Sept. 30	To Bank A/c (Purchases)	1,000	100	1,00,000		By Profit & Loss A/c			
	To Profit & Loss A/c - Profit			81,250		(Cost of drums destroyed)	130	100	13,000
						By Cash A/c (Sale of scrap)	250	25	6,250
						By Balance c/d:			
						— in hand	270	100	27,000
						— with customers	660	100	66,000
		1,510		2,32,250			1,510		2,32,250

Dr. Drums Suspense Account Cr.

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Drums Stock A/c				2014				
Sept. 30	(Deposit on drums retained)	200	120	24,000	April 1	By Balance b/d	360	120	43,200
	To Drums Debtors A/c				Sept. 30	By Drums Debtors A/c			
	(Refund of deposit)	4,300	120	5,16,000		(Deposit on drums sent out)	4,800	120	5,76,000
	To Balance c/d	660	120	79,200					
		5,160		6,19,200			5,160		6,19,200

Illustration 9

A manufacturer sends its products in barrels costing ₹ 60 each, charges its customers at ₹ 80 each, allows to customers at ₹ 70 each if returned in due time and values the stock of barrels for Balance Sheet purposes at ₹ 40 each on the average at depreciated value. From the following particulars prepare the Barrel Stock Account, Barrel Reserve Account for 2014 and show how the relevant items will appear in the Profit and Loss Account and Balance Sheet for 2014.

	Barrels		Barrels
Stock in hand on 1.1.2014	5,000	Stock in hand on 31.12.2014	?
Stock with customers on 1.1.2014 (returnable)	6,000	Sold for cash ₹ 9,000 as defective	450
Purchases for 2014	9,000	Scrapped and rejected (no value)	50

Sent out to customers in 2014	25,000	Retained by customers treated as sold	?
Returned by customers in 2014	16,000	Repaired old Barrels for ₹ 4,000	600
Stock with customers on 31.12.2014 (returnable)	12,000		

Solution

Working Notes:

(1) Charge out price (₹)	80	(2) Total Hire Charges	₹
Less: Returnable price (₹)	70	Number of barrels sent out x Hire charges for barrel	
Hire charges per unit (₹)	10	(25,000 x ₹ 10)	2,50,000

(3) Barrels in hand				(4) Barrels with customers			
Particulars	Nos.	Particulars	Nos.	Particulars	Nos.	Particulars	Nos.
Opening balance	5,000	Sent out	25,000	Opening balance	6,000	Returned	16,000
Purchased	9,000	Defective	450	Sent out	25,000	Retained	3,000
Returned	16,000	Scrapped	50			(Balancing figure)	
		Closing balance	4,500			Closing balance	12,000
	30,000		30,000		31,000		31,000

In the books of Manufacturer

Dr. Barrel Stock Account Cr.

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Balance b/d:				2014	By Barrel Reserve A/c			
Jan. 1	— in hand	5,000	40	2,00,000	Dec. 31	(Deposit on barrels retained)	3,000	70	2,10,000
	— with customers	6,000	40	2,40,000		By Hire Charges A/c			2,50,000
Dec. 31	To Bank A/c (Purchases)	9,000	60	5,40,000		By Bank A/c			
	To Bank A/c (Repairs)			4,000		(Sale of defectives)	450	20	9,000
	To Profit & Loss A/c - Profit			1,45,000		By Barrel Scrapped A/c	50		
						By Balance b/d:			
						— in hand	4,500	40	1,80,000
						— with customers	12,000	40	4,80,000
		20,000		11,29,000			20,000		11,29,000

Dr. Barrel Reserve Account Cr.

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Barrel Stock A/c	3,000	70	2,10,000	2014				
Dec. 31	To Barrel Debtors A/c				Jan. 1	By Balance b/d	6,000	70	4,20,000
	(Refund of deposit)	16,000	70	11,20,000	Dec. 31	By Barrel Debtors A/c			
	To Balance c/d	12,000	70	8,40,000		(Deposit on barrel sent out)	25,000	70	17,50,000
		31,000		21,70,000			31,000		21,70,000

Dr. Profit and Loss Account for the year ended 31st December, 2014 Cr.

Particulars	₹	Particulars	₹
		By Barrel Stock A/c - Profit	1,45,000

Balance Sheet as at 31st December, 2014

Liabilities	₹	Assets		₹
		Current Assets		
		Barrel Stock:		
		— In hand	1,80,000	
		— With customers	4,80,000	6,60,000
		Barrel Debtors	x,xx,xxxx	
		Less: Barrel Reserve	8,40,000	?
				?

Illustration 10

XYZ Ltd. sells goods in returnable boxes which are charged to customers at ₹ 50 each and credited with ₹ 40 each if returned within a month. From the following particulars prepare Boxes Stock Account, Boxes Reserve Account and Boxes Debtors Account assuming that the boxes were valued in the books at ₹ 20 each.

	Boxes		Boxes
Stock in hand on 1.1.2014	500	Returned by customers	1,800
Stock with customers on 1.1.2014	800	Destroyed in accident	100
Boxes Debtors balance on 1.1.2014 ₹ 48,000	—	Sold as scrap at ₹ 5 per box	40
Purchased at ₹ 30 each	1,200	Stock with customers on 31.12.2014	700
Sent out to customers	2,100	Cash received from customers ₹ 32,000	—

Solution

Working Notes:

(1) Charge out price (₹)	50	(2) Total Hire Charges	₹
Less: Returnable price (₹)	40	Number of boxes sent out x Hire charges per box	
Hire charges per unit (₹)	10	(2,100 x ₹ 10)	21,000

(3) Boxes in hand				(4) Boxes with customers			
Particulars	Nos.	Particulars	Nos.	Particulars	Nos.	Particulars	Nos.
Opening balance	500	Sent out	2,100	Opening balance	800	Returned	1,800
Purchased	1,200	Scrapped	40	Sent out	2,100	Retained	400
Returned	1,800	Destroyed	100			(Balancing figure)	
		Closing balance	1,260			Closing balance	700
	3,500		3,500		2,900		2,900

In the books of XYZ Ltd.

Dr. Boxes Stock Account Cr.

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Balance b/d:				2014	By Profit & Loss A/c			
Jan. 1	— in hand	500	20	10,000	Dec. 31	(Cost of boxes destroyed)	100	20	2,000
	— with customers	800	20	16,000		By Bank A/c (Sale of scrap)	40	5	200
Dec. 31	To Bank A/c (Purchases)	1,200	30	36,000		By Boxes Reserve A/c			
	To Profit & Loss A/c — Profit			16,400		(Deposit on boxes retained)	400	40	16,000
						By Hire Charges A/c (Note 2)			21,000
						By Balance c/d:			
						— In hand	1,260	20	25,200
						— With customers	700	20	14,000
		2,500		78,400			2,500		78,400

Dr. Boxes Reserve Account Cr.

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Boxes Debtors A/c				2014				
?	(Refund of deposit)	1,800	40	72,000	Jan. 1	By Balance b/d:	800	40	32,000
Dec. 31	To Boxes Stock A/c				Dec. 31	By Boxes Debtors A/c			
	(Deposit on boxes retained)	400	40	16,000		(Deposit on boxes sent out)	2,100	40	84,000
	To Balance c/d	700	40	28,000					
		2,900		1,16,000			2,900		1,16,000

Dr. Boxes Debtors Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014			2014		
Jan. 1	To Balance b/d	48,000	Dec. 31	By Boxes Reserve A/c (Refund of deposit)	72,000
Dec. 31	To Boxes Reserve A/c (Deposit on sent out boxes)	84,000		By Bank A/c	32,000
	To Hire Charges	21,000		By Balance c/d (Balancing figure)	49,000
		1,53,000			1,53,000

Tutorial Note : In the Balance Sheet, "Boxes Reserve Account" is shown as a deduction from "Boxes Debtors Account".

Method - 3 [Trading and Suspense Method]

Under this method, Containers Stock Account is merged with the Containers Trading Account. The common entries between the two accounts are eliminated. The Containers Trading Account discloses profit or loss on containers. Containers Deposits aand Containers Debtors Accounts are prepared in the usual manner.

The following accounts should be opened:

1. *Containers Trading Account*
   [Mixture of Containers Stock and Containers Trading Account of Method - 1]
2. *Containers Deposit/Suspense/Reserve/Provision Account*
   [Similar to Method - 1]
3. *Containers Debtors Account*
   [Similar to Method - 1]

Accounting Entries

1. For purchase of containers

Containers Trading Account Dr. [Cost price]
To Cash/Bank/Sundry Creditors Account

2. For containers sent out to customers

Containers Debtors Account Dr. [Charge out price]
To Hire Charges Account [Hire charges]
To Containers Suspense Account [Returnable price]

3. For containers returned by customers

Containers Suspense/Deposit Account Dr. [Returnable price]
To Container Debtors Account

4. For containers retained (sold) by customers

Containers Suspense Account Dr.
To Containers Trading Account

5. For containers scrapped

Cash/Bank Account Dr. [Sales proceeds]
To Containers Trading Account

6. For repairing of containers

Containers Trading Account Dr.
To Cash/Bank Account

7. For accidental loss of containers

Bank Account Dr. [Insurance claim received]
Profit and Loss Account Dr. [Loss]
To Containers Stock Account

8. For depreciation on containers

No entry

9. For transfer of hire charges

Hire Charges Account Dr. [Hire charges]
To Containers Trading Account

10. At the end of the accounting period

(i) The containers in hand as well as with the customers (returnable) are valued at cost or lower stock-taking price and these are carried forward as a debit balance on Containers Trading Account.
(ii) The balance of Containers Trading Account represents profit or loss on containers and is transferred to the Profit and Loss Account.
(iii) The credit balance of Containers Suspense/Deposit Account is carried forward to the next period.
(iv) The debit balance of Containers Debtors Account is also carried forward to the next period.

In the Balance Sheet, all the relevant matters are shown in the similar manner as we do in case of Method - 1.

Illustration 11

Gavaskar Co. Ltd. delivers goods to the customers in packages costing ₹ 30 each but charging them out at ₹ 60 each and crediting them at ₹ 48 each, if returned within three months.

On 1st April 2014, there were 5,000 packages in the godown of the company and 10,500 returnable packages in the hands of the customers. During the year ending 31st March 2015, 7,500 packages were purchased at ₹ 50 each and 16,000 packages were sent out to customers. Customers returned 11,500 packages in the year. 150 packages from the old lot were completely destroyed by a fire in the warehouse and another 250 packages from the old lot were accidentally broken and were sold as scrap value for ₹ 20 each. On 31st March 2015, 9,500 returnable packages from the old lot were with customers and the stock in godown of the company included all the new packages besides the old ones. The packages are valued at their cost price for stock-taking purposes.

Prepare for the year ended March 31 2015: (i) the Packages Trading Account; and (ii) the Packages Provision Account.

Solution

Working Notes:

(1) Charge out price (₹)	60	**(2) Total Hire Charges**	₹
Less: Returnable price (₹)	48	Number of packages sent out x Hire charges per unit	
Hire charges per unit (₹)	12	(16,000 x ₹ 12)	1,92,000

(3) Packages in hand

Particulars	Nos.	Particulars	Nos.
Opening balance	5,000	Sent out	16,000
Purchased	7,500	Destroyed	150
Returned	11,500	Scrapped	250
		Closing balance	7,600
	24,000		24,000

(4) Packages with customers

Particulars	Nos.	Particulars	Nos.
Opening balance	10,500	Returned	11,500
Sent out	16,000	Retained (Bal. figure)	5,500
		Closing balance	9,500
	26,500		26,500

In the books of Gavaskar Ltd.

Packages Trading Account

Dr. **Cr.**

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Balance b/d:				2015	By Hire Charges A/c			1,92,000
April 1	— In hand	5,000	30	1,50,000	Mar. 31	By Packages Provision A/c			
	— With customers	10,500	30	3,15,000		(Deposit on pack.retained)	5,500	48	2,64,000
2015	To Bank A/c (Purchases)	7,500	50	3,75,000		By Profit & Loss A/c			
Mar. 31	To Profit & Loss A/c - Profit			2,91,000		(cost of packages destroyed)	150	30	4,500
						By Bank A/c (Sale of scrap)	250	20	5,000
						By Profit & Loss A/c			
						(Acc. loss 250 x ₹ 10)			2,500
						By Balance c/d:			
						— In hand (old)	100	30	3,000
						— In hand (new)	7,500	50	3,75,000
						— With customers (old)	9,500	30	2,85,000
		23,000		11,31,000			23,000		11,31,000

Tutorial Note : Packages accidentally broken should not be treated as normal loss and the difference between cost price and sale of scrap should be charged to Profit and Loss Account. However, if it is treated as a normal incident, then the profit will be ₹ 2,88,500.

Packages Provision Account

Dr. **Cr.**

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2015	To Packages Trading A/c				2014				
Mar. 31	(Deposit on pack. retained)	5,500	48	2,64,000	April 1	By Balance b/d	10,500	48	5,04,000
	To Packages Debtors A/c				2015	By Packages Debtors A/c			
	(Refund of deposit)	11,500	48	5,52,000	Mar. 31	(Deposit on pack. sent out)	16,000	48	7,68,000
	To Balance c/d	9,500	48	4,56,000					
		26,500		12,72,000			26,500		12,72,000

Illustration 12

New Chemical Company sells its products in returnable canboys. Customers are billed at ₹ 5 for each canboy at the time of sale and credited with ₹ 4 if the canboys are returned in two months. In case the canboys are returned in a damaged condition credit is given only of ₹ 2.

The following figures are available for the year ended on 31st March 2015:

Particulars	Nos.	₹
Returnable stock with customers as on 1.4.2014	20,000	40,000
Stock on hand as on 1.4.2014	5,000	10,000
Canboys purchased during the year	15,000	45,000
Canboys sent out during the year	50,000	
Returnable canboys with customers as on 31.3.2015	10,000	
Canboys returned in damaged condition during the year	5,000	
Canboys not returned within the scheduled time during the year	20,000	

All stock is to be valued at cost. Damaged canboys are to be valued at 50% of cost. During the year ₹ 1,00,000 was received from debtors on account of canboys. Write-up the necessary Ledger Accounts.

Solution

Working Notes:

(1) Charge out price (₹)	5	**(2) Total Hire Charges**	₹
Less: Returnable price (₹)	4	Number of canboys sent out x Hire charges per unit	
Hire charges per unit (Re)	1	(50,000 x Re 1)	50,000

(3) Special charge for damaged canboys = 5,000 x ₹ 2 = ₹ 10,000.

(4) Canboys in hand

Particulars	Nos.	Particulars	Nos.
Opening balance	5,000	Sent out	50,000
Purchased	15,000	Closing balance	
Returned:		— Damaged	5,000
— Damages	5,000	— Good	5,000
— Good	35,000		
	60,000		60,000

(5) Canboys with customers

Particulars	Nos.	Particulars	Nos.
Opening balance	20,000	Returned:	
Sent out	50,000	— Damaged	5,000
		— Good	35,000
		Retained	20,000
		Closing balance	10,000
	70,000		70,000

In the books of New Chemical Company

Dr. **Canboys Stock Account** **Cr.**

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Balance b/d:				2015	By Canboys Reserve A/c			
April 1	In hand	5,000	2	10,000	Mar. 31	(Dep. on canboys retained)	20,000	4	80,000
	With customers	20,000	2	40,000		By Hire Charges A/c			50,000
2015						By Canboys Reserve A/c			
Mar. 31	To Bank A/c (Purchases)	15,000	3	45,000		(Special charge for			
	To Profit & Loss A/c — Profit			95,000		damaged canboys)			10,000
						By Balance c/d:			
						In hand			
						— Damaged	5,000	1	5,000
						— Good	5,000	3	15,000
						With customers	10,000	3	30,000
		40,000		1,90,000			40,000		1,90,000

Dr. **Canboys Reserve Account** **Cr.**

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2015	To Canboys Stock A/c				2014				
Mar. 31	(Dep. on canboys retained)	20,000	4	80,000	April, 1	By Balance b/d	20,000	4	80,000
	To Canboys Stock A/c				2015	By Canboys Debtors A/c			
	(Special charge for				Mar. 31	(Dep. on sent out canboys)	50,000	4	2,00,000
	damaged canboys)			10,000					
	To Canboys Debtors A/c								
	(Refund of deposit)								
	— Damaged	5,000	2	10,000					
	— Good	35,000	4	1,40,000					
	To Balance c/d	10,000	4	40,000					
		70,000		2,80,000			70,000		2,80,000

Illustration 13

On 1.1.2014 stock of packages in hand was ₹ 8,000 (valued in the books at cost less 25%) and ₹ 1,200 in the hands of customers at invoice price, which is cost plus 50%.

For the year ended 31st December 2014, packages were charged out at cost plus 50% and full credit was given in respect of those returned in good condition. Packages sent out during the year were ₹ 16,000 (invoice price) and returns (all in good condition) ₹ 10,000. Customers retained packages at an invoice price of ₹ 300 and closing stock of packages in hand at cost was ₹ 6,666.67.

Write-up the Packages Stock Account and Packages Reserve Account.

Solution

Working Notes:

Cost Price	Working Price	Invoice Price
₹ 100	₹ 75 (cost less 25%)	₹ 150 (cost plus 50%)

(1) Valuation price of packages in the hands of customers on 1.1.2014 = ₹ 1,200 x $\frac{75}{150}$ = **₹ 600**.

(2) Valuation price of packages in hand on 31.12.2014 = ₹ 6,666.67 x $\frac{75}{100}$ = ₹ 5,000

(3) Valuation price of packages with customers on 31.12.2014 = ₹ 6,900 x $\frac{75}{150}$ = ₹ 3,450

(4) Calculation of Purchases

Dr. Memorandum Stock Account [At Cost Price] Cr.

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/d:			By Sales ₹ 300 x 100/150	200.00
	In hand (₹ 8,000 x 100/75)	10,666.67		By Balance c/d:	
	With customers (₹ 1,200 x 100/150)	800.00		In hand	6,666.67
	To Purchases	Nil		With customers (₹ 6,900 x 100/150)	4,600.00
		11,466.67			11,466.67

Dr. Packages Stock Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014	To Balance b/d:		2014	By Packages Reserve A/c	
Jan. 1	In hand	8,000	Dec. 31	(Packages retained)	300
	With customers (Note)	600		By Balance c/d:	
Dec. 31	To Profit & Loss A/c - Profit	150		In hand (Note 2)	5,000
				With customers (Note 3)	3,450
		8,750			8,750

Dr. Packages Reserve Account Cr.

Date	Particulars	₹	Date	Particulars	₹
2014	To Packages Stock A/c		2014		
Dec. 31	(Packages retained)	300	Dec. 31	By Balance b/d	1,200
	To Packages Debtors A/c			By Packages Debtors A/c	
	(Returned)	10,000		(Sent out)	16,000
	To Balance c/d	6,900			
		17,200			17,200

Illustration 14

Bombay Chemicals Limited supplies its products in returnable containers. A container is invoiced to the customer at ₹ 50, but if it is returned within two months, a credit of ₹ 45 is given to the customer. A container costs ₹ 40 to the company and its life is estimated at 5 years at the end of which the scrap value is likely to be ₹ 5.

The following particulars are supplied to you:

	Nos.		Nos.
Containers with customers (1.1.2014)	20,000	Containers returnable	12,000
Containers in stock (1.1.2014)	4,000	Containers purchased during the year	5,000
Containers sent to customers during the year 2014	80,000	Containers condemned during the year, useful life being over	1,000
Containers returned by customers	85,000	Amount realised by sale of condemned containers	6,000

Depreciation is to be provided on straight line method. Prepare Containers Stock Account and Containers Suspense Account for the year and ascertain the profits or losses earned or incurred in the year assuming a separate account for provision of depreciation is maintained.

Solution

Working Notes:

(1) Charge out price (₹)	50	**(2) Total Hire Charges**	₹
Less: Returnable price (₹)	45	Number of containers sent out x Hire charges per unit	
Hire charges per unit (₹)	5	(80,000 x ₹ 5)	4,00,000

(3) Containers in hand				**(4) Containers with customers**			
Particulars	Nos.	Particulars	Nos.	Particulars	Nos.	Particulars	Nos.
Opening balance	4,000	Sent out	80,000	Opening balance	20,000	Returned	85,000
Purchased	5,000	Scrapped	1,000	Sent out	80,000	Retained (Bal. figure)	3,000
Returned	85,000	Closing balance	13,000			Closing balance	12,000
	94,000		94,000		1,00,000		1,00,000

(5) Cost of container is ₹ 40. Scrap value is ₹ 5. Therefore, depreciable value = ₹ 40 – ₹ 5 = ₹ 35. The life of containers is 5 years. Provision for depreciation is to be created per container = 35/5 = ₹ 7. Total provision for depreciation = ₹ 7 (13,000 + 12,000) = ₹ 1,75,000.

In the books of Bombay Chemicals Ltd.

Dr. Containers Stock Account Cr.

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Balance b/d:				2014	By Containers Suspense A/c			
Jan. 1	In hand	4,000	40	1,60,000	Dec. 31	(Dep. on contnr. retained)	3,000	45	1,35,000
	With customers	20,000	40	8,00,000		By Hire Charges A/c (Note 2)			4,00,000
Dec. 31	To Bank A/c (Purchases)	5,000	40	2,00,000		By Bank A/c (Sale of scrap)			6,000
	To Prov. for Dep. A/c (Note 5)			1,75,000		By Prov. for Dep. A/c (Note)			35,000
	To Profit & Loss A/c — Profit			2,41,000		By Balance c/d:			
						In hand	13,000	40	5,20,000
						With customers	12,000	40	4,80,000
		29,000		15,76,000			29,000		15,76,000

Note : The useful life of 1,000 containers is over. The accumulated depreciation (₹ 7 x 5 = ₹ 35 each) should be credited to Containers Stock Account. The total amount involved = ₹ 35 x 1,000 = ₹ 35,000.

Tutorial Note : When containers are valued at cost (both opening stock and closing stock) and a depreciation is also to be charged then the following entries are made in the books:

(i) For depreciation

Containers Stock Account Dr. [Yearly depreciation]
To Provision for Depreciation Account

(ii) For containers condemned (useful life being over)

Provision for Depreciation Account Dr. [Accumulated depreciation]
To Containers Stock Account

Dr. Containers Suspense Account Cr.

Date	Particulars	Nos.	Rate	₹	Date	Particulars	Nos.	Rate	₹
2014	To Containers Debtors A/c				2014				
Dec. 31	(Refund of deposit)	85,000	45	38,25,000	Jan. 1	By Balance b/d:	20,000	45	9,00,000
	To Containers Stock A/c				Dec. 31	By Containers Debtors A/c			
	(Dep. on containers retained)	3,000	45	1,35,000		(Dep. on containers sent out)	80,000	45	36,00,000
	To Balance c/d	12,000	45	5,40,000					
		1,00,000		45,00,000			1,00,000		45,00,000

THEORETICAL QUESTIONS

1. What are the objectives of keeping separate accounts for returnable containers?
2. Discuss the nature of the following accounts:
   (i) Containers Stock Account;
   (ii) Containers Debtors Account; and
   (iii) Containers Suspense Account.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each statement or answer each question below :

1. The income from retained containers is over and above the
   A cost price
   B hire charges
   C none of these.
2. The refundable price is generally set higher than the cost price of the container to encourage the customers to
   A return it
   B retain it
   C none of these.
3. The difference between the charge out price and the refund is treated as
   A loss
   B hire charges
   C none of these.

4. Income from hire charges arises in the accounting year when they are
   A sent out
   B returned
   C none of these.
5. Hire charges is the difference between charge out price and
   A cost price
   B returnable price
   C none of these.

PRACTICAL QUESTIONS

1. X sells his goods in special containers costing ₹ 20 each. Containers are charged out at ₹ 30 each to customers and credited at ₹ 25 each if returned in good condition within 2 months.
   On 1.1.2014, there were 5,000 containers in the factory godown and 3,000 in the hands of the customers (all returnable). During the year ended 31.12.2014, 20,000 containers were purchased by X : 16,000 containers were sent out to customers and 12,000 was received back from the customers within 2 months.
   On 31.12.2014, there were 5,000 containers in the hands of the customers (all returnable). You are required to show Containers Stock Account and Containers Trading Account.
2. A manufacturer sends his goods in drums which are valued in books at ₹ 40 each, but charged out to customers at ₹ 80 each. Customers are credited with ₹ 60 for each drum if returned in time and in good condition.
   From the following particulars, draw the Drums Stock Account and Drums Suspense Account for the year ended 31.12.2014.

Particulars	Nos.	Particulars	Nos.
Stock in hand on 1.1.2014	5,000	Returned by customers	12,630
Stock with customers on 1.1.2014	10,500	Destroyed in an accident	80
Purchases during 2014 at ₹ 50 each	8,200	Sold as scrap for ₹ 3,000	250
Sent out to customers	16,500		

3. A manufacturer sells his goods in containers bought at ₹ 30 each. Customers are charged at ₹ 40 per container and are allowed ₹ 35 each for containers returned within one month. For stock taking purposes, containers are valued at ₹ 18 each.
   From the following information, prepare Containers Stock Account and Containers Reserve Account.

Number of containers in hand on 1.1.2014	9,000	Sent out to customers during the year	20,000
Number of containers with customers on 1.1.2014	7,000	Returned by the customers during the year	18,000
Purchased during the year	10,000	Containers with customers on 31.12.2014	7,000

4. Calcutta Chemicals sells its goods in special containers costing ₹ 15 each. Containers are charged out at ₹ 20 each and credited at ₹ 18 each, if returned in good condition within 3 months. For stock taking purposes, all containers are valued at ₹ 12 each.
   On 1.1.2014, there were 5,000 containers in the factory godown and 3,000 were in the hands of the customers (all returnable).
   During the year ended 31.12.2014, 7,000 containers were purchased, 10,000 were sent out to customers and 6,000 were received back from them.
   On 31.12.2014, there were 4,000 containers in the hands of customers within the required period.
   Draw-up Containers Stock Account and Containers Suspense Account bearing in mind that 100 containers were destroyed (scrap value realised ₹ 100) and 200 containers were sold for ₹ 5 each.
5. X sells his goods in special packages costing ₹ 25 each. Packages are charged out at ₹ 45 each. The customers are credited with ₹ 35 each, if returned in good condition within 30 days. For stock taking purposes, all packages in the factory and with the customers are valued at ₹ 20 each.
   On 1.1.2014, there were 10,000 packages in the factory and 7,500 in the hands of customers (all returnable). During the year ended 31.12.2014, 15,000 packages were purchased by Mr. X, 20,000 packages were sent to customers (of which 7,000 were new) and 15,000 were received back from customers.
   On 31.12.2014, there were 12,000 packages in the hands of the customers capable of being returned within the required period.
   200 packages were destroyed, 100 packages were sold as scrap and ₹ 200 were realised. Some others were repaired at a cost of ₹ 300.
   You are required to prepare Package Stock Account, Package Trading Account and Package Reserve Account.

6. A firm sends its products in cases which it purchases at ₹ 18 each and which are charged to customers at ₹ 21 each, if there are returned within two months, credit is given at ₹ 19 each. The following are the particulars for the year ended 31.12.2014.

Particulars	Nos.	Particulars	Nos.
Cases with customers on 1.1.2014 (returnable)	5,000	Cases returned by customers	7,000
Cases with the firm on 1.1.2014	2,000	Cases sold as scrap for ₹ 600	150
Cases purchased during the year	3,000	Cases with customers on 31.12.2014 (returnable)	4,500
Cases sent out to customers during the year	8,000		

Write-up Cases Stock Account and Cases Trading Account.

