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DIRECTORATE OF DISTANCE AND CONTINUING EDUCATION
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INDEX

Chapter 1
ACCOUNTING PRINCIPLES, CONCEPTS AND CONVENTIONS

Accounting

Accounting is the art and science of recording monetary transactions in a systematic manner and evaluating the result thereof. Accounting communicates the result of business activities to various parties who are interested in the business such as owners, managers, creditors, investors, employees, Government departments and others .. Therefore it is termed as the language of business. According to American Accounting Association "Accounting is the process of identifying measuring and communicating economic information to permit informed judgement and decisions by users of the information".

By using the counting language, a business house communicates with the outside world. In order to make the language clear and understandable to all person, and to ensure uniformity in the preparation of accounts, some standards or guidelines have been prescribed. These guidelines are termed as accounting principles.

Accounting principles can not be exact as the principles of Physics, Chemistry, and other natural sciences. These principles have been evolved over a period of years by experience, necessity and usage. These principles are man-made, through a process of trial and error and this process till continues. For example, when an accounting problem arises different accounting bodies, associations, accountants or academics give different solutions and the best one is academics give different solutions and the best one is accepted as an accounting principle. With the passage of time, old principles may be replaced by newer ones.

Criteria for Accounts Principles.

Generally three conditions have to be a satisfied for the general acceptance of an accounting principle. These are relevance (usefulness), objectivity and feasibility. A principle is said to be relevant when it provides useful and meaningful information to the people who need them. A principle is objective when it cannot be influenced by personal of the people who prepare the accounts. It can notes reliability 'and trustworthiness. A principle is said to be feasible when it is simple and inexpensive to implement.

Concepts and Conventions

The accounting principles are broadly classified into two categories. 1. Accounting Concepts and 1. Accounting Conventions. The term Accounting Concepts refers to basic assumptions and conditions, upon which the science of accounting is based. Accounting Convention refers to basic assumptions and conditions upon which the science of a accounting is based. Accounting Conventions refer to the traditions, customs and practices followed by accountants as a guide in the preparation of financial statement.

Important Accounting Concepts

1. Separate Entity Concept

For Accounting purposes, a business is considered to be different from the persons who own it. (Of course, legally it is not so in the case of a sole-trade or a partnership). The accounting system deals only with the accounts of the firm and not that of the owners. Otherwise, the affairs of the business would get mixed up with the affairs of the owners. The Balance Sheet of a sole-trader does not disclose the private assets of its owner, even though such assets might be claimed by the creditors in case of lose in the business. Thus, this concept prescribes the boundaries for recording 'and reporting' the economic information of an enterprise. This concept also helps to record in the books of the firm, the transactions that take place between the business and its owners. Further, when a big business is divided into different departments or divisions, this principle of separate entity helps to measure the efficiency of such departments or divisions.

2. Money Measurement Concept

All the transactions of a business are recorded only in terms 'of money. Because money is the medium of exchange,and common measure of value. It is the yared stick with which different kinds of resource are measured. For example, a business may own say 2000 square metre of building space, Rs. 1,00,000/- cash, 5,000 tons of raw materials. 5 trucks 3 cars and 100 sets of table and chair. These cannot be added together to give a meaningful information. But when· the values of all these assets are expressed in terms of rupees or dollars, they can be added up to give a clear picture about the total value of the business.

But there are two limitations. Facts which cannot be expressed in terms of money, such as, say, the death of the Managing Director, an impending strike by the workers or the introduction of a competitive product in the market, are not reported even though they affect the business seriously. Secondly, the fluctuation in the value of money is not reported. For example, a building purchased in 1980 for Rs. 1,00,000/- is reported at the same value in 1990, even though its market value in 1990 is double of its original value. Thus the variation in the purchasing power of money is not taken into account. (Even though accounting for price level changes has been introduced, these are not widely followed).

3. Going Concern Concept

The general assumption is that a business will exist for a long time to come and will not be liquidated in the near future. People will not like to deal with a business that is to be closed down. Suppliers may not provide goods, workers may not provide their services and financial institutions may not provide credit facilities. If a business is to be closed down, its assets should be valued at current realisable values. But this is not on in the case or a going concern. Since the assets are meant for use in future, they are valued at their original cost only.

4. Cost Concept

The meaning of this concept is that an asset will be recorded at its cost, that is price paid or to be paid for acquiring it. The real or fair value is to considered for accounting purposes. Supposing an asset is purchased from a friend of Rs. 1,00,000 it is recorded only at Rs.1,00,000 even though its real value is Rs. 1,25,000. Also any subsequent change-increase or decrease - in the market value of the asset is not recorded in the accounts, even though investors and others are more interested in what the asset is worth to-day, rather than what the asset cost originally. one may say that financial reports prepared on the basis of cost concept do not reflect the real worth of the business and are irrelevant to the users. Inspite of this drawback, the cost concept is strictly followed. Because, if the market value of the asset is to be recorded, it will lead to a lot of confusion. The market value may fluctuate from time to time and also differ from person to person. As a result the accounts will have to be change frequently and will lead to instability in the accounting system. Since the cost price is definite and fixed. the cost concept is free from bias, much more reliable, feasible and comparable.

Though assets are valued on cost basis, it does not follow they are always valued at the same original cost. .The value of assets decline because of wear and tear, passage of time and obsolescence. Therefore they are shown at cost less depreciation.

As far as current assets are concerned, there is not much difference between cost price and book value, because these are held only for a short period, at the most one year.

5. Dual Aspect Concept.

Modern accounting is based on the dual aspect concept. For every debit there should be a corresponding credit. For every debit there should be a corresponding credit. Therefore the total of the debits will always be equal to the total of the credits. Further, assets of a firm are purchased by the funds provided by the owners and the creditors.

Therefore the total of the asset should always by equal to the total of the liabilities or equities.
Equities are the claims of the owners and outsiders on the assets of the firm. Hence the equation.

Assets =	Equities	Of
Assets =	Liabilities + Capital	OR
Assets =	Liabilities = Capital	

This is a fundamental equation. Whenever a transaction is recorded in the accounts, it affects both the assets and the equities. For example, When X introduces a capital of Rs. 100000/- for starting a business the dual aspect of this transaction is that the business has a cash balance of Rs. 100000/- (asset) and the same time X has a claim on the asset to the same extent, (Liability). Further, if X purchases furniture for Rs. 10000/-say from Godrej & Co., and pays Rs. 5000/- in part settlement, there would be a reduction of Rs. 5000/- in cash and in increase of Rs. 10000/- in Furniture (asset) and Godrej & Company's claim for Rs. 5000/- would appear on the liability side. The Balance sheet would be as follows.

Balance Sheet

Liabilities	Rs.	Assets	Rs.
X's Capital	100000	Cash	95000
Godrej & Co.,	5000	Furniture	1000
	105000		105000

Thus every transaction will affect two items in such a way that the total assets are equal to the total. of Capital & Liabilities .

6. Accounting Period Concept

As explained already under the 'Going Concern Concept' the life of a business is assumed to be indefinitely long. The business activity is a continuous, endless process and we cannot wait till the end of the business to evaluate its performance and financial position. Therefore, for reporting purposes, the entire life of a business is divided into small, uniform segments called accounting periods. The accounting period is usually one year or 12 months. A firm may select the calendar year or any period of 12 months. A firm may select the calendar year or any period of 12 months. A firm may select the calendar year or any period of 12 months as its accounting year. The profit and loss account is prepared once in a year, and the Balance Sheet is prepared as on the closing date of the accounting period.

Realisation Concept

This concept is related to realisation of revenue. Revenue arises from sale of goods or Services. But the question arises as to when this revenue should be recognised. (i.e. take into account) and how much of it should be recognised. One must ascertain the revenue of this year and distinguish it from the revenue of 'last - year' and that of the' next year'. Revenue arises when title to goods is transferred or when service is rendered to the customer. In the case of a credit sale, revenue arises when the sale is made, and not when the cash is received. Similarly when an advance is received for supply of goods, the advance received does not amount to revenue. Revenue arises in this case, only when goods are supplied.

" Further when goods and services have been sold on credit, the entire amount may.not be realised. A portion of it may become bad and may not be recovered. Similarly discounts may have to be allowed when the amount is received within the credit period. Therefore sufficient provision must be made for bad debts and discounts;

8. Matching Concept

The matching of expenses against revenues for ascertaining the net profit" or loss of a business is known as the matching concept. The matching concept requires that cost should be recognised as expenses in the period in which the associated revenue is recognised. For example when a T.V. is sold in the current year, all the costs associated with the production and sale of that T.V. should be recognised as expenses of the current year, even though some of these expenses have not been paid. In other words profits made by a business during a period can be measured only when the revenue earned during the period is compared with the expenses incurred for earning that revenue. The question as to when the payment for that expensive is made does not arise of all. Because of this concept, adjustment are made for all outstanding and prepared expenses and incomes receivable and received in advance, when preparing the final accounts at the end of the accounting period.

Explanation

Costs and expenses are not the same. Cost means use of resources for any purpose. Therefore cost may be either an asset.or expenses. An expense is that portion of the cost which is deducted from revenues to, ascertain net profit or loss. Expired cost is an expense. Unexpired cost is an asset. When a cost is treated as an asset, it does not affect profit or loss. Expenditure usually means a capital expenditure. But gradually, over a period of time, the expenditure becomes an expense.

Accounting Conventions

1. Materiality

This convention deals with the relative importance of the accounting information. An information which is immaterial i.e. unimportant need not be disclosed in the financial statements. Deciding what is material and what is immaterial is left to the discretion of the accountant. But generally an information is said to be material if it would influence the judgement of an investor or creditor. An accountant may not go into minute details because the work involved may not justify the usefulness of the result. For example, in a big concern the entire value of stationery items issued for use in the office may be written off as expense of that period. Strictly speaking stationery consumed should be treated as asset. But it is extremely difficult to find out and value the part of the stationery, which has been used up and that which remains unused. Most of the expenses for a period are mere estimates, and an attempt to find out the exact amount of expenses involved may not be worthwhile. Further while preparing financial statements unimportant items can be left out or merged with other items and figures may be rounded off to the nearest rupee (or nearest tens or hundreds)

2. Full Disclosure

Published accounts are supposed to convey and not to conceal information. This means that all material facts about a business should be disclosed in the financial statements. The Trading and Profit and Loss Account of a business should reveal a true and fair view of its profit or loss. Similarly the Balance Sheet would reveal the true and fair view of the financial position of a business. Non-disclosure of any material information will effect the judgement of prospective investors and creditors. Not only information known on the date of the balance sheet, but information arising after the end of the accounting period which may affect the business must-also be disclosed. For example, after the Balance Sheet, date plants might destroyed by fire or the Company may acquire a controlling interest in another concern. Such events would substantially affect the earning capacity and financial position of the enterprise. Their non-disclosure would reduce the utility of the published statements to the users."

3. Consistency

Any accounting practice should be followed consistently year after year. That is, if depreciation for a particular asset is provided on the basis of diminishing balance method in one year, and on the basis of original cost method in the subsequent year, there is no consistency and comparison of the accounting figures and trading results of various years would be meaningless. This does not mean accounting practices should not be changed at all. When there is a change, that should be properly explained and thereafter followed regularly.

4. Conservation

A business man is always conservative in estimating his profits. He never takes into account expected profits, but always takes into account all expected losses. This rather pessimistic attitude is reflected in the preparation of accounting statements also. Stock is always valued at cost or market price whichever is lower. Provision for doubtful debts, and discount and debtors is created. This convention is against the convention of full disclosure and is attracting a lot of criticism now-a-days.

Chapter - 2
Accounts of Non-Trading Concerns

Non-Trading Concerns .

Clubs, associations, hospitals, charitable institutions, are called as non-trading concerns. Their main aim is not to earn profit. They are not doing business. They do not busy or sell goods. So they do not prepare profit and loss account. Their main object is to serve its members and society. Some clubs are formed to promote art and culture. For example a sports club provides facilities to promote sports a public hospital renders medical services; a charitable institution helps orphans and disabled people.

Accounts non Non-Trading Concerns

Non trading concerns do not buy or sell goods. So they do not maintain books like purchased book, sales book sales returns book etc.

The following books are maintained by non-trading concerns.

1. Register of Members
2. Minutes book to record proceedings of meetings.

3. Cash Receipts, Journal & Cash Payments, Journal
4. Journal proper to record non-cash items.

At the end of every year the following accounts will be prepared,

1. Receipts and Payments account
2. Income and expenditure account
3. Balance Sheet.

Receipts and Payments Account

This Account is prepared at the year end with the help of cash receipts journal and cash payments journal. It helps to know how much cash is available with the treasurer. It is a real account. So the rule for real account viz., what comes in, credit what goes out is followed. It is prepared in lieu of cash book. This account contains two sides. They are receipts side (Left side) and payments side (Right Side). The opening balance of cash is the first item on the receipts side. Then all the actual cash receipts during the year will be debited. All the cash payments will be credited. The balancing figure will give the closing cash balance and that is the last item in the credit side of a receipts and payments account.

Income and Expenditure Account

This account is prepared at the year end with the help of receipts and payments account. It helps to know the surplus or deficit in running a non-trading concern. It is prepared in lieu of a profit and loss account. It is nominal account. So the rule for nominal account viz, debit all the expenses, credit all the incomes and gain will be followed. This account contains two sides. They are expenditure side (left side) and income side (right side). Only revenue items are considered while preparing this account. There is no opening balance in this account. All the expenditure and losses of current year, whether it is paid or outstanding will be shown on the debit side. All the incomes of current year, whether it is received or receivable will be credited. The balancing figure is surplus or deficit. If the incomes are more than expenditure it is a surplus, and if the expenditures are more than incomes it is deficit. The surplus or deficit will be taken to Balance Sheet.

Difference between Receipts and Payments account and Income and Expenditure account

Receipts and Payments Account	Income and Expenditure Account
1. It is a real account	It is a nominal account
2. It is prepared on lieu of cash book	It is prepared in lieu of profit and loss account.
3. The Opening balance represents cash in hand at the beginning of the year	There is no opening balance
4. Debit side shows the cash receipts	Debit side shows the expenditure losses.
5. Credit side shows the cash payments.	Credit side shows the incomes.
6. The closing balance represents cash in hand	The closing balance represents surplus or deficit
7. Capital items and revenue items are shown in this account	Only revenue items are shown in this account
8. All receipts and payments whether it relates to current year, previous year, or next year are taken into account.	Income and expenditure of current year alone will be considered.
9. It is necessary to prepare balance sheet along with this account.	It is necessary to prepare balance sheet along with this account.
10. It is prepared on the basis of cash system of accountancy.	It is prepared on the basis of mercantile system of accountancy.

Treatment of some important items

Legacy

It is just like a donation. It is the amount given to a non- trading concern by a deceased person as per his. 'WILL' It will be executed after the death of a person. It is shown on the debit side of the receipts and payments account. It is not a recurring income and so it is not taken to Income and Expenditure account. It is directly added to the capital fund. However, if the amount is too small as compared to other incomes. Legacy can also be taken as income and is shown in Income and expenditure account. A not regarding the treatment done should be given at the end of the solution of the question.

Capital Fund

Capital fund is the difference between assets and liabilities of a non-trading concern. It is shown on the liabilities side of a Balance Sheet. Every year the surplus shown by Income and expenditure account will be transferred to the capital fund. General donations, legacy and life membership fees are also added to the capital fund. If there is any deficit during a year, the deficit will be deducted from capital fund.

Life Membership Fees

Subscription is the regular income for a non-trading concern. Normally it is paid by the members annually or monthly. But some members may pay a lumpsum instead of monthly or annual subscription. It is called life membership fees. It is shown on the debit side of the Receipts and Payments account. It should be added to the Capital fund, because it is received only once from a member. Some other authors argue that it should be taken to Income and expenditure account because every year new members will be admitted and entrance fees will be collected every year. Instruction in the problem must be noted regarding the treatment of life membership fees.