7. Sarkar Dairy delivers goods to customers in bottles costing ₹ 60 each. Bottles are charged out at ₹ 70 each to customers and credited at ₹ 50 each if returned in good condition within stipulated time. For stock-taking purposes, all containers in the factory and those in the hands of customers are valued at ₹ 30 each.

   On 1.4.2014 there were 2,000 bottles in the factory and 4,000 in the hands of customers. During 2014-15, 6,300 bottles were sent out to customers of which 2,000 were new and 4,200 were returned by them within the required period. Out of the bottles returned by customers 50 were destroyed by an accident and 100 were sold as scrap. These realised ₹ 1,500. On 31.3.2015, there were 3,000 bottles in the hands of customers, capable of being returned within the stipulated period. Prepare Bottles Stock Account and Bottles Trading Account in the books of Sarkar Dairy.

8. Modern Biscuits Ltd sells their product in containers costing ₹ 15 each. Containers are charged at ₹ 25 each when sent out to the customers and if they return those containers within three months of their issue then they are credited at ₹ 20 each. For stock taking purposes, all used containers at the end of the year either in the hands of the customers or in stock was valued at ₹ 10 each.

   On 1st January, 2014, there were 10,000 containers in the Godown of the company and 12,500 returnable containers in the hands of the customers.

   During the year ended 31st December, 2014, 15,000 containers were purchased and 40,000 containers were sent to customers (of which 9,000 are new), 30,000 containers were returned by the customers within stipulated period. 500 containers were damaged in an accident and were sold for ₹ 1,000. Another 200 containers were scrapped as they were out of use.

   According to company records on December 31, 2014 there were 4,000 and 3,500 containers with customers whose date of return expired on 30th November, 2014 and 20th December, 2014 respectively.

   Show important Ledger Accounts in the books of the company.

9. M Ltd. sells its goods in special packages costing ₹ 25 each. Packages are charged out at ₹ 40 each and credited at ₹ 30 in case returned in good condition within 3 months. For stock-taking purposes all the packages in factory and in the hands of the customers are valued at ₹ 20 each. On 1st January 2014, there were 4,500 packages in the factory and 7,800 in the hands of the customers for less than 3 months.

   During the year end 31.12.2014, 13,000 packages were purchased by M. Ltd. Some packages were charged out to the customers and they had retained 5,500 packages.

   The customers had been given credit of ₹ 2,37,000 on account of returns within the stipulated period. 200 packages were sold for ₹ 2,000 as scrap. 300 packages were destroyed and had been damaged beyond repairs. Some packages were repaired for ₹ 1,000. As on 31.12.2014 there were 12,700 packages in factory.

   You are required to prepare: (a) Packages Stock Account; and (b) Packages Trading Account.

10. Prakas Gases Ltd delivers goods to customers in cylinders (included in the books at a cost of ₹ 200 each) charging them out at ₹ 300 each. Customers are credited with ₹ 225, if the cylinders are returned within one month. From the following information, prepare Cylinders Stock Account; Cylinders Trading Account; Memorandum Debtors Account and Profit and Loss Account (abstract).

11. A sold a product which required expensive containers costing ₹ 10 each. These were invoiced to customers at ₹ 15 each on the basis of sale or return within two months.

    In his impersonal ledger, A maintained a 'Customers Control Account', a 'Containers Stock Account' and to record the unrealised profit on containers in the hands of customers, a 'Containers Suspense Account'.

    On 1.1.2015, there were 70 containers in stock and in addition 60 in the hands of customers which had been delivered to them within the periods two months.

    During the six months ended 30.6.2015, 380 containers had been despatched to customers, 320 had been returned within two months, 40 had not been returned but were duly paid for by the customers, 100 containers had been purchased, and 20 had been scrapped after return and sold for cash in June 2015 for ₹ 5 each. Repairs to other containers amounted to ₹ 100.

    You are required to write-up the three accounts in A's impersonal ledger by recording these transactions and bring down the balances as on 30.6.2015.

12. Hard Luck Chemicals Ltd. delivers goods to customers in drums (which are valued in books at ₹ 30 each) charging them out at ₹ 60 each. Customers are credited with ₹ 40 each, if the drums are returned within 6 weeks. The following information is supplied to you:

Particulars	Drums.	Particulars	Drums.
Stock in hand on 1.4.2014	2,000	Drums returned by customers	4,600
Drums with customers on 1.4.2014 (returnable)	4,200	Drums destroyed in and accident	60
Purchases at ₹ 50 each	3,000	Drums sold as scrap for ₹ 1,000	100
Drums sent out to customers	6,400	Repairs carried out to drums ₹ 3,500	—

On 31.3.2015, 3,800 drums were with customers and could be returned within the following week.
You are required to show the Drums Stock Account, Drums Trading Account and Memorandum Customers Account in the books of the Company.

13. Isolate Chemicals Ltd supplies its products in returnable containers. A container is invoiced to the customers at ₹ 65 each but if it is returned in good condition within three months of the date of delivery of the containers, a credit of ₹ 55 each is given to the customers. A container costs ₹ 55 to the company and its life is estimated at 10 years at the end of which the scrap value is likely to be ₹ 5. The following particulars are supplied to you :

	Nos.
Stock in hand on 1.1.2014	20,000
Stock with customers on 1.1.2014	30,000
Containers sent to customers during the year	80,000
Containers returned by customers during the year	80,000
Containers returnable on 31.12.2014	20,000
Containers purchased during the year	3,000
Containers damaged, useful life being over	2,000

Amount realised from the sale of damaged containers — ₹ 30,000
Depreciation is to be provided on Straight Line Basis.
Prepare the Containers Trading Account, Containers Provision Account and Containers with Customers Control Account for the year and ascertain the profit or losses earned or incurred in the year.

14. A firm sells its goods in containers bought at ₹ 20 each. Customers are charged at ₹ 24 per container and are allowed ₹ 16 for each container returned within a given period. For stock taking purposes, all containers in the factory and in the hands of customers are valued at ₹ 14 each.
From the following information, draw up the Containers Stock Account and Containers Suspense Account in the books of the firm for the year ended 31st December, 2014:

Particulars	Nos.	Particulars	Nos.
In the factory at 1st January, 2014	9,000	Purchased during the year 2014	12,000
With customers at 1st January, 2014 (Returnable)	7,200	Sent to customers during the year 2014	20,000
With customers at 31st December, 2014 (Returnable)	5,800	Returned by customers during the year 2014	13,600

15. X Ltd. sells their products in special containers costing ₹ 5 each. Containers are charged out to the customers at ₹ 10 each and credited at ₹ 8 each if returned in good condition within 3 months. For accounting purposes, all the containers at the year end, owned by the company, whether within the factory or in customers' hands, are valued at ₹ 3 each.
On January 1, 2014, customers were holding 15,000 containers which were returnable and there were 12,000 containers in stock on the company's premises. During the year ended December 31, 2014, 10,000 containers were purchased, 30,000 were sent out to the customers (of which 4,000 were new). 28,000 were returned within the prescribed time. 400 defective containers were sold for Re 1 each during the year and 200 were scrapped.
On December 31, 2014, there were 16,000 containers with customers capable of being returned within the required period.
Prepare for the year ended December 31 2014, (i) Customers Stock Account; and (ii) Containers Reserve Account. (show calculation in details).

16. Pankaj Ltd. sells oil in drums which are charged out at ₹ 10 each. Customers will be given credit of ₹ 7 each if they return drums within the stipulated time. The following information is available from the books:

Particulars	Nos.	Particulars	Nos.
(a) Drums returnable as on 1.1.2014	4,000	(e) Drums returned	4,80,000
(b) Drums in stock as on 1.1.2014	8,000	(f) Drums scrapped (Sold for ₹ 7,000)	2,000
(c) Drums purchased @ ₹ 5 each	30,000	(g) Drums sent in 2014 lying with customers	10,000
(d) Drums sent out during 2014	5,00,000		

All drums as on 1.1.2014 were valued at ₹ 2.5 each. All the drums as on 31.12.2014 are to be valued at 50% of the cost price. You are required to prepare: (a) Drums Stock Account; (b) Drums Trading Account; and (c) Drums Deposit Account.

17. A manufacturer sells his products in containers charging them out at ₹ 12 each. Customers are credited by ₹ 10 each if the containers are returned within 3 months. For accounting purposes at closing, all stocks with customers and in factory are valued at ₹ 8 each except those representing new ones which are valued at their purchase price. The following particulars are available for the year ended 30th June 2015:

Particulars	Nos.	Particulars	Nos.
Stock with customers on 1.7.2014 (all returnable)	1,200	Sent to customers	6,500
Stock in hand on 1.7.2014	900	Returned by customers	6,000
Stock with customers on 30.6.2015 (all returnable)	1,000	Destroyed by fire	100
Stock in hand on 30.6.2015	800	Sold as scrap for ₹ 300	60
Purchase during the year (at a uniform rate) totalled to ₹ 5,040	?		

You are required to prepare: (a) Containers Stock Account; and (b) Containers Suspense Account in the books of the Manufacturer for the year ended 30th June 2015.

18. A company supplies its product in a tin which is returnable after use. The cost of the tin is ₹ 5 and is charged out to the customers on sale or return within 6 months at ₹ 6. The customers are given credit at ₹ 5 per tin if the tins are returned within six months.
At the end of the year, the company values all tins, whether returnable or in hand, at ₹ 3.
You are informed that:
At the beginning of the year : Tins held by the company were 2,760; Returnable held by the customers were 4,790.
At the end of the year : Tins held by the company were 3,144; Returnable tins held by the customers were 2,910.
During the year, 3,100 tins were purchased, 20,620 were invoiced to customers and 17,960 were returned; 56 tins had to be sold as scrap for ₹ 75.
You are required to prepare Tin Stock Account and determine the amount to be transferred to Profit and Loss Account.

19. X sells his goods in boxes which he charges out to customers at ₹ 6 each. Customers are allowed a credit of ₹ 4 per box returned within 60 days of sale.
While closing his accounts for the year ended 30th September 2014, X valued the stock of boxes in his factory and returnable boxes in the hands of customers invoiced within 60 days of the close of the accounting year, at ₹ 2 per box. The number of such boxes was 10,000 and 25,000 respectively.
For the year ended 30th September 2014, the following transactions took place:
50,000 boxes were purchased at ₹ 2.50 per box; 80,000 were charged to customers; 75,000 were returned by customers; 2,500 boxes out of those returned were scrapped and sold for ₹ 1,500; and 1,000 boxes were damaged by rain and discarded. At the close of the year, 15,000 boxes were with customers. Cash received on account of rentals and sales from customers was ₹ 2,40,000.
Record the above transactions in the books of X and draw Memorandum Debtors Account, Boxes Stock Account, Boxes Trading Account and Boxes Debtors Account.

20. A sells his products in returnable containers. Customers are charged at ₹ 8 for each package and credit is given at ₹ 50 each if returned in good condition within 3 months, but credit is given at ₹ 3 each if returned in a damaged condition. The following information is available for the year ended 31.12.2014:

Particulars		Quantity	₹
Stock in hand as on 1.1.2014		4,000	12,000
Stock with customers as on 1.1.2014 (returnable)		12,000	36,000
Purchased during the year		10,000	40,000
Sent out during the year		20,000	
Packages with customers as on 31.12.2014 (returnable)		6,000	
Packages returned:			
in good condition	Nos. 15,000		
in damaged condition	Nos. 2,000	17,000	
Packages not returned within the scheduled period during the year		9,000	

All stock is to be valued at cost but damaged packages are valued at 50% of cost. Show the necessary Ledger Accounts.

21. On 1.1.2014, a trader had a stock of packages valued at a cost of ₹ 15,000; out of these, packages costing ₹ 3,000 were in the hands of the customers. When packages are sent out to customers they are charged $33^1/_3\%$ above the cost price. When packages are returned, credit for full charged value is given. During 2014, packages costing ₹ 60,000 have been despatched to customers and they have been given credit for ₹ 78,000 on account of returns. Packages costing ₹ 1,200 have been retained by the customers. At the end of the year, the stock of packages in the hands of the trader, besides those in the hands of customers, are valued at ₹ 13,500.
Write-up necessary Ledger Accounts in the trader's books.

Guide to Answers

Multiple Choice

1. B; 2. A; 3. B; 4. A; 5. B.

Practical Questions

1. **Profit (including hire charges) ₹ 2,41,000 after charging depreciation (₹ 8,200 x 10) = ₹ 82,000. Drums in hand 9,000; Drums with customers 14,370; Total hire charges ₹ 3,30,000. Drums destroyed charged to Profit and Loss Account ₹ 3,200.**
2. **Profit ₹ 1,072.**
3. **Profit (including hire charges) ₹ 15,400; Cases retained 1,500; Cases in hand 3,850.**
4. **Profit (including hire charges) ₹ 9,10,000; Drums retained 8,000; Drums in hand 30,000. All drums have been valued @ ₹ 30 each.**
5. **Profit ₹ 800; Packages purchased ₹ 6,000.**
6. **Profit (including hire charges) ₹ 1 ,81,000 without charging depreciation on new boxes. If depreciation of ₹ 30,000 (₹ 60,000 × .5) is charged, the profit will be ₹ 1,51,000. Boxes retained 20,000.**
7. **Profit (including hire charges) ₹ 1,26,500 after charging depreciation ₹ 60,000.**
8. **Profit (including hire charges) ₹ 2,28,000 after charging depreciation ₹ 45,000.**
9. **Profit (including hire charges) ₹ 1,09,000 after charging depreciation ₹ 65,000.**
10. **Profit (including hire charges) ₹ 7,35,000.**
11. **Profit (including hire charges) ₹ 1,93,000; Containers in hand 6,125; Containers with customers 4,500; All containers at the year end have been valued @ ₹ 10 each. Abnormal loss charged to Profit and Loss Account ₹ 9,750.**
12. **Profit (including hire charges) ₹ 10,58,000 after providing depreciation on new containers. When new containers are valued at cost price, then the profit will be ₹ 15,58,000.**
13. **Profit (including hire charges) ₹ 6,15,000 after charging depreciation ₹ 2,05,000.**
14. **Profit (including hire charges) ₹ 1,03,600.**
15. **Profit (including hire charges) ₹ 43,600.**
16. **Profit (including hire charges) ₹ 14,90,000.**
17. **Profit (including hire charges) ₹ 14,220.**
18. **Profit (including hire charges) ₹ 23,407.**
19. **Profit (including hire charges) ₹ 1,61,500.**
20. **Profit (including hire charges) ₹ 2,09,400; Loss on drums destroyed ₹ 2,800 (after insurance claim ₹ 400); Drums in hand 3,050; Drums retained 2,400.**
21. **Profit (including hire charges) ₹ 10,08,000; Drums retained 14,000; Drums in hand 16,000.**

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Introduction to Accounting Standard

Introduction

Accounting standards are accounting rules and procedures relating to measurement, valuation and disclosure issued by the Council of The Institute of Chartered Accountants of India. Accounting standards are stated to be the norms of accounting policies and practices by way of guidelines that should be followed while preparing accounts and disclosed in the annual financial statements. The accounting standards are intended to apply only to items which are material.

Since accounting standards are the rules to be followed in the preparation of financial statements, these are regarded as a *mechanism* for resolving the conflicts of interest among various preparers and users of accounting information. Accounting standards are generally appropriate to the normal conduct of business and are in conformity with local conditions. Accounting standards serve public interest and are based on a conceptual framework of accounting. Necessarily, the utility of accounting standards results in a consequential improvement in the quality of preparation of financial statements.

Nature

Accounting standards are *mandatory* in nature. They are mainly applicable to the published accounts of limited companies. However, in case of sole proprietorships or partnerships, accounting standards mandatorily apply when the financial statements are statutorily required to be audited.

The accounting standards apply to the preparation of general purpose financial statements, i.e., Balance Sheet, Profit and Loss Account, and other statements and statutory notes which form part of the financial statements. It is necessary to examine whether the mandatory accounting standards are complied with in the preparation of financial statements. If there is any deviation, adequate disclosure should be made so that the users of financial statements become aware of such deviations.

Accounting policies have a *direct effect* on the working results and the financial position of a business concern. Accounting policies are the specific accounting bases adopted and constantly followed by a business unit in the preparation of its financial statements. Owing to varying circumstances, different accounting policies are adopted by different business enterprises. Accounting standards, therefore, require that all significant policies adopted in the preparation and presentation of financial statements should be disclosed and should form part of the financial statements. Any change in the accounting policies which has a material effect, and the amount by which any item in the financial statement is affected by such a change should be disclosed. Lastly, if a fundamental *accounting assumption* is not followed, the fact should be disclosed.

Accounting standards could be national, international or both. Every national institute frames its own accounting standards, which generally are in keeping with the international norms. In effect, the development of accounting standards in India has been contemporaneous with that of the International Accounting Standards, which are formulated by global organisations of accounting bodies. As such, there is not much difference among the parameters of these standards.

Scope

1. Accounting Standards are to be issued in conformity with the provisions of the applicable laws, customs, usages and business environment of our country. If there is any conflict between the accounting standards and laws (because of subsequent amendments in the law), the provisions of the said law will prevail and financial statements should be prepared in conformity with such law.
2. Accounting Standards can not override the local regulations.
3. Accounting Standards are intended to apply only to items which are material.
4. The Institute will use its best endeavours to persuade the government, appropriate authorities, industrial and business community to adopt these standards in order to achieve uniformity in the preparation of financial statements.
5. In carrying out the task of formulation of Accounting Standards, the intention would be to concentrate on basic matters.

Purposes

The concepts of accounting have permitted a variety of practices to follow and, in effect, different results can be drawn from the same set of data. Consequently, the lack of uniformity of such practices has made it difficult for users of accounting information to compare the results of different firms. The overall direction of the accountant should be towards *uniformity*, so that accounting information may become comparable, leading to better analysis and comparison of performances.

The need for accounting standards is based on the necessity of harmonising the diverse policies and practices adopted by different business firms. When accounting standards are followed, accounting information become transparent and, in effect, it helps towards meaningful comparison and study. It also ensures consistency in the accounting statements of a business enterprise from year to year. In effect, it facilitates a more meaningful comparison among accounting statements of different enterprises. As a result, the users of accounting information can understand and make proper use of accounting statements for decision-making.

The need for the *uses* of accounting standards are as follows :

(1) Accounting standards promote better understanding of accounting statements, the disclosure of significant accounting policies and the manner in which accounting policies are disclosed in the statements.
(2) Accounting information is more useful if it is published on a comparable basis, and *comparability* is not possible without accounting standards.
(3) Accounting standards provide a generally accepted language for financial statements that renders them more comprehensible to the users of accounting information.
(4) Accounting standards may be regarded as a means to establish that the collective wisdom and experience rather than the viewpoint of individual accountant may prevail in the matter.

Accounting Standard Board (ASB)

On April 21, 1977, The Institute for Chartered Accountants of India constituted the Accounting Standard Board (ASB) for formulation of Accounting Standards in India. The main functions of ASB is to formulate different accounting standards after taking into consideration the applicable laws, customs, usages and business environment. ASB will issue guidance notes on the Accounting Standards and give clarifications on issues arising therefrom.

ASB will also review the Accounting Standards at periodical intervals. However, the Accounting Standards will be issued under the authority of the Council of the Institute of Chartered Accountants of India.

Procedure for Issuing Accounting Standards

Broadly, the following procedures are adopted by ASB for formulating Accounting Standards :

1. Determination of the broad areas in which Accounting Standards need to be formulated.
2. Formulation of Study Groups. At the time of formation of study groups, provisions will be made for wide participation by the members of the Institute and others. The study groups will help ASB in the preparation of the Accounting Standards.
3. Holding of dialogue by ASB with the representatives of the Government, Public Sector Undertakings, Industry and other organisations for ascertaining their views.
4. Preparation and publication of an exposure draft of the proposed standard for comments by members of the Institute and the public at large. An exposure draft is prepared on the basis of the work of the study groups and the dialogue with the different parties as mentioned above.

The draft of the proposed standard will include the following basic points :
(a) A statement of concepts and fundamental accounting principles relating to the Standard.
(b) Definitions of the terms used in the Standard.
(c) The manner in which the accounting principles have been applied for formulating the Standard.
(d) The presentation and disclosure requirements in complying with the Standard.
(e) Class of enterprises to which the Standard will apply.
(f) Date from which the Standard will be effective.

5. Finalisation of the draft by ASB after considering the comments received from different corners.
6. Submission of the final draft to the Council of the Institute of Chartered Accountants of India.
7. The Council will consider the final draft of the proposed standard and if found necessary modify the same in consultation with ASB.
8. Publication of the Standard on the relevant subject under the authority of the Council.

National and International Accounting Authorities

In response to the long felt need for standardisation of accounting on a global scale, the International Accounting Standards Committee (IASC) was formed in 1973. This leading professional accounting institute of nine developed countries was set up for securing more sophistication and precision in accounting procedure worldwide. In 2001, the IASC was dissolved and the IASB (International Accounting Standard Board) was established.

The sixteen accounting bodies from these nine nations are as follows :

Sl. No.	Nations	Sl. No.	Bodies
1.	Australia	1.	The Institute of Chartered Accountants in Australia.
		2.	Australian Society of Accountants.
2.	Canada	3.	The Canadian Institute of Chartered Accountants.
3.	France	4.	Order des Experts Compatables et des Compatables Agrees.
4.	Germany	5.	Institut der Wirtschaftspirufer in Deutschland e.V.
		6.	Wirtschaftspruferkammer.

5.	Japan.	7.	The Japanese Institute of Certified Public Accountants.
6.	Mexico.	8.	Instituto Mexican de Contadores Publicos
7.	Netherlands	9.	Netherlands Institute van Register - Accountants.
8.	United Kingdom & Ireland	10.	The Institute of Chartered Accountants in England & Wales.
		11.	The Institute of Chartered Accountants of Scotland.
		12.	The Institute of Chartered Accounts in Ireland.
		13.	The Association of Certified Accountants.
		14.	The Institute of Cost and Management Accountants.
		15.	The Chartered Institute of Public Finance and Accountancy.
9.	United States of America	16.	The American Institute of Certified Public Accountants.

The revised agreement and constitution were signed in November 1982. Both the Institute of Chartered Accountants of India and the Institute of Cost and Works Accountants of India are the members of the IASC.

Adoption of International Financial Reporting Standard (IFRS)

Introduction

In the last decade of the past century phenomenal growth in the fields of communication and transportation has created the concept of an economic global village and this has given tremendous thrust in trade and commerce worldwide.

In the present scenario, the corporate entities are going for cross border businesses. More and more countries are opening their doors to foreign investments. Many foreign companies, e.g., Nokia, Toyota, Honda, HP and Dell computers are investing huge amount of capital in India and China. Similarly, many Indian companies are also investing in foreign countries, for example, Tata Motors Ltd., has invested in UK, Korea and Thailand, etc. In the same way, Reliance Industries Ltd. has invested in Brazil, Iraq, etc.

In addition, more and more Indian companies are increasingly accessing the global capital market to fulfill their capital needs.

For example:

During 2014-15, more than ₹ 1,20,000 crores of capital were arranged from global market by the Indian Companies [Source: Hindu Business Line]

There has been a paradigm shift in the economic environment of our country too, so the need for a country-specific accounting standard has given way to a need for global or international accounting standards. In present scenario, the corporate entities are going for cross border businesses. You must be hearing about the multinational companies everyday in newspapers and other media. So, do you understand what huge amount of capitals will be required and raised by these companies and how these can change the economic prospects of all of us, you and me and all learned persons who are actually investing in these companies? Yes, it involves humongous amount of money and so we the users and our investors need to understand their working to put so much money in them. Well, we can just study the reports they present us and these reports better be based on an uniform standard which is followed by every country taking part in the world-wide trade and commerce.

The International Accounting Standards Board (IASB), has developed and issued the International Financial Reporting Standards (IFRS) which has been recognized as Global Reporting Standards. More than 120 countries like the European Union, Australia, New Zealand and Russia has either already adopted or permitted the IFRSs as a tool for financial reporting.

The Ministry of Corporate Affairs (MCA) has issued 39 converged Accounting Standards on 16th February, 2015. The list of Accounting Standards are given in the next page.

The list of these new standards are given below. It is called 'Ind-AS". However, the MCA has not notified the date from when these Ind-AS will be effective.

1. **Ind-AS : 1 Presentation of Financial Statements**
2. **Ind AS : 2 Inventories**
3. **Ind AS : 7 Statement of Cash Flows**
4. **Ind AS : 8 Accounting Policies, Changes in Accounting Estimates and Errors**
5. **Ind AS : 10 Events after the Reporting Period**
6. **Ind AS : 12 Income Taxes**
7. **Ind AS : 16 Property, Plant and Equipment**
8. **Ind AS : 17 Leases**
9. **Ind AS : 19 Employee Benefits**
10. **Ind AS : 20 Accounting for Government Grants and Disclosure of Government Assistance**
11. **Ind AS : 21 The Effects of Changes in Foreign Exchange Rates**
12. **Ind AS : 23 Borrowing Costs**
13. **Ind AS : 24 Related Party Disclosures**
14. **Ind AS : 27 Separate Financial Statements**
15. **Ind AS : 28 Investments in Associates and Joint Ventures**
16. **Ind AS : 29 Financial Reporting in Hyperinflationary Economies**
17. **Ind AS : 32 Financial Instruments: Presentation**
18. **Ind AS : 33 Earnings per Share**
19. **Ind AS : 34 Interim Financial Reporting**
20. **Ind AS : 36 Impairment of Assets**
21. **Ind AS : 37 Provisions, Contingent Liabilities and Contingent Assets**
22. **Ind AS : 38 Intangible Assets**
23. **Ind AS : 40 Investment Property**
24. **Ind AS : 41 Agriculture**
25. **Ind-AS : 101 First-time Adoption of Indian Accounting Standards**
26. **Ind AS : 102 Share-based Payment**
27. **Ind AS : 103 Business Combinations**
28. **Ind AS : 104 Insurance Contracts**
29. **Ind AS : 105 Non-current Assets Held for Sale and Discontinued Operations**
30. **Ind AS : 106 Exploration for and Evaluation of Mineral Resources**
31. **Ind AS : 107 Financial Instruments: Disclosures**
32. **Ind AS : 108 Operating Segments**
33. **Ind AS : 109 Financial Instruments**
34. **Ind AS : 110 Consolidated Financial Statements**
35. **Ind AS : 111 Joint Arrangements**
36. **Ind AS : 112 Disclosure of Interests in Other Entities**
37. **Ind AS : 113 Fair Value Measurement**
38. **Ind AS : 114 Regulatory Deferral Accounts**
39. **Ind AS : 115 Revenue from Contracts with Customers**

Obligation to comply with Indian Accounting Standards (Ind AS)

The Companies and their auditors shall comply with the Indian Accounting Standards (Ind AS) specified in Annexure to these rules in preparation of their financial statements and audit respectively, in the following manner, namely :

(i) any company may comply with the Indian Accounting Standards (Ind AS) for financial statements for accounting periods beginning on or after **1stApril, 2015**, with the comparatives for the periods ending on 31st March, 2015, or thereafter;

(ii) the following companies shall comply with the Indian Accounting Standards (Ind AS) for the accounting periods beginning on or after **1st April, 2016**, with the comparatives for the periods ending on 31st March, 2016, or thereafter, namely :

(a) companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of rupees five hundred crore or more;

(b) companies other than those covered by sub-clause (a) of clause (ii) of subrule (1) and having net worth of rupees five hundred crore or more;

(c) holding, subsidiary, joint venture or associate companies of companies covered by sub-clause (a) of clause (ii) of sub- rule (1) and sub-clause (b) of clause (ii) of sub- rule (1) as the case may be; and

(iii) the following companies shall comply with the Indian Accounting Standards (Ind AS) for the accounting periods beginning on or after **1st April, 2017**, with the comparatives for the periods ending on 31st March, 2017, or thereafter, namely :

(a) companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of less than rupees five hundred crore;

(b) companies other than those covered in clause (ii) of sub- rule (1) and sub-clause (a) of clause (iii) of sub-rule (1), that is, unlisted companies having net worth of rupees two hundred and fifty crore or more but less than rupees five hundred crore.

(c) holding, subsidiary, joint venture or associate companies of companies covered under sub-clause (a) of clause (iii) of sub- rule (1) and sub-clause (b) of clause (iii) of sub- rule (1), as the case may be.

Provided that nothing in this sub-rule, except clause (i), shall apply to companies whose securities are listed or are in the process of being listed on SME exchange as referred to in Chapter XB or on the Institutional Trading Platform without initial public offering in accordance with the provisions of Chapter XC of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.

Explanation 1. – SME Exchange shall have the same meaning as assigned to it in Chapter XB of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.

Explanation 2. – 'Comparatives' shall mean comparative figures for the preceding accounting period.

Benefits of Achieving the Convergence with IFRSs

To understand the benefits of achieving the convergence with the IFRSs, you need to understand who or what are exactly the prime beneficiaries. The beneficiaries are:

1. The economy of our country
2. The investors
3. The industry
4. The accounting professionals

Let us now consider the advantages of having a uniform global accounting standard and regulatory framework from the viewpoint of all the above-mentioned aspects.

1. The Economy of Our Country

Globalization has given birth to lots of hope and scopes for the economic benefit of our country. With globalization and liberalization of policies, the entire world has taken the form of an economic village. Advent of Internet and the revolution in telecommunication has made it possible for businesses to reach out to foreign shores crossing borders. More and more countries are opening their doors to foreign investments and more and more markets are emerging to fulfill the capital needs as well as the end users or customers for the businesses. In such a situation, convergence of our accounting principles with an international standard is of vital importance. It helps the economy to:

- Expand.
- Be more dynamic.
- Be more strategic.
- Be more competitive
- Maintain the capital markets more efficiently.
- Encourage investment from foreign investors.
- Bring more foreign capital.

2. The Investors

Investors could be stated as the party most benefited by the convergence. They are the people to invest money into different companies and markets. So they are in need of relevant, reliable and comparable financial reports available at right time. They are taking the risks of investing money crossing not only geographic borders but also crossing different jurisdiction. Convergence with IFRSs will help them in:

- Acquiring relevant, reliable, comparable and timely information regarding businesses across the globe.
- Understanding the business opportunities better.
- Reducing cost of interpretation of different accounting standards for different countries.
- Gaining confidence.

3. The Industry

A global market with a global and standard regulatory framework gives tremendous thrust to the industry. A global market will bring more foreign capital and give boost to the country's economy. A globally accepted accounting standard will simplify the process of financial reporting which in turn will reduce cost. So if we list out the benefits, these are:

- More foreign investors.
- More foreign capital.
- Simplicity in financial reporting.
- Reduced cost of reporting.

4. The Accounting Professionals

Accounting professionals provide their services and expert knowledge to different business entities and enterprises. Presence of a global accounting standard will help in opening doors for our professionals to different parts of the world. You must have observed our engineers, doctors and technicians have gone to foreign countries and have done extremely well in all aspects of life. But it was not the case for our accounting professionals. India traditionally had followed her own 'Generally Accepted Accounting Principles' which was substantially different from other developed countries. It hindered the scope for our accounting professionals to sell their expertise and knowledge in these countries. With convergence to IFRSs they can:

- Provide their skills and knowledge in different parts of the world.
- Can provide recommendation in financial reporting to different MNCs and foreign companies both as professionals in industry or private practice.

List of Current Accounting Standards

AS– 1 : Disclosure of Accounting Policies
AS– 2 : Valuation of Inventories
AS– 3 : Cash Flow Statement
AS– 4 : Contingencies and Events Occurring After the Balance Sheet Date
AS– 5 : Net Profit or Loss for the Period, Prior Period Items and Change in Accounting Policies
AS– 6 : Depreciation Accounting
AS– 7 : Construction Contracts

AS– 9 : Revenue Recognition
AS–10 : Accounting for Fixed Assets
As–11 : Accounting for the Effects of Changes in Foreign Exchange Rates
AS–12 : Accounting for Government Grants
AS–13 : Accounting for Investments
AS–14 : Accounting for Amalgamation
AS–15 : Accounting for Retirement Benefits in the Financial Statements of Employees
AS–16 : Borrowing Costs
AS–17 : Segment Reporting
AS–18 : Related Party Disclosures
AS–19 : Accounting for leases
AS–20 : Earnings Per Share
AS–21 : Consolidated Financial Statements
AS–22 : Accounting for Taxes on Income
AS–23 : Accounting for Investments in Associates in Consolidated Financial Statement
AS–24 : Discounting Operations
AS–25 : Interim Financial Reporting
AS–26 : Accounting for Intangible Assets
AS–27 : Financial Reporting of Interests in Joint Ventures
AS–28 : Impairment of Assets
AS–29 : Provisions, Contingent Liabilities and Contingent Assets
AS–30 : Financial Instruments : Recognition and Measurement
AS–31 : Financial Instruments : Presentation
AS–32 : Financial Instruments : Disclosure

AS — 1 : Disclosure of Accounting Policies [Effective Date : 1st April, 1991]

Introduction

Accounting policies are the specific accounting principles and the methods of applying these principles adapted by an enterprise in preparing and presenting financial statements. For some type of transactions and events, an Accounting Standard provides alternative accounting principles and methods of accounting.

For example, a business enterprise is required to provide for depreciation on its fixed assets and also to value the stock at the end of each accounting period. There are, however, a number of alternative methods of providing for depreciation (e.g., Straight Line Method, Reducing Balance Method, etc.) or of valuing stock (e.g., FIFO, Weighted Average, etc.).

The other examples are:

» Treatment of expenditure during construction
» Conversion or translation of foreign currency items
» Treatment of goodwill
» Valuation of investments
» Treatment of retirement benefits
» Recognition of profit on long-term contracts
» Valuation of fixed assets
» Treatment of contingent liabilities.

Since there is no list of accounting policies which are applicable to all circumstances, the accountant should evaluate the appropriateness of accounting policies employed by management. An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions. In the absence of a standard of an interpretation that specifically applies to a situation of diverse and complex economic activity, management shall use its judgment in developing and applying an accounting policy that results in information that is relevant and reliable.

Fundamental Accounting Assumptions

Certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.

The following have been generally accepted as fundamental accounting assumptions:

(a) Going Concern
(b) Consistency
(c) Accrual

Going Concern

Unless otherwise stated, the users of financial statements assume that the enterprise is a going concern, and it will continue operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations.

Consistency

Unless otherwise stated, the users of financial statements assume that there is no change in the accounting policies from one period to another.

If it is necessary to change the method being employed, then an explanation of the change and the effects it is having on the results must be disclosed for the benefit of the users of financial statements.

For example, X Ltd. charging depreciation following straight line method for last 5 years (2009-10 to 2013-14). The users of financial statements will assume that the straight line method of depreciation has been adapted at the time of preparation of financial statements for the year 2014-15 also.

Accrual

Unless otherwise stated, the users of financial statements assume that the financial statements have been prepared on accrual basis. Under accrual basis of accounting revenues and costs are recognised as they are earned or incurred, not as money is received or paid.

Example 1 : X Ltd. sold goods of ₹ 10,00,000 on 20th March, 2014. Credit term — one month. At the time of preparing financial statements for the period 2013-14, this revenue from sale of ₹ 10,00,000 will be recognised in the accounts of 2013-14, though cash will be received in the next financial year.

Example 2 : X Ltd has received electricity bill for the month of March 2014. The due date for payment is 10th April, 2014. As the electricity bill is related to accounting year 2013-14, it should be recognised as expenses for the year 2013-14, though the payment to be made in the next financial year.

Considerations in the Selection of Accounting Policies

The primary consideration in the selection of Accounting Policies by an enterprise is that the financial statements prepared and presented on the basis of such accounting policies should represent a true and fair view of the state of affairs of the enterprise as at the Balance Sheet date and of the profit or loss for the period ended on that date. For this purpose, the major considerations governing the selection and application of accounting policies are:

Prudence

Future is always uncertain. Many times, accountants are faced with uncertainties in estimating and judging some items at the time of preparation of financial statements. In these situations the accountants look to the concept of prudence / conservatism.

This concept requires that assets and profits should not be overstated and revenue should never be anticipated at the time when the financial statements are prepared. Revenue can only be recorded in the books of account when there is a reasonable certainty about its realisation. At the same time, provision must be made for all possible liabilities. It is not important whether the amount of liability is known with certainty or is based on estimation. To illustrate, inventories are recorded at their cost or Net Realisable Value (NRV), whichever is lower. Likewise, if there is an anticipation that a debt may not be realised, a specific amount is set aside from profit as a provision for doubtful debts. This concept is expressed as : "Recognise all losses and anticipate no gains". This concept attempts to state the *lowest likely value* of assets and profits, and the *highest likely amount* of any losses or liabilities incurred.

Substance over Form

The accounting treatment and presentation in financial statements of transactions and events should be governed by their substance and not merely by the legal form. In accounting, substance should normally take *precedence* over form in deciding how a particular transaction should be recorded. The legal form of a transaction is frequently descriptive of its economic substance. However, the form occassionally misrepresents the characteristics that are relevant to users. If the substance can be reliably determined, the accountant should describe the transaction in terms of the substance rather than the form. Accounting for hire-purchase transactions, for example, is based on the above concept, i.e., it looks at the substance of the transaction rather than its legal form. The hire-purchaser can record the asset at its cash down price, while paying for it by installments over an agreed period of time.

Materiality

Financial statements should disclose all material items. An item is material if the user would have done something differently if he or she had not known about the item. The accountants are often faced with decisions about small items or events that make little difference to users of financial statements no matter how they are handled. For example, Reliance Industries Ltd. may decide that expenditure for utensils in Workers' Canteen should be charged as expenses rather than recorded as long-term assets and depreciated.

Disclosure of Accounting Policies

To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.

Such disclosure should form part of the financial statements. It would be helpful to the reader of financial statements if they are all disclosed as such in one place instead of being scattered over several statements, schedules and notes.

Any change in the accounting policy which may have a material effect should be disclosed. The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. If a change is made in the accounting policies which has no material effect on the financial statements for the current period but which is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.

OBJECTIVE TYPE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below :

1. Disclosure of fundamental accounting assumptions are :
   A necessary if they are followed at the time of preparation of financial statements
   B necessary if they are not followed at the time of preparation of financial statements
   C none of the above

2. What does the going concern mean ?
   A a business is profitable
   B a business will continue to operate for the foreseeable future
   C the assets of a business exceed its liabilities
3. A very large company has prepared financial statements without including very small items of furniture in its fixed assets. What accounting concept has the company applied ?
   A prudence
   B consistency
   C materiality
4. Two companies buy identical computer equipment. The large company writes it off immediately, but the smaller company treats it as a fixed asset. Which accounting concept are the companies applying ?
   A going concern
   B materiality
   C consistency
5. Which is an example of the prudence concept ?
   A only items with a monetary value are included in accounting
   B accrued expenses are charged to profit and loss account
   C profit is not over-stated
6. Which of the following statements explain prudence concept most closely ?
   A All legislation and accounting standards have been complied with
   B Understatement of assets or gains and overstatements of liabilities or losses
   C The application of a degree of caution in exercising judgment under conditions of uncertainty
7. Which of the following statements is / are correct ?
   (1) In order to achieve comparability it may sometimes be necessary to override the prudence concept.
   (2) Substance over form is an accounting concept whereby transactions and other events are accounted for and presented in accordance with their economic reality rather than legal form.
   A both (1) and (2)
   B (1) only
   C (2) only
8. A company purchases a machinery on hire purchase over four years but does not own the machinery until the final payment has been made. At the end of year 1, the company shows the machinery in its Balance Sheet as a fixed asset and also records the liability for the amount still owed. Which accounting concept is being applied ?
   A going concern
   B substance over form
   C prudence

Guide to Answers

1. B; 2. B; 3. C; 4. B; 5. C; 6. C; 7. C; 8. B.

AS–2 "Valuation of Inventories" — See Chapter 9 — Page 9.1 to 9.13

AS — 3 : Cash Flow Statement (Revised)
[Effective Date : 1st April, 2001]

Introduction

Balance Sheet and Profit and Loss Account prepared by an enterprise (on accrual basis) can not provide the information in respect of its cash flow. An enterprise can earn good profits by selling goods on credit but it may not generate sufficient cash to carry on its operating activities or investing activities. A cash flow statement shows an enterprise's inflows and outflows of cash during a particular accounting period. The statement shows the impact of operating, financing and investing activities on cash.

The ability to make profits may not be enough for the survival of an enterprise. It is also important for the enterprise to generate sufficient cash for its survival. The enterprise must pay great attention to liquidity as well as profitability if they are to succeed.

Negative cash flows for more than one accounting period is a strong sign of potential problem that can affect enterprise's operations as well as financing and investing activities. Therefore, cash flow statement is extremely useful for proper financial planning and control.

Objective

Information about the cash flows of an enterprise is useful in providing users of financial statements with a basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilise those cash flows. The economic decisions that are taken by users require an evaluation of the ability of an enterprise to generate cash and cash equivalents and the timing and certainty of their generation.

Scope

1. An enterprise should prepare a cash flow statement and should present it for each period for which financial statements are presented.
2. Users of an enterprise's financial statements are interested in how the enterprise generates and uses cash and cash equivalents. This is the case regardless of the nature of the enterprise's activities and irrespective of whether cash can be viewed as the product of the enterprise, as may be the case with a financial enterprise.

Enterprises need cash for essentially the same reasons, however different their principal revenue-producing activities might be. They need cash to conduct their operations, to pay their obligations, and to provide returns to their investors.

Benefits of Cash Flow Information

1. It provides information about an enterprise's liquidity, flexibility and ability to generate future cash flows, which is critically important to survival and to successful growth.
2. It can provide information about an entity's ability to meet its obligations as they become due.
3. It enhances the comparability of the reporting of operating performance by different enterprises because it eliminates the effects of using different accounting treatments of the same transactions and events.
4. It helps to assess the reliability of the amount of net profit.
5. It can account for the difference between net profit and net cash flow from operating activities.
6. The statement enables users to assess why assets and liabilities are increased or decreased during an accounting period.
7. It can provide information concerning cash and non-cash, financing and investing transactions during an accounting period.
8. It will help in assessing likely future financing needs.
9. It will help in assessing the effect of major events such as issue of shares or acquiring another business on the liquidity of the business.

Definitions

Cash: Cash comprises cash in hand and demand deposits with bank.

Cash Equivalents: Cash equivalents are short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

For example, your company at present holding cash of ₹ 200 crores received from recent IPO. All these cash will be required after two months from now. To earn interest on this cash balance, your company put it in 60 days short-term deposits. This short-term deposit will be treated as cash equivalent.

Cash Flows: Cash flows are inflows and outflows of cash and cash equivalents.

Operating Activities : Operating activities are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.

Investing Activities : Investing activities are the acquisition and disposal of long-term assets not included in cash equivalents.

Financing Activities : Financing activities are activities that result in changes in the size and composition of the owners' capital (including preference share capital in the case of a company) and borrowings of the enterprise.

Cash and Cash Equivalents

Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. For an investment to qualify as a cash equivalent, it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Investments in shares are excluded from cash equivalents unless they are, in substance, cash equivalents; for example, preference shares of a company acquired shortly before their specified redemption date (provided there is only an insignificant risk of failure of the company to repay the amount at maturity).

For example, X Ltd. has purchased some preference shares of Reliance Industries Ltd. on 20th January, 2014. These preference shares are due for redemption on 4th April, 2014. These may be considered to be cash equivalents because there is no risk of failure of RIL to pay the amount at maturity.

Here, it should be noted that bank overdraft will be treated as cash and cash equivalents. Bank overdraft is an integral part of an enterprise's cash management.

For example, your company is manufacturing woollen garments only. From September to February, your company is having positive cash balance because of seasonal sale. Your company is putting it in short-term deposit. From March to August the company is having negative cash balance because of purchase of raw materials and other expenses and these are financed by bank overdraft. The overdraft is treated as a cash equivalent.

Cash flows excluded movements between items that constitute cash or cash equivalents because these components are part of the cash management of an enterprise rather than part of its operating, investing and financing activities. Cash management includes the investment of excess cash in cash equivalents.

Presentation of a Cash Flow Statement

The standard requires that three separate categories of cash flow should be shown in the Cash Flow Statement. These are :

1. Operating Activities;
2. Investing Activities; and
3. Financing Activities.

An enterprise presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its business. Classification by activity provides information that allows users to assess the impact of those activities on the financial position of the enterprise and the amount of its cash and cash equivalents. This information may also be used to evaluate the relationships among those activities.

A single transaction may include cash flows that are ***classified differently***.

For example, when the installment paid in respect of a fixed asset acquired on deferred payment basis includes both interest and loan, the interest element is classified under financing activities and the loan element is classified under investing activities.

Operating Activities

The amount of cash flows arising from operating activities is a key indicator of the extent to which the operations of the enterprise have generated sufficient cash flows to maintain the operating capability of the enterprise, pay dividends, repay loans and make new investments without recourse to external sources of financing.

For example, H Ltd. manufactures motor cars. Because of poor response for the new model introduced recently, the operating activity is not generating cash. Inventories are increasing rapidly and dealers are asking excessive credit period. Unless corrective action is taken, H Ltd. will have to take loan from the bank or will have to sell its investments. Therefore, cash flow from operating activities are important.

Information about the specific components of historical operating cash flows is useful, in conjunction with other information, in forecasting future operating cash flows.

For example, RIL run chain of super markets — "Reliance Fresh". Every retail store that the company opens require ₹ 50,00,000 of additional inventory. Proper communication of this information will help users to predict the future operating cash flow.

Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the enterprise. Therefore, they generally result from the transactions and other events that enter into the determination of net profit or loss.

Examples of cash flows from operating activities are:

(a) cash receipts from the sale of goods and the rendering of services;

(b) cash receipts from royalties, fees, commissions and other revenue;

For example, your company is the owner of few patented life savings drugs. Your company receive an annual licence fee from each manufacturer of the drug, and a royalty for every unit sold. This royalty and licence fee will be treated as cash flows from operating activities.

(c) cash payments to suppliers for goods and services;

(d) cash payments to and on behalf of employees;

(e) Cash receipts and cash payments of an insurance enterprise for premiums and claims, annuities and other policy benefits;

(f) Cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities; and

(g) Cash receipts and payments relating to future contracts, forward contracts, option contracts and swap contracts when the contracts are held for dealing or trading purposes.

Some transactions, such as the sale of an item of plant, may give rise to a gain or loss which is included in the determination of net profit or loss. However, the cash flows relating to such transactions are cash flows from investing activities.

For example, X Ltd. sold a plant for ₹ 5,00,000. The book value was ₹ 4,00,000. The company made a profit of ₹ 1,00,000. For cash flow purposes, this profit is deducted from net profit and shown in investing activities ₹ 5,00,000 (₹ 4,00,000 + ₹ 1,00,000).

An enterprise may hold securities and loans for dealing or trading purposes, in which case they are similar to inventory acquired specifically for resale. Therefore, cash flows arising from the purchase and sale of dealing or trading securities are classified as operating activities. Similarly, cash advances and loans made by financial enterprises are usually classified as operating activities since they relate to the main revenue-producing activity of that enterprise.

Example 1 : Reliance Securities Ltd. is buying and selling securities. Cash flows arising from such activity will be treated as cash flow from operating activities.

Example 2 : HDFC Ltd. is giving housing loans and receiving repayments. The cash flows from these loans are shown as operating activity.

Investing Activities

The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows.

Examples of cash flows arising from investing activities are:

(a) cash payments to acquire fixed assets (including intangibles). These payments include those relating to capitalised research and development costs and self-constructed fixed assets;

For example, your company T.M. Ltd. has developed a new fuel efficient Bharat III diesel engine for its cars. Total cost for development of the engine is ₹ 150 crores. After successful trial it has been decided by the company to capitalise these expenses. For cash flow purposes, this will be treated as investing activity.

(b) cash receipts from disposal of fixed assets (including intangibles);

(c) cash payments to acquire shares, warrants or debt instruments of other enterprises and interests in joint ventures (other than payments for those instruments considered to be cash equivalents and those held for dealing or trading purposes);

For example, your Company Gujarat Chemicals Ltd. has purchased 15% equity shares of RPL which is supplying raw materials to your company. For cash flow purposes, this purchase of shares will be treated as investing activity.

(d) cash receipts from disposal of shares, warrants or debt instruments of other enterprises and interests in joint ventures (other than receipts from those instruments considered to be cash equivalents and those held for dealing or trading purposes);

(e) cash advances and loans made to third parties (other than advances and loans made by a financial enterprise);

(f) cash receipts from the repayment of advances and loans made to third parties (other than advances and loans of a financial enterprise);

(g) cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and

(h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

When a contract is accounted for as a hedge of an identifiable position, the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged.

Example 1 : Your company, Kamal Printers Ltd. has purchased a printing machine from Germany on credit. This is an investing activity. Your company will have to pay the price in 3 months' time in Euro. Your company has a forward contract to fix the purchase price of the Euro. This will also be treated as investing activity.

Example 2 : Let us assume that Kamal Printers Ltd has purchased ink from Mitsubishi Company, Japan on credit. This is an operating activity. The payment is to be made in two months in Yen. The company has a forward contract to fix the purchase price of the Yen. This is also treated as operating activity.

Financing Activities

The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of funds (both capital and borrowings) to the enterprise. Examples of cash flows arising from financing activities are:

(a) cash proceeds from issuing shares or other similar instruments;

(b) cash proceeds from issuing debentures, loans, notes, bonds, and other short or long-term borrowings; and

(c) cash repayments of amounts borrowed.

Reporting Cash Flows from Operating Activities

An enterprise should report cash flows from operating activities using either:

(a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(b) the indirect method, whereby net profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

The ***direct method*** provides information which may be useful in estimating future cash flows and which is not available under the indirect method and is, therefore, considered more appropriate than the indirect method. Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either:

(a) from the accounting records of the enterprise; or

(b) by adjusting sales, cost of sales (interest and similar income and interest expense and similar charges for a financial enterprise) and other items in the statement of profit and loss for:

i. changes during the period in inventories and operating receivables and payables;
ii. other non-cash items; and
iii. other items for which the cash effects are investing or financing cash flows.

Illustration 1

From the following summarised Cash Book of Green View Ltd calculate Net Cash Flows from Operating Activities.

Dr. Summarised Cash Book Cr.

Date	Particulars	₹ '000	Date	Particulars	₹ '000
2014			2015		
April 1	To Balance b/d	50	?	By Payment to Suppliers	2,600
	To Receipts from Customers	3,000	?	By Purchase of Plant	400
	To Issue of Shares	1,000	?	By Wages and Salaries	200
	To Sale of Plant	450	?	By Rent, Rates and Taxes	100
			?	By Income Tax	50
			?	By Dividends	100
			2015	By Repayment of Bank Loan	150
			March 31	By Balance c/d	900
		4,500			4,500

Solution

Green View Ltd.
Calculation of Net Cash Flows from Operating Activities [Direct Method]

Particulars	₹ ('000)	₹ ('000)
Cash receipts from Customers	3,000	
Cash payments to Suppliers	(2,600)	
Cash paid to Employees (Wages and Salaries)	(200)	
Other Cash Payments (for rent, rates and taxes)	(100)	
Cash Generated from Operations	100	
Income taxes paid (Note 1)	(50)	
Net Cash from Operating Activities		50

Working Note : **(1)** Income tax paid to be shown separately.

Illustration 2

From the following information calculate net cash flows from operating activities :

Dr. Trading, Profit and Loss Account for the year ended 31st March, 2015 Cr.

Particulars	₹	Particulars	₹
To Purchases :		By Sales :	
Cash	6,00,000	Cash	9,00,000
Credit	2,00,000	Credit	1,00,000
To Wages	1,00,000		
To Gross Profit c/d	1,00,000		
	10,00,000		10,00,000
To Depreciation on Plant	20,000	By Gross Profit b/d	1,00,000
To Salaries	50,000	By Interest Received	20,000
To Loss on Sale of Plant	5,000	By Profit on Sale of Long-term Investments	30,000
To Net Profit	75,000		
	1,50,000		1,50,000

All credit sales and purchases were made during the last quarter of the financial year. Therefore, no cash was paid to creditors or collected from debtors during the year.

You are required to calculate Cash Flows from Operating Activities by adopting Direct Method.

Solution

Calculation of Net Cash Flows from Operating Activities [Direct Method]

Particulars	₹	₹
Cash Sales		9,00,000
Cash Received from Customers		—
		9,00,000
Less: Cash Purchases	6,00,000	
Cash paid to Suppliers	—	
Cash Expenses (Wages + Salaries)	1,50,000	7,50,000
Net Cash Flows from Operating Activities		1,50,000

Under the indirect method, the net cash flow from operating activities is determined by adjusting net profit or loss for the effects of:

(a) changes during the period in inventories and operating receivables and payables;

(b) non-cash items such as depreciation, provisions, deferred taxes, and unrealised foreign exchange gains and losses; and

(c) all other items for which the cash effects are investing or financing cash flows.

Alternatively, the net cash flow from operating activities may be presented under the indirect method by showing the operating revenues and expenses excluding non-cash items disclosed in the statement of profit and loss and the changes during the period in inventories and operating receivables and payables.

Illustration 3

Calculate net cash flows from operating activities from the following :

(i) Profits made during the year ₹ 2,50,000 after considering the following items : —

	₹
(a) Depreciation on fixed assets	10,000
(b) Amortisation of goodwill	5,000
(c) Transfer to General Reserve	7,000
(d) Profit on sale of land	3,000

(ii) The following is the position of current assets and current liabilities —

Particulars	2014 (₹)	2013 (₹)
Debtors	15,000	12,000
Creditors	10,000	15,000
Bills Receivable	8,000	10,000
Prepaid Expenses	4,000	6,000

Solution **Calculation of Net Cash Flows From Operating Activities**

Particulars	₹	₹
Profit for the year 2014 after transferring to General Reserve		2,50,000
Add: Transferred to General Reserve		7,000
		2,57,000
Add back :		
Depreciation on fixed assets	10,000	
Amortisation of goodwill	5,000	15,000
		2,72,000
Deduct :		
Profit on sale of land		3,000
Cash Generated from Operations before Working Capital Changes		2,69,000
Increase in debtors	(3,000)	
Decrease in creditors	(5,000)	
Decrease in bills receivable	2,000	
Decrease in prepaid expenses	2,000	(4,000)
Net Cash Flows from Operating Activities		2,65,000

Reporting Cash Flows from Investing and Financing Activities

An enterprise should report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows are reported on a net basis.

Reporting Cash Flows on a Net Basis

Cash flows arising from the following operating, investing or financing activities may be reported on a net basis:

(a) cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the enterprise; and

Examples of cash receipts and payments are:

(a) the acceptance and repayment of demand deposits by a bank;

(b) funds held for customers by an investment enterprise; and

(c) rents collected on behalf of, and paid over to, the owners of properties.