Donations

Donations are given to a non-trading concern by member or Soceity. It is shown on the debit side of the Receipts and payments account. Donations may be general donations or specific creations .

General Donations

If a donation can be used for any purpose as decided by the office-bearers, it is called general donation. The donor does not lay any restriction regarding the use of the donation. If the amount is small it is taken to Income and Expenditure account. If the account is big it is directly taken to capital fund.

Specific Donation.

If a donor donates some amount for a specific purpose like prize distribution, construction of a Building lit is called specific donation. It is not added to the Capital fund. It is shown separately in the liabilities side, of the balance sheet as prize, fund, Tournament fund etc.

Treatment of Expenditure and Income Relating to a specific fund.

If there are certain income or expenditure relating to a specific fund, the income or expenditure should not be taken to Income and expenditure account. The income will be added to that fund and expenditure will be deducted from the fund. The balance in the fund will be shown in the liabilities side of the balance sheet.

This can be explained with the following examples.

	Dr.	Cr.
Prize distribution fund		20000
Prize fund Investments	20000	
Interest on prize fund Investments		1200
Prizes awarded	1000	

These on figures will appear in the balance sheet as follows.

Balance Sheet

Liabilities	**Rs.**	**Assets**	**Rs.**
Prize fund	20000	Prize fund	
		Investments	20000
Add Interest 1200			
	21200		
Less prize awarded	1000		
	20200		20000

Illustration : 1

Apollo Club was started on January 1, 1993. It had the following receipts and Payments during the year ended December 31, 1993.

Receipts : Subscriptions Rs. 5000, Entrance fee Rs. 500, Donations Rs. 1500, Payments : Furniture Rs. 500. Games equipments Rs. 1000, Rent Rs. 2200. General expenses Rs. 400 Postage and Stationery Rs. 100. Cash in hand on December. 31,1993. Rs. 300 Cash at bank on December 31, 1992 Rs. 3000 subscription outstanding at the end of the year Rs. 500. Rent due, Rs. 200 Write off games equipments Rs. 200 and furniture Rs. 50.

Prepare the Receipts and Payments Account and the Income and Expenditure Account for the year ended December 31, 1993.

Receipts and Payments Account for the year ended Dec. 31, 1993

Balance Sheet

			Cr.
To Subscriptions	5500	By Furniture	500
To Entrance fee	500	By Games equipments	1000
To Donations	1500	By Rent	2200
		By General Expenses	400
		By Postage and Stationery	100
		By Cash in hand	300
		By Cash at Bank	3000
	7500		7500

Income and Expenditure Account for the year ended Dec. 31, 1993

Balance Sheet

Dr.					
To Rend paid	2200		By Subscriptions received	5500	
Add			Add		
Outstanding at end	200		Outstanding at end	500	
	--------	2400		--------	6000
To General Exp.		400	By Entrance fee		500
To Postage and Stationery		100	By Donations		1500
To Depreciation on Games equipment	200				
To on furniture	50				
	--------	250			
To Surplus – transferred to capital fund		4850			
		8000			8000

Types of Problems

There are four types of problems. viz.,

a. When receipts and payments account with accompanying notes is given and income and expenditure account and balance sheet are to be prepared (Illustration 2 to 6)

b. When a trial balance is given and Income and expenditure account Balance Sheets are required to be prepared (Illustration 7)

c. When receipts and payments and income and expenditure accounts are given and balance sheets both in the beginning and at the end are to be prepared (Illustration 8 to 9)

d. When income and expenditure account with accompanying notes is given and receipts and payments account is to prepared (Illustration 10)

Summary of Cash Book

Balance Sheet

Balance from last year		23500	Salaries	12000
Entrance fees		3000	Electricity	1200
Subscriptions			Newspapers and Journals	5250
1992	500		Fixed deposits	25000
1993	35000		Equipments	2000
1994	750		Payments of Creditors	10000
	-------- 36250		Balance c/f	11500
Profits from entertainment		1000		
Locker rents		2000		
Sundry income		1200		
		66950		66950

The assets and liabilities on 1[st] January 1993 were; equipments Rs. 8000, Furniture Rs. 25000, Consumable stores Rs. 3500, Creditors Rs. 12000

On 21.12.2003 value of consumable stores was Rs. 7000, Creditors amounted to Rs. 5500 the subscriptions outstanding were Rs. 750; and the interest accured on fixed deposit was Rs. 250.

Income and Expenditure Account for the year ended Dec. 31, 1992

Expenditure	Rs.	Income		Rs.
To Salaries	12000	By Entrance fees		300
To Electricity	1200	By subscriptions received	3500	
To Newspaper and journals	5250	Add Accured		750
To Excess of Income			....	3570
Over Expenditure	24750	Add Profit from entertainment		1000
		Add Locerk rents		2000
		Add Sundry Income		1200
		Fixed deposit		250
	43200			43200

Balance Sheet as on 31-12-1993

Balance Sheet

Liabilities		Rs.	Assets		Rs.
Creditors		5500	Equipment (8000+2000)		10000
Subscriptions received			Consumable Stores		7000
In advance		750	Furniture		25000
Capital Fund			Accrued		
Balance b/d	48500		subscriptions		750
Add : Excess of			Fixed Deposit	25000	
Income over			Add : Interest	250	
Expenditure	24750				
	----------	73250		-------	25250
		79500			79500

The arrive at the opening balance of capital fund, balance sheet as on 1-1-1993 to b e prepared as shown below.

Balance Sheet as on 1-1-1993

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	12000	Cash Balance	23500
Capital fund		Consumable stores	3500
(Balancing figure)	48500	Equipment	8000
		Furniture	25000
		Subscriptions accured	500
	60500		60500

Illustration 3

The following is the Receipts and Payments Account of madras Club for the year ending 31-12-1994.

Receipts		Rs.	Payments	Rs.
Opening Balance		Nil	Salaries	6000
Cash		1050	Sports Expenses	6900
Stamps		25	Electricity	1000
Bank FD		10000	Telephone	1200
S.B. A/c		4200	Postage expenses	200
Current A/c		2100	General Body Expenses	700
Subscription	1993	1010	Prining and Statinery	850
	1994	18900	Building purchase a/c	12000
	1995	900	Repairs	
Donations		7000	Closing Balances	
Bank interest received		1340	Cash	1740
Receiptss from Sports		2600	Stamps	25
Telephones recoveries		900	Bank FD	11000
			S.B. a/c.	4310
			Current a/c	3700
		50025		50025

A building costing Rs. 100000 was purchased during last year and Rs. 880000 was paid for it.

Subscriptions outstanding for 1994	1100
Salaries outstanding	200
Interest accured on bank deposits but not received	200

From the above, prepare Income and Expenditure Accounts for the year 1994 and also the Balance Sheet as on 31-12-1994 of the Madras Club.

Income and Expenditure Account for the year ending 31st December 1994

Balance Sheet

To Salaries	6000		By Subscription	18900	
Add : O/S	200		By **ADD : O/S**	1100	
	--------	6200		--------	20000
To Sports expenses		6900			
To Electricity		1000	By Donations		7000
To Telephone		1200	By Bank Interest	1340	
To Postage expenses	200		Add : O/S	200	
				-------	1540
Add : Stamps on hand			By Receipt from sports	2600	
On 1-1-1994	25		By Telephone recoveries		900
Less : Stamp at	25				

	175			
Less : Stamp at the end	25	200		
Less : General body expenses		700		
Less : Printing and Stationery		850		
Less Repairs		400		
Less Excess Income				
Over expenditure	14990			
	32040			32040

Balance Sheet as on 1-1-1994

Creditor for building	1200	Cash	1050
Capital fund		Stamps	25
(Balancing Figure)	106385	Bank F.D.	10000
		S.B. A/c	4200
		Current A/c	21000
		Outstanding Subscriptions	1010
		Building	100000
	118385		118385

Balance Sheet as on 31-12-1994

Capital Fund 106385		Cash		1740	
Add :			Stamps		25
Excess Income	14590		Bank F.D.		11000
		120975	S.B. a/c		4310
Outstanding salary		200	Current a/c		3700
Subscriptions received			Subscriptions outstanding	1100	
In advance		900	Bank interest outstanding	200	
			Building		100000
		122075			122075

Illustration 4

The following is the Receipts and Payments Account of the Nellai Sports Club in respect of the year ending March 31, 1991.

Receipts		Rs.	Payments	Rs.
To Balance b/d 1-4-90		20500	March 31,1991	
March 31,1991			By Salaries	41600
To Subscriptions			By rates and Taxes	12000
1989 – 90	800		By Stationery	8000

1990 – 91	42200		By Telephone	2000
1991- 92	1600		By Investments in Govt.	
	----------	44600	Securities	25000
To Profits on				
Sports meeting		28500	By Sundry Expenses	18500
To Interest on Investment		20000	By Balanced c/d	9000
To Sundry Receipts		2500		
		--------		----------
		116100		116100
		----------		----------

The following additional facts ascertains.

1. Stock of stationery on April 1, 1990 was Rs. 1000 and on March 31, 1991 Rs. 1800
2. Rates and taxes were prepaid to the extent of Rs. 4000
3. Telephone charges outstanding amounts to Rs. 750.
4. In 1989 – 90 subscription received in advance amounting to Rs. 2000 for current year and Rs. 1800 were due on March 31, 1991 for 1990 – 91
5. On March 31, 1990 the building stood in the books at Rs. 200000 and it is required to write off depreciation at 5% . Investments at March 31, 1990 were Rs. 400000

   You are required to prepare Income and Expenditure Account for the year ended March 31, 1991 and a Balance sheet as at that date.

Income and Expenditure Account for the year ended March 31, 1991

To Salaries		41600	By Subscription	42200	
To Rates and taxes	12000		Add received in		
			89-90 for 90 – 91	2000	
To Less Prepaid	4000		o.s for 90-91	1800	
	--------	8000		--------	46000
To Stationery	8000		Interest on Investments	20000	
Add Opening	1000		Profit on Sports		
	--------	9000	" Meeting		28500
Less : Closing	[illegible]		" Sundry Receipts		2500
	---------	7200			
Less Telephone	2000				
Add : Outstanding	750				
	---------	2750			
Add : Sundry Expenses		18500			
Add : Depreciations Building		10000			
Add : Excess of Income over					
Expenditure		8950			
		----------			------------
		97000			97000
		----------			------------

Balance Sheet as on which 31, .990

Liabilities		Rs.	Assets		Rs
Subscriptions received inadvance		2000	Cash in office		20500
Capital Fund (Building figure)		620300	Stock at Stationery		1000
			Outstanding subscriptions		800
			Investment		400000
			Building		200000
		622300			622300

Balance Sheet as on March 31, 1991

Liabilities		Rs.	Assets		Rs.
Outstanding Telephone		750	Cash in office		9000
Subscription received in Advance		1600	Stock of stationery		1800
Capital Fund	620300		Rates and taxes Prepaid		4000
Add : Surplus	8950	629250	Outstanding subscription		1800
			Investments		425000
			Building	200000	
			Less : Depreciation	10000	190000
		631600			631600

Illustration 5

The following is the Receipts and Payments Account of Red Roses Club in respect of the year ended March 31, 1993

Receipts and Payments Account for the year ended March 31, 1993

Receipts		Rs.	Payments	Rs.
To Balance b/d Cash in hand		2000	By Salaries	3000
To subscriptions			By Stationery	1000
1991-92	3000		By Rates & Taxes	300
1992-93	4000		By Telephone charges	1500
1993-94	1000	80000	By 8% Debentures	5000
To Profits on sports		3000	By Sundry Expenses	200
To Interest at 8% on Securities			By Balance c/d Cash in Hand	3000
Interest received (8% Debentures)		1000		
		14000		14000

The following additional facts are ascertained

a. There are 500 members, each paying an annual subscription of Rs. 10 per year Rs. 3500 being in arrears for 1991-92 at the beginning of 1992-93 During 1991-92 subscriptions were paid in advance by 30 member for 1992-93

b. Stock of Stationery at March 31, 1992 was Rs. 400 and at march 31, Rs. 500

c. At march 31,1993 the rates and taxes were prepaid to the following January 31. the yearly charge being Rs. 300

d. A quarter's charge for telephone is outstanding on 31-03-93 the amount accrued being Rs. 300. The charge for each quarters same for both 1991-92 and 1992-93. Six months charges were payable on 31-03-1992.

e. Sundry Expenses accruing at March 31, 1992 were Rs. 50 and at March 31,1993 Rs. 60

f. At March 31, 1992 Building stood in the books at Rs. 30000 and it is required to write off depreciation at 10% p.a.

g. Value of 8% Debentures at March 31,1992 was Rs. 15000 which was purchased at that date at par. You are required to prepare.

1. At Income and Expenditure Account for the year ended March 31, 1993 and

2. A Balance Sheet as at that date.

Income and Expenditure Accounts for the year ended March 31, 1993

Dr.		Rs.	Cr.		
To Salaries		3000	By Subscription	4000	
To Stationery	1000		Add : received on		
Add OP Stock of Stationery	400		91-92 for the year 92-93	300	
	--------			4300	
	1400		Add : O.S. for the year 92-93	700	
Less : Clo Stock of Stationery	500				
	--------	900		---------	5000
Less : Rates and Taxes	300		Profit on Sports		3000
Add : Prepaid in the year 91-92	250		" Interest on 8% Securites	1000	
			Add : Out-Standing	200	
	-------			-------	
	550				1200
Less : Prepaid in the year 92-93	250				
	------	300			
Telephone charges	1500				
Add : O.S on 31-03-1993	300				

	1800				
Less : O.S. on 31.3.1993	600				
	----------	1200			
Sundry					
Expenses	200				

Less paid for 91-92	**50**			

	150			
Add : O.S for 92-93	**60**			
	------	**210**		
Depreciations on Building		3000		
Excess of Income				
Over Expenditure		590		
		--------		--------
		9200		9200
		-------		--------

Balance Sheet as on March 31, 1992

Liabilities	Rs.	Assets	Rs.
Subscription received in		Cash in hand	2000
In advance (30 x 10)	300	Outstanding subscription	3500
Outstanding Sundry Expenses	50	Stock of Stationery	400
Telephone charges outstanding	600	Prepaid rates and taxes	250
Capital fund (Balancing figure)	50200	Investments	15000
		Building	30000
	-------------		----------
	51150		51150
	-------------		----------

Balance Sheet as on March 31, 1993

Liabilities		Rs.	Assets		Rs.
Subscriptions received			Cash in hand		3000
Advance		1000	O.S. subscription 9.93		
			(5000-4000-3000)		700
Outstanding Telephone			O.S.Subscription 91-92		
Charges		300	(3500-3000)		500
Outstanding Sundry exepenses		60	Stock of Stationery		500
Capital Fund	50200		Prepaid rates and taxes		
Add : surplus	590		(300 x 10/12)		250
	-------	50790	O.S. Interest on Investment		200
			Building	30000	
			Less Depre.	3000	
				----------	27000
			Investment		20000
		---------			---------
		52150			52150
		---------			---------

Illustration 6

The following was a receipts and payments Account prepared by the treasure of the Nellai Cricket Club for the year ended December 31, 1990.

Receipts	Rs.	Payments	Rs.
1990			
Jan. 1 Cash in Hand	100	Dec. 31 Repairs	750
Balance at Bank as per		Moving Machine	1500
Pass Book :		Rent of Ground	250
Deposit Account	2230	Cost of Teas	250
Current Account	600	Fares	400
Dec. 31 Bank Interest	30	Printing and office	
Donations and		Expenses	280
Subscription	2600	Repairs to equipment	500
Receipts from Teas	300	Honorarium to Secretary	
Contribution to fares	100	and Treasurer for 1989	400
Sale of Equipment	80	Balance at Bank as per	
Net proceeds of Variety		Pass Book ::	
Enmt.	780	Deposit Account	2490
Interest on Securities @		Current Account	250
5% of Cost	400	Cash in hand	150
	7220		7220

You are given the following additional information

		On. Jan. 1, 1990 Rs.	On Dec. 31, 1990 Rs.
1.	Subscription due	150	100
2.	Sums due for printing etc.	100	80
3.	Unpresented cheques being payments for repairs	300	250
4.	Interest on Deposit Account no entered in Pass Book	---	20
5.	Estimated value of machinery and equipment	800	1750

6. For the year ended Dec. 31. 1990 the honorarium to the Secretary and Treasure are to increased by a total of Rs. 200 and the groundsman is to receive a bonus of Rs. 200.