(b) cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.

Examples of cash receipts and payments are advances made for, and the repayments of:
- **(a) principal amounts relating to credit card customers;**
- **(b) the purchase and sale of investments; and**
- **(c) other short-term borrowings, for example, those which have a maturity period of three months or less.**

Cash flows arising from each of the following activities of a financial enterprise may be reported on a net basis:
- (a) cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;
- (b) the placement of deposits with and withdrawal of deposits from other financial enterprises; and
- (c) cash advances and loans made to customers and the repayment of those advances and loans.

Foreign Currency Cash

Cash flows arising from transactions in a foreign currency should be recorded in an enterprise's reporting currency by applying to the foreign currency amount, the exchange rate between the reporting currency and the foreign currency at the date of the cash flow.

For example, your company Kid's Wear Ltd. has received $ 1,00,000 on March 20, 2015. Company's reporting currency is Rupee. The exchange rate on March 20, was $1 = ₹ 40. The transaction should be reported at ($1,00,000 × ₹ 40) = ₹ 40,00,000.

A rate that approximates the actual rate may be used if the result is substantially the same as would arise if the rates at the dates of the cash flows were used.

This permits the use of approximate rate in place of actual rate for recording foreign currency transaction.

For example, your company Kid's Wear Ltd. has received $1,00,000 on March 20, 2015. Company's reporting currency is Rupee. The policy of the company is to use Weighted Average Rate. The weighted average rate for the period is 39.95. The rate on March 20 was ₹ 40. The transaction can be reported at ($1,00,000 × ₹ 39,95) = ₹ 39,95,000.

Cash flows denominated in foreign currency are reported in a manner consistent with Accounting Standard (AS) 11, Accounting for the Effects of Changes in Foreign Exchange Rates.

Unrealised gains and losses arising from changes in foreign exchange rates are not cash flows.

For example, your Company, Tata Steel Ltd. has a foreign investment worth £250 crores. Company's reporting currency is Rupee. The exchange rate on January 1, 2015 was £1 = ₹ 60, but on 31st March, 2015 it is £1 = ₹ 65. The unrealised gain in rupee is not a cash flow.

However, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported in the cash flow statement in order to reconcile cash and cash equivalents at the beginning and the end of the period. This amount is presented separately from cash flows from operating, investing and financing activities and includes the differences, if any, had those cash flows been reported at the end of period exchange rates.

For example, your company, REL has a cash balance of 10,000 Euros. Company's reporting currency is Rupee. The exchange rate on 1st April, 2013 was 1 Euro = ₹ 60. The exchange rate on 31st March, 2015 is 1 Euro = ₹ 62. The gain of ₹ 20,000 is an exchange difference and is to be shown separately as part of reconciliation of change in cash and cash equivalents for the period.

Extraordinary Items

The cash flows associated with extraordinary items should be classified as arising from operating, investing or financing activities as appropriate and separately disclosed.

The cash flows associated with extraordinary items are disclosed separately as arising from operating, investing or financing activities in the cash flow statement, to enable users to understand their nature and effect on the present and future cash flows of the enterprise. These disclosures are in addition to the separate disclosures of the nature and amount of extraordinary items required by Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

For example, your company, Dunlop India Ltd. had a plot of prime land in Kolkata. During the year 2014-15 it has been sold at ₹ 150 crores which is 100 times more than the book value.

This is an extraordinary item and it is to be disclosed separately as cash flowfrom investing activity.

Interest and Dividend

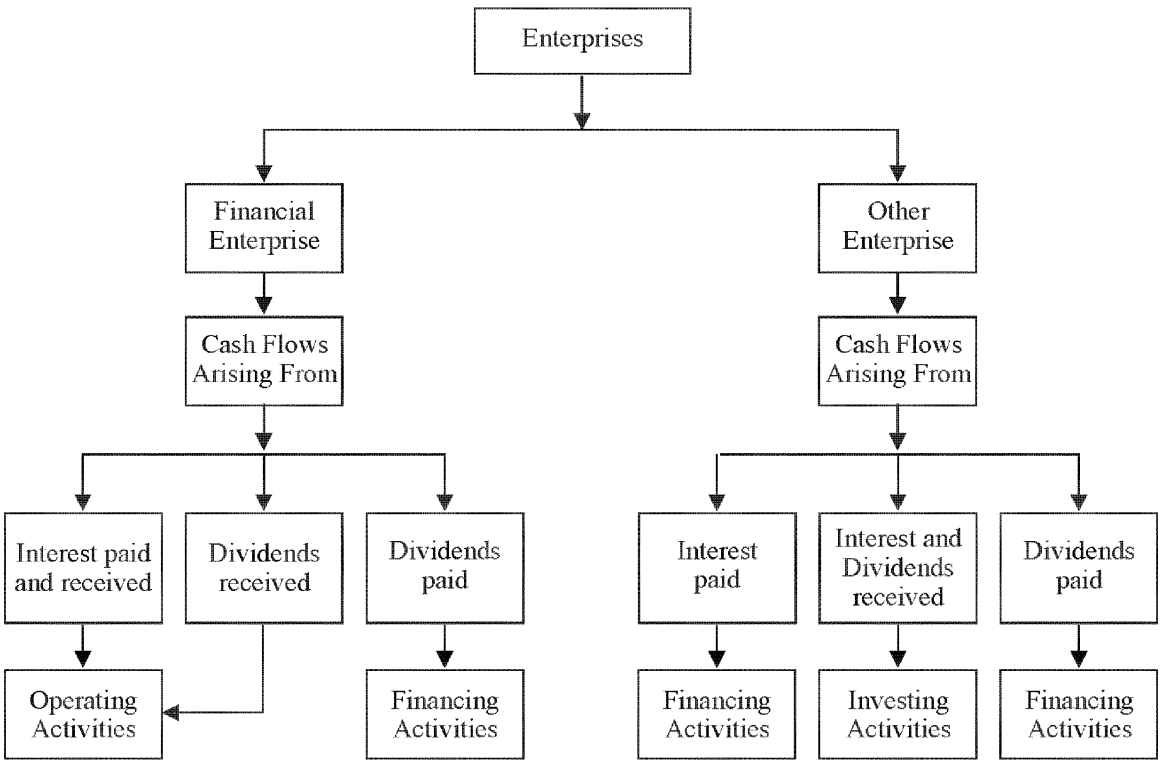
Interest and dividend shall be classified as follows :

For a financial enterprise

Interest paid and received, dividend received as ***operating activities***.
Dividend paid as ***financing activities***.

For other enterprises

Interest and dividend received as ***investing activities***.
Interest and dividend paid as ***financing activities***.
The following diagram will clear the matter.



Interest and dividends are received from investments. Naturally, they should be classified as cash inflows from investment activities (in case of other enterprises).
It should be noted that interest and dividend received from short-term investments included in cash and cash equivalents should be considered as cash inflows from operating activities. Similarly, any interest received on advance to employees, suppliers should be treated as cash inflows from operating activities. Interest paid on long term loan and dividend paid on equity / preference shares should be treated as cash outflows for financing activities. But interest on overdue payment, interest on overdraft etc. should be treated as outflows from operating activities.

Income-tax

Cash flows arising from taxes on income should be separately disclosed and should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities.

Similarly, income tax refund should be treated as cash inflow from operating activities and to be shown separately.

When tax cash flow are allocated over more than one class of activity, the ***total amount*** of taxes paid is disclosed.

Example 1 : Your company, Dunlop India Ltd. has sold a plot of land in Kolkata for ₹ 150 crores. Capital gain tax of ₹ 30 crores were paid for that transaction. This can be classified as a tax on investing activities.

Example 2 : Your company, X Ltd. has paid ₹ 2,00,000 tax for operating activities, ₹ 3,00,000 for investing activities and ₹ 1,00,000 for financing activities.

In each individual section, tax paid is to be shown separately and total tax paid ₹ 6,00,000 should be disclosed in the cash flow statement as a note.

Investment in Subsidiaries, Associates and Joint Ventures

When accounting for an investment in an associate or a subsidiary or a joint venture, an investor restricts its reporting in the cash flow statement to the cash flows between itself and the investee / joint venture, for example, cash flows relating to dividends and advances.

For example, X Ltd. owns 20% of Y Ltd. X Ltd. provided a loan of ₹ 10,00,000 to Y Ltd. and received ₹ 6,00,000 as dividends. These transactions will appear in the cash flow statement of X Ltd.

The internal cash flows of Y Ltd. are not consolidated into the cash flow figure of X Ltd.

Acquisitions and Disposals of Subsidiaries and Other Business Units

The aggregate cash flows arising from acquisitions and from disposals of subsidiaries or other business units should be presented separately and classified as ***investing activities***.

For example, X Ltd. has sold one of its subsidiary for ₹ 40 crores. This proceeds of ₹ 40 crores is to be shown in the cash flow statement of X Ltd. as an investing activity.

An enterprise should disclose, in aggregate, in respect of both acquisition and disposal of subsidiaries or other business units during the period each of the following :

(a) the total purchase or disposal consideration; and
(b) the portion of the purchase or disposal consideration discharged by means of cash and cash equivalents.

The separate presentation of the cash flow effects of acquisitions and disposals of subsidiaries and other business units as single line item helps to distinguish those cash flows from other cash flows. The cash flow effects of disposals are not deducted from those of acquisitions.

For example, during 2014-15 H Ltd. buy S Ltd.'s 30% equity shares for ₹ 100 crores. For this purpose, H Ltd. sold one of its subsidiary, X Ltd. for ₹ 80 crores. The flow for purchase of S Ltd. and sale of X Ltd. is to be disclosed in the cash flow statement separately. Net ₹ 20 crores outflow will not be shown in the cash flow statement.

Non-Cash Transactions

Investing and financing transactions that do not require the use of cash or cash equivalents should be excluded from a cash flow statement. Such transactions should be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.

Many investing and financing activities do not have a direct impact on current cash flows although they do affect the capital and asset structure of an enterprise. The exclusion of non-cash transactions from the cash flow statement is consistent with the objective of a cash flow statement as these items do not involve cash flows in the current period. Examples of non-cash transactions are :

(a) the acquisition of assets by assuming directly related liabilities;
(b) the acquisition of an enterprise by means of issue of shares; and
(c) the conversion of debt to equity.

For example, during 2012-13 X Ltd. issued 20,000, 10% fully convertible debentures of ₹ 100 each. These debentures were converted into 2,00,000 equity shares of ₹ 10 fully paid during 2014-15. This conversion of debt into equity involves no inflow or outflow of cash. Therefore, it will not be shown in the cash flow statement of X Ltd. for the year 2014-15.

Components of Cash and Cash Equivalents

An enterprise should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the Balance Sheet.

For example, cash and cash equivalents includes :
(i) Cash in hand;
(ii) Cash at bank — in current account;
(iii) Short-term bank deposits;
(iv) 5% Government bonds (to be matured within 60 days)

In view of the variety of cash management practices, an enterprise discloses the policy which it adopts in determining the composition of cash and cash equivalents.

The effect of any change in the policy for determining components of cash and cash equivalents is reported in accordance with Accounting Standard (AS) – 5, Net Profit or Loss for the period, prior period items and changes in Accounting Policies.

Other Disclosures

An enterprise should disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the enterprise that are not available for use by it.

There are various circumstances in which cash and cash equivalent balances held by an enterprise are not available for use by it.

Example 1 : G Ltd. has a subsidiary in Bangladesh. It has cash balance of 20 lakhs Taka. The Bangladesh Government has frozen the bank account of the company for violation of foreign exchange regulations. This amount would be disclosed as cash not available for use with proper explanation by the management.
Example 2 : ₹ 20 crores has been deposited by your company in an 'Escrow Account' for the purpose of buy-back of its shares from the market. This amount would be disclosed as cash not available for use.

Additional information may be relevant to users to understand the financial position and liquidity of an enterprise. Disclosure of this information, together with a commentary by management, is encouraged and may include :

(a) the amount of undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these liabilities; and

(b) the aggregate amount of cash flows that represent increases in operating capacity separately from those cash flows that are required to maintain operating capacity.

Example 1 : For future requirement, H Ltd. applied for long-term loan. SBI has sanctioned ₹ 100 crores, which can be used in coming 4 years. At present, H Ltd. is using only ₹ 20 crores. This piece of information will help the users to understand the company's future plans for expansion and how it will be financed.

Example 2 : At present, M Ltd.'s Chennai Plant is operating at 100% capacity. During the accounting year 2014-15 the operating activities have generated ₹ 100 crores cash. For the purpose of increasing capacity M Ltd. has purchased 50 acres of land from Tamil Nadu Government which is adjacent to its existing Plant.

A separate disclosure will help the users to understand the future plan of the company.

The separate disclosure of cash flows that represent increases in operating capacity and cash flows that are required to maintain operating capacity is useful in enabling the user to determine whether the enterprise is investing adequately in the maintenance of its operating capacity. An enterprise that does not invest adequately in the maintenance of the operating capacity may be prejudicing future profitability for the sake of current liquidity and distributions to owners.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below :

1. A cash flow statement provides information that enables users to evaluate
   A the profitability of the company
   B the solvency of the company
   C the liquidity, flexibility and ability of the company to generate future cash flows.
2. Revenue from sales, expenses paid for purchases, employee salary and overheads comprise
   A operating activities
   B financing activities
   C investing activities
3. Payment to acquire plant and machinery and patents are
   A operating activities
   B investing activities
   C financing activities
4. Cash equivalents are held
   A for investment purposes
   B for the purpose of meeting short-term cash commitments
   C for other purposes
5. Activities that result in changes in the size and composition of the owners' capital and borrowing of the enterprise are
   A investing activities
   B financing activities
   C operating activities

6. An investment normally qualifies as a cash equivalent only when it has a short maturity of, say,
   A six months or less
   B four months or less
   C three months or less
7. Examples of cash flows arising from investing activities are :
   1. Cash received for sale of plant and machinery.
   2. Cash proceeds from issuing of shares.
   3. Cash received from disposal of shares of other enterprise.
   4. Cash paid for buy-back of shares.
   A all four
   B 1, 3 and 4
   C 1 and 3 only
   D 3 and 4 only
8. Examples of cash flows arising from financing activities are :
   1. Cash repayments of amount borrowed on long-term basis.
   2. Cash advances and loans made to third parties by a non- financial enterprise.
   3. Cash proceeds from short-term borrowings.
   A all three
   B 1 and 2 only
   C 1 and 3 only
   D 2 and 3 only
9. Which method of cash flow reporting starts with net profit for calculating cash flow from operating activities ?
   A Direct method
   B Indirect method
   C Neither
   D Both
10. Interest and dividend received from short-term investments included in cash and cash equivalents should be considered as
    A cash flow from investing activities
    B cash flow from financing activities
    C cash flow from operating activities
11. Dividend paid will be treated as cash flow from
    A operating activities in case of a financial enterprise
    B financing activities in case of a financial enterprise only
    C financing activities in case of both financial enterprise and other enterprise
12. Interest on overdue payment and interest on overdraft should be treated as cash flow from
    A financing activities
    B operating activities
    C investing activities
13. Generally cash flows arising from taxes on income should be classified as cash flows from
    A operating activities
    B investing activities
    C financing activities
14. Which of the following statement is true ?
    A The cash flows arising from acquisitions and from disposals of subsidiaries or other business units should be presented after netting off and classified as investing activities.
    B The cash flows arising from acquisitions and from disposals of subsidiaries or other business units should be presented separately as financing activities.
    C The cash flows arising from acquisitions and from disposals of subsidiaries or other business units should be presented separately as investing activities.

15. The acquisition of an enterprise by issue of shares will
    A be shown in the cash flow statement under investing activities
    B not be shown in the cash flow statement
    C be shown in the cash flow statement under financing activities
16. Cash flows arising from transactions in a foreign currency should be recorded
    A in an enterprise's reporting currency at the rate on the date of closing the books of account
    B in an enterprise's reporting currency at the rate on the opening date of the accounting period
    C in an enterprise's reporting currency at the rate on the date of cash flow
17. Unrealised gains and losses arising from changes in foreign exchange rates
    A are treated as cash flows from operating activities
    B are not treated as cash flow
    C are treated as cash flows from financing activities
18. Which of the following statement is correct ?
    A cash equivalents are short-term, highly liquid investments that are readily convertible into cash but the amount is not known
    B cash equivalents are short-term, semi-liquid investments that can be converted into cash at a discount
    C cash equivalents are short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value

Guide to Answers

1. C; 2. A; 3. B; 4. B; 5. B; 6. C; 7. C; 8. C; 9. B; 10. C; 11. C; 12. B; 13. A; 14. C; 15. B; 16. C; 17. B; 18. C

AS — 4 : Contingencies and Events Occurring After Balance Sheet Date*
[Effective Date : 1 April, 1995]

Introduction

There is a time gap between the Balance Sheet date and the date of approval of accounts by the Board of Directors. Many events may take place between these two dates, which can influence the profits of the enterprise. In many countries these events are reported through notes to the financial statements. However, in India, there is a specific accounting standard AS–4 to deal with post Balance Sheet events.

Events occurring after Balance Sheet date may be favourable or unfavourable.

These events can be disclosed either by changing the amounts included, or by way of disclosure. These measures are considered necessary as a means of ensuring that the financial statements are not misleading.

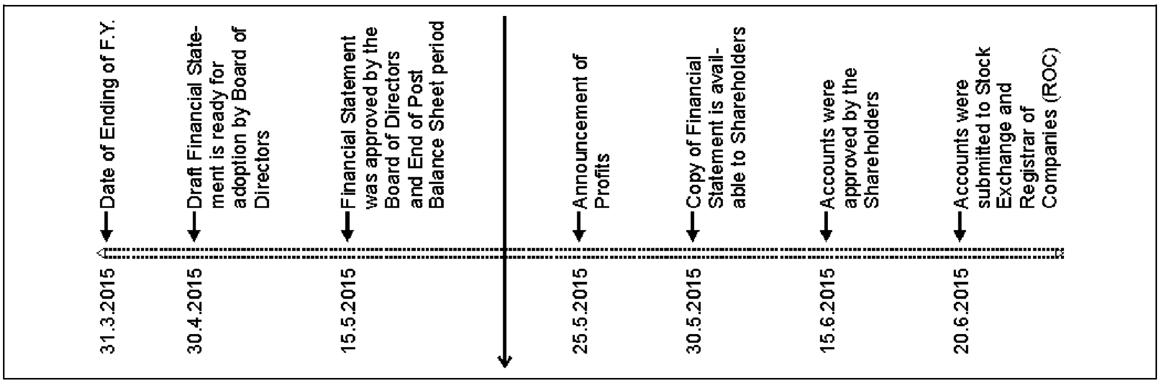
Definitions

Events after the Balance Sheet Date

Events occurring after the Balance Sheet date are those significant events, both favourable and unfavourable, that occur between the Balance Sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and, by the corresponding approving authority in the case of any other entity.

Here, date of approval of financial statements by the Board of Directors is very important. This date may vary depending on factors such as requirement of the Companies Act, Stock Exchange, etc. The date of approval by the Board of Directors is the end of the post Balance Sheet period.

Example :
(i) On 30.4.2015, A Ltd.'s draft financial statement was ready for the financial year ending on 31st March, 2015.
(ii) On 15.5.2015, the Board of Directors of A Ltd. approved the financial statements for issue.
(iii) On 25.5.2015, the enterprise announced its profits and selected other financial information.
(iv) On 30.5.2015, the financial statements were available with the shareholders of the company.
(v) On 15.6.2015, A Ltd.'s annual general meeting was held and the financial statements of the company was approved by the shareholders.
(vi) On 20.6.2015, the approved financial statements was filed with the Stock Exchange and ROC.
In this case, post Balance Sheet period starts from 1.4.2015 and ending on 15.5.2015.
Date of approval by the shareholders is not vital for this purpose.



*In this section, events occurring after Balance Sheet date will be discussed. Matters relating to "**Contingencies in AS–4**" have been superseded by "**AS–29 — Provisions, Contingent Liabilities**".

Events after Balance Sheet Date are classified into ***two*** categories :

(i) Adjusting Events

(ii) Non-adjusting Events

Adjusting Events

Adjusting Events are events that provide additional evidence relating to conditions ***existed*** at the Balance Sheet date and they require changes to be included in the financial statements.

Example 1 : A trade customer, for whose balance, a full specific provision has been made at 31st March, 2015, paid the full amount of ₹ 84,000 before the date of approval of financial statements by the Board of Directors.

It is an adjusting event. Provision for bad debts is to be reduced by ₹ 84,000 in the financial statements.

Journal entry :

Provision for Bad Debts Account	**Dr.**	**₹ 84,000**	
To Profit and Loss Account			**₹ 84,000**

The other examples are :

(a) The valuation of a fixed asset indicating a permanent diminution of value at the Balance Sheet date.

(b) The insolvency of a debtor included in the year and figure for debtors.

(c) The discovery of an error in the accounts.

Example 2 : Swapna Printing Press Ltd. is in the process of repairing one of its printing machine on 31st March, 2015 (the date of closing the books of account). On 10th May, 2015, the servicing company informed that the printing machine is irreparable for non-availability of some vital parts.

The machine at present appearing in the Balance Sheet of 31st March, 2015 at ₹ 40,00,000. The scrap value of the machine is ₹ 5,00,000 only.

Financial statements have not yet been approved by the Board of Directors.

This is an adjusting event. The value of the printing machine should be reduced to ₹ 5,00,000.

Journal Entry

Depreciation Account	**Dr. ₹ 35,00,000**	
To Accumulated Depreciation Account		**₹ 35,00,000**

Non-adjusting Events

Non-adjusting Events concerns conditions that ***did not exist*** at the Balance Sheet date and they do not result in changes in the financial statements, but they may be significant enough to justify a note to the accounts. The financial figures remain unaltered.

Example 1 : In April, 2015 a fire destroyed part of the company's warehouse, with an uninsured loss of inventory worth ₹ 10,00,000 and damaged the building, also uninsured, of ₹ 25,00,000. The going concern status of the company is not affected.

It is a non-adjusting event. The profit of the period under consideration will not be altered. However, a detailed note should be given stating the fact and its impact.

Example 2 : X Ltd. has invested a large amount in shares of Indian Bluechip Companies like Reliance Industries, ONGC and SBI. These shares performed well during the year 2014. Because of different factors, stock market crashed in the month of January, 2015 and remained very depressed until the date of approval of the financial statements. X Ltd. prepares its accounts on calendar year basis.

It is a non-adjusting event and financial figures remain unaltered. However, it is to be disclosed by way of a note stating the amounts involved.

Going Concern

Events occurring after the Balance Sheet date may indicate that the enterprise ceases to be a going concern. A deterioration in operating results and financial position, or unusual changes affecting the existence or substratum of the enterprise after the Balance Sheet date (e.g., destruction of a major production plant by a fire after the Balance Sheet date) may indicate a need to consider whether it is proper to use the fundamental accounting assumption of going concern in the preparation of the financial statements.

Example 1 : B Ltd. has prepared its account for year ended 31st March, 2015 in the usual manner. B Ltd.'s only plant has been destroyed by fire on 5th May, 2015. The plant was not insured. Now it is certain that the company will be liquidated.
The financial statements to 31st March, 2015 should be produced on a liquidation basis, not a going concern basis.

Example 2 : R Securities Ltd. has a client, A Agarwal & Co. that owes the company ₹ 50 crores in respect of securities trading on 31st March, 2015.
On 3rd April, 2015, A Agarwal & Co. goes into liquidation. It is estimated that nothing can be recovered from them.
R Securities Ltd. may be able to raise funds to recover the loss but the company is not sure about the timing.
The financial statements to 31st March, 2015 should be produced on a liquidation basis, not a going concern basis because of the uncertainty.

Disclosures

The following information should be disclosed in the report of the approving authority (i.e., Board of Directors) in respect of the events occurring after the Balance Sheet date :

(a) the nature of the event;
(b) an estimate of the financial effect or a statement that such an estimate cannot be made.

Illustration 1

State with reasons, whether the following are adjusting or non- adjusting events :

(a) The professional valuation of a fixed asset one month after the Balance Sheet date at a figure of ₹ 3,00,000 below the current book value. The diminution in value is considered to be permanent.
(b) The destruction of the company's warehouse two weeks after the Balance Sheet date. The loss on the building and the stock it contained amounted to ₹ 6,00,000; due to administrative error neither was insured.

Solution

(a) This is an adjusting event, because the valuation provides information about a condition existing at the Balance Sheet date. If it could be established that the decline in value occurred after the Balance Sheet date, it would become a non-adjusting event.
(b) This is a non-adjusting event which concerns a condition which did not exist at the Balance Sheet date. Moreover this event does not indicate that the enterprise ceases to be a going concern. Therefore, it should be disclosed in the notes to the financial statements.

Illustration 2

An earthquake destroyed a major warehouse of Daya Ltd on 18th May, 2015. The accounting year of the company ended on 31st March, 2015. The accounts were approved on 30th June, 2015. The loss from earthquake is estimated at ₹ 45 lakhs. State with reasons, whether the loss due to earthquake is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company ?

Solution

The loss due to earthquake is ***not an adjusting event*** because on the Balance Sheet date the event 'earthquake' did not exist.

The loss of ₹ 45 lakhs due to earthquake need not be recognised in the financial statement of 2014-15.

As the earthquake loss is significant, it should be mentioned in the Directors' Report of 2014-15. In this report, it is also to be stated that whether going concern assumption is still applicable or not.

Illustration 3

Cashier of A-One Limited embezzled cash amounting to ₹ 6,00,000 during March, 2015. However, the same comes to the notice of the company's management during April, 2015 only. Financial Statements of the company is not yet approved by the Board of Directors of the company. With the help of provisions of AS-4 'Contingencies and Events Occurring after the Balance Sheet Date' decide, whether the embezzlement of cash should be adjusted in the books of account for the year ending March, 2015 ?

What will be your answer, if embezzlement of cash comes to the notice of the company's management only after approval of Financial Statements of the company ?

Solution

The loss due to embezzlement by the cashier is ***an adjusting event*** because on the Balance Sheet date the embezzlement was existing though it was detected after Balance Sheet date but before approval of financial statements by the Board of Directors. The loss of ₹ 6,00,000 should be recognised in the financial statement of 2014-15.

If the embezzlement of cash comes to the notice of the company's management after the approval of financial statements by the Board of Directors, then it should be treated under AS-5. The loss should be shown in the Statement of Profit and Loss of 2015-16 as ***extraordinary item***. The nature and the amount of prior period items should be disclosed separately in the Statement of Profit and Loss.

Illustration 4

A company entered into an agreement to sell its immovable property to another company for ₹ 35 lakhs. The property was shown in the Balance Sheet at ₹ 7 lakhs. The agreement to sell was concluded on 15th February, 2015 and sale deed was registered on 30th April, 2015. The financial statements for the year 2014-15 were approved by the Board on 12th May, 2015.

You are required to state, how this transaction would be dealt with in the financial statements for the year ended 31st March, 2015.

Solution

According to para 13 of AS-4 'Contingencies and Events Occurring after the Balance Sheet Date', assets and liabilities should be adjusted for events occurring after the Balance Sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the Balance Sheet date. The agreement to sell was concluded on 15th February, 2015, i.e., before the Balance Sheet date. However, the registration of the property was done on 30th April, 2015 and this provides additional information relating to the conditions existing on the Balance Sheet date. Therefore, the assets should be adjusted and the profit on sale of property should be recognised in the financial statements of 2014-15.