You are required to prepare the Income and Expenditure Account for the year ended December 31, 1990 and Balance Sheet on that due.

Income and Expenditure Account of Nellai Cricket Club

For the year Ending 31st December 1990.

Dr.		Rs.	Cr.		Rs.
To Repairs		750	By Donation &		
To Bonus to Grounds		200	Subscriptions	2600	
To Rent of Ground		250	Less Relating		
To Fares	400		to 1989	150	
Less : contribution					
To fares	100	300		2450	
			By Add O/S	100	
To Printing & Office					2550

Expenses (280 + 80 – 100) 260		Receipt from teas	300		
To Repairs to		Less : Cost of tea	250		
Equipment	450		------	50	
Secretary and		By Proceeds of variety			
Treasurer	600	Programme		780	
To Depreciation of		By Interest on Securities		400	
Machinery and		Bank Interest		30	
Equipment	470	Interest Accured on Bank			
To Excess of Income		Deposit		20	
Over Expenditure	550				
	3850			3850	

Balance Sheet of Nellai Cricket as on 31st 1990

Liabilities		Rs.	Assets		Rs.
Printing & Stationery			Cash in hand		150
Outstanding		80	Deposit Account		2490
Honoraria Outstanding		600	Current Account		
Groundman' bonus			Subscription due		100
Outstanding		200	Interest on Bank		
Capital fund	11080		Deposit accured		20
Add : Surplus	550		Machinery & Equipments	800	
		11630	**Add : Purchases**	1500	
				2300	
			Less : Sold	80	
				2220	
			Less		
			Depreciation	470	
					1750
			Investment		8000
		12510			12510

To arrive at capital fund. the Balance Sheet as 31 st Dec. 1989 is to be prepared.

	Rs.		Rs.
Printing Outstanding	100	Cash in hand	100
Honorarium Secretary and		Deposit Account	2230
Treasurer	400	Current Account	
Capital Fund		(Less Cheque issue)	200
(Balancing figure)	11080	subscriptions due	150
		Machinery and Equipment	800
		Investment (400 X 100/5)	8000
	11580		11580

Illustration

From the following trial balance and accompanying notes for adjustments, prepare Income, and Expenditure Account for the year ended 31[st] December, 1994 and the Balance Sheet as on that date of a Club.

	Dr.	Cr.
Buildings	34700	
Library Books	2280	
Furniture and Fixtures	3250	
Glass, Cutley etc., purchase	2000	
During the year	1000	
Printing and Stationery	225	
Rent received		10370
Annual Subscription		12150
Entertainment Cost	345	
Billiard Room Receipts		3845
Billiard Table	10400	
Billiard Expenses	2135	
Canteen Profit		1200
Subscriptions arrears 1st Jan. 1990	1125	
Honorarium	1500	
Sale of Tickets for annual dinners		1600
Annual dinner expenses	1875	
Salaries to staff	2700	
Audit fees	600	
Donations		8500
Repairing, Clearing and washing	350	
Newspaper and magazines	180	95
Interest on Bank Deposits		25
Bank charges	20	
Entrance fees		225
Election expenses	2995	
Stock of Canteen provision on 31st Dec. 1990	300	
Sundry Creditors		3135
Cash in hand	1400	
Cash at Bank	1735	32940
	74085	74085

Note for Adjustment

1. Out of the total subscription, Rs.1125 represented arrears collected and Rs.760 peid in advance Balance as on 31[st] Dec. 1990.
2. An amount of Rs. 500 was outstanding on account of rent
3. Unpaid salary amount to Rs.200.
4. Entrance fees to be capitalised

5. Out of the donation Rs. 3600 represented donations towards election expenses and of the balance of the amount shall be capitalized.

6. Depreciation to be provided as under

i.	Library books	-	100%
ii.	Furniture and Fixture	-	15%
iii.	Club Building	-	4 %
iv.	Glass, Cutlery, etc.	-	Rs. 1700

Income and Expenditure Account for the year ended 31st Dec. 1990

Dr.					Cr.
To Printing & Stationery		225	By Rent received	10370	
To Entertainment Cost		345	By ADD		
To Billiard Room Expenses		2135	Outstanding	500	
To Honorarium		1500		--------	10870
To Annual dinner Expenses		1875	Annual		
To Salaries	2700		Subscription	12150	
Add Outstanding	200		Less for 1989	1125	
	-------	2900	To Audit Feeds	600	
To Repairing, Cleaning etc.		350		--------	
To Newspaper & Magazines		180		11025	
To Bank Charges		20	Less for 1991	760	
" Receipts		3845		-------	10265
To Depreciation Library Books		228	" Billiard Room		
" Sale of Tickets for annual			" Canteen Profit		1200
To Furniture and Fixtures		528	Dinner		1600
Club Buildings		1870	Less Donations	8500	
To Glass, Cutley, etc.		1700	Less for election		
Excess of Income over			expenses	3600	
Expenditure		15894		--------	
			Half captalised	4900	
				--------	2450
			" News paper &		
			Magazines		95
			" Interest on Bank		
			Deposit		25
		-----------			------------
		30350			30350
		----------			------------

Balances as on 31st Dec. 1990

Cash in Hand	1400
Cash in Bank	1735
Stock of Canteen Provision	300
Rent Outstanding	500

Sundry creditors		3135	Library Books	2280	
Outstanding Salary		200	Less : Deptn.	228	
Subscription received in				--------	
Advance		760	Glass. Cultely etc.		
Donation for election	3600		1st Jan. 1990	2000	
(-) election	2995		Addition	1000	
Expense	------			-------	
				3000	
Capital Fund	32940		Less : Deptn	1700	
Add : Surplus	15894			------	1300
Add : Donation to be			Furniture & Fixtures	3250	
Capitalised	2450		Less ::Deptn	528	
Add : Entrance fees	225			------	29992
	------	51509			--------
					10400
			Furniture & Fixtures		
			Billiard Board		
			Club Building	37400	
			Less Deprecn.	1870	
				--------	35530
		--------			--------
		56209			56209

Illustration 8

The following particulars related to a Sports Club Income and Expenditure account for the year ended 1st Dec. 1989.

Liabilities	Rs.	Assets	Rs.
To Salaries	6000	By Admission Fees	15000
To Printing & Stationery	2500	By Subscriptions	2500
To Advertising	1000	By Rent Receivable	4800
To Insurance Charges	900		
To Electricity Charges	500		
To Depreciation on sports equipment	12000		
To Excess of Income over Expenditure	21900		
	44800		44800

On 1st January 1989 the Club had the following assets.

Land and Buildings	60000
Sports equipment	30000
Furniture	4500

Prepare opening and Closing Balance Sheets.

Balance Sheet as on 1st January 1989.

Capital Fund (Balancing Figure)	103000	Cash at Bank	5000
		Subscriptions outstanding	1000
		Admission fees outstanding	2500
		Sports equipment	30000
		Furniture	4500
		Land and Buildings	60000
	103000		103000

Balance Sheet as at 31st December 1989

Capital Fund	103000		Cash at Bank		17900
Excess Income	21900		Subscriptions Outstanding		2000
		124900			
Subscription received In advance		2000	Admission fees Outstanding		1500
			Advance Salary		1500
			Rent Outstanding		1200
			Prepaid Insurance		300
			Sports equipment	30000	
			Less : Deprecn.	12000	
					18000
			Furniture		4500
			Fixed Assets		20000
			Land and Buildings		60000
		126900			126900

Illustration 9

The following particulars relate to the Able Sports Club :

Income and Expenditure Account for the year ended December 31,1991

Liabilities	Rs.	Assets	Rs.
To Salaries	1500	By Entrance Fees	10500
To Printing and Stationery	2200	By Subscriptions	15600
To Advertising	1600	By Rents	4000
To Audit Fees	500		
To Fire Insurance	1000		
To Depreciation of Sports Equipment	9000		
To Excess of Income over Expenditure	14300		
	30100		30100

Receipts and Payments Account for the year ended December 31,1991

	Rs.		Rs.
To Balance b/d	4200	By Salaries	1000
To Entrance Fees	10500	By Printing and Stationery	2600
To Subscription		By Advertising	1600
1990	600	By Fire Insurance	1200
1991	15000	By Investments	20000
1992	400	By Balance c/d	7800
To Rent received		3500	
	--------		--------
	34200		34200
	--------		--------

The assets on 1st January 1991 included Club grounds and pavilion Rs. 44000; Sports Equipment Rs. 25000 and Furniture and Fixtures Rs. 4000. Subscription in arrear on that date were Rs. 800.

Prepare the Balance Sheet as at December 31, 1991.

Balance Sheet as on 31st December 1991

Liabilities		Rs.	Assets	Rs.	
Subscription received in			Club Ground & Pavillions	44000	
Advance		400	Sports Equipment		16000
Salaries Outstanding		500	Furniture & Fixtures		4000
Audit Fees Outstanding		500	Subscription Outstanding	800	
Capital Fund	77600		Cash in hand		7800
Add : Excess of			Rent Receivable Outstanding	500	
Income over Exp.	14300				
	--------	91900	Investments		20000
		--------			--------
		93300			93300
		--------			--------

Balance sheet as on 31st December 1990

Capital Fund		Club Grounds & Pavilions	44000
(Balancing Figure)	77600	Sports Equipment	25000
Printing & Stationery		Furniture & Fixtures	4000
Outstanding	400	Subscriptions Outstanding	800
		Cash in Hand	4200
	--------		--------
	78000		78000
	--------		--------

Illustration 10

From the following Income and Expenditure Account and the Balance Sheet of a Club, Prepare its receipts and Payments Account for the year ended 31-03-1993.

Income and Expenditure Account for the year 1992-93

	Rs.		Rs.
To Upkeep of Ground	100000	By Subscriptions	173200
To Printing	10000	By Sale ofold News Paper	2600
To Salaries	110000	By Lectures	15000
To Depreciation on Furniture	1000	By Entrance fee	13000
To Rent	6000	By Deficit	28200
	-------		---------
	236000		236000
	---------		---------

Balance Sheet as on March 31,1993

		Rs.		Rs.
Subscription in Advance (193-84)		1000	Furnitures	90000
Prize Fund Opening Bal	250000		Grounds and Buildings	470000
Add Interest	10000		Prize fund investment	200000
	---------		Cash in hand	23000
	260000		Subscriptions (1992-93)	7000
Less Prizes	20000			
	-------	240000		
General Fund Opening Bal	564200			
Less : Deficit	28200			

	536000			
Add : Entrance fee	13000			
	---------	549000		
		---------		---------
		790000		790000
		----------		----------

The following adjustments have been in the above accounts.

1. Upkeep of ground Rs. 6000 and printing Rs. 2400 relating to 1991-92, were paid in 1992-93
2. One – half of entrance fee has been capitalized by transfer to General fund.
3. Subscriptions outstanding 1991-92 were Rs. 8000 and for 1992-93 Rs. 7000
4. Subscriptions received in advance in 1991-92 were Rs. 2000 in 1992-93 for 1993-94 Rs. 1000 (C.A. Entrance)

Receipts and payments Account for the year ended March 31, 1993

Receipts	Rs.	Payments		Rs.
To Balance b/d		By Upkeep of		
(Balancing Figure)	46600	Ground	100000	
To subscription as per		Add paid for	6000	
Income &		91 – 92	----------	106000
Exp. Account	173200	By Printing	10000	
Add 1991-92	8000	Add paid for		
1993 – 94	1000	91-92	2400	
	----------		-------	12400

	182200			" Salaries	110000
Less : 1992 – 93				" Rent	6000
Received in 1991-92	2000			" Prizes	20000
	----------			" Balance c/d	23000
	180200				
Less : 1992 – 93 Outstanding	7000				
	--------	173200			
To Sale of Newspapers		2600			
To Lectures		15000			
To Entrance Fees		13000			
Add : Capitalised		13000			
		_____	26000		
" Misc Income			4000		
" Interest on prize fund			10000		
		---------			----------
		277400			277400
		--------			---------

Accounts of Professional People

Doctors, Lawyers, Solicitors etc. are called as professional people. They prepare Receipts and expenditure account to know the Income during a particular period. Some professional people maintain accounts under double entry system of book-keeping. They prepare a trial balance and then prepare Receipts and Expenditure account, and a Balance Sheet.

Some doctors prepare receipts and payments account and then receipts and expenditure account and balance sheet. Such doctors keep a diary in which they record the fees collected are grouped from the diary. Receipts and Payments account will be debted with fees received, receipts from visits sale of other assets etc. All payments like salaries, rent, medicine, purchase, of equipments – etc. will be redited.

The method of preparing receipts and expenditure account is just like that of Income and Expenditure account. The only difference is professional people prepare accounts on cash basis. Fees is considered as income only if it was received in cash basis. Fees is considered as in come only if it was received in cash, Fees receivable or outstanding is not consider as income because doctors do not sure that patients for fee receivable.

Illustration II

Karthick commenced practice as an eye specialist, investing Rs. 50000 in equipment on1st January 1989. The Receipts and Payments Account for the year was as follows.

	Rs.			Rs.
To fees	90000	By Medicine		6000
To Misc, Receipts	200	By Salaries to Assistance	15000	
To Equipment sold	4000	By Rent		2000
To Receipts from visits	10000	By Library books		6000
		By Equipment purchased	8000	
		By Drawings		24000
		By Balance at Bank		43000
		By Balance in hand		200
	----------			---------
	104200			104200
	----------			---------

Rs. 3000 of the fees were still outstanding equipment sold and purchased was on 1st October 1989. The cost of Equipment sold being Rs. 6000. Depreciation of Equipment is 20% and on Library books 5% Salaries to assistance still payable is Rs. 20000.

Prepare the receipts and expenditure account and the balance shet relating to 1989.

Solution

Receipts & Expenditure A/c. of Dr. Karthick
For the year ended Dec. 31, 1989

Expenditure		Rs.	Receipts	Rs.
To Medicine		6000	By Fees Received	90000
To Salaries to Assistants			By Misc. Receipts	200
Paid	15000		By Receipts from visits	10000
Add : Outstanding	2000			
	--------	17000		
Add : Depreciation				
Equipment	110100			
Lib. Books	300			
	----------	10400		
" Loss on equipment		1100		
" Surplus – Excess of Receipt over Exprenses		63700		
		---------		---------
		100200		100200
		---------		---------

Balance Sheet of Dr. Karthick as on 31st December 1989

Liabilities		Rs.	Assets		Rs.
Outstanding Salaries		2000	Cash in hand		200
Capital			Cash at Bank		43000
Introduced	50003		Equipment cost	50000	
Add : Surplus	63700		Add : Additions	8000	
	----------			------------	
	113700			58000	
Less : Drawing	240000		Less : Book value Of equipment sold	5100	

				52900	
			Less : Deprec.	10100	
				---------	42800
			Library books cost	6000	
			Less : Deprecn % %	300	
				---------	57000
		---------			---------
		91700			91700
		---------			---------

1. Depreciation on equipment has been calculated as follows :

On Rs. 44000 (Rs. 50000 – 6000 cost of equipment sold)	
For the year @ 20% p.a	8800
On Rs. 6000 for 9 months from 1-1-89 to 30-9-89 @ 20% p.a.	900
On Rs. 8000 for 3 months from 1-10-89 to 31-12-89 @ 20 p.a.	400
	10100

2. Loss on Sale of equipments been calculated as follows :

Cost of equipment sold	6000
Less : Depreciation @ 20% p.a. for 9 months	900
Book value of equipment when sold	5100
Less : Sale Proceeds	4000
Less on sale	1100

Accounts of Solicitors

Solicitors act as a link between a Client and his advocate. Solicitors need by lawyers. Solicitors help to prepare various documents which are necessary to file a case. For such services they charge their clients and that is the income of solicitors.

They receive cash and pay cash on behalf of their clients, also, while preparing documents. So they maintain cash book with two columns one for their own office, and another for the clients. At the year end they prepare Receipts and Expenditure account and a Balance sheet.

Illustration 12.

The following trial balance is extracted from the books of Mr. Kumaran a solicitor. Prepare final accounts for the year ended 1st Dec. 1992 and a Balance sheet as on that date.

Trial Balance as on 31st December 1992.

	Dr.	**Cr.**
Capital		18000
Drawings	7260	
Disbursement on behalf of clients	2658	
Rent	3704	
Salaries	1700	
Printing and Stationery	712	
Telephone Charges	368	
Cost Charged to Client		18966
Work – in – progress at 1-1-92	2592	
W.I.P. Provision at 1-1-92		2592
Money held on behalf of clients		4000
Creditors		984
Debtors Provision on at 1-1-92		7134
Debtors	11852	
Sundry Office Expenses	2464	

Furniture	5600	
Cash at Bank Clients account	4000	
Own account	8776	
	-------	--------
	51676	51676

The uncompleted work at 31-12-92 was valued at Rs. 3700. Bad debts Rs. 712 should be written off. Debtors includes Rs. 2800 for disbursements (ie. Paid on behalf clients and should be collected from clients)

Receipts and Expenditure account of a solicitor for the year

W.I.P. on 1-1-92	2592	Cost charged to client	18900
Rent	3704	W.I.P. Provision on 1-1-92	2592
Salaries	1700	Debtors provision on 1-1-92	7134
Printing	712	W.I.P. on 31-12-92	3700
Telephones Charges	368		
Office expenses	2464		
Bad debts	712		
W.I.P. Provision on 31-12-92	3700		
Debtors provision on 31-12-92	28340		
To Profit	8100		
	-------		--------
	32392		32292
	--------		---------

Balance Sheet as on 31st December 1992

Capital	18000		Furniture		56000
Add : Profit	8100		Debtors	11852	
	---------		(-) for disbursement	2800	
	26100			--------	
Less : Drawings	7260			9052	
		18840	(-) Bad debts	712	
		984		---------	
Creditors				8340	
Money held on behalf Client		4000	(-) Provision	8340	
				---------	---------
			Debtors for		
			Disbursement	2658	
			(+) From Debtors	2800	
				-------	5458
			Work – In – Progress	3700	
			(-) Provision	3700	
				-------	---------
			Cash at Bank		
			Own Account		8766
			Client Account		4000
		---------			---------
		23824			23824
		---------			---------

Exercise

Problem 1

The following is the Receipts and Payments Account of the Kumari Sports Club for the year ending 31st March. 1990.

Receipts	Rs.	Payments	Rs.
To Balance 1st April 1989	3000	By Rent	52000
To Entrance Fees	5500	By Stationery Printing	30680
To Subscriptions, 1988-89	2000	By Wages	53300
To Subscriptions 1989 – 90	169000	By Equipments	39000
To Subscriptions 1990 – 91	3000	By Repairs and renewals	8060
To Locker Rents	5000	By Interest	15000
To Donation for Building	34500	By Balance 31st March 1990	23960
	222000		222000
To Balance b/d	23960		

Locker rents, Rs. 600 referred to 1988-89 Rs. 900 is still owing Rent. Rs. 13000, pertained to 1988- 89 and Rs. 13000 is still due; Stationery expenses etc., Rs. 3120 related to 1988 – 89, still owing Rs. 3640, Subscriptions unpaid for 1989-90, Rs. 4680.

From the above information you are required to make out an Income and Expenditure Account of the Club and Expenditure Account for the year ending 31st March. 1991 and Balance sheet as at the date.

	Rs.		Rs.
To Member's Subscription	80000	By Grass Seeds	20000
To Entrance Fees	3000	By Expenses Regarding	
To Sale of old balls, bats, etc.	500	Tournament	37000
To Locker Rent	3000	By Rates and Insurance	2000
To Subscription for Tournament	40000	By Wages	4500
To Bank Drawn	40000	By Printing and Stationery	1000
To Donation	100000	By General Charges	2200
		By Secretary's Honorarium	5000
		By Telephone	1300
		By Bats, Balls, etc.,	27000
		By Bank Lodged	166500
	266500		266500

Assets on 1st April 1990	Rs.
Cash at Bank	30000
Stock of Bats, Balls etc.	15000
Printing and Stationery	2000
Subscription due	5000

Donation and surplus on account of tournament should be kept in Reserve for a Permanent Pavilion.

Subscriptions due at 31st March. 1991. Rs. 7500, write of 50 per cent on Bats, Balls Account and 25 percent of Printing an Stationery Account. (Surplus 32350. B/s Total 187250)

Note : Entrance Fees is not capitalised.

Problem 3

Gymkana Club gives you the following Receipts and Payments Account for the year ended 31st March. 1994.

Receipts		Rs.	Payments	Rs.
To Balance of Cash on 1-4-93			By Salaries	12000
At Office	150		By Sports Equipment	46785
At Bank	14200		By Stationery and Printing	1220
	---------	14350	By Wages	6000
To Subscriptions		61100	By Prizes	1060
To Admission Fees		350	By Balance of cash on 31st March 1994	
To Interest on Investments @9% per annum for full year		9000	At Office	380
			At Bank	17385
		84800		84800

The following additional information is provided to you

i.	Subscriptions Due	480	560
ii.	Subscriptions Received in Advance	80	40
iii.	Sports Equipment	21800	29700
iv.	Land and Buildings (Cost less depreciation)	80000	76000

Prepare Income and Expenditure Account for the year ended 31st March 1994 and Balance Sheet as that date.

Ans : (Excess of income over expenditure Rs. 7405; Balance Sheet Total Rs. 223995)

Lesson 3

ACCOUNTS FROM INCOMPLETE RECORDS

Accounting records which have not been maintained according to strict double entry principles are usually referred to as incomplete records. This does not necessarily mean that the records are unsatisfactory. Very fee small cash traders will keep a full double entry ledger system. An analytical cash book entered up regularly and accurately together with nearly filed invoices and other relevant vouchers will prove quite adequate for most small traders since their accountant will be able to compile a trading and profit and loss account and balance sheet from those records.

The expression incomplete records " therefore covers a wide range of accounting records varying from the decimal and incomplee to the very good thoughtstill incomplete.

Single Entry Accounts are designed to indicate accounts from incomplete records. The term single is significant only in the sense that this system does not faithfully observe the rules of Double Entry Accounts in all cases.

MEANING

Single Entry system may be defined as any system which is not exactly the Double Entry system. In other words, Single Entry system may consist of (i) double entry in respect of certain transactions such as cash

Mrs. Prakash Loan	5,000	Stock	12,000
Prakash Capital	40,000	Debtors	20,000
Ramesh's Capital	25,000	Investments	12,000
		Profit and Loss A/c	8,000
		Cash	5,000
		Good will	15,000
	---------		---------
	1,00,000		1,00,000

It was agreed by the company to take over the assets at book value with the exception of Land and Building and Stock which are taken over at Rs. 41,000 and Rs. 41,000 and Rs. 15,000 respectively. The value of the goods will fixed at Rs. 25,000. Investment were sold by the firm of Rs. 10,000. The company also agreed to take over the liabilities except Mrs. Prakash's Loan by the firm for Rs. 10,000. The company also agreed to take over the liabilities except Mrs. Prakash loan which was discharged by the firm by paying Rs. 4,500. The cost of dissolution of the firm came to Rs. 500.

The purchase consideration was discharged by the company by the allotment of 4,450 shares of Rs. 10 each and the balance in each cash.

Show ledger accounts to close the books of the firm, assuming that the shares are distributed among the partners in proportion to the amount due to them.

	Rs.		Rs.
To land and building	30,000	By Bills payable	8,000
Furniture	8,000	Sundry Creditors	22,000
Stock	12,000	Bright Ltd.,	79,000
Debtors	20,000	Mrs. Prakssh losn	500
Good will	5,000		
Bank A/c	500		
Investments – Loss	2,000		
Realisation profits			
Prakash'c capital A/c	21,000		
Ramesh Capital a/c	8,000		
	1,09,500		1,09,500

BRIGHT LTD

To Realisation A/c	79,000	By shares in Bright Ltd.,	44,500
		Bank A/c	34,500
	--------------		--------------
	79,000		79,000
	--------------		--------------

PRAKASH'S CAPITAL ACCOUNT

To profit and Loss a/c	6,000	By Balance b/d	40,000
Shares in Bright Ltd	29,000	Realisation A/c	24,000
Bank A/c	29,000		
	--------------		--------------
	64,000		64,000
	--------------		--------------

3.	In this system, cash Book, general Ledger, Doctors ledger and Creditors' Ledger are maintained.	In this system, only Debtors' Ledger and creditors Ledger are kept. Cash Book is also kept but personal transactions got mixed up with business transaction.
4.	Under this system, arithmetical accuracy can be Checked by preparing trial Balance at any moment of time	Under this system, arithmetical accuracy can not be checked because no Trial Balance can be prepared.
5.	In this system, Trading, profit and loss Accounts And Balance sheet can also be prepared.	In this system, Trading, profit and loss Accounts and Balance sheet can not be prepared.
6.	For interpretation of financial statement, we can compute different ratios if the accounts are maintained under this method.	Vital ration can not 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.	This system is uscientific and does not follow any concrete rules

Advantages

The relative advantages of single entry book keeping are :

i) It is a very simple method of recording business transactions.

ii) Accounting records can easily be maintained since their maintenance does not call for adequate knowledge of the principles of book-keeping.

iii) It is less expensive when compared to double entry book-keeping.

iv) Ascertainment of profit or loss is such easier.

v) It is eminently suited to small concern with limited number of transactions and very few assets and liabilities.

Disadvantages

a) Since the two-fold aspect of every transaction is not recorded the arithmetical accuracy of the accounting records cannot be tested by preparing a trial balance.

b) Trading and profit and Loss Account cannot be prepared in the absence of detailed record of incomes and expenditure.

c) In the absence of real accounts, a balance sheet cannot be drawn up with a view to ascertaining the financial position of the business as on a particular date.

d) Since internal check is not possible, the method gives room for errors and frauds, besides rendering their detection very difficult.

e) Accounting information supplied by the records is inadequate for managerial planning and control.

f) If the business is sold, it becomes difficult to assess the value of goodwill.

g) Owing to legal restrictions, the method cannot be adopted by joint stock companies, however systematic the method might be.

h) Outsides, specially the Tax Authorities, look down upon this method with suspicion.

i) The system does not provide accurate figures about the performance of the business and its financial position. For example, separate figure of gross profit, net profit and sales are not available. Thus, the ratio of gross profit to sales or net profit to sales cannot be found out. Similarly in the absence of any information about the cost of goods sold, the proportion of different elements of cost to sales cannot be found out. In the absence of such information, it becomes difficult for the proprietor of the business to know the reasons of his improving or deteriorating profitability and financial position. Thus, he is not in a position to compare, plan and take sound decision for the prosperity of the business, Moreover, it may be difficult for him to find the real value of his business in the event of his deciding to sell the business.

COMPUTATION OF PROFIT

The profit (or loss) in case of business maintaining accounts according to Single Entry System can be computed by two method.

i) Net worth Method

ii) Conversion Method

Net Worth Method

According to this method, profit or loss made by the business is computed by comparing he net worth (or capital) of the business on two different dates. For example, if the capital of the business on 1-1-1980 was Rs. 80,000 and it is Rs. 90,000 on 31st December 1980, it can be said that the business has made profit of Rs. 10,000 during the period.

Adjustments Following adjustments are required for determination of the profit in case of this method.

i) Adjustment for drawing : The proprietor may withdraw money from the business for his personal use. In the absence of any such withdrawal, the capital at the end of accounting period would have been more by the amount of money withdrawn by him. Thus, the amount of drawings should be added back to the Capital at the end of the accounting period to find out his true capital on that date.

ii) Adjustment for capital introduced. The proprietor may introduce further capital in the business during the course of the accounting year. This will increase the capital of the proprietor at the end of the accounting year. It is therefore, necessary to reduce the amount of capital by the amount of capital introduced by the proprietor during the year in order to ascertain the real increase in the capital of the proprietor on account of profit earned by him during the course of the accounting year.

Illustration 3.1

From the following information, prepare a Statement of Profit showing the amount of profit earned by 'A' during the year 1980.

	Rs.
Capital on 31-12-1980	90,000
Capital as on 1-1-1980	80,000
A's drawings	5,000
Further capital introduced by A	3,000

Solution

Statement of Profit for the year 1980	90,000
Capital as on 31-12-1980	5,000
Add : Drawing	-----------
	95,000
Less : Further capital introduced by A	3,000

	92,000
Less : Capital as on 1-1-1980	80,000

Profit made during the year	12,000

Computation of net worth or capital, On the basis of whatever, has been stated in the preceding pages, it is clear that in order to determine profit or loss made during a period on the basis of net worth method, It is necessary to know the net worth or capital both in the beginning as well as at the end of the accounting period. This is done by preparing a Statement of Affairs.

Statement of Affairs is a statement giving the assets and liabilities of the business on a particular date. It is virtually the Balance Sheet of the business. However, the term Balance Sheet is used for the Statement of Assets and Liabilities in the Double Entry System of Book keeping where balance are taken from the ledger. In case of Single Entry System, all the assets and liabilities which appear in the Statement of Affairs are not necessarily taken from the ledger accounts on account of incomplete recording of the transaction. Moreover, the term Balance Sheet is used for statement which shows the correct financial position of the business since the information is collected from different sources which may include not only the books of accounts but other sources which may not be hundred percent reliable. For example, estimate about drawings may have to be made on the basis of the estimated living expenses of the proprietor of the business and also other estimated payments which might have been paid on his behalf.

Step for preparing statement of affairs; The following steps may be taken for preparing the Statement of Affairs.

i) In most cases in single entry system, a cash book is maintained. In case, this has been done, the cash and the bank balance can be taken from the cash book. In the absence of a proper cash book, cash balance may have to be found out by preparing a receipts and payments accounts on the basis of information collected from the proprietor of the business and the statement of accounts which might have been received or sent by the proprietor from his debtors and creditors. Information regarding other business expenses can be collected from the salaries register of his employees, petty cash book if any maintained by him. etc., and the actual cash balance available with the business. The balance at the bank can be verified from the bank pass book or Statement of Account from the bank.

ii) A list of sundry debtors and creditors should be prepared. This may not be difficult because in most cases, a record of the personal accounts is maintained under the single entry system.

iii) The value of the fixed assets like building, plant, furniture etc. Should be ascertained from vouchers or other documents available with the business. A reasonable charge from depreciation should also be made and the assets should be shown in the Statement of Affairs after charging depreciation.

iv) A physical verification of the stock should be taken and the value of the stock should be ascertained on the basis of the different invoices received from suppliers from time to time in respect of the goods purchased.

v) The amount of outstanding expenses and the accrued income should also be determined. Last year 's figures about these items may be of considerable help in this respect.

vi) The excess of assets over liabilities should be found out and this will denote the net worth or the capital of the business on the date on which the Statement of Affairs has been prepared.

Illustration 3.2

A keeps his books by single entry system. His position on January 1, 1978 was as follows

Cash at Bank Rs. 5,000 Cash in hand Rs. 1,000 Stock Rs. 7,000 Sundry Debtors Rs. 8,400; Machinery and Plant Rs. 6,500 Bills Receivable Rs. 2,600, Creditors Rs. 2,500 Bills Payable Rs. 4,000.