Illustration 5

While preparing its final accounts for the year ended 31.3.2015, a company made a provision for bad debts @ 5% of its total debtors. In the last week of February 2015, a debtor for ₹ 2 lakhs had suffered heavy losses due to an earthquake, the loss was not covered by any insurance policy. In April, 2015 the debtor became bankrupt.

Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31.3.2015?

Solution

This is an adjusting event because it provides additional evidence relating to conditions ***existed*** at the Balance Sheet date. The company should provide for the entire amount of ₹ 2 lakhs arising out of bankruptcy of the debtors as loss of the current period.

Illustration 6

A company closed its accounting year on 31.3.2015 and the accounts for that period were considered and approved by the Board of Directors on 20.5.2015. The company was engaged in laying pipeline for an oil company, deep beneath the earth. While doing the boring work on 1.6.2015, it had made a rocky surface for which it was estimated that there would be an extra cost to the tune of ₹ 80 lakhs.

You are required to state with reasons, how the event would be dealt within the financial statements for the year ended 31.3.2015.

Solution

The date of approval by the Board of Directors is the end of the post Balance Sheet period. Here, accounts were approved by the Board of Directors on 20.5.2015. Any event occurring after this date should be disclosed as a note so as to enable the users of financial statements to make proper evaluations and decisions.

Illustration 7

A company deals in petroleum products. The sale price of petrol is fixed by the Government. After the Balance Sheet date, but before the finalisation of the company's accounts, the Government unexpectedly increased the price retrospectively.

Can the company account for additional revenue at the close of the year ? Discuss.

Solution

The company cannot recognise the unexpected increase in sale price as additional revenue. As per para 8 of AS—4: 'Events Occurring After the Balance Sheet Date', unexpected increase in sale price cannot be regarded as an event occurring after Balance Sheet date, which requires an adjustment of the Balance Sheet date, since it does not represent a condition present at the Balance Sheet date.

This retrospective increase in sale price of petrol should not be considered as a prior period item, as per AS—5 because there was no error in the preparation of previous period's financial statements. This revenue should be recognised in the subsequent year and it should be disclosed properly.

Illustration 8

A company follows April to March as its financial year. The company recognises cheques dated 31st March or before, received from customers after Balance Sheet date, but before approval of financial statement by debiting 'Cheques in Hand Account' and crediting 'Debtors Account'. The cheques in hand is shown in the Balance Sheet as an item of cash and cash equivalents. All cheques in hand are presented to bank in the month of April and are also realised in the same month in normal course after deposit in the bank. State with reasons, whether the collection of cheques bearing date 31st March or before, but received after Balance Sheet date is an adjusting event and how this fact is to be disclosed by the company ?

Solution

Cheques received after Balance Sheet date bearing the date of 31st March or before is ***not an adjusting event*** because receiving cheques after Balance Sheet date, do not represent any condition existing on the Balance Sheet date.

Collection of cheques after Balance Sheet date does not represent any material change affecting the financial position of the business. Therefore, ***no disclosure in Directors' Report is required***.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below :

1. Events occurring after balance sheet date are events, favourable or unfavourable, which occur between the Balance Sheet date and the date on which the financial statements:
   A are approved by the shareholders
   B are approved by the accounts committee
   C are approved by the Board of Directors
   D are approved by the audit committee.

2. Which of the following dates marks the end of the period covered by AS–4 ?
   A on 2nd May, 2015 the draft financial statements are ready for issue to accounts committee
   B on 9th May, 2015, accounts committee approves the financial statements
   C on 15th May, 2015 Board of Directors approves the financial statements
   D on 30th May, 2015 shareholders approve the financial statements in the general meeting
3. T.M. Ltd. made a major acquisition after the date of Balance Sheet but before the approval of the financial statements by the Board of Directors. The company should :
   A adjust the financial statements
   B ignore it
   C leave the financial statements but, disclose it by way of a note
4. R Ltd., a pharmaceutical company, has been sued by its competitor for patent violation. For this law suit, the company made a provision of ₹ 10,00,000 in its financial statements at 31st March, 2013 which have not yet been approved.
   On 14th April, 2015 the court awards ₹ 12,00,000 damages against R Ltd. The company should :
   A adjust the financial statements
   B leave the financial statements, but disclose it by way of a note
   C ignore it
5. X Ltd. sold its subsidiary, S Ltd. to Y Ltd. on 1st July, 2014 for ₹ 200 crores. In addition, X Ltd. will get ₹ 10 crores if the subsidiary (S Ltd.) can earn a targeted profit of ₹ 20 crores for the year 2014-15. At the time of preparing financial statements for the period 2014-15, X Ltd. had the information that S Ltd.'s profit for the period was less than targeted profit of ₹ 20 crores. Therefore, sales proceeds of ₹ 200 crores were taken into consideration. Before the approval of financial statements, X Ltd. was informed officially by Y Ltd. that the profits of S Ltd. for the year 2014-15 as per audited accounts is ₹ 21 crores. Now, X Ltd. should :
   A adjust the financial statements for additional ₹ 10 crores sale proceeds (to be received)
   B leave the financial statements but, disclose it by way of a note
   C ignore it now
6. Which of the following events after the balance sheet date would normally qualify as adjusting events according to AS–4 (Events after Balance Sheet date) ?
   1. The insolvency of a customer with a balance outstanding at the balance sheet date.
   2. A decline in the market value of investments.
   3. The declaration of an ordinary dividend.
   4. The determination of the cost of assets purchased before the balance sheet date.

   A 1, 3 and 4
   B 1 and 2 only
   C 2 and 3 only
   D 1 and 4 only
7. Which of the following events occurring after the balance sheet date are classified as adjusting events according to AS–4 (Events after balance sheet date) ?
   1. The sale of inventories valued at cost at a balance sheet date for a figure in excess of cost.
   2. A valuation of land and buildings providing evidence of an impairment in value at the year end.
   3. Issue of shares and debentures.
   4. The insolvency of a customer with balance outstanding at the end.

   A 1 and 3
   B 2 and 4
   C 2 and 3
   D 1 and 4
8. Which of the following material events after the balance sheet date and before the financial statements are approved by the directors should be adjusted for in those financial statements ?
   1. A valuation of property providing evidence of impairment in value at the balance sheet date
   2. Sale of inventory held at the balance sheet date for less than cost.

3. Discovery of fraud or error affecting the financial statements
4. The insolvency of a customer with a debt owing at the balance sheet date which is still outstanding.

A all of them
B 1, 2 and 4 only
C 3 and 4 only
D 1, 2 and 3 only

9. The draft financial statements of X Ltd. are under consideration. The accounting treatment of the following material events after the balance sheet date needs to be determined.
   1. The insolvency of a major customer with a substantial debt outstanding at the balance sheet date.
   2. A fire destroying some of the company's inventory (the company's going concern status is not affected).
   3. An issue of shares to finance expansion.
   4. Sale for less than cost of some inventory held at the balance sheet date.

   According to AS–4 (Events after Balance Sheet date), which of the above events require an adjustment to the figures in the draft financial statements ?

   A 1 and 4 only
   B 1, 2 and 3 only
   C 2 and 3 only
   D 2 and 4 only

10. H Ltd.'s one of the major client has gone into liquidation after the balance sheet date but before the approval of the financial statements by the Board of Directors.
    The amount due was very large and H Ltd. can not survive the loss.
    The financial statements for the year to be produced

    A on a going concern basis
    B on a liquidation basis
    C none of the above

Guide to Answers

1. C; 2. C; 3. C; 4. A; 5. A; 6. D; 7. B; 8. A; 9. A; 10. B

AS — 5 : Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

[Effective Date : 1st April, 1996]

Introduction

The Profit and Loss Account for any accounting period should be prepared in such a manner that it is comparable with those of the other years and with the financial statements of other enterprises. This standard is intended to enhance the ***relevance*** and ***reliability*** of the financial statements of the enterprise.

Though the financial information provided by the Profit and Loss Account about the financial performance of an enterprise is historical in nature, yet users use this information to evaluate the enterprise's future performance.

Objective

The objective of this statement is to prescribe the classification and disclosure of certain items in the statement of profit and loss so that all enterprises prepare and present such a statement on a uniform basis.

This statement requires the classification and disclosure of ***extraordinary*** and ***prior period*** items, and disclosure of certain items within profit or loss from ordinary activities.

It also specifies the accounting treatment for changes in ***accounting estimates*** and the disclosures to be made in the financial statements regarding changes in ***accounting policies***.

Scope

1. This Statement should be applied by an enterprise in ***presenting profit or loss*** from ordinary activities, extraordinary items and prior period items in the statement of profit and loss, in accounting for changes in accounting estimates, and in disclosure of changes in accounting policies.
2. This Statement deals with, among other matters, the disclosure of certain items of net profit or loss for the period. These disclosures are made in addition to any other disclosures required by other Accounting Standards.
3. This Statement ***does not deal*** with the tax implications of extraordinary items, prior period items, changes in accounting estimates, and changes in accounting policies for which appropriate adjustments will have to be made depending on the circumstances.

Definitions

Ordinary Activities

Ordinary activities are any activities which are undertaken by an enterprise as part of its business and such related activities in which the enterprise engages in furtherance of, incidental to, or arising from, these activities.

Example : X Ltd. is a software development company operating from Kolkata. Recently they have started a training institute for future software developers. All activities relating to training institute will be treated as ordinary activities.

Extraordinary Items

Extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to re-occur frequently or regularly.

Example : Sale of old machinery and furniture at a profit / loss is an ordinary activity but sale of excess land adjacent to existing factory should be treated as an extraordinary item. Similarly, loss due to earthquake shall be treated as an extraordinary item.

Prior Period Items

Prior period items are income or expenses which arise in the current period as a result of ***errors*** or ***omissions*** in the preparation of the financial statements of one or more prior periods.

Example : Inventory had been overstated in 2014 but it was detected only in 2015. It is a prior period item.

Accounting Policies

Accounting policies are the specific accounting principles and the methods of applying those principles adopted by an enterprise in the preparation and presentation of financial statements.

Net Profit or Loss for the Period

All items of income and expense which are recognised in a period should be included in the determination of net profit or loss for the period unless an Accounting Standard requires or permits otherwise.

The net profit or loss for the period comprises the following components, each of which should be disclosed on the face of the statement of profit and loss:

a. profit or loss from ordinary activities; and
b. extraordinary items.

Profit or Loss from Ordinary Activities

When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and the amount of such items should be disclosed separately. This disclosure will enhance the ***transparency*** in reporting income and expenses.

Example : Sale of old furniture is an ordinary transaction, the profit or loss from such sale should be disclosed separately because it is not related to operation of the business.

A separate disclosure of items of income and expense is necessary in the following cases.

a. the write-down of inventories to net realisable value as well as the reversal of such write-downs;
b. a restructuring of the activities of an enterprise and the reversal of any provisions for the costs of restructuring;
c. disposals of items of fixed assets;
d. disposals of long-term investments;
e. legislative changes having retrospective application;
f. litigation settlements; and
g. other reversals of provisions.

Illustration 1

During the year 2014-15, a medium size manufacturing company wrote down its inventories to net realisable value by ₹ 5,00,000. Is a separate disclosure necessary?

Solution

This is an ordinary activity. Ordinary activities are any activities which are usually, frequently or regularly, undertaken by an enterprise as part of its business.

Expenses or income which are exceptional on account of size (large or small) and/or incidence (extent or frequency of occurrence) that arises from the ordinary activities of a business, should be separately disclosed.

Therefore, writing down inventories to net realisable value by ₹ 5,00,000 is ***to be disclosed separately***.

Extraordinary Items

Extraordinary items are those items which arise from abnormal or unusual events lying outside the ordinary range of firm's activities and which are both ***material and expected not to occur frequently or regularly***.

Classification of an item as extraordinary will depend on the circumstances of a business. An event or transaction may be extraordinary for one enterprise but not so for another enterprise. This is because of the differences between their respective ordinary activities. ***For example***, losses sustained as a result of an earthquake may qualify as an extraordinary item for many enterprises. However, claims for an insurance company that insures against such risks is an ordinary item.

Extraordinary items should be disclosed in the statement of profit and loss as a part of net profit and loss for the period. The nature and the amount of each extraordinary item should be ***separately disclosed*** in the statement of profit and loss in such a manner that its impact on current profit or loss will be clearly observed.

It should be remembered that ***only on rare*** occasions do an event or transaction give rise to an extraordinary item.

Illustration 2

A company signed an agreement with the Employees Union on 1.9.2014 for revision of wages with retrospective effect from 30.9.2013. This would cost the company an additional liability of ₹ 5,00,000 p.a.

Is a disclosure necessary for the amount paid in 2014-15?

Solution

The additional wages liability of ₹ 7,50,000 (₹ 5,00,000 p.a. for $1^1/_2$ years) should be included in current year's wages, as it arises from ordinary activities of the organisation. This should not be treated as a prior period item since it does not arise because of an error in an earlier accounting year has been discovered. Likewise, the nature of additional expense is not such that it can be treated as an extraordinary item, which arises only on ***rare occasion***.

Ordinary activities which are exceptional on account of size (large or small) and/or incidence (extent of frequency or incidence) should be separately disclosed. Therefore, in this case, ***disclosure*** is necessary for the additional wage payment to be made.

Illustration 3

X Co. Ltd. signed an agreement with its employees union for revision of wages in June 2014. The wage revision is with retrospective effect from 1.4.2010. The arrear wages up to 31.3.2014 amounts to ₹ 80 lakhs. Arrear wages for the period from 1.4.2014 to 30.6.2014 (being the date of agreement) amounts to ₹ 7 lakhs.

Decide whether a separate disclosure of arrear wages is required.

Solution

Revision of wages was made in June 2014 with retrospective effect from 1.4.2010. The additional wages liability ₹ 87 lakhs (₹ 80 lakhs + ₹ 7 lakhs) should not be treated as a prior period item since it does not arise because of an error or omission in an earlier accounting year which has been discovered now. Likewise, the nature of additional wages is not such that it can be treated as an extraordinary item, which arises only on rare occasion. This additional wages of ₹ 87 lakhs should be shown in the Profit and Loss Account for the year ended 31st March, 2015.

Para 12 of AS—5 (Revised) states that when items of income and expense within profit and loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

Therefore, ₹ 80 lakhs wages (for the period 1.4.2010 to 31.3.2014) should be ***disclosed separately***. However, wages payable for the current year (1.4.2014 to 30.6.2014) ₹ 7 lakhs need not be shown separately. It will be merged with the wages of the current year, i.e., 2014-15.

Prior Period Items

The term 'Prior Period Items' refers only to income and expenses which occurred in a previous period. It will normally arise because some errors in an earlier account has been discovered. Errors may occur as a result of mathematical mistakes, mistakes in applying accounting policies, misinterpretation of facts, or oversight. Material errors in the Profit and Loss Account of one accounting period that are discovered in a subsequent period usually involve an asset or liability and a revenue or expense of a period. They do not include normal recurring adjustments (e.g., arrears payable to workers in current period as a result of retrospective revision of wages) or correction of accounting estimates made in prior years.

Prior period items are normally included in the determination of net profit or loss for the current period. An alternative approach is to show such items in the statement of profit and loss after determination of current net profit or loss. In either case, the objective is to indicate the effect of such items on the current profits or losses.

The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on the current profit or loss can be perceived.

Illustration 4

In preparing the financial statements of R Limited for the year ended 31.3.2015, you come across the following information. State with reasons, how you would deal with them in the financial statements:

There was a major theft of stores valued at ₹ 10 lakhs in the preceding year which was detected only during the current financial year.

Solution

This is a prior period item. It is an error as a result of oversight. This error was discovered in the subsequent period. Since this loss was not charged in the previous year, there was an overstatement of profit, brought forward to the current year. Therefore, adjustments are to be made in the opening stock of the current year and the profit brought forward from the previous year. The amount of loss should be shown in the Profit and Loss Account after ***determination of current net profit or loss***.

Illustration 5

Goods worth ₹ 5,00,000 were destroyed due to flood in September, 2013. A claim was lodged with insurance company. But no entry was passed in the books for insurance claim in the financial year 2013-14.

In March 2015, the claim was passed and the company received a payment of ₹ 3,50,000 against the claim. Explain the treatment of such receipt in final accounts for the year ended 31st March, 2015.

Solution

This is a prior period item. This is an error occurred in 2013-14 due to negligence. In March 2015, claim of ₹ 3,50,000 was received and it should be separately disclosed in the Statement of Profit and Loss for the year ending on 31st March, 2015.

Illustration 6

During the course of the last three years, a company owning and operating Helicopters lost four Helicopters. The company's accountant felt that after the crash, the maintenance provision created in respect of the respective helicopters was no longer required and proposed to write back to the Profit and Loss Account as a prior period item.

Is the company's proposed accounting treatment correct ? Discuss.

Solution

Company's proposed accounting treatment of writing back off the 'maintenance provision' as a prior period item is ***not correct***.

As per definition given in AS—5: "Net Profit or Loss for the Period, Prior Period Items and Change in Accounting Policies", prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of prior periods. However, the company should disclose it as an extraordinary item if the amount is material.

Change in Accounting Estimates

The use of reasonable estimates is an essential part of the preparation of financial statements. The process of accounting requires estimation in many areas, ***for example***, allowance for doubtful debts, inventory obsolescence or estimated useful lives of fixed assets.

Estimation involves judgments based on the latest available information. Accounting estimates, by their very nature, can rarely be measured with precision. Where circumstances change or new information becomes available the accounting estimate may need to be revised. ***The revision of an estimate does not relate to prior periods and is not the correction of an error***.

The effect of a change in an accounting estimate should be included in the determination of net profits and losses in :

(a) the period of the change, if the change affects that period only (e.g., provision for doubtful debts);

(b) the period of change and future periods, if the change affects both (e.g., change in the estimated life of a fixed asset).

Example : Your company Delhi Transport (P) Ltd. has a fleet of 20 diesel buses which are operating in NCR (National Capital Region) area. New legislation on pollution will ban them for use in NCR from 1st April, 2015, reducing their useful lives. The company will need to accelerate depreciation and review their residual values. This is a revision in estimates and will have no effect on prior periods, but the depreciation of the current year and subsequent years will increase.

Illustration 7

While preparing its final accounts for the year ended 31.3.2015, Rainbow Limited created a provision for bad and doubtful debts at 2% on trade debtors. A few weeks later, the company found that the payments from some of the major debtors were not forthcoming. Consequently, the company decided to increase the provision to 10% on the debtors as on 31.3.2015 as the accounts were still open awaiting approval of the Board of Directors. Is this to be considered as an extraordinary item or prior period item?

Solution

This is a change in accounting estimate. It is not to be considered as an extraordinary item or prior period item.

The provision for bad and doubtful debts has been increased from 2% to 10%. The effect of change should be shown in the Profit and Loss Account for the year ending on 31st March, 2015.

Illustration 8

A limited company created a provision for bad and doubtful debts at 2.5% on debtors in preparing the financial statements for the year 2014-15.

Subsequently, on a review of the credit period allowed and financial capacity of the customers, the company decides to increase the provision to 8% on debtors as on 31.3.2015. The accounts were not approved by the Board of Directors till the date of decision. While applying the relevant accounting standard, can this revision be considered as an extraordinary item or prior period item ?

Solution

This is a change in accounting estimate. It is not to be considered as an extraordinary item or prior period item.

The provision for bad and doubtful debts has been increased from 2.5% to 8%. The effect of change should be shown in the Profit and Loss Account for the year ending on 31st March, 2015.

Disclosure

Change in estimates are disclosed, except when it is impracticable to estimate the impact and the reasons for non-disclosure should be disclosed.

Changes in Accounting Policies

Users need to be able to compare the financial statements of an enterprise over a period of time in order to identify trends in its financial position, performance and cash flows. Therefore, the same accounting policies are normally adopted for similar events or transactions in each period.

Example : Sita Travels Ltd. is a tour operator, operating 50 luxury buses at present. The company is charging depreciation under Straight Line Method for all buses (AC and non-AC). During the accounting period 2014-15 the company has acquired 10 Volvo buses. It can be assumed that the company will depreciate these new buses under Straight Line Method also.

A change in an accounting policy should be made only if the adoption of a different accounting policy is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate presentation of the financial statements of the enterprise.

Example : H Ltd.'s inventory has been accounted for using Last-In-First-Out (LIFO) method. AS—2 (Inventories) does not allow LIFO for valuation of inventory. The company has changed its policy to FIFO in accordance with AS—2.

A more appropriate presentation of events or transactions in the financial statements occurs when the new accounting policy results in more relevant or reliable information about the financial position, performance or cash flows of the enterprise.

Students should note that the following are not changes in accounting policies :

a. the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions.

Example : Introduction of a formal retirement gratuity scheme by an employer in place of ad-hoc ex-gratia payments to employees on retirement.

b. the adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial.

Example : X Ltd. is using financial instruments for the first time and apply AS—30. This is not a change in accounting policy.

Disclosure of Change in Accounting Policies

(a) Any change in an accounting policy should be disclosed if it has a material effect.

(b) The impact of change should be shown in the financial statements of the period in which such change is made.

(c) Where the effect of such change is not ascertainable, the fact should be indicated.

(d) If a change is made in the accounting policies which has no material effect on the financial statements for the current period but which is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.

Example : X Ltd. at present showing buildings at cost in its books of account. At the end of the financial year 2014-15, the company has decided to revalue the buildings (because the price of properties have increased three times in that locality).
The revaluation profit will increase charge for depreciation on buildings in the current and future periods. This change in policy should be appropriately disclosed in the year 2014-15.

A change in accounting policy consequent upon the adoption of an Accounting Standard should be accounted for in accordance with the specific transitional provisions, if any, contained in that Accounting Standard.

Students should note that in many cases it could be difficult to distinguish between a change in accounting policy and a change in an accounting estimate. In such a situation, the change is treated as a change in an accounting estimate.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below :

1. Profit on sale of old furniture :
   A is an ordinary activity
   B is an extraordinary activity
   C is a prior period item
2. Extraordinary items
   A are both material and expected to occur frequently or regularly
   B are not material and expected not to occur frequently or regularly
   C are both material and expected not to occur frequently or regularly
3. Errors include :
   1. Mathematical mistakes
   2. Mistakes in applying accounting policies
   3. Changes in provisions for bad and doubtful debts
   4. Misinterpretation of facts, or oversight.
   Which of the following is correct ?
   A all four
   B all except 4
   C all except 3
4. Revision of salary with retrospective effect is a
   A change in policy
   B change in accounting estimate
   C prior period item
5. Change in accounting policies
   A should only make the change in the coming period
   B should only make the change in the current period
   C should make the change in the periods reported
6. Change in the method of depreciation will be treated as
   A change in the accounting policy
   B change in the accounting estimate
   C none of the above
7. Revision of estimated useful life of a fixed asset
   A is a change in accounting policy
   B is a change in an accounting estimate
   C none of the above
8. The effect of a change in an accounting estimate should be included in the determination of net profits or losses of the
   A current period only
   B previous periods only
   C current period as well as future periods
9. Accounting estimates are made for
   1. Change in accounting policy
   2. Provision for bad and doubtful debts
   3. Inventory obsolescence
   A all three above
   B all except 1
   C all except 2

Guide to Answers

1. A; 2. C; 3. C; 4. B; 5. C; 6. A; 7. B; 8. C; 9. B

AS — 6 : Depreciation Accounting (Revised)
[Effective Date : 1st April, 1995]

Introduction

Different fixed assets, for example, buildings, machinery and furnitures are used by an enterprise for different purposes like production, administration, sales and service, etc. Expenditure is made early in the life of the assets for acquiring the assets but benefits are derived throughout their useful life.

When a fixed asset is acquired, it is recorded in the books of account at its acquisition cost and it is capitalised. In each accounting period, a portion of acquisition cost is charged to the Profit and Loss Account as expense. This accounting process of gradually converting the acquisition cost of fixed asset into expense over a series of accounting periods is called ***depreciation***.

Objectives

Depreciation has a significant effect in the preparation of the financial statements of an enterprise. It will influence the profit / loss and value of assets of the enterprise. Different enterprises adopt different accounting policies for depreciation.

The main objective of this accounting standard is to prescribe the ***guidelines for charging depreciation*** for different assets.

Scope

This statement deals with depreciation accounting and applies to all depreciable assets, except the following items to which special considerations apply —

(i) forests, plantations and similar regenerative natural resources;
(ii) wasting assets including expenditure on the exploration for and extraction of minerals, oils, natural gas and similar non-regenerative resources;
(iii) expenditure on research and development;
(iv) goodwill;
(v) live stock.

This statement also does not apply to land unless it has a limited useful life for the enterprise.

Definitions

Depreciation

Depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time or obsolescence through technology and market changes. Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset. Depreciation includes amortisation of assets whose useful life is predetermined.

Depreciable Assets

Depreciable assets are assets which

(i) are expected to be used during more than one accounting period; and
(ii) have a limited useful life; and
(iii) are held by an enterprise for use in the production or supply of goods and services, for rental to others, or for administrative purposes and not for the purpose of sale in the ordinary course of business.

Useful Life

Useful life is either :

(i) the period over which a depreciable asset is expected to be used by the enterprise; or
(ii) the number of production or similar units expected to be obtained from the use of the asset by the enterprise.

Depreciable Amount

Depreciable amount of a depreciable asset is its historical cost, or other amount substituted for historical cost in the financial statements, less the estimated residual value.

Factors in the Measurement of Depreciation

The amount of depreciation to be charged for a particular fixed asset will depend upon the following three factors :

(i) Cost of the asset
(ii) Useful life of the asset
(iii) Residual value of the asset

Cost of the Asset

The cost of an asset is the basis for calculation of depreciation. For the purpose of determination of cost of an asset, the following points are important as stated in AS—10 "Accounting for Fixed Assets" :

(a) Where an asset is purchased from a supplier: The cost of a fixed asset should comprise its purchase price and any attributable cost of bringing the asset to its working condition for its intended use.

Examples of directly attributable costs are :

(i) site preparation;
(ii) initial delivery and handling costs;
(iii) installation cost, such as special foundations for plant; and
(iv) professional fees, for example, fees of architects and engineers.

(b) Where an asset is self-constructed : The cost of a self-constructed fixed asset should comprise those costs that relate directly to the specific asset and those that are attributable to the construction activity in general and can be allocated to the specific asset.

(c) Where a fixed asset is acquired either in exchange or in part exchange for another asset: The asset acquired should be recorded either :

(i) at its fair value; or
(ii) the net book value of the asset given up, adjusted for any balancing payment or receipt of cash or other consideration.

Useful Life of the Asset

The useful life of an asset is its ***service life*** which can be defined as the number of accounting periods during which it will be useful to the business. The physical life of an asset may be considered longer than its economic life. When the operating cost of an asset is considered to be more than the revenue which it generates, it has exceeded its economic life and should not be kept in use. Since there is no way to measure correctly how long an asset will be useful, the asset's useful economic life is always estimated.

The useful life of a depreciable asset should be estimated after considering the following factors:

(i) expected physical wear and tear;
(ii) obsolescence;
(iii) legal or other limits on the use of the asset, e.g., safety limitation or the expiry dates of assets taken on lease.

Estimation of useful life of the asset is very difficult. It is a matter of judgment and depending on the experience of the enterprise with similar assets. Depreciation will vary directly with the useful life of the asset. If the estimated life is too long, each year's depreciation charge will be less and profits in the periods before disposal will be inflated.

Residual Value of the Asset

Residual value of asset is the estimated value of a fixed asset at the end of its economic life. It is the amount which is expected to be received when the asset is sold after being removed from service. The purpose of estimating residual value is to ascertain the ***depreciable amount*** (acquisition cost – residual value), which is allocated to different accounting periods during which the asset is gainfully employed. Depreciable amount is calculated as under:

Acquisition cost (say)	₹ 11,00,000
Less : Residual Value (say)	₹ 1,00,000
Depreciable Amount	₹ 10,00,000

Example : It is the policy of Sita Travel (P) Ltd. to keep their tourist bus in service for 5 years only. The company has purchased one new tourist bus for ₹ 25,00,000. A similar bus purchased 5 years back can be sold at present for ₹ 5,00,000 (Net). Here ₹ 5,00,000 is a reasonable estimate for the residual value of the new bus.
The depreciable amount will be ₹ 20,00,000 (₹ 25,00,000 – 5,00,000).
Annual depreciation = ₹ 20,00,000 / 5 = ₹ 4,00,000.

Unless the residual value of the asset is guaranteed (e.g., buyback by the manufacturer at a guaranteed amount), the residual value will only be ***estimate*** because of future uncertainties.

In some cases, residual value is insignificant and it is taken as zero for calculating the amount of depreciation.

The higher the residual value, the lower will be the depreciation charge. In effect, the profits of the previous periods will be inflated and there may be a loss on disposal of the asset.

Depreciation Methods

There are several methods of allocating depreciation over the useful life of the assets. Those most commonly employed in industrial and commercial enterprises are the ***straight line*** method and the ***reducing balance*** method. The management of a business selects the most appropriate method(s) based on various important factors e.g., (i) type of asset, (ii) the nature of the use of such asset and (iii) circumstances prevailing in the business. A combination of more than one method is sometimes used. In respect of depreciable assets which do not have material value, depreciation is often allocated fully in the accounting period in which they are acquired.

No particular method is specified by AS—6. However, it has been stated in para 20 that the depreciable amount of a depreciable asset should be allocated on a systematic basis to each accounting period during the useful life of the asset.

1. Straight Line Method

This is the most popular method because of its simplicity and consistency. It requires allocation of an equal amount to each period. The asset is written down in value each year by the same amount. Since this method assumes that the cost of the asset expires at a steady (straight line) function of time, the acquisition cost less residual value is divided by the estimated economic life.

$$\textit{Annual Depreciation} = \frac{\textit{Cost of the Asset} - \textit{Residual Value}}{\textit{Estimated Economic Life}}$$

Example : If a machine costs ₹ 1,20,000 on 1.1.2008, has a residual value at ₹ 20,000 and a life of 10 years, assuming the accounting year ends on 31st December, the depreciation per annum will be :

$$\textit{Depreciation} = \frac{1,20,000 - 20,000}{10} = ₹\ 10,000.$$

2. Reducing Balance Method

Under this method, a fixed rate on the reduced balance of the asset is charged as depreciation every year. Though the percentage at which depreciation is charged remains fixed, the amount of depreciation goes on diminishing.

Example : On 1st January, 2014, X Ltd. purchased a motor car for ₹ 5,00,000. It is the policy of the company to charge depreciation @ 20% p.a. on reducing balance method.

The depreciation will be as follows :

2014 — 20% of ₹ 5,00,000	**₹ 1,00,000**
2015 — 20% of ₹ (5,00,000 – 1,00,000)	**80,000**
2016 — 20% of ₹ (5,00,000 – 1,80,000)	**64,000**
2017 — 20% of ₹ (5,00,000 – 2,44,000)	**51,200**

3. Machine Hour Rate Method / Unit of Production Method

This method of depreciation is suitable for those assets whose life mainly depends upon the usage of the assets. Depreciation is calculated as :

(1) Depreciation per hour $= \dfrac{\text{Cost of the Asset} - \text{Residual Value}}{\text{Effective Working Hours}}$

(2) Depreciation per unit $= \dfrac{\text{Cost of the Asset} - \text{Residual Value}}{\text{Total Estimated Number of Units}}$

Example 1 : 'Dell Laptop - EXP' is estimated to have effective life of 20,000 hours. The cost of the laptop is ₹ 60,000 with no residual value. If the laptop has worked for 2,000 hours in 2012 and 3,000 hours in 2013, then the depreciation will be as follows :

Depreciation per hour $= \dfrac{\text{Cost of the Laptop} - \text{Residual Value}}{\text{Estimated Effective Working Hours}}$

$= \dfrac{60{,}000}{20{,}000} = ₹\ \mathbf{3}$

Depreciation for 2012 = 2000 × ₹ 3 = ₹ 6,000

2013 = 3,000 × ₹ 3 = ₹ 9,000.

Example 2 : Apollo Hospital has purchased a new 'X-Ray' machine for ₹ 5,00,000. It is estimated that 10,000 X-ray plates can be exposed throughout its economic life. The residual value is expected to be ₹ 50,000.

Depreciation per X-Ray plate $= \dfrac{5{,}00{,}000 - 50{,}000}{10{,}000} = ₹\ \mathbf{45}$

Change in the Method of Depreciation

The depreciation method selected should be applied consistently from period to period. A change from one method of providing depreciation to another should be made only if the adoption of the new method is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements of the enterprise. When such a change in the method of depreciation is made, depreciation should be recalculated in accordance with the new method from the date of the asset coming into use.

The deficiency or surplus arising from retrospective recomputation of depreciation in accordance with the new method should be adjusted in the accounts in the year in which the method of depreciation is changed. In case the change in the method results in deficiency in depreciation in respect of past years, the deficiency should be charged in the statement of profit and loss. In case the change in the method results in surplus, the surplus should be credited to the statement of profit and loss. Such a change should be treated as a change in accounting policy and its effect should be quantified and disclosed.

The following points are important :

1. ***The change in the method of depreciation should be treated as a change in accounting policy. Accordingly, depreciation should be recomputed in accordance with the new method from the date of first use of the asset.***
2. ***The deficiency or surplus arising from retrospective recomputation of depreciation in accordance with the new method should be adjusted in the accounts in the year in which the method of depreciation is changed.***
3. ***The deficiency or surplus of depreciation in respect of past years, should be debited or credited to the Profit and Loss Account of the year of change in the method of depreciation.***

Illustration 1

X Co. Ltd. charged depreciation on its assets on SLM basis. For the year ended 31.3.2015, it changed to WDV basis. The impact of the change when computed from the date of the asset coming to use amounts to ₹ 20 lakhs being additional charge.

Decide how it must be disclosed in Profit and Loss Account. Also discuss, when such change in method of depreciation can be adopted by an enterprise as per AS—6.

Solution

Para 21 of AS—6 states that in case the change in the method results in deficiency in depreciation in respect of past years, the deficiency should be charged to the Statement of Profit and Loss.

Here, ₹ 20 lakhs should be charged to the Profit and Loss Account for the year ended on 31st March, 2015.

An enterprise may change the method of depreciation only under the following conditions :

(a) the change is required by a statute or an Accounting Standard;
(b) the change would produce a more appropriate presentation.

Illustration 2

Ram Co. (P) Ltd. furnishes you the following information for the year ended 31.3.2015 : (₹ in lakhs)

(i)	Depreciation for the year ended 31.3.2015 (under SLM)	100
(ii)	Depreciation for the year ended 31.3.2015 (under WDV)	200
(iii)	Excess of depreciation for the earlier years calculated under WDV over SLM	500

The company wants to change its method of charging depreciation from straight line method to written down value method.

Decide how the depreciation should be disclosed in the financial statement for the year ended 31.3.2015.

Solution

Para 21 of AS—6 states that

"When such a change in the method of depreciation is made, depreciation should be recalculated in accordance with the new method from the date of the asset coming into use. The deficiency or surplus arising from retrospective recomputation of depreciation in accordance with the new method should be adjusted in the accounts in the year in which the method of depreciation is changed. In case the change in the method results in deficiency in depreciation in respect of past years, the deficiency should be charged in the statement of profit and loss. In case the change in the method results in surplus, the surplus should be credited to the statement of profit and loss. Such a change should be treated as a change in accounting policy and its effect should be quantified and disclosed."

In this case, the deficiency of ₹ 500 lakhs would be charged to the Profit and Loss Account for the year ending on 31st March, 2015.

In the notes to account the reasons for change in the method of depreciation is to be elaborated. The effect of ₹ 500 lakhs is also to be disclosed. Current year's depreciation of ₹ 200 lakhs is to be charged to Profit and Loss Account for the year ended 31st March, 2015.

Illustration 3

A plant was depreciated under two different methods as under :

Year	SLM (₹ in Lakhs)	WDV (₹ in Lakhs)
1	7.80	21.38
2	7.80	15.80
3	7.80	11.68
4	7.80	8.64
	31.20	57.50
5	7.80	6.38

What should be the amount of resultant surplus / deficiency, if the company decides to switch over from W.D.V. method to S.L.M. method for first four years ? Also state, how will you treat the same in accounts.

Solution

Here, in this case, there is a surplus of ₹ 26.30 lakhs (57.50 – 31.20) on account of change in the method of depreciation.

As per para 21 of AS—6, when a change in the method of depreciation is made, depreciation should be recalculated in accordance with the new method from the date of the asset coming into use. The surplus arising from retrospective recomputation of depreciation in accordance with the new method should be credited to the statement of profit and loss. Such a change should be treated as a change in accounting policy and its effect should be quantified and disclosed.

Therefore, the surplus of ₹ 26.30 lakhs will be ***credited*** to Profit and Loss Account.

Revision of the Estimated Useful Life

The useful lives of major depreciable assets or classes of depreciable assets may be reviewed periodically. Where there is a revision of the estimated useful life of an asset, the ***unamortised depreciable amount*** should be charged over the ***revised remaining useful life***.

Illustration 4

On 1.4.2012, ABC Limited purchased plant and machinery worth ₹ 20,00,000, useful life being 8 years. Till the year ended 31.3.2015, the amount of accumulated depreciation on this plant and machinery was ₹ 8,00,000. The remaining useful life of the plant and machinery was reviewed during 2015-16, which was estimated at 2 years due to wear and tear. Calculate the amount of depreciation to be charged from the year 2015-16 onwards.

Solution

Here, in this case, the unamortised depreciable amount is ₹ (20,00,000 – 8,00,000) = ₹ 12,00,000 and the revised remaining useful life is 2 years. Therefore, the amount of depreciation to be charged from the year 2015-16 onwards is ₹ 12,00,000 / 2 = ₹ 6,00,000 p.a.

Depreciation on Addition or Extention of the Asset

Any addition or extension which becomes an integral part of the existing asset should be depreciated over the remaining useful life of that asset. The depreciation on such addition or extension may also be provided at the rate applied to the existing asset. Where an addition or extension retains a separate identity and is capable of being used after the existing asset is disposed of, depreciation should be provided independently on the basis of an estimate of its own useful life.

Example : ACC Ltd. has installed a conveyor belt system for material handling at its 25 years old cement plant. The cost of the entire conveyor belt unit is ₹ 20,00,000 and its useful life is 10 years without any residual value. However, the remaining life of the principal plant is 5 years.
The conveyor belt unit should be recognised as an item of fixed asset separate from principal plant. It will be depreciated over its useful life, i.e., 10 years. However, if the 'conveyor belt' cannot be used separately, its useful life will terminate with the life of the principal plant, i.e., 5 years. The entire amount of ₹ 20,00,000 is to be depreciated in 5 years.

Illustration 5

On 1.4.2015, the value of X Limited's plant and machinery was ₹ 1,000 lakhs. The company provided depreciation @ 15% p.a. under Reducing Balance Method. It was found that about ₹ 150 lakhs of imported asset, which is the component of plant and machinery acquired on 1.4.2013, would be obsolete in 3 years. Accordingly, X Limited wants to write off this asset over 3 years. Can the company do so as per AS–6?

Solution

As per para 24 of AS–6, any addition or extention which becomes an integral part of the existing asset should be depreciated **over the remaining useful life of that asset**. The depreciation on such addition or extention may also be provided at the rate applied to the existing asset. Where an addition or extention retains a separate identity and is **capable of being used after the existing asset is disposed of**, depreciation should be provided **independently** on the basis of an estimate of its own useful life.

Therefore, in this case, the company can write off the asset in 3 years, since the asset has independent useful life.

Change in the Historical Cost

Where the historical cost of a depreciable asset has undergone a change due to increase or decrease in long term liability on account of exchange fluctuations, price adjustments, changes in duties or similar factors, the depreciation on the revised unamortised depreciable amount should be provided ***prospectively*** over the residual useful life of the asset.

Illustration 6

ABC Ltd. purchased an imported Printing Machinery from Germany for ₹ 20,00,000 on 1.4.2009. The life of the machine is 10 years without any residual value. The company followed straight line method of depreciation. During 2013-14 due to change in foreign exchange rate the amount of unpaid liability increased by ₹ 3,00,000.

Calculate amount of depreciation to be charged for the year 2013-14 and onwards.

Solution

		₹
Cost of the printing machinery		20,00,000
Less: Depreciation under SLM :		
2009-10	2,00,000	
2010-11	2,00,000	
2011-12	2,00,000	
2012-13	2,00,000	8,00,000
Unamortised depreciable amount on 1.4.2013		12,00,000
Add: Increase in liability for change in foreign exchange		3,00,000
Revised depreciable amount		15,00,000

Depreciation for the year 2013-14 and onwards :

$$\text{Depreciation p.a. - } \frac{15,00,000}{(10 - 4)} = ₹\ 2,50,000$$

Depreciation of Revalued Assets

Where the depreciable assets are revalued, the provision for depreciation should be based on the revalued amount and on the estimate of the remaining useful lives of such assets. In case the revaluation has a material effect on the amount of depreciation, the same should be disclosed separately in the year in which revaluation is carried out.

Illustration 7

A Ltd acquired a building on 1st January, 1997 at a cost of ₹ 6,40,000. The useful life of the building was estimated as 50 years and depreciation is provided on a straight line basis. The building was revalued on 30th June 2014 for ₹ 16,80,000 and the revaluation incorporated in the accounts. Assuming no change made to the remaining useful life. You are required to calculate : (i) the surplus on revaluation; (ii) depreciation to be charged in the Profit and Loss Account of 2014.

Solution

(i) Surplus on Revaluation

	₹
Revaluation at 30th June, 2014	16,80,000
Net book value at 30th June, 2014 (Note 1)	4,16,000
Surplus	12,64,000

This surplus of ₹ 12,64,000 should be credited directly to owners' interests under the heading of Revaluation Reserve as per the requirement of AS—10 Para 30.

(ii) Depreciation Charged in the Profit and Loss Account of 2014

Here, it should be noted that upto 30.6.2014 depreciation will be calculated on original value and from 1.7.2014 it is to be calculated on revalued value.

	₹
(a) On historical cost (upto 30.6.2014) — $\frac{6,40,000}{50} \times \frac{1}{2}$	6,400
(b) On revalued amount (1.7.2014 to 31.12.2014) — $\frac{16,80,000}{32\frac{1}{2}} \times \frac{1}{2}$	25,846
Total	32,246

Working Note :

(1) Net Book Value on 30th June, 2014

	₹
Original cost on 1.1.1997	6,40,000
Less: Depreciation for 17.5 years (₹ 6,40,000 / 50 × 17.5)	2,24,000
	4,16,000

Disclosure

1. If any depreciable asset is disposed of, discarded or destroyed, the net surplus or deficiency, if material, should be disclosed separately.
2. The following information should be disclosed in the financial statements:
   (i) the historical cost or other amount substituted for historical cost of each class of depreciable assets;
   (ii) total depreciation for the period for each class of assets; and
   (iii) the related accumulated depreciation.
3. The following information should also be disclosed in the financial statements alongwith the disclosure of other accounting policies:
   (i) depreciation methods used; and
   (ii) depreciation rates or the useful lives of the assets, if they are different from the principal rates specified in the statute governing the enterprise.

OBJECTIVE TYPE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below :

1. AS—6 deals with depreciation accounting and applies to all depreciable assets, except :
   A assets used for administrative purposes
   B assets used for sales and service
   C wasting assets
2. Depreciable assets are assets which
   A have unlimited useful life, e.g., land
   B have a limited useful life, e.g., furniture
   C are expected to be used not for more than one year
3. Residual value is specifically
   A scrap value
   B the estimated value of a fixed asset at the end of its economic life
   C the estimated value of a fixed asset at the end of its physical life

4. The useful life of an asset is :
   A its service life
   B its physical life
   C none of the above
5. Which of the following statement is **not** correct ?
   A depreciation will vary directly with the useful life of the asset
   B the higher the residual value, the lower will be the depreciation charge
   C the higher the residual value, the higher will be the depreciation
6. Repairs and maintenance costs are :
   A normally capitalised
   B expensed in the profit and loss account as incurred
   C recorded as deferred expenses
7. Which of the following statement is correct in relation to AS—6 ?
   A only straight line method can be adopted for calculation of depreciation
   B only reducing balance method can be adopted for calculation of depreciation
   C no particular method has been specified for calculation of depreciation
8. Which of the following statement is correct in relation to AS—6 ?
   A the change in the method of depreciation should be treated as a change in estimate
   B the change in the method to depreciation should be treated as change in accounting policy but the depreciation should be computed in accordance with the new method from the date of change in the method of depreciation
   C the change in the method of depreciation should be treated as change in accounting policy but the depreciation should be recomputed in accordance with the new method from the date of first use of the asset
9. The cost of a fixed asset should comprise :
   (i) its purchase price
   (ii) any attributable cost of bringing the asset to its working condition for intended use
   (iii) overhead of purchase department relating to the purchase of asset
   Which of the following is correct ?
   A (i) only **B** (i) and (ii) only **C** (i), (ii) and (iii)
10. Depreciation charges for a period are recorded
   A only in the Profit and Loss Account
   B only in the Balance Sheet
   C in the Profit and Loss Account or as part of the Cost of another asset (such as inventory).

Guide to Answers

1. C; 2. B; 3. B; 4. A; 5. C; 6. B; 7. C; 8. C; 9. B; 10. C.

AS — 7 : Accounting for Construction Contracts (Revised)
[Effective Date : 1st April, 2003]

Introduction

AS—7 deals with accounting for construction contract in the financial statements of the contractor. It also applies to enterprises undertaking construction activities on their own account (not as contractors) as a venture of a commercial nature where the enterprises have entered into agreement for sale.

In many cases, contracts can span for more than one accounting year and this creates some dilemma.

The question which arises are :

(i) how much revenue should be included in the Profit and Loss Account ?
(ii) how much should be charged for related costs ?
(iii) how much profit should be recognised in the current period in respect of a particular contract ?

AS—7 prescribe the accounting treatment for the above matters.

Meaning of Some Important Terms

Fixed Price Contract

In this type of contract, price is usually fixed and agreed upon in advance. Generally, tenders are invited, giving details of the contract, to fix up the contract price. As per agreement between the parties, any additional work may be charged separately. There may be a provision in the agreement to allow the contractor to pass to the contractee additional costs incurred due to price rise of materials or wages, awards, etc.

Cost Plus Contract

Cost plus contract is a contract in which price is not agreed upon in advance for one reason or other. This type of contract is entered into when it is impossible to calculate future price or cost with reasonable accuracy because of lack of past records and experience or because of particular circumstances, for example, digging of an oil well. The contract price is ascertained later by adding a fixed percentage of profit to the total cost of the contract. The different items of expenditure to be considered for ascertaining cost of the contract are agreed upon in advance.

Scope

Construction contracts include :

(i) Services related to the construction, such as project managers and architects.
(ii) Contracts for destruction, or restoration, of assets and the restoration of the environment.

Example 1 : L&T Ltd. has received a contract for the construction of a bridge over Hooghly river near Kolkata. For the construction of the new bridge, the old existing bridge is to be demolished. This demolition is a part of the bridge contract.
Example 2 : Your company HRBC Ltd. is constructing a new 6 lane highway on behalf of Highway Authority of India. A clause in the contract requires that on both the sides of the highway, three rows of trees are to be planted at the cost of the company. This is a part of the highway contract.

Combining and Segmenting Construction Contracts

When a contract covers more than a single asset, the construction of each asset should be treated as a separate contract when :

(i) separate proposals have been submitted for each asset;
(ii) separate negotiation for each asset and each party has the right to reject the part of the contract
(iii) costs and revenue of each asset can be measured.

Example : Jindal Steel Co. Ltd. is putting a new steel plant in West Bengal. L&T Ltd., the contractor has submitted three separate bids for the following :

(a) Blast Furnace ₹ 600 crore
(b) Captive Power Plant ₹ 100 crore
(c) Conveyor Belt ₹ 20 crore.

Each one of the above should be treated as a separate contract.

A group of contracts, with one client or more, should be treated as a single contract when :

(i) the contracts were signed as a single package;
(ii) the contracts are in essence part of a single project with the overall profit margin.
(iii) the contracts are executed concurrently or in a continuous sequence.

For example : Simplex Ltd. has received a contract from West Bengal Industrial Development Corporation Ltd. for the design, development and construction of a IT Park in Siliguri, West Bengal. Contract includes the construction of :

(a) Buildings for IT companies;
(b) Common Conference Hall;
(c) Food Court;
(d) Swimming Pool;
(e) Gymnasium, etc.

All the contracts are covered under a master contract. For accounting purposes, Simplex Ltd. should treat all contracts as a single contract.

Contract Revenue

Contract revenue should comprise the following :

(i) The amount of revenue agreed by the contractee initially.
(ii) Variation in contract work, claims and incentive payments.
(These are included in the revenue if there is a chance that they will result in revenue and are capable of being reliably measured).

For various reasons, such as cost escalation clauses, claims, penalties, etc., contract revenue could be increased or decreased from one period to next.

Variation in Contract Work

Contract variation may change the scope of the contract and in return the revenue of the contract will also be changed.

For example : Your company Modern Road Construction Company Ltd. has received a contract for converting a two lane road into four lane road through the city. Public is protesting for demolition of unauthorised construction of two sides of the present road. It is becoming a political issue. Now the Municipal Corporation has decided that a flyover will be constructed to solve the problem. The contract would be revised accordingly along with the revenue.

Claims

In some cases, contractor claims extra money from the client for cost not included in the original contract. It might so happen because of some unforeseen events which is beyond the control of the client.

For example : HCC Ltd. has received a contract from Tata Motors Ltd. for the construction of factory buildings. The work was held up for two months for protest by the farmers.
This may be the basis for a claim.
Now, Tata Motors may raise some objection, so claim should be included in the project revenue only when the amount of claim that is likely to be received can be reliably determined.

Incentive Payments

There may be a clause in a contract that bonus will be given to the contractor for early completion of the project.

When a project is completed before the planned date, the contractor is entitled to get extra money as bonus. They are included in the contract revenue when it can be measured reliably.

Contract Cost

Costs incurred by a contractor can be divided into:

(i) Costs that relate directly to a specific contract;
(ii) Costs that can be attributed to the contract activity in general and can be allocated to specific contracts;
(iii) Costs that relate to the activities of the contractor generally, or that relate to contract activity but cannot be related to specific contracts.

Direct Cost

Costs relating specifically to the contract include :

(i) site labour costs, including supervision;
(ii) materials used for project construction;
(iii) depreciation of plant and equipment required for a contract;
(iv) costs of moving plant and equipment to and from a site;
(v) hiring cost of special plant and equipment;
(vi) consultancy fees that directly relate to the contract;
(vii) contract design cost;
(viii) rectification, guarantee, and expected warranty cost;
(ix) claim from third parties.

Common Cost

Costs that can be attributed to the contract activity in general and can be allocated to specific contracts include the following :

(i) Insurance
(ii) Construction overheads
(iii) Design and technical assistance from central office.

It should be noted that incidental income (e.g., sale of scrap, surplus materials, sale of equipment and plant at the end of the contract) will reduce the contract cost.

Cost Not to be Included

Costs not specifically attributable to any contract incurred by the contractor before a contract is secured will be treated as general overhead and charged to the Profit and Loss Account of the concerned period. Other expenses which will not be treated as contract costs are :

(a) general administration costs;
(b) selling cost;
(c) finance cost;
(d) research and development cost.

Recognition of Contract Revenue and Expenses

In order to estimate an appropriate part of revenue and cost (expense) to be included in the Profit and Loss Account, any of the following two methods can be adopted according to situations :

(i) Percentage of Completion Method
(ii) Completed Contract Method

When a contractor uses a particular method of accounting for a contract then the same method should be adopted for all other contracts which meet similar criteria.

Percentage of Completion Method

Under the percentage of completion method, the amount of revenue recognised is determined by reference to the stage of completion of the contract activity at the end of each accounting period.

For calculating stage of completion, any of the following methods can be adopted by the contractor. The methods are :

(1) the proportion that ***cost incurred to date*** bear to the ***estimated total cost of the contract***. Alternatively, it can be expressed as follows :

$$\frac{\text{Cost incurred for the work up to date}}{\text{Estimated Total Cost}} \times 100$$

Example : Your company X Ltd. has received a contract for construction of a fly over in Delhi. The contract price is ₹ 200 crore and estimated cost is ₹ 160 crore. The company has incurred cost so far worth ₹ 80 crore.

The percentage of completion = $\frac{80 \text{ crore}}{160 \text{ crore}} \times 100 = 50\%$.

(2) ***Surveys of the work done*** : In this case, client's surveyor or independent surveyor survey the progress of the work and issue certificate accordingly.

Example : GMR Ltd. is constructing a stadium at Delhi. The Delhi Government surveyors have confirmed that 40% of the work is completed and recommend payment for the work.

(3) ***Completion of a physical portion of the work*** : Stage of completion can be calculated on the basis of physical completion of the work.

Example : Your company H Ltd has received a contract for building of 150 km, 6 lane highway. Out of 150 km, 100 km has been completed in all respect.

The percentage of completion = $\frac{100 \text{ km}}{150 \text{ km}} \times 100 = 66.67\%$.

The following points are important in respect of above discussion:
(i) Cost to be incurred relating to future work on the contract should not be included in the calculation.
(ii) Progress payments and advanced received from clients often do not reflect the work done.

Under this method '***Contract Revenue***' is recognised as :

Year

1 (Total contract revenue × % of completion) = Revenue to be recognised at the end of 1st year.

2 (Total contract revenue × % of completion) **–** Revenue recognised in the year 1
= Revenue to be recognised at the end of 2nd year.

3 (Total contract revenue × % of completion) **–** Revenue recognised in the year 1 and 2
= Revenue to be recognised at the end of 3rd year.

Illustration 1

GMR Infrastructure Ltd. has the following details of a contract that started in 2011.

(i) Contract Value ₹ 10,00,000.

(ii) Percentage of completion :
2012 — 40%;
2013 — 60%;
2014 — 80%.

Calculate the amount of revenue to be recognised in the Profit and Loss Account of 2012, 2013 and 2014.

Solution **Revenue to be Recognised**

Particulars	2012 (₹)	2013 (₹)	2014 (₹)
2012 : 40% of ₹ 10,00,000	4,00,000	—	—
2013 : 60% of ₹ 10,00,000	—	6,00,000	—
2014 : 80% of ₹ 10,00,000	—	—	8,00,000
Less: Revenue recognised in prior periods	—	(4,00,000)	(6,00,000)
Revenue for the period	4,00,000	2,00,000	2,00,000

Note : ***In the Profit and Loss Account, contract revenue is recorded only once. If the contract span is 3 years, we must deduct any contract revenues previously recognised.***

Illustration 2

Mr. X as a contractor has just entered into a contract with a local municipal body for building a flyover. As per the contract terms, X will receive an additional ₹ 2 crores if the construction of the flyover were to be finished within a period of two years of the commencement of the contract. Mr. X wants to recognise this revenue since in the past he has been able to meet similar targets very easily.