On December 31, 1978, his position was as follows :

Cash at Bank Rs. 4,300

Cash in hand Rs. 1,700/- Stock Rs. 9,000; Sundry Debtors Rs. 6,000; Machinery and Plant Rs. 6,500/- Bills payable Rs. 3,200; Bill Receivable Rs. 3,200 Creditors Rs. 1,600. During the year A introduced further capital of Rs. 2,000 and his drawings were Rs. 800 per months.

Depreciate Machinery and plant by 5% and create a Reserve for bad and Doubtful Debts @ 5%

From the above information, prepare a statement showing the profit or loss made by him for the year ended December 31,1978.

Solution :

A's Statement of Affairs
as on 1-1-1978

Liabilities	**Rs.**	**Assets**	**Rs.**
Creditors	2,500	Cash at Bank	5,000
Bills Payable	4,000	Cash in hand	1,000
Capital (balancing figure)	24,000	Stock	7,000
		Debtors	8,400
		Machinery and Plant	65,000
		Bills Receivable	2,600
	30,500		30,500

A's Statement of Affairs
as on 31-12-1978

Liabilities	**Rs.**	**Assets**		**Rs.**
Bills payable	3,200	Cash at Bank		4,300
Creditors	1,600	Cash in hand		1,700
Capital (balancing figure)	25.275	Stock		9,000
		Debtors		6,000
		Less Provision		300
		Machinery and Plant	6,500	5,700
		Less Depreciation @5%	325	6,175
		Bills receivable		3,200
	30,075			30,075

Statement of Profit for the year ending 31-12-1978

	Rs.
Capital as on 31-12-1978	26,275
Add Drawing maded during 1978 (Rs. 800 X 12)	9,600
	34,875
Less Fresh capital introduced	2,000

	32,875
Less Capital as on 1-1-1978	24,000

Profit made during 1978	8,878

Single Entry system as Applied to partnerships

When the single entry system is adopted by 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 partner's 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

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 Bad debts etc.	-------
Net profit for the period	
Less : Appropriations	--------
i) Salary of Partners	-------
ii) Interest on capital	--------
Add : Interest on Drawings	--------
Divisible profit	---------

Illustration 3.3

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 1983, the following Statements Affairs was extracted from their books.

Liabilities	Rs.	Assets	Rs.
Creditors 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 1984 their assets and liabilities were : Sundry Debtors Rs. 40,000 Sundry creditors Rs. 25,000 Plant & Machinery Rs. 50,000. Stock Rs. 30,000. Bills Receivable Rs. 50,000. Cash at bank Rs. 25,000 Loan - Bikash Rs. 25,000.

You are required to prepare a profit and Loss Statement for the year ended 31st December , 1984 and a Statement Affairs as at that date after taking into consideration the following.

a) Plant & Machinery is to be depreciated by 10% p.a.
b) Stock is to be reduced to Rs. 25,000
c) A Reserve 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 draw Rs. 5,000 and Rs. 3,000 respectively. (C.U.B. Com – (1985) – Adopted'

Solution

Ascertainment of Combined Closing Capital (Before Adjustments)

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	25,000	Sundry Debtors	40,000
Loan-Bikahs	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		1,50,00

Statement of profit and Loss of Akash and Bikash
for the year ending 31-12-1994

Combined closing Capital (as above)			1,00,000
Add : Combined Drawing during the year (Rs. 5,000 + Rs. 3,000)			8,000
			1,08,000
Less : Combined Opening Capital (Rs. 25,000 + Rs. 20,000)			45,000
Profit before adjustment			63,000
Less : Adjustments			
1)	Stock written off	5,000	
2)	Depreciation on plant & Machinery (Rs. 3,000 + Rs. 1000)	4,000	
3)	Provision for Doubtful debts (5% on Rs. 40,000)	2,000	
4)	Interest on loan (6 of Rs. 25,000)	15,000	12,5000
			50,500

Divisible Profit :		
Akash –3/5th of Rs. 50,500	30,300	
Bikash 2/5th of Rs. 50,500	20,200	50,500

Statement of Affairs if Akash & Bikash as at 31-12-1994

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital Akash			Plant &		
Opening balance	25,000		Machinery	50,000	
Add : Profit	30,300		Less : Depreciation	4,000	46,000
Less : Drawings	5,000	50,300	Stock		25,000
Capital-Bikash			Sundry debtors	40,000	
Opening balance	20,000		Less : Provision for		
Add profit	20,200		doubtful debts	2,000	38,000
	40,200				
Less : Drawings	30,000				
Loan-Bikash	25,000				
Add : Outstanding					
Interest	1,500	26,500	Bills Receivable		5,000
Sundry Creditors		25,000	Cash at bank		25,000
		1,39,000			1,39,000

Conversion to double Entry System

We have seen that under the single entry system adequate accounting information is not available and the profit disclosed by that system is not gladly accepted by the revenue authority. For better management of the business, avoiding harassment by the revenue authority, and facing challenge of the competitors in a scientific manner, sometimes a trader may adopt the double entry system by giving up the single entry system.

In the single entry system there are varying degrees of incompleteness, and the procedure to be adopted for conversion must depend upon the nature of the records and data available. It is not possible to give a formula can be applied in every situation. However. as a general rule. the following steps are followed.

Step : 1

A statement of affairs of the business should be prepared at the beginning of the accounting period from which the change is to be effected. The balance of the Statement of Affairs will represent the opening capital.

In examination problems on the single entry system, it may not be possible to prepare the Statement of Affairs due to the missing out of opening balance 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 statement as far as possible with the available information and leave if for the time being, (We discuss the procedures of calculating missing figures in the next few pages)

Step : 2

If not 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 ban columns etc.) should be prepared by showing :

a) On the debit side :
   - i) Cash collected from debtors (cash/cheque)
   - ii) Cash sales;
   - iii) Income from investment; and
   - iv) Sales proceeds of assets, etc.

b) On the credit side;
   - i) Total payment to creditors;
   - ii) Wages, salaries and other expenses paid
   - iii) Payment for purchase of assets; and
   - iv) Drawing by the proprietor etc.

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 figures 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 Sales 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 balance (iii) credit purchases and (iv) credit sales, etc.

Step : 4

Now complete the Statement of Affairs (Left incomplete at Step I) with the available information. The balance of the Statement of Affairs represents opening capital.

Step : 5

Pass the appropriate opening entry in the journal in respect of the assets and liabilities includes in the above statement of Affairs.

Step : 6

Write up the Real and Nominal Accounts from the information contained in the cash Book and other accounts. Every account should be carefully scanned; and the double entry effect of every transaction must be given by passing corresponding debit and credit entry in appropriate Ledger Accounts which should be opened if necessary.

Step : 7

Balance the accounts and prepare the Trial Balance in the usual manner.

Step : 8

From the Trial Balance and allied information, prepare Trading, Profit and Loss Account and Balance Sheet.

In examination, the students should skip steps 5, 6 and 7 directly prepare Trading, Profit and Loss Account and balance Sheet for saving time.

Calculation of Missing Figures :

In Examination problems on single entry, 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 3.4

S, a trader, does not keep a complete set of books. On May 1, 1984 his debtors were Rs. 24,500 and creditors Rs. 7,500.

A summary of his Cash Book for the year to 30th April 1985 showed the following totals :

	(Cash Rs.)	(Bank Rs.)
Credits – Payments to Creditors for purpose	1,350	11,250
Debits – Receipts form Debtors for sales	---	21,250
Sales of machinery	13,000	---
Rent of Warehouse sublet	390	---
Cash Sales	---	2,500
Cash Capital introduced on November 1, 1984		

At April 30, 1985 the debtors and creditors respectively amounted to Rs. 44,000 and Rs. 9.750. Cash discount allowed to debtors were Rs. 230 and those received from creditors were Rs. 810.

Ascertain Total Sale and Total Purchases for the year.

(C.U.B. Com- Adapted)

Solution

Total Debtors Account

Date	Particulars	Rs.	Date.	Particulars	Rs.
1-5-84	To Balance b/f	24,500	30-4-85	By Bank	21,250
30-04-85	To Credit Sales (Balancing figure)	40,980	30-4-85	By Discount allowed	230
				By Balance /d	44,000
		65,480			65,480

Total Creditors Account

Date	Particulars	Rs.	Date.	Particulars	Rs.
30-4-85	To Cash	1,350	1-5-84	By Balance b/f	7,500
30-4-85	To Bank	11,250	30-4-85	By Credit Purchased Balancing figure	15,660
30-4-85	To Discount received	810			
30-4-85	To Balance c/d	9,750			
		23,160			23,160

Calculation of Total Sales and Total Purchases Total Sales Cash Rs. 8,750 Credit Rs. 40,980 = Rs. 49,730; Total purchases – Cash Rs. Nil + Credit Rs. 15,600 = Rs. 15,600.

Illustration 3.5

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 :

	Rs.		Rs.
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

Bills Payable Account

Dr. **Cr.**

Particulars	**Rs.**	**Particulars**	**Rs.**
To cash	8,900	By Balance of b/f	5,000
To Balance c/d	9,000	By Total Creditors (Balance figure)	12,900
	17,900		17,900

Total Creditors Account

Dr. **Cr.**

To Cash Particulars	**Rs.**	**Particulars**	**Rs.**
To Cash	30,200	By Balance of b/f	6,000
To Returns outwards	1,200	By Credit purchases	42,300
To Bills payable		(Balancing figure)	
(Acceptance given)	12,900		
To Balance c/d	4,000		
	48,300		48,300

Total purchases = Cash Rs. 25,800 + credit Rs. 42,300 = Rs. 68,100

Illustration 3.6

From the following facts supplied by Mr. X who keeps his books on the Single entry systems, you are required to calculate "Total Sales"

Opening balance of bills receivable Rs. 2,500; Opening balances of Sundry debtors Rs. 3,900; Closing balance of bills receivable Rs. 3,500; Closing balance of Sundry debtors Rs. 2,540; Bills receivable encashed during the Year Rs. 10,000; cash received from the Debtors during the year (Including Rs. 300 being the sales proceeds of an old Typewriter sold on credit received during the year) Rs. 29,000; Returns Inwards Rs. 560 Bad debts written- of- Rs 700; Bills receivable dishonoured Rs. 500; cash sales Rs. 7,000.

Solution

Bills Receivable Account

Particulars	Rs.	Particulars	Rs.
To Balance b/f	2,500	By Cash	10,000
To Total Debtors A/c Receivable recd. During The year – Balancing Figure	11,500	By Total Debtors A/C (Bills receivable dishnoured)	500
		By Balance c/d	
	14,000		14,000

Dr. **Cr.**

Total Debtors Account

Particulars	Rs.	Particulars	Rs.
To Balance b/f	3,900	By Cash (Rs. 29,000 – Rs. 300)	28,700
To Bills Receivable (dishonoured)	500	By Return Inwards	
56			
To Credit sales (balance 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 Rs. 7,000 + Credit Rs. 39,600 = Rs. 46,000

Illustration 3.7

From the following information, calculate Drawing in cash by proprietor :

Opening Cash in hand	10,000	Cash purchases	5,000
Opening Cash in Bank	5,000	Purchase of furniture or Office use in cash	600
Cash Sales	20,000		
Cash collected from Debtors	50,000	Expenses – cash	1,000
Drawing by Cheque	5,000	Expenses – cheque	1,500
Cheque issued to creditors	30,000	Cash deposited	60,000
Closing cash at Bank	8,500	Closing cash in hand	12,500

Solution

Cash Book

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 Purchase	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 fig)	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 Rs. 10,900 in cash

Illustration 3.8

Anandram is wholesaler in textile goods. On January 1,1982 had stocks of main varieties A and B valued at Rs. 14,000 and Rs. 24,000 respectively. During the six months ended June 30, 1982, his purchases were Rs. 72,000 and Rs. 1,44,000 respectively. He had taken personal and family use one bale of variety A costing Rs. 6000. On 30th, June, his stocks were : A Rs. 8,000 and B Rs. 18,000.

Goods were sold by Anandram at the retail prices fixed by the manufacturer, which yield 25% gross profit on sale.

Determine the total sales figure of Anandram for the six months.

Solution :

Ascertainment of total sales figure of Anandram for the six months ending 30th June 1982.

	Variety A Rs.	Variety B Rs.
Cost of Sales		
Opening Stock	14,000	24,000
ADD : Purchase	72,000	1,44,000
	86,000	1,68,000
LESS : Withdrawal of Stock (of Varity A)	6,000	----
	80,000	1,68,000
LESS Closing Stock	8,000	18,000
	72,000	1,50,000
ADD : Profit @ 33.1/3% on sales (see note) Or 25% on sales	24,000	50,000
Sales	96,000	2,00,000

Therefore, the total sales is Rs. 96,000 + Rs. 2,00,000 = Rs. 2,96,000. Working Note : (1) Gross profit is 25% on sales, i.e., 33 1/3% on cost which is calculated as under :

We know, sales = cost of Sales + Profit. When sales is Rs. 100, profit 25% of Rs. 25 putting the above figures. We get 100 = cost of sales + Rs. 25 or cost of Sales = Rs. 75. Therefore, Profit is 33 1/3% on cost of sales (i.e. 25 is 33 1/3 of Rs. 75)

Illustration 3.9

From the following particulars for the year 1980 and 1981 determine the value of closing stock at the end of 1981.

	1980	1981
	Rs.	Rs.
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.

Solution

Trading Account for the year ended 1980

Dr.			Cr.
Particulars	**Rs.**	**Particulars**	**Rs.**
To Opening stock	20,000	By Sales	2,00,000
To purchases	1,20,000	By closing stock	30,000
To Gross Profit	90,000	By closing stock	
	2,30,000		2,30,000

Working Note :

Opening stock of 1981 is the closing stock of 1980. Rate of Gross Profit on sales. Rs. 90,000 x 100/Rs. 2,00,000 = 45% Closing stock of 1981 can be ascertained only when we prepare the Trading Account for 1981, which is as under.

Trading Account for the year ended 1981

Particulars	Rs.	Particulars	Rs.
To Opening stock	30,000	By Sales	2.40,000
To Purchases	1,90,000	By closing (Balancing figure)	88,000
To Gross Profit 45% Of Sales)	1,08,000		
	3,28,000		3,28,000

Illustration 3.10

You are required to calculate for each product of the company as a whole.

(a) Value of stock at 31st December, 1989 at cost.

(b) The amount of Gross profit, as they would appear in the company's Trading Accounts.

The company sells three products, A, B and C on which it earns gross profit percentage. calculated on normal selling prices, of 20, 25 and 33 1/3 respectively.

The value of its stock at 1st Juanry, 1989 valued at cost, were A Rs. 24, 000. B Rs. 36,000 C Rs. 12,000

During the ended 31st December 1989 the actual purchases and sales were;

Purchase :	A Rs. 1,46,000	B Rs. 1,24,000	C Rs. 48,000
Sales :	A Rs. 1,72,500	B Rs. 1,59,400	C Rs. 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 chosen above. The items sold at a discount were :

Normal Sales Price :	A Rs. 10,000	B Rs. 3,000	C Rs. 1,000
Actual Sales Price :	A Rs. 7,500	B Rs. 2,400	C Rs. 600

These discounts were not provided for in the cost values at Ist January , 1989 given above.

Solution

Product.	A(Rs.)	B (Rs.)	C(Rs.)	Total
Actual Sales (A)	1,72,500	1,59,400	74,600	
Add : Discount	2,500	600	600	
Nominal Sales	1,75,000	1,60,000	75,000	
Gross Profit ratio	20%	25%	33.1/3%	
Cost of Sales (B)	1,40,000	1,20,000	50,000	
Opening Stock	1,24,000	36,000	12,000	
Add : Purchases	1,46,000	1,24,000	48,000	
	1,70,000	1,60,000	60,000	
Less : Cost of sales	1,40,000	1,20,000	50,000	
Closing Stock	30,000	40,000	10,000	80,000
Gross Profit (A-B)	32,500	39,400	24,600	9,65,000

Illustration 3.11

S.K.S. does not maintain proper books of account, However, he provides you with the following details :

a) **Sales ana Purchases Policy :**

Total Sales during the year 1987- Rs. 6,00,000. Volume of Sales during 2nd half of 1987 was 1/3 that of 1st half. Volume of credit sales was twice that of case sales throughtout the year. All purchases were credit and were made evenly throughtout 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% on Sales

d) **Inventory Policy :**

The first two month's requirements was held as opening stock whereas the last months requirements was held as closing stock.