Solution

AS—7: "Accounting for Construction Contract" states that incentive payments should be included in contract revenue if the following conditions are satisfied :

(i) the contract is sufficiently advanced and it is probable that the specified performance will be met or exceeded; and

(ii) the amount of the incentive payment can be measured reliably.

In this case, the contract has not even begun and hence Mr. X (the contractor) ***should not recognise any revenue of this contract.***

Applicability of Percentage of Completion Method

The percentage of completion method can be used if the ***outcome*** of the contract can be ***reliably estimated.***

(a) In case of fixed price contracts, this degree of reliability would be provided if the following conditions are satisfied :

   (i) total contract revenues to be received can be reliably estimated;

   (ii) both the costs to complete the contract and the stage of contract performance completed at the reporting date can be reasonably estimated; and

   (iii) the cost attributable to the contract can be clearly identified so that actual expenses can be compared with the prior estimates.

(b) In the case of cost plus contracts this degree of reliability would be provided only if both the following conditions are satisfied :

   (i) cost attributable to the contract can be clearly identified; and

   (ii) costs other than those which are specifically reimbursable under the contract, can be reliably estimated.

Completed Contract Method

Under completed contract method, the recognition of revenue is based on results as determined when the contract is completed or substantially completed.

The main advantage of this method is that the risk of recognising profits that may not have been earned is therefore minimised.

The principal disadvantage of the completed contract method is that periodic reported income does not reflect the level of activity on contracts during the period. For example, when a few large contracts are completed in one accounting period but no contracts have been completed in the previous period or are to be completed in the subsequent period, the level of reported income can be erratic although the level of activity on contracts may have been relatively constant throughout. Even when numerous contracts are regularly completed in each accounting period, and reported income may appear to reflect the level of activity on contracts, there is a continuous lag between the time when work is performed and the related revenue is recognised.

It should be mentioned here that this method is not suitable for long-term contracts. This method is suitable for those contracts which are started and completed within the accounting period.

Recognition of Profits

(a) Profit in case of fixed price contracts normally should not be recognised unless the work on contract has progressed to a ***reasonable extent***. Ordinarily, this test is not considered as having been satisfied unless 20% to 35% of the work is completed.

(b) While recognising the profit under percentage of completion method an appropriate allowance for future unforeseeable factors should be made on either a specific or a percentage basis.

Outcome of the Contract

When the outcome of a contract cannot be estimated the following ***rules must be observed*** :

(1) No profit is to be recognised, though an expected loss should be recognised immediately.
(2) Revenue should be recognised only to the extent of contract costs incurred.
(3) Costs should be recognised in the period in which they are incurred.

Uncertainty over the outcome of the contract may arise from any of the following events :

(a) Financial difficulty of the client

Example : Your company RCC Ltd. has completed 80% work of the new office building of its client R. Securities Ltd. Last installment of payment has not been received from the client. It is the apprehension of the management of RCC Ltd. that this client is in financial trouble and the contract is at risk.

(b) Disputes on reimbursement of costs

Example : Your company Unitech Ltd. is constructing a shopping mall for RPG Ltd. Government officials of fire department is asking for additional fire safety features. Your company has submitted a variation proposals to RPG Ltd. They are not ready to bear the additional cost on the ground that it is contractor's cost.

(c) Anticipated failure to complete the contract in time

Example : Your company L&T Ltd. is executing a 100 km. highway project in Madhya Pradesh. Company's original plan was to work in night shift also. Because of 'Naxalite' problem no night shift work is possible. The management of the company is apprehending that the project will not be completed within the contract period.

Recognition of Foreseeable Losses

A foreseeable loss on the entire contract should be provided for in the financial statements irrespective of:

(i) Whether or not work has started on the contract

Example : Your company X Ltd. has been awarded a contract by HPC Ltd. for building a chemical factory at Haldia, West Bengal. Staff, machinery and materials have been transported to the site. Farmers are protesting for acquisition of farm land. There is no sign of settlement of disputes. The client offers another site, but for the same contract price.
If alternative site is accepted, it will reduce loss, but not eliminate it.
X Ltd. should recognise the loss up to date immediately.

(ii) The stage of completion of the contract or
(iii) The amount of profits expected to arise from other contracts

Example : Your company Simplex Ltd. is constructing 3 shopping malls for RIL at Kolkata, Howrah and Jamshedpur. The company's project at Jamshedpur is hit by labour problems. The company will have to incur extra labour costs and penalties are to be paid for late completion. The management of the company is estimating that there will be a loss of ₹ 50,00,000 in Jamshedpur project but there will be profits in Kolkata and Howrah project of ₹ 2 crore each.
Simplex Ltd. must still recognise the loss on the Jamshedpur project immediately.

Illustration 3

A company took a construction contract for ₹ 100 lakhs in January 2013. It was found that 80% of the contract was completed at a cost of ₹ 92 lakhs on the closing date, i.e., on 31.3.2014. The company estimates further expenditure of ₹ 23 lakhs for completing the contract. The expected loss would be ₹ 15 lakhs. Can the company recognise the loss in the financial statements prepared for the year ended 31st March, 2014 ?

Solution

	₹
Cost upto 31.3.2014	92 Lakhs
Add: Cost to be incurred	23 Lakhs
	115 Lakhs
Less: Contract Price	100 Lakhs
Loss	15 Lakhs

Here, the company should recognise the loss of ₹ 15 lakhs in the Profit and Loss Account for the year ending on 31.3.2014.

Illustration 4

On 1st December, 2013, Viswakarma Construction Company Ltd undertook a contract to construct a building for ₹ 85 lakhs. On 31st March, 2014 the company found that it had already spent ₹ 64,99,000 on the construction. Prudent estimate of the additional cost for completion was ₹ 32,01,000. What is the additional provision for foreseeable loss which must be made in the final accounts for the year ended 31st March 2014 as per provision of the AS7 on "Accounting for Construction Contracts"?

Solution

As per para 35 of AS–7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.

Here, in the present case, the contract price is ₹ 85 lakhs whereas the costs incurred and costs to be incurred to complete the contract comes to ₹ 97 lakhs (₹ 64.99 lakhs + 32.01 lakhs). Therefore, the probable loss is ₹ 12 lakhs (₹ 97 lakhs – ₹ 85 lakhs). As per the requirement of the AS–7, the company should recognise the ***entire loss of ₹ 12 lakhs*** in the current accounting year.

Illustration 5

Sagar Limited belongs to the engineering industry. The Chief Accountant has prepared the draft accounts for the year ended 31.3.2014. You are required to advise the company on the following items from the viewpoint of finalisation of accounts, taking note of the mandatory accounting standards:

The company undertook a contract for building a crane for ₹ 10 lakhs. As on 31.3.2014, it incurred a cost of ₹ 1.5 lakhs and expects that there will be ₹ 9 lakhs more for completing the crane. It has received so far ₹ 1 lakh as progress payment.

Solution

As per para 35 of AS–7 when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.

Here, in this case, total contract estimated cost is ₹ 10.5 lakhs (₹ 1.5 lakhs + ₹ 9 lakhs), whereas the contract price is ₹ 10 lakhs. Therefore, it is probable that total contract costs will exceed total contract revenue.

As per the requirements of the standard, the foreseeable loss of ₹ 50,000 ***should be recognised as an expense*** in the financial statements of 2013-14.

Illustration 6

A firm of contractors obtained a contract for completion of bridges across river Revathi. The following details are available in the records kept for the year ended 31st March, 2014: (₹ in Lakhs)

Total contract price	1,000
Work certified	500
Work not certified	105
Estimated further cost to completion	495
Progress payment received	400
Progress payment to be received	140

The firm seeks your advice and assistance in the presentation of accounts keeping in view the requirements of AS7 "Accounting for Construction Contracts". ***[C.A. — Adapted]***

Solution

Here, in this case, the total contract costs exceed total contract revenue. Therefore, there is a foreseeable loss, which is calculated as under:

		₹ in Lakhs
Contract price		1,000
Less: Total contract cost — Incurred (500 + 105)	605	
To be incurred	495	1,100
Anticipated loss on contract		(100)

Calculation of Stage of Completion	₹ in Lakhs
Work certified	500
Work uncertified	105
	605

Therefore, the percentage of completion of contract is : 605/1100 × 100 = 55%.

Amount of contract revenue to be recognised	₹ in Lakhs
55% of contract value	550
Less: Cost incurred to date to complete 55% of contract value	605
Loss to be recognised	55

As per para 35 of AS–7, when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately. Therefore, the total loss of ₹ 100 lakhs is to be recognised (₹ 55 lakhs current loss and ₹ 45 lakhs anticipated future loss) as an expense in the financial statements during 2013-14.

Disclosure

There should be disclosure in the financial statements of

i. the amount of construction work-in-progress;
ii. progress payments received and advances and retentions on account of contracts included in construction work-in-progress; and
iii. the amount receivable in respect of income accrued under cost plus contracts not included in construction work-in-progress.

If both the percentage of completion method and the completed contract method are simultaneously used by the contractor the amount of contract work described in (i) above should be analysed to disclose separately the amounts attributable to contracts accounted for under each method.

Disclosure of changes in an accounting policy used for construction contracts should be made in the financial statements giving the effect of the change and its amount. However if a contractor changes from the percentage of completion method to the completed contract method for contracts in progress at the beginning of the year it may not be possible to quantify the effect of the change. In such cases disclosure should be made of the amount of attributable profits reported in prior years in respect of contracts in progress at the beginning of the accounting period.

OBJECTIVE TYPE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below :

1. Cost-plus contract is a contract in which price is
   A agreed upon in advance
   B not agreed upon in advance
   C agreed upon in advance but subject to change in future
2. Contract revenue should comprise
   A all cash flows
   B initial revenue agreed *plus* variations, claims and incentive payments and proceeds from sale of scrap
   C initial revenue agreed, plus variations, claims and incentive payments
3. Incidental income, such as from the sale of scrap income, should be shown as
   A contract revenue
   B deduction from cost
   C other income in the profit and loss account
4. A foreseeable loss on the entire contract should be
   A recognised at the end of the contract
   B recognised immediately
   C spread over the remaining period of the contract
5. When the outcome of a contract cannot be estimated
   A a portion of the revenue may be recognised
   B revenue should not be recognised
   C all revenues can be recognised

Guide to Answers

1. B 2. C 3. B 4. B 5. A.

AS–9 "Revenue Recognition" — See Chapter 13.

AS — 10 : Accounting for Fixed Assets
[Effective Date : 1st April, 1991]

Introduction

Fixed assets represent a significant portion of the total assets of an enterprise. In some industries like iron and steel, oil refinery etc., fixed assets consist of 70% to 80% of the total assets. Therefore, fixed assets are very important in the presentation and preparation of financial statements. Furthermore, the operating profits of an enterprise will depend upon whether an expenditure represents an asset or an expense.

This statement deals with accounting for fixed assets. Generally, fixed assets are grouped into various categories, e.g., land, building, plant and machinery, furniture and fixtures, vehicles, patents, trade marks, etc.

Objectives

The main objectives of this statement are :

(a) the recognition of the fixed assets; and

(b) determining their carrying amounts.

Scope

1. This statement does not deal with accounting for the following items to which special considerations apply :
   (a) forests, plantations and similar regenerative natural resources;
   (b) wasting assets including mineral rights, expenditure on the exploration for and extraction of minerals, oil, natural gas and similar non-generative resources;
   (c) expenditure on real estate development; and
   (d) livestock.

Expenditure on individual items of fixed assets used to develop or maintain the activities covered in (a) to (d) above, but separable from those activities, are to be accounted for in accordance with this statement.

Example : Irrigation equipments used for plantation are to be accounted for in accordance with this statement, though plantations is outside the scope of this statement.

2. This statement does not deal with the ***accounting for depreciation*** of the fixed assets.
3. This statement does not deal with the ***treatment of government grants and subsidies*** and assets under ***leasing rights***.

Definitions

Fixed Assets

Fixed asset is an asset held with the intention of being used for the purpose of producing or providing goods or services and is ***not held for sale*** in the normal course of business.

Fair Market Value

Fair market value is the price that would be agreed in an open and unrestricted market between knowledgeable and willing parties dealing at arm's length who are fully informed and are not under any compulsion to transact.

Gross Book Value

Gross book value of a fixed asset is its historical cost or other amount substituted for historical cost in the books of account or financial statements. When this amount is shown net of accumulated depreciation, it is termed as ***net book value***.

Identification of Fixed Assets

An asset will be accounted for as a ***fixed asset*** if the following conditions are satisfied :

(a) It is held with the intention of being used for the purpose of producing or providing goods and services; and

(b) It is not held for sale in the normal course of business.

In some cases, an enterprise may treat an item as expense though it would otherwise be classified as fixed asset.

It is done because the amount of the expenditure is not material.

Example : Saraswati Printers (P) Ltd purchased a punching machine for ₹ 500. Life of the punching machine is 5 years. As the amount of expenditure is small, it can be treated as an expense instead of recording it as a fixed asset.

It should be noted that the Standard permits the aggregation of individually insignificant items, such as tools, modules and dies, as one fixed asset.

Stand-by Equipment and Servicing Equipment

Stand-by equipment and servicing equipment are accounted for as fixed assets.

Example : Factory washing machine and stand-by generator are fixed assets.

Spare Parts

Regularly used spare parts are usually carried as inventory. It is charged to Profit and Loss Account when consumed.

However, if spare parts can only be used in connection with an item of fixed asset and their use is expected to be irregular, they are accounted for as ***fixed assets***. They are depreciated on a systematic basis over the useful life of the ***principal fixed asset***.

Component Accounting

In certain circumstances, the accounting for an item of fixed asset should be done on the basis of its ***separable components***, if

(a) they are in practice separable;

(b) their useful lives are different.

Example : Instead of treating an aircraft and its engines as one unit, it will be better to treat engines and aircraft as separate units. The useful life of engines are usually shorter than that of the aircraft. It should be noted that separate recognition will lead to better estimation of depreciation.

Components of Cost

The cost of an item of fixed assets comprises its purchase price, including import duties and other non-refund-able taxes of levies and any directly attributable cost of bringing the asset to its working condition for its intended use; any trade discounts and rebates are deducted in arriving at the purchase price.

Examples of directly attributable costs are:

(i) site preparation;

(ii) initial delivery and handling costs;

(iii) installation cost, such as special foundations for plant; and

(iv) professional fees, for example fees of architects and engineers.

The cost of a fixed asset may undergo changes subsequent to its acquisition or construction on account of exchange fluctuations, price adjustments, changes in duties or similar factors.

Modvat Credit

Modvat credit is a refund of excise duty. Modvat credit is deducted from the cost of the fixed asset provided certain conditions are satisfied.

Start-up and Commissioning Costs

The expenditure incurred on start-up and commissioning of the project, including the expenditure incurred on test runs and experimental production, is usually capitalised as an indirect element of the construction cost. However, the expenditure incurred after the plant has begun commercial production, i.e. production intended for sale or captive consumption, is not capitalised and is treated as revenue expenditure even though the contract may stipulate that the plant will not be finally taken over until after the satisfactory completion of the guarantee period.

Illustration 1

A company is in the process of setting up a production line for manufacturing a new product. Based on trial runs conducted by the company, it was noticed that the production lines output was not of the desired quality. However, the company has taken a decision to manufacture and sell the sub-standard product over the next one year due to the huge investment involved.

In the background of the relevant accounting standard, advice the company on the cut-off date for capitalisation of the project cost.

Solution

The cut-off date for capitalisation of the project cost would be the date when the ***trial run was completed***. Here, the company has taken a decision to manufacture and sell the sub-standard product over the next one year due to huge investment involved. Any loss incurred on sale of sub-standard product will not be capitalised but to be charged to Profit and Loss Account.

Compensation from the Supplier of the Fixed Asset

Sometimes, as per the terms and conditions of the contract, an enterprise may receive compensation from the supplier of the fixed asset. The amount of compensation will be deducted from the cost of the fixed asset. However, if the enterprise is receiving any penalty also from the supplier, it should be credited to Profit and Loss Account.

Administration and Other General Overhead

Administration and other general overhead expenses are usually excluded from the cost of fixed assets because they do not relate to a specific fixed asset. However, in some circumstances, such expenses as are specifically attributable to construction of a project or to the acquisition of a fixed asset or bringing to its working condition, may be included as part of the cost of the construction project or as a part of the cost of the fixed asset.

Example 1 : Goodricke Ltd is planning to set up a plant for instant tea in Assam. To explore the possibility of getting special equipment, the managing director of the company visited China. During this trip, MD short-listed two manufacturers and negotiation is going on for different matters. The company had incurred ₹ 1,00,000 as expense for this trip. This expense should be charged to Profit and Loss Account because the cost do not relate to a specific fixed asset.

Example 2 : Let us assume that Goodricke Ltd had placed an order with a manufacturer for supply of the equipment. The chief engineer visited China to inspect the equipment before despatch. The company incurred ₹ 80,000 for this visit.

This ₹ 80,000 forms part of the cost of the equipment as it is directly attributable.

Commercial Production

If the interval between the date of a project is ready to commence commercial production and the date at which commercial production actually begins is prolonged, all expenses incurred during this period are charged to the profit and loss statement.

Self-Constructed Fixed Assets

In arriving at the cost of self-constructed fixed asset, the same principles apply as for an acquired asset. The cost of a self-constructed fixed asset should comprise those costs that relate directly to the specific asset and those that are attributable to the construction activity in general and can be allocated to the specific asset.

Exchange of Fixed Assets

(i) When a fixed asset is acquired in exchange or in part exchange for another asset, the cost of the asset acquired should be recorded either :

(a) at fair value; or

(b) at the net book value of the assets given up, adjusted for any balancing payment or receipt of cash or other consideration.

For those purposes 'fair value' may be determined by reference either to the asset given up or to the asset acquired, whichever is more clearly evident.

Example: On 1st January, 2012 P. Ltd. purchased a roasting machine for ₹ 60,000. On 1st January, 2014 the roasting machine got out of order and new roasting machine was purchased after surrendering old one and paying cash of ₹ 90,000. The cost of the new machine in the market is ₹ 1,20,000. Rate of depreciation is 20% and residual value is nil.

Here, new roasting machine purchased on 1st January, 2014 will be recorded at ₹ 1,20,000 because fair value of asset acquired is more clearly evident (see (a) below)

(a) Fair value (which is market price)		**₹ 1,20,000**
(b) Net book value of the asset given up (₹ 60,000 – 24,000)	**36,000**	
Add: Balance payment	**90,000**	**₹ 1,26,000**

(ii) When a fixed asset is acquired in exchange for shares or other securities in the enterprise should be recorded at its fair market value or the fair market value of the securities issued whichever is more clearly evident.

Subsequent Expenditure

Subsequent expenditures related to an item of fixed asset should be added to its book value only if they increase the ***future benefits*** from the existing asset beyond its previously assessed standard of performance.

Illustration 2

On 1.1.2011, X Ltd. purchased a plant at a cost of ₹ 1,80,000. Additionally, installation costs totalled ₹ 20,000. During 2013, major repairs costing ₹ 31,500 had been carried out on this plant. In order to increase the capacity of the plant, a new motor had been fitted on 1.1.2014 at a cost of ₹ 22,000. A further overhauling cost of ₹ 13,500 had been carried out during 2014. You are required to determine the cost of the plant at different years (assume rate of depreciation 10% on straight-line basis).

Solution

(i) Cost of Plant on 1 January, 2011	₹
Purchase price	1,80,000
Add: Installation costs	20,000
	2,00,000
(ii) Book Value on 1 January, 2012	
After depreciation for 2011 @ 10% on ₹ 2,00,000 = ₹ 1,80,000.	
(iii) Book Value on 1 January, 2013	
After depreciation for 2012 @ 10% on ₹ 2,00,000 = ₹ 1,60,000.	
(iv) Cost of Plant on 1 January, 2014	
Book value on 1.1.2014 (₹ 160,000 – 20,000)	1,40,000
Add: **Cost of new motor**	22,000
	1,62,000

Tutorial Note : Major repairs in 2013 costing ₹ 31,500 are to be treated as revenue expenses and are to be charged to Profit and Loss Account. Similarly, overhauling cost of ₹ 13,500 in 2014 is to be treated as revenue expenses and it is to be charged to the Profit and Loss Account of that year.

Illustration 3

During the current year 2014-15, X Limited made the following expenditure relating to its plant building:

	₹ in Lakhs
Routine Repairs	4
Repairing	1
Partial replacement of roof bills	0.5
Substantial improvements to the electrical wiring system which will increase efficiency	10

What amount should be capitalised?

Solution

As per para 12.1 of AS—10, only expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance is included in the gross book value, e.g., an increase in capacity.

Here, in this case, repairs of ₹ 5 lakhs and partial improvement of ₹ 50,000 do not meet the above criterion. Therefore, these should be charged to Profit and Loss Account as expenses. But, substantial improvements to the electrical wiring system which will increase efficiency will be capitalised, i.e., ***added*** to the cost of the plant.

Retirements and Disposals

Material items retired from active use and held for disposal should be stated at the lower of their net book value and net realisable value and shown separately in the financial statements.

Fixed asset should be eliminated from the financial statements on disposal or when no further benefit is expected from its use and disposal.

Losses arising from the retirement or gains or losses arising from disposal of fixed asset which is carried at cost should be recognised in the profit and loss statement.

Example: Swapna Printers (P) Ltd. replaced its offset printing machine with a modern Web Printing Machine during the year 2013-14.

The book value of the offset printing machine is ₹ 5,00,000 but it can be sold as scrap for ₹ 3,00,000 (net) only. Negotiation is going on with two buyers. Till the end of the accounting year (31st March, 2014) nothing has been finalised.

At the time of preparation of financial statements for the year 2013-14, this machine will be shown in the Balance Sheet at ₹ 3,00,000 and to be disclosed separately. The loss of ₹ 2,00,000 (₹ 5,00,000 – 3,00,000) will be recognised as expenses and to be charged to the Profit and Loss Account of 2013-14.

Revaluation of Tangible Fixed Assets

When a fixed asset is revalued in financial statements, an entire class of assets should be revalued, or the selection of assets for revaluation should be made on a systematic basis. This basis should be disclosed.

Points to be noted:

(1) If an item is revalued, the entire class to which that asset belongs will also be revalued.

(2) A class is a grouping of assets of a similar nature and use (e.g., land, building, plant and machinery, furnitures and fixtures, etc.).

(3) Revaluation should not be selective but carried out in a methodical and organised manner. For example, an enterprise may revalue all the fixed assets within an unit.

The revaluation in financial statements of a class of assets should not result in the net book value of that class beyond the recoverable amount of assets of that class.

The ***recoverable amount*** is the higher of the following :
(i) an asset's net selling price; or
(ii) its value in use*

Example

We consider the following example (all figures in rupees) :

Assets	A	B	C
Net book value (before revaluation)	10,000	12,000	15,000
Recoverable amount	12,000	15,000	8,000

If the business decides to revalue assets A and B but not C, the position will be as under :

Assets	A	B	C	Total
Net book value (after revaluation)	12,000	15,000	15,000	42,000
Recoverable amount	12,000	15,000	8,000	35,000

Here, the net book value is more than the recoverable amount. This is not permissible under the standard.

Surpluses / Deficits on Revaluation

An increase in net book value arising on revaluation of fixed assets should be credited directly to owners' interests under the head of revaluation reserve, except that, to the extent that such increase is related to and not greater than a decrease arising on revaluation previously recorded as a charge to the profit and loss statement, it may be credited to the profit and loss statement. A decrease in net book value arising on revaluation of fixed asset should be charged directly to the profit and loss statement except that to the extent that such a decrease is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or utilised, it may be charged directly to that account.

An increase in net book value arising on revaluation of a fixed asset is to be recorded by debiting the Asset Account and crediting the Revaluation Reserve Account. Conversely, a decrease in net book value arising on revaluation of a fixed asset is to be recorded by debiting Profit and Loss Account and crediting Asset Account.

A fixed asset which was revalued downwards in a previous accounting period, may be revalued upwards in the current accounting period. In such a case, the previous decrease is to be adjusted against the current increase by crediting Profit and Loss Account. The surplus balance, if any, is to be transferred to Revaluation Reserve Account.

For example, an asset is revalued downwards in 2013 by ₹ 5,000, debiting the Profit and Loss Account and crediting the Asset Account. In 2014, the same asset is revalued upwards by ₹ 7,000. Here, Asset Account is to be debited by ₹ 7,000, Profit and Loss Account is to be credited by ₹ 5,000 and Revaluation Reserve Account to be credited by ₹ 2,000.

On the other hand, a fixed asset which was revalued upwards in a previous accounting period, may be revalued downwards in the current accounting period. In such a case, the previous increase is to be adjusted against the current decrease by debiting Revaluation Reserve Account. The deficit balance, if any, is to be transferred to Profit and Loss Account.

For example, an asset is revalued upwards in 2013 by ₹ 5,000, debiting the Asset Account and crediting Revaluation Reserve Account. In 2014, the same asset is revalued downwards by ₹ 7,000. Here, Revaluation Reserve Account is to be debited by ₹ 5,000, Profit and Loss Account is to be debited by ₹ 2,000 and Asset Account is to be credited by ₹ 7,000.

Illustration 4

How will you treat the following ?

A revaluation of land and building of a firm during the year showed surpluses totalling ₹ 40,00,000 and a revaluation of plant and machinery showed deficits totalling ₹ 5,00,000. The firm's revaluation reserve of ₹ 65,00,000 includes previous revaluation surpluses of ₹ 2,00,000 on plant and machinery now showing a deficit on revaluation.

*It is the present value of estimated future cash flows expected to arise from the continuing use of a fixed asset over its useful life and from its ultimate disposal.

Solution

The revaluation surplus of ₹ 40,00,000 must be taken directly to revaluation reserve. The revaluation deficit of ₹ 5,00,000 will be taken to the Profit and Loss Account to the extent that it is not covered by previous unrealised surpluses on the same assets. Thus ₹ 2,00,000 will be adjusted against revaluation reserve and the remaining ₹ 3,00,000 written-off to the Profit and Loss Account, **being disclosed as an exceptional item**.

Sale of Previously Revalued Assets

On disposal of a previously revalued item of fixed asset, the difference between net disposal proceeds and the net book value should be charged or credited to the profit and loss statement except that to the extent that such a loss is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or utilised, it may be charged directly to that account.

The amount standing in Revaluation Reserve following the retirement or disposal of an asset which relates to that asset may be transferred to General Reserve.

Example: The net book value of an asset is ₹ 10,000 which is disposed off for ₹ 6,000. The asset was previously revalued upwards by ₹ 3,000. Here, the loss of ₹ 4,000 (₹ 10,000 – 6,000) is to be adjusted first by debiting Revaluation Reserve (₹ 3,000) and the balance by debiting Profit and Loss Account (₹ 1,000).

It should be noted that if the Revaluation Reserve Account in respect of that asset has already been reversed or utilised, no adjustment against Revaluation Reserve Account is possible. In this case, the entire amount is to be debited to Profit and Loss Account.

Jointly Owned Fixed Assets

In the case of fixed assets owned by the enterprise jointly with others, the extent of the enterprise's share in such assets, and the proportion of the original cost, accumulated depreciation and written-down value should be stated in the Balance Sheet. Alternatively, the pro rata cost of such jointly owned assets may be grouped together with similar fully-owned assets with an appropriate disclosure thereof.

Purchase of Several Fixed Assets for a Consolidated Price

Where several fixed assets are purchased for a consolidated price, the consideration should be apportioned to the various assets on a fair basis as determined by competent valuers.