From the above details, ascertain the following (1) opening stock; (2) Closing stock (3) Total purchases and (4) Closing Debtors and Creditors.

Solution

a) Ratio of Sales 1st halt and 2nd half of the year (3:1) Therefore, Sales of Ist half = Rs. (1,60,000 / 4) x3 = Rs. 4,50,000 and sales of 2nd half = Rs. (6,00,000 / 4 x 1 = Rs. 1,50,000.

b) Average sales per month during Ist half of the year = 4,50,000 /6 = Rs. 75,000

Sales of January and Februay 87 = Rs. 75,000 X 2 = Rs. 1,50,000

c) Ratio of Cash Sales and Credit Sales = (1.2)

(i) Cash sales in Jan &		ii)	Credit sales in Jan &	1,00,000
Feb = 1,50,000 / 3	50,000		Feb (1,50,000 /3) x 2	10,000
Less : 5% profit on	2,500		Less : 10% Profit on	
Sales			Sales	10,000
	---------			----------
Cost of goods sold (cash Sales)	47,500		Goods sold (credit Sales)	90,000
	---------			----------

Therefore, Opening Stock = (Rs. 47,500 + Rs. 90,000) = Rs. 1,37,500

d) Average sales per month during the 2nd half of the year Rs. 1,50,000/6 = Rs. 25,000

e) Cash Sales of December 1987 = Rs. 8,333

Less Profit @ 5% on sales = Rs. 517. Therefore, total cash sales g December = Rs. 7916. Credit sales of December 1987 Rs. 16,667 less profit @ 10% of sales = Rs. 1,667. Therefore total credit sales during December = Rs. 15,000.

Therefore, closing stock = (Rs. 7,916 + Rs. 15,000) = Rs. 22,916

f) Total cash sales = Rs. 2,00,000 Less : Profit @ 5% - Rs. 10,000, Therefore, cost of goods sold = Rs. 3,60,000

Total cost of goods sold = Rs. (1,90,000 + 3,60,000) = Rs. 5,50,000

Cost of goods = Opening Stock + Purchase – Closing Stock. Or 5,60,000 = 1,37,500 + Purchases – Rs. 2,916 or purchase = Rs. 4,35,416.

g) Average sales of 2nd half per month = 1,50,000/6 = Rs. 25,000 Total sales of last 2 months (Nov. – Dec) Rs. 50,000, Last two months credit sales = Debtors = 50,000 X 2/3 = Rs. 33,33

h) Creditors = last three months' purchases (4,35,416/12) X 3 = 1,08,854.

Illustration 3.12

The following is a summary of the Bank Account of Mr. Kannan, a trader for the year 1985,.

Bank Summary

Particulars	**Rs.**	**Particulars**	**Rs.**
Balance on January 1985	5,410	Payment to trade creditors	1,87,860
Cash receipts on account of credit sales Balance on	2,43,720	General expenses	16,970
December 31.1 1985	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 Rs. 21,180 out of which he paid wages amonting to Rs. 12,800

He retained Rs. 8,380 for private purposes. The following information is obtained from the books.

	31-12-84	31-12-85
Stock in trade	24,300	31,500
Creditors for goods	19,40	17,000
Debtors for goods	22,400	26,900
Amount owing to a customer who had over paid		

His account	600	---
Rates paid in advance	420	450
Creditors for general expenses	10	1,340
Furniture and fittings	10,000	10,000

Discount received from trade creditors during 1985 amounted to Rs. 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 1985.

You are required to prepare a Trading and Profit and Loss Account for the year ended 31-12-1985 and a Balance Sheet as on the date.

(C.U.B. Com – Adapted)

Solution :

Working Notes : Ascertainment of opening Capital (1-1-85)

Liabilities	Rs.	Assets	Rs.
Creditors for goods	19,450	Furniture and Fittings	10,000
Creditors for general Expenses	810	Stock in trade	24,300
Capital (balancing figure)	41,400	Debtors (Rs. 22,400 – 600) Note – 1)	21,800
		Rates paid in advance	420
		Cash at bank	5,140
	61,660		61,660

Total Debtors Account

To Balance b/f	22,400	By Balance b/f	600
To Sales (balancing Figure) (Rs. 2,43, 720 + 21,180)	2,64,900	By Cash	2,70,000
		By Balance c/d	26,900
	2,92,400		2,,92,400

Total Creditors Account

Particulars	Rs.	Particulars	Rs.
To Bank	1,87,860	By Balance b/f	10,450
To Discount received	1,500	By Purchases (Balancing figure)	1,87,000
To Balance c/d	17,090		
	2,06,450		2,06,450

Trading and Profit and Loss Account of
Mr. Kannan for the year ended 31-12-1985

Dr. Particulars	Rs.	Particulars	Cr. Rs.
To opening stock	24,300	By Sales	2,70,000
To purchases	1,87,000	By closing stock	31,500
To Gross Profit	90,200		
	3,01,500		3,01,500
To General Rs. 16970 + 1340 + 810	17,500	By Gross profit b/d	90,200
To Rent & rates (Rs. 7,710 + Rs. 420 - Rs. 450)	7,680	By Discount received	1,500
To wages (Note 2)	12,800		
To Net Profit	53,720		
	91,700		91,700

Balance Sheet of Mr. Kannan as at 31-12-85

Liabilities	Rs.	Rs.	Assets	Rs.
Capital			Furniture and fittings	10,000
Opening balance	41,400		Stock in trade	31,500
Add : Net profit	53,720		Debtors	26,900
	95,120		Rates paid in advance	450
Less : Drawings (Rs. 38,500 + 8,380)	45,880	49,240		
Creditros for goods		17,090		
Creditors for general Expenses		1,340		
Bank overdraft		1,180		
		68,850		68,850

Notes : (1) An amount of Rs. 600 owing to a customer who has overpaid his account, has been deducted the debtors of Rs. 22,400 to ascertain the exact total debtors as on 1-1-1985. Alternatively, if the total debtors is shown as Rs. 22,400 a liability of Rs. 600 is to be shown. (2) Since Mr. Kannan has no manufacturing function, wages have been treated as indirect and charged to profit and Loss Account.

Illustration 3.13

X a retail trademan asks you to prepare accounts of his business for the year ended 31st December, 1982. On invesigation you find they have not been reconciled with cash in hand. From time to time cash has been paid into bank account and cheque theron have been drawn both for business and private purposes.

From the following information obtained from the the records and from your client, prepare the Trading and Profit and Loss account for the year ended 21st December, 1982 and the Balance Sheet as at that date. During the year, cash amounting to Rs. 1,00 was stolen from the safe. No record has been kept of amounts taken from cash for personal expenses and the differenece in cash amounting to Rs. 365 is treated as private expenses.

Cash paid into bank	7,500	Wages	2,000
Private dividend paid into bank	100	Delivery expenses	350
Private payment out of bank	1,300	Rent and rates	100
Business payment out of bank	6,100	Lighting	50
Cash taking (Sales)	12,500	General Expenses	230
Payment for goods by Cash and Cheque	8,000		

The assets and liabilities at the beginning and at the end of the period are as follow :

	Stock Balance	Bank Balance	Cash in hand	Trade debtors	Trade creditors	Investment
Opening Rs.	1,000	400	15	700	1365	2,500
Closing Rs.	750	600	20	1000	1500	2,500

Solution

Working Notes :

Cash Book

Particulars	**Cash**	**Bank**	**Particulars**	**Cash**	**Bank**
To Balance b/g	15	400	By Bank 'C'	7500	
To Cash 'C'		7500	By Drawings	365	1,300
To Private dividends		100	By Trade Creditors (Notes. I)	1900	6,100
To Trade Debtors	12500		By wages		2000
			By Delivery expenses	350	
			By Rent and rates	100	
			By Lighting	50	
			By General expenses	23/	
			By cash stolen	100υ	
			By Balance c/d	20	600
	13,515	8,000		13,515	8,000

Ascertainment of Opening Capital (1-1-1982)

Liabilities	**Rs.**	**Assets**	**Rs.**
Trade creditors	1,365	Stock	1000
Capital (balancing figure)	3,250	Bank balance	400
		Cash in hand	15
		Trade Debtors	700
		Investment	2,500
	4,615		4,615

Particulars	Rs.	Particulars	Rs.
To Balance	700	By Credit	12,500
To credit sales	12,800	By Balance c/d	1,000
(Balancing figure			
	13,500		13,500

Total Creditors Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To cash	1,900	By Balance b/f	1,365
To Bank	6,100	By Credit Purchases	8,135
		(Balancing figure)	
To balance c/d	1,500		
	9,500		9,500

Note : (1) Payments to creditors by cash is ascertained by deducing business payment out to bank (Rs. 6,100) from payments for goods by cash and cheque (Rs. 8,000)

(2) Since MR. X is trader, 'wages' has been treated as indirect expenses and taken in Profit and Loss Account.

Trading and Profit & Loss Account for the year ended 31-12-1982

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To opening stock	1,000	By sales :	
To purchases	8,135	Cash	1,000
		Credit	12,800
To Gross Profit c/d	5,415	By closing stock	750
	14,550		14,550
To Rent and rates	100	By Gross Profit b/d	5,415
To Delivery expenses	350		
To Wages (Note 2)	2,000		
To Lighting	50		
To General Expenses	230		
To Cash-Stolen	1,000		
To Net Profit (transferred To Capital)	1,685		
	5,415		5,415

Balance Sheet as at 31-12-1982

Liabilities	Rs.		Assets	Rs.
Capital			Investment	2,500
Opening balance	3,250		Stock	750
Add : Net Profit	1,685		Trade Debtors	1,000
Capital Introduced	100		Cash at Bank	600
			Cash in Hand	20
	------			------
	5,035			
Less : Drawing				
(Rs. 1,300 + Rs. 365)	1,665	3,370		

Trade Creditors		1,500		
		--------		----------
		4,870		4,870
		--------		--------

Illustration 3.14

Mr. Jagajeevan commenced business on 1st January, 1986 with a capital of Rs. 45,000. He immediately purchased furniture of Rs. 24,000. During the year he received from his uncle a gift of Rs. 3,000 and he borrowed from his father a sum fo Rs. 5,000. He had withdrawn Rs. 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.

	Rs.
Sales (Including cash sales Rs. 30,000)	1,00,000
Purchase (Including cash purchase Rs. 10,000)	75,000
Carrings Inwards	700
Wages	300
Discount allowed to Debtors	800
Salaries	6,200
Bad debts written of	1,500
Trade expenses	1,200
Advertisements	2,200

He used goods worth Rs. 1,300 for personal purposes and paid Rs. 500 to his son for examination and college fees.

On 31st December 1986, his Debtors were worth Rs. 21,000 and Creditors Rs. 15,000. Stock in trade was valued at Rs. 10,000. Furniture to be depreciated by 10% pa.

Prepare Trading and Profit and Loss Accounts for the year ended for the year ended on 31st December 1986 and Balance Sheet as at 31st December 1986.

Solution

Working Notes :

Cash Account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
1-1-86	To capital A/c	45,000	1-1-86	By Furniture A/c	24,000
	To Loan A/c (Father's)	5,000		By Drawing A/c (Rs. 600 X 12)	7,200
	To Capital A/c (Gift)	3,000		By purchases A/c	10,000
	To Sales (cash)	30,000		By charges inward	700
	To Sundry debtors A/c	46,700		By wages	300
				By salaries	6,200
				By Trade expenses	1,200
				By Advertisement	2,200
				By Drawing (examination less)	500
				By Creditors	50,000
				By Balance c/d	27,400
		1,29,700			1,29,700

Sundry Debtors Account

Date	Particulars	Rs.	Date	Particulars	Rs.
1986	To Sales (Credit)	70,000	1986	By Cash (Balancing figure)	46,700
				By Discount Allowed	800
				By Bad debts	1,500
			Dec. 31	By Balance c/d	21,000
		70,000			70,000

Sundry Creditors Account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
1986	To cash (balance figure)	50,000		By purchase (Rs. 75,000 + Rs. 10,000)	65,000
Dec. 31.	To Balance c/d	15,000			
		65,000			65,000

Mr. Jagajeevan's Trading and Profit & Loss Account for the year ended 31-12-86

Particulars			Particulars	
To Purchases	75,000		By Sales	1,00,000
Less : Purchases	1,300		By closing stock	10,000
	--------	73,700		
To Carriage Inwards		790		
To wages		300		
To Gross Profit c/d		35,300		
		---------		-------------
		1,10,000		1,10,000
		-----------		------------
To Salaries		6,200	By Gross Profit b/d	35,300
To Discount allowed		800		
To Bad debts		1,500		
To advertisement		2,200		
To Trade expenses		1,200		
To Depreciation of furniture @ 10% p.a on Rs. 24,000				
To Net Profit (transferred to capital)		21,000		
		-----------		--------------
		35,300		35,300
		----------		-------------

Balance Sheet of Mr. Jagajeevan as at 31-12-1986

Cash Book

Liabilities		Rs.	Assets		Rs.
Capital			Furniture	24,000	
Opening Balance	45,000		Less : Depreciation	2,400	21,600
Add : Capital Introduced (Gift)	3,000		Closing Stock		10,000
Add : Net Profit	21,000		Debtors		21,000

	69,000		Cash in hand		27,400
Less : Drawings					
(7,200+500+1,300)	9,000	60,000			
Loan father's		5,000			
Creditors		15,000			
		----------			----------
		80,000			80,000
		----------			----------

Illustration 3.15

A commenced business in a retail shop on July Ist 1986, in premises for which he paid a rent of Rs. 200 per month. The shop occupied the ground floor and he used the upper story for residential purposes. It is agreed that one-third of all expenditure or rent, rated and insurance is attributable to such residential portion.

The only records he kept apart from his Bank Statement were files of suppliers's statement and unpaid invoices for good purchased, together with a notebook in which he recorded sales on credit to special customers who paid him by cheques. Cash received from cash sales was paid into the till our of which A paid certain amounts, of which he kept a rough recard and he made weekly bankings out of the balance in the till. He paid all suppliers for goods purchased by cheque. An analysis of the bank Statement for the six months ended December 31st 1986, was as follows.

Particulars	Rs.	Particulars	Rs.
Capital paid in	4,000	Shop Fixtures & Fittings	2,000
Loan (Interest – free)	2,000	Household furniture	1,800
Supplier's Cheque for gods returened	280	Suppliers for goods puchased	9,840
Special customers	300	Rent	1,000
Deposit of other Collections	11,930	Rates	300
		Heal and Light	180
		Insurance	200
		Closing Balance	3,190
	18,510		18,510

A estimated that the total amounts paid out to the till before making the weekly bankings for the six months were.

Drawings Rs. 2,000; Salaries And Wages Rs. 1,400 and Sundry shop expenses Rs. 800. It is also ascertained that as on December 31st 1986.

a) Stock correctly taken at cost were : Goods Rs. 1,720 Fuel Rs. 120
b) The balance in the till was Rs. 260, including a post-date cheque for Rs. 150, cashed for a customer.
c) The cash paid to the bank included Rs. 300 from the sale of surplus shop fittings.
d) The insurance premium covered the year to June 30th 1987 and the rates for the period of nine months to March 31st 1987.
e) Supplier's unpaid invoices amounted to Rs. 2,240 and profit and Loss Account for the half year ended 31st December, 1986 and a Balance Sheet as on that date.

Solution

Working Notes :

Cash Book

Dr. **Cr.**

Particulars	Rs.	Particulars	Rs.
To shop fixtures & Fittings	300	By Drawings	2,000
To Cash sales (balancing figure)	16,090	By Salaries and wages	1,400
		By Sundry shop expenses	800
		By Bank (weekly deposits)	11,930
		By Advance to Customer (post dated cheque)	150
		By Balance c/d (Rs. 260, Rs. 150)	110
	16,290		16,290

Total Creditors Account

Dr. Particulars	Rs.	Particulars	Cr. Rs.
To Bank – Payment made	9,840	By Bank-goods returned	280
To Balance c/d	2,240	By credit purchase (Balancing figure)	11,800
	12,080		12,080

Drawings of A

Household furniture

Cash

Approinment of Household expenses :

Rent 1/3rd of Rs. 1,200 (Rs. 1,000 + Rs. 200)

Rents 1/3rd of Rs. (Rs. 300 – Rs. 100)

Insurance premium 1/3 rd of Rs. 100 (Rs. 200 – Rs. 100)

Trading and Profit and Loss Account

For the half – year ended 31-12-1986

Dr. Particulars	Rs.	Particulars	Cr. Rs.
To purchases 11,800		By sales : 16,090	
To Gross Profit c/d	6,310	Cash	300
		Credit	300
		By Closing stock	1,720
	18,110		18,110
To Rent	800	By Gross Profit b/d	6,310
To Rates	113		
To Heat and light (Rs. 180 + Rs. 80 – Rs. 120)	140		
To Insurance	67		
To Salaries and Wages	1,400		
To Sundry shop expenses	800		
To Net Profit (transferred to Capital)	2,970		
	6,310		6,310

Balance Sheet of A as at 31-12-1986

Liabilities	Rs.	Assets	Rs.
Capital		Shop fixtures and fittings	2,000
Opening balance	4,000	Less : Sold	300
Add : Net Profit	2,970		1,700
	6,970		
Less : Drawings	4,300		

--------	2,670	Closing stock	1,720
Loan (Interst free)	2,000	Goods	120
Sundry Creditors	2,240	Fuel	150
Outstanding rent	200	Advance to customer	100
Outstanding light expenses	80	Prepaid rates	100
		Cash at bank	3,190
		Cash in hand	110
	--------		--------
	7,190		7,190
	---------		--------

Illustration 3 : 16

Mr. Rupakumar does not maintain complete records of his business but given you the following information :

	31-3-1989	31-3-1988
Machineries	2,00,000	1,50,000
Sundry Creditors	86,000	?
Sundry Debtors	?	93,000
Stock in trade	70,000	50,000
Cash in hand	2,600	1,500
Furniture	27,000	30,000
Cash at bank	15,560	18,700

His cash transaction for the year ended 31st March 1989 included the following (besides, certain other times)

	Rs.
Payment to creditors	4,10,000
Cash Sales (25% of total sales)	1,70,000
Business Expenses	82,000
Cash purchases	1,30,000
Collection from Debtors	5,27,000
Withdrawn for household expenses	30,000

He maintains a uniform rate of gross profit of 25% on turnover. Outstanding business expenses on 31st March 1989 amounted to Rs. 5,000. Addition of new machinery was make of October 1, 1988. Some old furniture (book value Rs. 6,000) was sold during the year and the purchaed stand credit to Furniture Account.

Provide depreciation on Machinery @ 15% p.a. and on Furniture @ 10% p.a. (excluding sold item).

Mr. Rupakumar requests you to prepare a Trading and Profit and Loss account for the year ended 31st March 1989 and a Balance Sheet as on the date.

Solution

Working Notes :

1 Cash sales Rs. 1,70,000 which represents 25% of total sales. Therefore, total sales = Rs. 1,70,00 X 4 = Rs. 6,80,000

2 Gross Profit 25% of sales, Therefore, cost of sales 75% i.e. 6,80,000 X 975/100) = Rs. 5,10,000

3. Cost of sales = Opening stock + Purchases – closing stock or Rs. 5,10,000 = Rs. 50,000 Purchases Rs. 70,000

4 Sales proceeds of Furniture Rs. 30,000 . Rs. 27,000 = Rs. 3,000. Book value of furniture sold

Rs. 6,000. Therefore, loss Rs. 3,000

5. Depreciation on Machineries ; on Rs. 1,50,000 @ 15% for full year + on Rs. 50,000 @ 15% for 12 year.

6. Depreciation on Furniture : 10% of Rs. 30,000 – Rs. 6,000 = Rs. 2,400

7. Sundry Debtors Account

Dr.					Cr.
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
1-4-88	To Balance b/f	93,000	31-3-89	By Cash	5,27,000
31-3-89	To sale	5,10,000	31-3-89	By Balance of c/d (balancing figure)	76,000
		6,03,000			6,03,000

8. Sundry Creditors Account

Dr.					Cr.
Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
	To Cash	4,10,000	1-4-88	By Balance b/d (Balancing figrue)	96,000
31-3-89	To Balance (see note) c/d	86,000	?	By purchases By Purchases (Note 3)	4,00,000
		4,96,000			4,96,000

9. Balance Sheet of Mr. Rupakumar as at 31-03-1988

Liabilities	Rs.	Assets	Rs.
Capital (balancing figure)	2,47,200	Machineries	1,50,000
Sundry Creditors (see note)	96,000	Furniture	30,000
Stock in trade	50,000	Sundry Creditors	93,000
		Cash in Bank	18,700
		Cash in hand	1,500
	3,43,200		3,43,200

Trading Profit & Loss Account of Mr. Rupakumar for the year ended 31-03-1989

Dr.				Cr.
Particulars		**Rs.**	**Particulars**	**Rs.**
To opening stock		50,000	By Sales (Note 1)	6,80,000
To Purchases		5,30,000	By Closing stock	70,000
To Gross Profit c/d		1,70,000		
		7,50,000		7,50,000
To Business expenses	82,000		By Gross Profit c/d	1,70,000
Add. Outstandind	5,000			
		87,000		

To Loss on sale of Furniture (Note 4)	3,000		
To Depreciation on Machineries (Note 5)	26,250		
To Depreciation on Furniture (Note 6)	2,400		
To Net Profit	51,350		
	1,70,000		1,70,000

Balance Sheet of Mr. Rupakumar as at 31-03-1989

Liabilities		Rs.	Assets		Rs.
Capital			Machineries	1,50,000	
Opening balance	2,47,200		Auditors :	50,000	
Add : Net Profit	51,350				
	,98,550			2,00,000	
Less : Drawings	30,000	2,68,550	Less : Depreciaton	26,250	1,73,750
Sundry Creditors		86,000	Furniture	30,000	
			Less : Sold	6,000	
Outstanding Business expenses		5,000		24,000	
			Less : Depreciation	2,400	21,600
			Stock in trade		70,000
			Sundry Debtors		76,000
			Cash in bank		15,600
			Cash in hand		2,600
		3,59,550			3,59,550

Illustration 3.17

The following is the Balance Sheet of the retail business of Mr. Raju as at 31st December 1989.

Particulars	Rs.	Particulars	Rs.
Mr. Padamsi's Capital	1,25,000	Furniture & Fittings	25,000
Creditors for goods	30,000	Stocks	75,000
Outstanding expenses	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. Raju always sells his goods at a profit of 25% on sales.
2 Goods are sold for cash and credit. Credit customers pay be cheques only.
3 Payments for purchases are always made by cheques.
4 It is the practice of Mr. Raju to send to the bank every weekend the takings of the week after paying every week salaries of Rs. 250 to the clerk, sundry expenses of Rs. 50 and personal expenses of Rs. 100.

An Analysis of the Bank Pass Book for the period ending 31st March, 1990 disclosed the following :

Payment to Creditors Rs. 75,000; payment of rent Rs. 4,000. Amount remitted into the bank Rs. 1,35,000 including cheques for Rs. 10,000 received from customers to whom the goods were sold on credit. The following are the balance on 31st March 1990.

Stocks Rs. 32,500; creditors for goods Rs. 32,500; Sundry Debtors Rs. 30,000

On the evening at 31st March. 1990 the cashier absconded with the cash available in the cash box.

You are required to prepare a statment showing the amount of cash defalcated by the cashier and also a profit and Loss Account for the period ended 31st March 1990 and a Balance Sheet as on that date solution.

Mr. Raju's

Trading Profit & Loss Account for the period ended 31-09-1990

Dr. Particulars	Rs.	Particulars	Cr. Rs.
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 (Rs. 25 x 13)	3,250	By Gross Profit b/d	40,000
To Sundry expenses (Rs. 50 x 13)	650		
To Rent (Rs. 4,000 – Rs. 1,000)	3,000		
To Defalcation loss	10,800		
To New Profit	22, 300		
	40,000		40,000

Balance Sheet of Mr. Raju as at 31-03-1990

Liabilities	Rs.	Rs.	Assets	Rs.
Capital				
Opening balance	1,25,000		Furniture & Fittings	25,000
Add: Profit	22,300		Stock	32,500
	1,47,300		Sundry Debtors	30,000
Less Drawings			Cash at Bank	91,000
(Rs. 100 x 13)	1,300	1,46,000		
Creditors		32,500		
		1,78,500		1,78,500

Working Notes : (Taking 13 Weeks : (5212 X 3)

Dr.	Cash Book	Cr	Dr.	Bank Account		Cr.	
To Balance				To Balance			
b/f	1,000	By Bank	1,25,000	b/f	35,000	By cre.	75,000
To Sales	1,40,000	By Salary	3,250	To cash	1,25,000	By rent	4,000
		By Sundry Expenses	650	To Debtors	10,000	By B. C/d	91,000
		By Drawing	1300		1,70,000		1,70,000
		By Defal.	10,800				
	1,41,000		1,41,000				

Dr. Sundry Debtors A/c			Cr.	Dr.	Bank Account		Cr.
To Balance						By Balance	
b/f	20,000	By Bank	10,000	To Bank	75,000	c/d.	30,000
To Sales	20,000	By ba/c/d	30,000	To Ba c/d	32,500	By pur.	77,500

Cost of Sales = Opening Stock + Purchases – Closing Stock = Rs. 77,500 – Rs. 32,500 = Rs. 1,20,000

No depreciation has been charged on furniture owing to lack of information.

Illustration 3.18

From the following data, you are required to prepare a Trading and Profit and Loss Account for the year ended 31st March, 1989 and a Balance Sheet as on that date. All workings should form a part of your answers.

Assets and Liabilities	**1-4-1988**	**31-3-1989**
	Rs.	**Rs.**
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	6,960	17,870
Details relating to transaction in the year		**Rs.**
Cash and discount credited to Debtors		64,000
Sales return		1,450
Bad debts		420
Sales (cash & Credit)		71,810
Discount allowed by trade creditors		700
Purchases returns	400	
Additional Capital paid into bank		8,500
Realisation from Debtors – paid into bank		62,500
Cash Purchases		1,030
Cash expenses		9,570
Paid by cheque for machinery purchased		430
Household expenses drawn from back		3,180
Cash paid into bank		5,000
Cash drawn from bank		9,240
Cash in hand on 31-3-1989		1,200

Cheque issued to trade creditors 60,270

Solution

Trading Profit and Loss Account for the year ended 31-3-1989

Dr.					Cr.
Liabilities		**Rs.**	**Assets**		
To Opening stock	59	8,040	By Cash sales	4,600	
To Purchases (Note I)	59,030		By Credit sales	67,210	
	------------			----------	
Less : Returns	400	58,630		71,810	
		14,810	Less : Returns	1,450	
				----------	70,360
			By Closing stock		11,120
	------------				------------
	81,480				81,480
	------------				------------
To Sundry Expenses (Note 2)	9,300		By Gross Profit b/d	14,810	
To Discount Allowed	1,500		By Discount received	700	
To Bad debts	420				
To Net Profit	4,290				
	---------			---------	
	.5,510			15,510	
	---------			---------	

Balance Sheet as at 31-03-1989

Liabilities	Rs.		Assets	Rs.
Capital :			Sundry Assets	12,040
Opening balance	26,770		Stock in trade	11,120
New Capital	8,500		Sundry Debtors	17,870
Profit	4,290		Cash in hand & at bank	8,080

	39,560			
Less : Drawings	3,180	36,380		
Sundry Creditors		12,400		
Outstanding Expenses	330			
		------------		------------
		49,110		49,110
		------------		------------

Working Notes :

1) Purchases = Credit 58,000 + cash 1,030 = Rs. 59,030
2) Sundry expenses = Paid in cash Rs. 9,570 plus outstanding on 31-3-89 Rs. 330 minus outstanding on 31-4-99 Rs. 600 = Rs. 9,300.

3) No depreciation has been charged on fixed assets due to lack of information

4. Balance Sheet as on 1st April 1988

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	15,770	Sundry Assets	11,610
Outstanding expenses	600	Stock in trade	8,040
Capital (balancing figure)	26,770	Sundry Debtors	16,530
		Cash in hand & at Bank	6,950
	43,140		43,140

Dr. 5. Sundry Debtors Account Cr.

Particulars	Rs.	Particulars	Rs.
To Balance b/d (balancing figure)	16,530	By Bank	62,500
To Sales (Rs. 71,810 – Rs. 46,000)	67,210	By Return Inward	1,450
		By Discount allowed	1,500
		By Bad debts	420
		By Balance c/d	17,870
	83,740		83,740

Dr. 6 Sundry Creditors Account Cr.

Particulars	Rs.	Particulars	Rs.
To Bank	60,270	By Balance b/d	15,770
To Discount Received	700	By purchases (balancing figure)	58,000
To Returns outward	400		
To Balance c/d	12,400		
	73,770		73,770

Dr. 7 Cash Book (Cash & Bank jointly) Cr.

Particulars	Rs.	Particulars	Rs.
To Balance b/d	6,960	By Sundry Creditors	60,270
To Sundry debtors	62,500	By Drawings	3,180
To Capital A/c	8,500	By Machinery	430
To Sales (Cash sales, Balancing figure)	4,600	By Sundry expenses	9,570
		By purchases	1,030
		By Balance c/d	8,080
	82,560		82,560

Exercises

1. What are the essentials of the Single Entry System of Book keeping? In what respect 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?

6. Sri. R. Mitra commenced business on 1st January 1991, with Rs. 20,000 as capital. He kept his books on Single Entry System.

On 31st December, 1991, his books disclosed the following position, Sundry Creditors Rs. 7,500; Plant Rs. 15,000; Stock –in –traade Rs. 12.00; December Rs 13,500; and Cash at Bank Rs. 3,000 He drew from his business at the rate of Rs. 225 at the end of each month. On 1st July, 1991 he introduced a further capital amounting to Rs. 6,000

You are required to prepare a statement of Profit and Loss for the year ended 31-12-1991 and Statement of Affairs as on that date after taking into considertation 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.

7. 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. Rs. 1,000 (cost) furniture was sold for Rs. 5,000 on 1-1-1982 ; drawn Rs. 1,000 per month, Rs. 2,000 was invested by Mr. A in 1982.

	1-1-82	31-12-82
	Rs.	Rs.
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 1-1-82 is as per cash Book, but the bank overdraft on 31-12-82 is as per bank statement Rs. 2000 Cheques drawn in December, 1982 have not been encashed within the year.

CONVERSION OF SINGLE ENTRY INTO DOUBLE ENTRY

8. Rajesh does not maintain proper books of account. From the following particulars. Prepare trading and profit and Loss account for the year ended 31st December., 1990 and the balance sheet as on that date.

	31-12-89	31-12-90
Debto	9,000	12,500
Stock	4,900	6,600
Furniture	500	750
Creditors	3,000	2,250

Analysis of the other transactions is as follows :

	Rs.		Rs.
Cash collect from debtors	30,400	Cash sales	750
Cash paid to creditors	22,000	Discount received	350
Salaries	6,000	Discount allowed	150
Rent	750	Returns inward	500
Office expenses	900	Returns outward	400
Drawings	1,500	Bad debts	100
Additon Capital introduced	1,100	Cash purchases	2,500

He had Rs. 2,500 as cash balance at the beginning of the year

9. From the information given below. Prepare a Trading and Profit and Loss Account of the year ended

30th June, 1986 and Balance Sheet as at the date.