Goodwill should be recorded in the books only when some consideration in money or money's worth has been paid for it. Whenever a business is acquired for a price (payable in cash or in shares or otherwise) which is in excess of the value of the net assets of the business taken over, the excess should be termed as "goodwill".

Disclosures

The following information should be disclosed in the financial statements:

(i) gross and net book values of fixed assets at the beginning and end of an accounting period, showing additions, disposals, acquisitions and other movements;

(ii) expenditure incurred on account of fixed assets in the course of construction or acquisition; and

(iii) revalued amount substituted for historical costs of fixed assets, the method adopted to compute the revalued amounts, the nature of indices used, the year of any appraisal made, and whether an external valuer was involved, in case where fixed assets are stated at revalued amounts.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below :

1. AS—10: 'Accounting for Fixed Assets' deal with accounting for the following items :
   A forest, plantations and solar energy
   B livestock
   C equipments used for plantations
2. Regularly used spare parts are usually
   A treated as expense on purchase
   B carried as inventory and treated as an expense on consumption
   C treated as a fixed asset and depreciated accordingly
3. Standby equipment and servicing equipments are
   A ignored
   B accounted for as current assets
   C accounted for as fixed assets
4. Modvat credit is
   A added with the cost of the fixed asset
   B deducted from the cost of the fixed asset without any condition
   C deducted from the cost of the fixed asset if certain conditions are satisfied
5. The expenditure incurred on test runs is usually
   A capitalised as a direct element of the construction cost
   B capitalised as an indirect element of the construction cost
   C treated as revenue expenditure
6. The expenditure incurred between the date of a project is ready to commence commercial production and the date of actual commercial production will be
   A capitalised
   B ignored
   C charged to Profit and Loss Account
7. Individually-insignificant items, such as moulds, tools and dies may be
   A expensed on purchase
   B aggregated as one asset
   C ignored
8. Components of cost are
   (i) purchase price
   (ii) general office overheads
   (iii) any costs directly attributable to bringing the asset to its working condition for its intended use
   A all the above
   B all except (iii)
   C all except (ii)
9. When a fixed asset is acquired in exchange for another asset, the cost of the asset acquired should be recorded
   A at replacement cost
   B at fair value
   C at the net book value of the asset given up only
10. Subsequent expenditures related to an item of fixed asset should be added to its book value
   A only if it is recommended by the auditors
   B only if it is recommended by the Board of Directors
   C only if they increase the future benefits from the existing asset beyond its previously assessed standard of performance.

Guide to Answers

1. C; 2. B; 3. C; 4. C; 5. B; 6. C; 7. B; 8. C; 9. B; 10. C.

AS — 11 : The Effects of Changes in Foreign Exchange Rates

[Effective Date : 1st April, 2009]

Introduction

Today, it is very common for enterprises to operate in more than one country. There are many multinational companies which are operating throughout the world. HP, for example, has operations in more than 100 countries. Similarly many Indian companies, for example, Reliance Industries Ltd., Tata Motors Ltd., TISCO Ltd., are operating in foreign countries. Reliance Industries Ltd. is operating in more than 10 countries like Kenya, Malaysia, Australia, UK, UAE, etc.

Again many Indian companies exports goods to foreign countries and imports goods, raw materials, plant etc., from foreign countries. All these transactions involve foreign exchange.

International business transactions have major effects on accounting. Different countries follow different currencies and majority of sales and purchases are made in local currencies. Thus local currency value needs to be converted into reporting currency value using exchange rates.

Like any commodity, the exchange rate also changes daily according to supply and demand for the currency. As a consequence, the profit of an enterprise, trading in foreign currency is influenced by the fluctuation in the exchange rate.

The main theme of this accounting standard is to prescribe for the accounting treatment of exchange difference.

Objective

An enterprise may carry on activities involving foreign exchange in two ways. It may have transactions in foreign currencies or it may have foreign operations. In order to include foreign currency transactions and foreign operations in the financial statements of an enterprise, transactions must be expressed in the enterprise's reporting currency and the financial statements of foreign operations must be translated into the enterprise's reporting currency.

The principal issues in accounting for foreign currency transactions and foreign operations are to decide which exchange rate to use and how to recognise in the financial statements the financial effect of changes in exchange rates.

Scope

1. This Statement should be applied :
   (a) in accounting for ***transactions*** in foreign currencies; and
   (b) in ***translating*** the financial statements of foreign operations.
2. This Statement also deals with accounting for foreign currency transactions in the nature of forward exchange contracts.
3. This Statement does not specify the currency in which an enterprise presents its financial statements. However, an enterprise normally uses the currency of the country in which it is domiciled. If it uses a different currency, this Statement requires disclosure of the reason for using that currency. This Statement also requires disclosure of the reason for any change in the reporting currency.
4. This Statement does not deal with the restatement of an enterprise's financial statements from its reporting currency into another currency for the convenience of users accustomed to that currency or for similar purposes.
5. This Statement does not deal with the presentation in a cash flow statement of cash flows arising from transactions in a foreign currency and the translation of cash flows of a foreign operation (see AS 3, Cash Flow Statements).
6. This Statement does not deal with exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs (see paragraph 4(e) of AS 16, Borrowing Costs).

Definitions

The following terms are used in this Statement with the meanings specified:

Average rate is the mean of the exchange rates in force during a period.

Closing rate is the exchange rate at the balance sheet date.

Exchange difference is the difference resulting from reporting the ***same number of units of a foreign currency*** in the reporting currency at different exchange rates.

Exchange rate is the ratio for exchange of two currencies.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledge-able, willing parties in an arm's length transaction.

Foreign currency is a currency other than the reporting currency of an enterprise.

Foreign operation is a subsidiary , associate , joint venture or branch of the reporting enterprise, the activities of which are based or conducted in a country other than the country of the reporting enterprise.

Forward exchange contract means an agreement to exchange different currencies at a forward rate.

Forward rate is the specified exchange rate for exchange of two currencies at a specified future date.

Integral foreign operation is a foreign operation, the activities of which are an integral part of those of the reporting enterprise.

Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Net investment in a non-integral foreign operation is the reporting enterprise's share in the net assets of that operation.

Non-integral foreign operation is a foreign operation that is not an integral foreign operation.

Non-monetary items are assets and liabilities other than monetary items.

Reporting currency is the currency used in presenting the financial statements.

Foreign Currency Transactions

Initial Recognition

A foreign currency transaction is a transaction which is denominated in or requires settlement in a foreign currency, including transactions arising when an enterprise either:

(a) buys or sells goods or services whose price is denominated in a foreign currency;

(b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency;

(c) becomes a party to an unperformed forward exchange contract; or

(d) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

A ***foreign currency transaction*** should be recorded in the reporting currency using the exchange rate between the reporting currency and the foreign currency at the ***date of the transaction***.

The rate that should be used is the mid market rate, or 'spot' rate of the date of transaction.

An average rate may be used for a week, or a month, for all transactions in each foreign currency, if there is no significant fluctuation in the exchange rates.

The date of transaction is the date when the transaction is ***contracted*** or ***recognised***, rather than the date of receiving (or paying) cash.

Example: On 1st January, 2015 your company TCS Ltd. has raised an invoice for $ 10,000 on its USA client. The payment was received on 1st March, 2015. The exchange rate was :

1st January, 2013 — $1 = ₹ 59

1st March, 2013 — $1 = ₹ 60

It is to be recorded in the books of TCS Ltd. as follows :

1st January, 2015

Accounts Receivable Account (USA Client)	**Dr.**	**₹ 5,90,000**	
To Sales Account (₹ 59× 10,000)			**₹ 5,90,000**

1st March, 2015			
Bank Account (₹ 60 × 10,000)	**Dr.**	**₹ 6,00,000**	
To Accounts Receivable Account			**₹ 5,90,000**
To Foreign Exchange Difference Account			**₹ 10,000**

Reporting at Subsequent Balance Sheet Dates

(a) ***Foreign Currency monetary*** items like money held in cash and cash equivalents, accounts receivable and accounts payable should be reported using the ***closing rate***.

(b) ***Non-monetary items*** like property, plant and equipments, which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange rate at the date of the transaction.

Example : **HPCL purchased a plant for its chemical factory on 1st January, 2015 but had not been paid for by 31st March, 2015, the date of closing the books of accounts. The cost of the plant was $ 1,00,000.**

The exchange rates were :

1st January, 2015 — $1 = ₹ 59

31st March, 2015 — $1 = ₹ 60

In the books of HPCL, it will be recorded as follows :

1st January, 2015			
Plant Account (₹ 59× 1,00,000)	**Dr.**	**₹ 59,00,000**	
To Accounts Payable Account			**₹ 59,00,000**
31st March, 2015			
Exchange Difference Account	**Dr.**	**₹ 1,00,000**	
To Accounts Payable Account			**₹ 1,00,000**

(c) ***Non-monetary items*** which are carried at fair value or other similar valuation denominated in a foreign currency should be reported using the exchange rates that existed when the values were determined.

Recognition of Exchange Differences

Exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as ***income*** or as ***expenses*** in the period in which they arise.

Net Investment in a Non-integral Foreign Operation

Exchange differences arising on a monetary item that, in substance, forms part of an enterprise's net investment in a non-integral foreign operation should be accumulated in a foreign currency translation reserve in the enterprise's financial statements until the disposal of the net investment, at which time they should be recognised as income or as expenses.

Illustration 1

From the following information, calculate foreign exchange gain / loss for the financial years 2011-12 and 2012-13 :

	Exchange Rate (₹)
Goods purchased on 22.1.2012 for US $ 20,000	45.80
Exchange rate on 31.3.2012	46.10
Payment made on 4.4.2013	46.30

Solution

As per AS-11 (revised), a foreign currency transaction should be recorded by applying the exchange rate between the reporting currency and the foreign currency at the ***date of the transaction***. Therefore, both purchases and creditors should be recorded at the following figure: 20,000 × ₹ 45.80 = ₹ 9,16,000.

AS-11 (revised) prescribes that all monetary items in the Balance Sheet should be reported using closing rate. Therefore, the creditors should be valued at : 20,000 × ₹ 46.10 = ₹ 9,22,000.

The exchange loss of ₹ 6,000 (₹ 9,22,000 – 9,16,000) should be debited in the Statement of Profit and Loss for the year 2011-12.

AS-11 (revised) states that exchange differences arising on the settlement of monetary items at rates different from those at which they were reported in previous financial statements should be recognised as income or loss in the period in which they arise.

In this case, though the value of the creditors is ₹ 9,22,000, they are settled at ₹ 9,26,000 (20,000 × ₹ 46.30). The exchange loss of ₹ 4,000 (₹ 9,26,000 – 9,22,000) should be debited to the Statement of Profit and Loss for the year 2012-13.

Illustration 2

How will you treat the following as per AS-11 (revised)?

(1) Debtors include amount due from X Limited, USA, fo r ₹ 6,00,000, which was recorded at $1 = ₹ 39.20 — the prevailing exchange rate on the date of sales. The exchange rate on the Balance Sheet date was $1 = ₹ 40.10.

(2) A long-term loan was obtained from Y Limited, amounting to ₹ 20,00,000, which was recorded at $1 = ₹ 36.20 — the prevailing exchange rate on the date of transaction. The exchange rate on the Balance Sheet date was $1 = ₹ 37.40.

(3) For credit purchase of plant, another loan was obtained from Z Ltd., UK for ₹ 12,00,000, which was recorded at £ = ₹ 64.10. The exchange rate on the Balance Sheet date was £ = ₹ 67.20.

Solution

AS-11 (revised) provides for the following :

(a) A foreign currency transaction should be recorded by applying the exchange rate between the reporting currency and the foreign currency at the date of the transaction.

(b) Monetary items in the Balance Sheet should be reported using the closing rate.

(c) Exchange rate differential in respect of foreign currency deferred liability relatable to fixed assets will have to be absorbed in the Statement of Profit and Loss.

(1) Initial recognition : ₹ 6,00,000 / ₹ 39.20 = $15,306.
Rate at the Balance Sheet date : $1 = ₹ 40.10.
Debtors to be shown on the Balance Sheet date : 15,306 × ₹ 40.10 = ₹ 6,13,770.
Therefore, the exchange difference is a gain of ₹ 13,770 (₹ 6,13,770 – 6,00,000) which should be credited in the Statement of Profit and Loss.

(2) Initial recognition : ₹ 20,00,000 / ₹ 36.20 = $ 55,249.
Rate at the Balance Sheet date : $1 = ₹ 37.40.
Long-term loan to be shown on the Balance Sheet date : 55,249 × ₹ 37.40 = ₹ 20,66,312.
Therefore, the exchange difference is a loss of ₹ 66.312 (₹ 20,66,312 – 20,00,000) which should be debited in the Statement of Profit and Loss.

(3) Initial recognition : ₹ 12,00,000 / ₹ 64.10 = £ 18,721.
Rate at the Balance Sheet date : £1 = ₹ 67.20.
Long-term loan for the purchase of plant on credit to be shown on the Balance Sheet :
18,721 × ₹ 67.20 = ₹ 12,58,051.
Therefore, the exchange difference is a loss of ₹ 58,051 (₹ 12,58,051 – 12,00,000) which should be debited in the Statement of Profit and Loss.

Illustration 3

A company had imported raw materials worth US $ 6,00,000 on 5th January, 2010 when the exchange rate was ₹ 43 per US $. The company had recorded the transaction in the books at the above mentioned rate. The payment for the import transaction was made on 5th April, 2010 when the exchange rate was ₹ 47 per US$. However, on 31st March, 2010, the rate of exchange was ₹ 48 per US$. The company passed an entry on 31st

March, 2010 adjusting the cost of raw materials consumed for the difference between ₹ 47 and ₹ 43 per US$.

In the background of the relevant accounting standard, is the company's accounting treatment correct ? Discuss.

Solution

AS—11 "The Effects of Changes in Foreign Exchange Rates", states that foreign currency monetary items should be reported using the ***closing rate***.

Exchange difference arising on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period should be recognised as income or as expenses in the period in which they arise.

(a) On 5th January, 2010 creditors were recorded for	₹ 258,00,000	(₹ 43 × 6,00,000)
(b) On 31st March, 2010 creditors were reported for	₹ 288,00,000	(₹ 48 × 6,00,000)
Loss due to exchange difference [(b) – (a)]	₹ 30,00,000	

This ₹ 30,00,000 will be charged to Profit and Loss Account for the year **2009-10** as expenses.

The accounting treatment adopted by the company was not correct **at all**.

It should be noted that in the year 2010-11 when the creditors were paid off, the exchange rate was lower than closing rate by Re 1 (₹ 48 – ₹ 47). Therefore, in 2010-11, ₹ 6,00,000 should be credited to Profit and Loss Account of 2010-11 as income.

Financial Statements of Foreign Operations

Classification of Foreign Operations

Foreign operations are classified as :

(i) Integral foreign operations; and (ii) Non-integral foreign operations.

An ***integral*** foreign operation is a dependent foreign operation or an extension of the activities of the reporting enterprise.

For example, Tata Motors Ltd. has a branch office at Dhaka, Bangladesh. This branch is exclusively selling Tata commercial vehicles and passenger cars and remits the cash immediately to Tata Motors Ltd. This is an integral foreign operation.

A ***non-integral*** foreign operation tends to act as a ***stand-alone*** unit, accumulates cash and other monetary items, incurs expenses, generate incomes and perhaps arranges borrowings, all substantially in its local currency.

The following are indications that a foreign operation is a non-integral foreign operation rather than an integral foreign operation:

(a) while the reporting enterprise may ***control the foreign operation***, the activities of the foreign operation are carried out with a ***significant degree of autonomy*** from those of the reporting enterprise;
(b) transactions with the reporting enterprise are not a high proportion of the foreign operation's activities;
(c) the activities of the foreign operation are financed mainly from its own operations or local borrowings rather than from the reporting enterprise;
(d) costs of labour, material and other components of the foreign operation's products or services are primarily paid or settled in the local currency rather than in the reporting currency;
(e) the foreign operation's sales are mainly in local currencies other than the reporting currency;
(f) cash flows of the reporting enterprise are insulated from the day-to-day activities of the foreign operation rather than being directly affected by the activities of the foreign operation;
(g) sales prices for the foreign operation's products are not primarily responsive on a short-term basis to changes in exchange rates but are determined more by local competition or local government regulation; and

(h) there is an active local sales market for the foreign operation's products, although there also might be significant amounts of exports.

The appropriate classification for each operation can, in principle, be established from factual information related to the indicators listed above. In some cases, the classification of a foreign operation as either a non-integral foreign operation or an integral foreign operation of the reporting enterprise may not be clear, and judgement is necessary to determine the appropriate classification.

Translation of Foreign Integral Operations

The financial statements of an integral foreign operation should be translated as if the transactions of the foreign operation had been those of the reporting enterprise itself.

The cost and depreciation of tangible fixed assets is translated using the exchange rate at the date of purchase of the asset or, if the asset is carried at fair value or other similar valuation, using the rate that existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when those costs were incurred. The recoverable amount or realisable value of an asset is translated using the exchange rate at the date as at which the net realisable value is determined. The rate used is therefore usually the closing rate.

Translation of Foreign Non-integral Operations

In translating the financial statements of a non-integral foreign operation for incorporation in its financial statements, the reporting enterprise should use the following procedures:

(a) the assets and liabilities, both monetary and non-monetary, of the non-integral foreign operation should be translated at the ***closing rate***;

(b) income and expense items of the non-integral foreign operation should be translated at exchange rates at the ***dates of the transactions***; and

(c) all resulting exchange differences should be accumulated in a foreign currency translation reserve until the disposal of the net investment.

For practical reasons, a rate that approximates the actual exchange rates, for example an average rate for the period, is often used to translate income and expense items of a foreign operation.

Illustration 4

X Limited has a foreign branch in New York, USA. On 31.3.2013, the following trial balance was prepared from the books of New York office (figures in US $):

Particulars	Dr.	Cr.
Plant and machinery at cost	40,000	—
Accumulated depreciation on plant and machinery	—	26,000
Opening stock (1.4.2012)	4,000	—
Debtors and Creditors	12,000	6,000
Purchases and Sales	4,000	24,600
Cash and Bank	2,000	—
Salaries	9,000	—
Rent	2,400	—
Goods received from head office	1,000	—
Office expenses	3,600	—
Commission	—	20,000
Head Office Current Account	—	1,400
TOTAL	78,000	78,000

Additional information :

Goods sent to branch ₹ 20,000; Branch current account in the books of head office ₹ 24,000; Closing stock $625.

You are required to convert the above trial balance into rupees assuming that the branch is (a) an integral foreign operation; and (b) a non-integral foreign operation.

The exchange rates were as under :

Opening rate $1 = ₹ 40; Closing rate $1 = ₹ 48; Average rate $1 = ₹ 44, which approximates the actual exchange rate. For plant and machinery $1 = ₹ 36.

Solution

(a) AS-11 (revised) states that in case a foreign operation is determined as an integral operation, financial statements should be translated using the same principle, as if the foreign operation had been those of the reporting entity itself. The resulting exchange gain or loss should be recognised in the Statement of Profit and Loss.

New York Branch
Trial balance as at 31.3.2013 (figures in ₹)

Particulars	Conversion Rate	Dr.	Cr.
Plant and machinery at cost	36	14,40,000	—
Accumulated depreciation on plant and machinery	36	—	9,36,000
Opening stock (1.4.2012)	40	1,60,000	—
Debtors and Creditors	48	5,76,000	2,88,000
Purchases and Sales	44	1,76,000	10,82,400
Cash and Bank	48	96,000	—
Salaries	44	3,96,000	—
Rent	44	1,05,600	—
Goods Received from Head Office		20,000	—
Office Expenses	44	1,58,400	—
Commission	44	—	8,80,000
Head Office Current Account		—	24,000
Foreign Exchange Loss (balancing figure)		82,400	—
		32,10,400	32,10,400
Closing Stock	48	30,000	

(b) AS-11 (revised) states that in case a foreign operation is determined as a non-integral operation, assets and liabilities (both monetary and non-monetary items) are to be converted by applying closing rate, but incomes and expenses are to be converted by applying average rate. The resulting exchange difference gain or loss should be accumulated in a foreign currency translation reserve.

New York Branch
Trial balance as at 31.3.2013 (figures in rupees)

Particulars	Conversion Rate	Dr.	Cr.
Plant and machinery at cost	48	19,20,000	—
Accumulated depreciation on plant and machinery	48	—	12,48,000
Opening stock (1.4.2012)	40	1,60,000	—
Debtors and Creditors	48	5,76,000	2,88,000
Purchases and Sales	44	1,76,000	10,82,400
Cash and Bank	48	96,000	—
Salaries	44	3,96,000	—
Rent	44	1,05,600	—
Goods Received from Head Office		20,000	—
Office Expenses	44	1,58,400	—
Commission	44	—	8,80,000
Head Office Current Account		—	24,000
Foreign Currency Translation Reserve (balancing figure)		—	85,600
		36,08,000	36,08,000
Closing Stock	48	30,000	—

Disposal of a Non-integral Foreign Operation

On the disposal of a non-integral foreign operation, the cumulative amount of the exchange differences which have been deferred and which relate to that operation should be recognised as income or as expenses in the same period in which the gain or loss on disposal is recognised.

Change in the Classification of a Foreign Operation

When there is a change in the classification of a foreign operation, he translation procedures applicable to the revised classification should be applied from the date of the change in the classification.

Forward Exchange Contracts

An enterprise may enter into a forward exchange contract or another financial instrument that is in substance a forward exchange contract, which is not intended for trading or speculation purposes, to establish the amount of the reporting currency required or available at the settlement date of a transaction. The premium or discount arising at the inception of such a forward exchange contract should be amortised as expense or income over the life of the contract. Exchange differences on such a contract should be recognised in the statement of profit and loss in the reporting period in which the exchange rates change. Any profit or loss arising on cancellation or renewal of such a forward exchange contract should be recognised as income or as expense for the period.

Illustration 5

Sterling Ltd. purchased a plant for US $ 20,000 on 31st December, 2011 payable after 4 months. The company entered into a forward contract for 4 months @ ₹ 48.85 per dollar. On 31st December, 2011 the exchange rate was ₹ 47.50 per dollar.

How will you recognise the profit or loss on forward contract in the books of Sterling Limited for the year ended 31st March, 2012 ?

Solution **Calculation of Profit or Loss to be Recognised in books of Sterling Ltd**

Particulars		₹
Forward Contract Rate		48.85
Less: Spot Rate		47.50
Loss per Dollar		1.35
Forward contract Amount	($)	20,000
Total Loss on entering into Forward Contract (20,000 x 1.35)	(₹)	27,000
Contract Period		4 Months
Loss per month to be Amortised (27,000 ÷ 4)		6,750
In 2011-12 Loss to be recognised (3 x ₹ 6,750)	(₹)	20,250
In 2012-13 Loss to be recognised (1 x ₹ 6,750)	(₹)	6,750

Illustration 6

X Limited closes its books of account on 31st December.

On 1.9.2011, it took a forward contract cover against US $ 1,00,000. This is to be repaid on 28.2.2012. The spot rate was ₹ 46.10 and the forward rate was ₹ 46.60. What will be the treatment as per AS-11 (revised) for the accounting years 2011 and 2012 for the premium paid on the forward contract, if the exchange rate on 31.12.2011 was as follows:

(i) ₹ 46.30; (ii) ₹ 45.90; and (iii) ₹ 46.80.

Solution

The premium on the forward contract is = 1,00,000 (₹ 46.60 – 46.10)

= 1,00,000 × Re 0.50

= ₹ 50,000.

AS-11 (revised) provides for the following:

(1) The premium at the inception of a forward contract should be amortised over the tenor of the contract period.

(2) Any exchange difference on a forward contract should be recognised in the Statement of Profit and Loss at the Balance Sheet date in which the exchange rates change.

Calculation of Exchange Difference for the year ending on 31.12.2011

Particulars	Case 1 (₹)	Case 2 (₹)	Case 3 (₹)
Initial recognition (Amount x Spot Rate)	46,10,000	46,10,000	46,10,000
Value at the Balance Sheet Date (Amount x Closing Rate)	46,30,000	45,90,000	46,80,000
Exchange Difference : Profit / (Loss)	(20,000)	20,000	(70,000)

Calculation of Exchange Difference for the year ending on 31.12.2012

Particulars	Case 1 (₹)	Case 2 (₹)	Case 3 (₹)
Value at the Balance Sheet Date	46,30,000	45,90,000	46,80,000
Contracted Forward Rate Payable (Amount x forward rate)	46,60,000	46,60,000	46,60,000
Exchange Difference : Profit / (Loss)	(30,000)	(70,000)	20,000

It can be seen that the loss is ₹ 50,000 in all the above cases.

Disclosure

An enterprise should disclose:

(a) the amount of exchange differences included in the net profit or loss for the period; and

(b) net exchange differences accumulated in foreign currency translation reserve as a separate component of shareholders' funds, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.

When the reporting currency is different from the currency of the country in which the enterprise is domiciled, the reason for using a different currency should be disclosed. The reason for any change in the reporting currency should also be disclosed.

When there is a change in the classification of a significant foreign operation, an enterprise should disclose:

(a) the nature of the change in classification;

(b) the reason for the change;

(c) the impact of the change in classification on shareholders' funds; and

(d) the impact on net profit or loss for each prior period presented had the change in classification occurred at the beginning of the earliest period presented.

The effect on foreign currency monetary items or on the financial statements of a foreign operation of a change in exchange rates occurring after the balance sheet date is disclosed in accordance with AS–4, 'Contingencies and Events Occurring After the Balance Sheet Date'.

Disclosure is also encouraged of an enterprise's foreign currency risk management policy.

OBJECTIVE QUESTIONS

Multiple Choice

Select the best choice to complete each sentence or answer each question below :

1. Monetary items are
   A cash only
   B cash and cash equivalent
   C money held and assets and liabilities to be received or paid in fixed or determinable amounts of money
2. Forward rate is
   A the determinable exchange rate for exchange of two currencies at a specified future date
   B the specified exchange rate for exchange of two currencies at a specified future date
   C neither of the above
3. Foreign currency is a currency
   A other than the functional currency
   B other than the reporting currency of an enterprise
   C neither of the above

4. A foreign currency transaction should be recorded in the reporting currency, using the exchange rate between the reporting currency and the foreign currency
   A at the date of settlement
   B at the last date of the month of transaction
   C at the date of transaction
5. Foreign currency monetary items should be reported using
   A the average rate for the year
   B the closing rate on the Balance Sheet date
   C the rate on the date of transaction
6. Non-monetary items should be reported using
   A the average rate for the year
   B the closing rate on the Balance Sheet date
   C the rate on the date of transaction
7. The date of transaction is
   A the date on which it is recorded in the books of account
   B the date when the transaction is contracted or recognised
   C the date of receiving (or paying) cash
8. Exchange differences arising on the settlement of monetary items should be recognised
   A in the Balance Sheet as capital reserve
   B in the Profit and Loss Account as income or expenses
   C neither of the above
9. Net investment in a non-integral foreign operation is
   A the amount invested by the reporting enterprise at cost
   B the reporting enterprises' share in the net assets of that operation
   C neither of the above
10. If the US$ falls in value against the Indian rupees (INR), and you have net $ liability
    A an exchange loss will result
    B an exchange gain will result
    C neither gain or loss will result

Guide to Answer

1. C; 2. B; 3. B; 4. C; 5. B; 6. C; 7. B; 8. B; 9. B; 10. B.