	1-7-85 Rs.	30-06-86 Rs.
Debtors	8,000	7,400
Creditors for purchases	3,000	2,400
Rent payable (outstanding)	50	30
Cash	750	3,250
Stock	500	800
Plant	5,000	6,000

Cash Transaction :

Receipts : Cash sales Rs. 500, Debtors-Rs. 35,500 payments; purchases of plant Rs. 1,000; Rent Rs. 620 Cash purchases Rs. 1,000; payment to Creditors – Rs. 15,600; Sal[illegible]; Wages – Rs. 3,000; Electricity – Rs. 1,000; (Shortage in cash balance to be treated as drawings), Bad debt already written – off Rs. 100 Depreciation on Plants has to be preovided at 10% p.a.

GUIDE TO ANSWERS

7. Closing Capital Rs. 36,000; Profit before adjustment Rs. 12,700, Net Profit Rs. 9,875; Balance Sheet Rs. 40,675
8. Opening Capital Rs. 65,000; Closing Capital Rs. 63,000; Profit adjustment Rs. [illegible] Net Pr. (trading) Rs. 3,800; Profit on sale of Furniture Rs. 4,000; Statement of Affairs Rs. [illegible]
9. Credit sales Rs. 34,650; Credit purchases Rs. 22,000; Credit purchases Rs. 15,000; Drawings Rs. 1280; Net Profit Rs. 4750; Balance Sheet Rs. 24,100.

Lesson 4

PARTNERSHIP ACCOUNTS

(Final Accounts, Past Adjustment and Guarantee)

When two are more individuals agree to carry on business for their mutual advantage, they are said to form partnership. Partnership in India is Governed by the Indian Partnership Act which defines Partnership as the relation between persons who have agreed to share the profit of a business carried on by all or any of them acting for all. According to this definition, there are the following essentials of partnership.

i) There should be more than one person to form partnership.
ii) The persons concerned must combine to carry on business.
iii) They must agree to share the profits of business.
iv) The business must be carried on by all or any of them acting for all.
v) The number of partners must not exceed 20; and if the business is that of banking, it must not exceed 10.

Persons who have entered into a partnership with one another are called individually partners, and collectively, a firm and the name under which their business as carried on is called the firm's name.

PARTNERSHIP BOOK KEEPING

In a sole trader's business, the proprietor being the only person contributing capital, the capital, and drawing accounts opened in his name represent, 'Proprietorship' accounts. In the case of a partnership, however, the proprietorship accounts consists of a capital account, current account and a drawing count opened in the name of each partner .

Capital account

The amount of capital contributed by each partner will be credited to a capital account opened in his name. If a partner does not make any cash payment towards his capital but brings in assets and liabilities his capital would be the excess of assets over liabilities brought in. Amounts drawn by partners, in anticipation of profits, would be debited to the respective capital accounts. Share of profit would be credited, or loss would be shown on the liabilities side of the balance sheet prepared at the close of the accounting period:

Drawing account:

Cash wide drawn by partners in anticipation of profit, and goods used for private purposes are debited to drawing account opened in the name of each partner. At the end of the accounting period, the total of the drawings is transferred to the respective capital accounts, by debiting the letter and crediting the 'former accounts.

Interest on Capital:

Interest on capital is usually allowed by agreement between the partners. If partners contribute equal amounts of capital, and share profits equally, no need arises for any interest to be allowed on capital. In practice, however, capital contributions would be unequal and profit sharing ratios would also be unequal, mainly because of the different types of partners.

Where capital contributions are equal but the profit sharing ratios are unequal, a partner with a lower share of profit stands to lose. Again, where capitals are unequal put profit sharing ratios are equal, a partner with larger capital contribution is affected financially. Interest on capital tens to balance capital accounts equitably, without allowing any partner to get an unfair advantage over the other

Interest on capital, if allowed by agreement, is brought into accounting records by debiting interest on capital account and crediting the capital account of each partner. At the close of the accounting period, interest on capital account is closed by transfer to profit and loss account. The entry for this is to debit the profit and loss account and to credit interest on capital account.

Interest on drawings:

The partnership deed may stipulate the maximum amount that each partner is permitted to withdraw, without paying any interest. If a partner exceeds the limit, he had to pay interest on drawings, usually at the same rate as interest on capital. A partner, who withdraws a higher amount has to pay interest on his drawings to the firm. To that extent, he loses the benefit of interest on capital. On the other hand, a partner whose drawings are well within the limits, need not pay any interest on his drawings. At the same. time he enjoys the benefits of a higher amount of interest on capital.

Thus, where drawings are equal, partner's accounts are equitably adjusted through the mechanism of interest on drawings. Hence, the need for interested on drawings. Being a gain to the firm, when interest is charge on drawings, partner's capital accounts are debited and interest on drawings account is credited. At the time of financial close, interest on drawings account is closed by transfer to the profit and loss account, by debiting the former account and creding the latter

Partners' Salaries.

No partner is entitled to any salary for taking part in the business, since it is his duty to work deligently for the profits of the firm. However, the partnership deed may provide for the payment of salary to a partner. If that is so, partner's salary should be brought into accounting records. This is done by debiting the concerned partner's salary account and crediting his capital account. At the close of the accounting period, partner's salary account is transferred to the profit and loss account, by debiting, the letter and creding the former account.

TIME FACTOR IN RELATION TO INTEREST

Normally, interest on capital and interest on drawing are calculated for one full year. This would be so, if a partner, allows his capital balance to remain in the firm for the whole year by withdrawing only the amount permissible by the deed. In case a partner withdraws, in the course of the year, more than that permitted by the deed, his capital effectively employed in the firm gets reduced.

Consequently, either he should accept interest on capital on the basis of time, or pay interest on drawings. It is for this adjustment that the rate of interest on drawings is invariably the same as the rate of interest on capital. If a partner withdraws different amounts, or the same amount at stated periods during the course of the year, it becomes necessary to calculate interest on drawings, taking time into consideration.

The time factor in calculating interest is also important if partners introduce additional amounts of capital at different time during the year.

Illustration 4.1

Vijay and Bhargav are partners sharing profits and losses equally with capitals of Rs.30,000 and Rs.20,000 respectively. Their drawings during the year are as follows:

Vijay's drawing on	31.3.1984	Rs. 500
	30.4.1984	600
	1.7.1984	450
	1.12.1984	1,400

Bharagav drew Rs. 300 atthe end. of each month. The deed provides interest on capitals and drawings at 6%. Calculate interest on capitals and drawings.

Solution:

Interest on Capital:

Vijay : @ 6% Rs. 30,00 for 1 year = Rs. 1,800

Bhargav : @ 6% Rs. 20.00 for 1 year = Rs. 1,200

Interest on Drawings :

Vijay :

Interest on Rs.	500	for 9 months; interest on Rs. 4,500 for 1 month
	600	for 8 months; interest on Rs. 4,800 for 1 month
	450	for 6 months; interest on Rs. 2,700 for 1 month
	1,400	for 1 months; interest on Rs. 1,400 for 1 month

$$\text{Interest} : \frac{\text{Balance of product X Rate X Time}}{100}$$

$$= \frac{13{,}400 \times 6 \times 1}{100 \times 12} = \text{Rs. } 67$$

Bhargav :

Interest on Rs.	300	for 11 months; interest on Rs. 3,300 for 1 month		
	300	for 10 months; Interest on Rs. 3,000 for 1 month		
	300	for 9 months; Interest on Rs. 2,700 for 1 month		
	300	for 8 months; Interest on Rs. 2,400 for 1 month		
	300	for 7 months; Interest on Rs. 2,100 for 1 month		
Interest on Rs.	300	for 6 months; Interest on Rs. 1,800 for 1 month		
	300	for 5 months; Interest on Rs. 1,500 for 1 month		
	300	for 4	1,200	for 1 month
	300	for 3	900	for 1 month
	300	for 2	600	for 1 month
	300	for 1	300	for 1 month
	300	for 0	0	for 1 month
		Rs.	19,800	

$$\text{Interest} : \frac{19{,}800 \times 6 \times 1}{100 \times 12} = \text{Rs. } 99$$

Although the partners get the benefit of interest on their full amounts of capital, they have each to pay to the firm interest on drawings as calculated above. Thus, out of Rs. 1,800 interest on capital which vijay receives if he pays Rs. 67 to the firm as interest on drawings, he will be getting only Rs. 1,733. In the case of Bahargav also, the actual amount of interest on capital will be Rs. 1,101. This can be verified by ignoring interest on drawing, and calculating interest on capital on the basis on time.

PROFIT AND LOSS APPROPRIATION ACCOUNT

In the case of partnership accounting, it is usual to allocate interest on capital, interest on drawings, salary, commission and the respective shares of profit or loss to the capital account of partners through the profit and loss appropriation account.

The above items, popularly known as 'payments to partners' and allowed by the partnership deed, are not charged to the profit and loss account as items of expenditure which every partnership business must incur. Since they may or may not be allowed by the deed of every partnership, they are treated as appropriations of profit, if allowed by the deed. Accordingly, profit as disclosed by the profit and loss account is transferred to profit and loss appropriation account, and payments to partners are made through this account. Any balance remaining on this account is allocated to capital accounts on the basis of profit sharing proportions.

A profit and loss appropriation account thus shows the distribution of profit earner by a business to various accounts. Even if a partnership business does not open a profit and loss appropriation account, it may happen sometimes that the books of account are closed ignoring that it becomes necessary to give effect to the omissions, through a profit and loss appropriation account, and transfer the balance on this account to the capital accounts of partners.

In case the omissions are discovered in any subsequent year, it is used to give effect to the same by opening another account.

Styled profit and loss adjustment account.

Illustration 4 .2

X and Y are partners in a firm sharing profits and losses in the ration of 3 : 2 X has contributed Rs. 15,000 and Y has contributed Rs. 10,000 towards capital of the business. X is entitled to a salary of Rs. 2,000 per annum and interest is to be calculated at 5% per annum on the capital and drawings of each partner. The drawings during the year were as follows :

X	Rs	Y	Rs.
1st April	300	1st February	200
1st June	500	1st April	600
Ist August	200	1st June	200
1st October	800	1st November	900

The profit of the firm before charging salary and interest on capital and drawings amounted to Rs. 12,265. Show the Profit and Loss Appropriation Account.

Solution

Interest on Drawings :

Partner X :			Partner Y		
Drawings	**Period**	**Product**	**Drawings**	**Period**	**Product**
Rs.	**Rs.**	**Rs.**	**Rs.**	**Rs.**	**Rs.**
300	9 months	2,700	200	11 months	2,200
500	7 months	3,500	600	9 months	5,400

200	5 months	1,000	200	7 months	1,400
800	3 months	2,400	900	2 months	1,800
		9,600			10,800

$$\frac{9{,}600 \times 5 \times 1}{100 \times 2} = \text{Rs. } 40 \qquad \frac{10{,}800 \times 5 \times 1}{100 \times 2} = \text{Rs. } 45$$

PROFIT AND LOSS APPROPRIATION ACCOUNT

To Salary to X	2,000		By Profit and Loss account		12,265
" Interest on Capital			" Interest on Drawings		
X	750		X	40	
Y	500	1,250	Y	45	85
"Net Profit X	5,460				
	3,640	9,100			
		12,350			12,350

INTEREST ON CAPITAL CHARGE AGAINST PROFITS

The Partnership Act has laid down very clearly that, where a partner is entitle to interest on capital, the same is payable only out of profits, subject to a contract to the contract. Accordingly, if a partner is entitled to interest on capital by virtue of a clause in the deed; the same becomes payable only if the firm has made profits. This obviously means that interest on capital is an appropriation of profit and not, a charge against it.

Interest on capital paid out of profit not merely determines the true earnings of a business but is also equitable, specially in the case of partner who has contributed a higher amount of capital than his share of profit.'

The question, however, is whether interest on capital could be paid even in the case of no profits or. inadequacy of the same. The partnership Act is liberal in this respect, and leaves the question to be answered by the deed. As such; if it is agreed by. the partners that interest on capital is payable in any case the same may be considered to be a charge against profits.

Neverthelss, if the profits of the firm are insufficient to cover the full amount of interest, it is not advisable to charge the same to the profit and loss account, and divide the loss consequent upon such a charge. "The adjustment is, however, an appropriation of profit - it represents such share of the profits as is attributable to the use of capital, and, in fact, forms a special division of profits". Accordingly, where the profits are insufficient to cover the full amount of interest, in the absence of a clear agreement to the contrary, the partners are entitled to such interest as would just cover the profits:

Illustration: 4.3

A and B are partners with capitals of Rs. 3,000 and Rs.1,000 respectively. They agree to allow interest on capital at 5 per annum, and to share profit and losses equally. The profit for the year before charging, interest was Rs. 160. Show the profit and loss appropriation account.

Solution :

PROFIT AND LOSS APPROPRIATION ACCOUNT

		Rs.		Rs.
To Interest on capital			By Profit and Loss a/c	160
A	120			
B	40			
		160		
		-------		---------
		160		160

PROFIT AND LOSS APPRPIRATOIN ACCOUNT

	Rs.			Rs.
To Interest on capital			By Profit and Loss a/c	160
A	150		A	20
B	50		B	20
	-------	200		40
		------		-------
		200		200
		------		-------

The appropriation accounts above are prepared under the assumptions that (a) interest just covers the profit and (b) interest is a charge against profits, to be payable in full regardless of profit or loss.

FIXED AND FLUCTUATING CAPITALS

The partnership deed usually mentions the methods of maintaining capital accounts of partners. In the absence of any specific mention to the contrary, capital accounts will be in the usual form, i.e., credited with the original contributions and additions, interests, salary, commission, share of profit, etc., and debited with drawings, interest on drawings, etc:"

The above adjustments made on the capital account, at the close of the accounting year, cause an increase or decrease of the capital account balance every year. As such, capital is said to be fluctuating year after year.

If partners agree that capitals should be fixed, all the adjustments that would normally be made on capital accounts are by virtue of the purpose. Original capital contributions are credited to the respective capital accounts, and a 'separate current account is opened in the name of each partner. The current accounts are credited and debited with the usual adjustments, including, allocation of profit or loss, and the balances, on . these accounts, whether debit or credit, are shown distinctly in the balance sheet along with the fixed capital balances.

Illustration: 4:4

On 1st January 1979, A and B enter into partnership contributing Rs. 20,000 and Rs. 15,000 respectively and sharing profits and losses in the ratio of 3:2 B is allowed a salary of Rs.4,000 per year. Interest is to be charged on drawings. During the year A withdraw Rs.3,000 and B Rs. 6,000 interest on drawings being Rs.70 and Rs. 50 respectively. Profit in 1979, before the above-noted adjustments, amounted to Rs.10,580, Show how the profit is to be distributed .

Also show the capital accounts of A and B under Fixed Capital Method and fluctuating Capital Method.

Solution :

PROFIT AND LOSS APPROPRIATION ACCOUNT

		Rs			Rs.
To Interest on Capital			By Profit and Loss		10,580
A	1,000		" Interest on Drawings		
B	750		A	70	
	--------	1,750	B	50	
" Salary to A		2,970			120
B	1,980	-------			---------
		10,700			10,700
	--------			--------	

Fixed Capitals :

A'S CAPITAL ACCOUNT

To Balance c/d	20,000	By Bank	20,000
	---------		---------
	20,000		20,000
	---------		---------
		By Balance b/d	

B'S CAPITAL ACCOUNT

To Balance	15,000	By Bank	15,000
	---------		---------
	15,000		15,000

		By Balance b/d	

A'S CURRENT ACCOUNT

To Drawings	3,000	By Interest on Capital	1,000
" Interest on Drawings	70	" P & L Appropriation A/C	
" Balance c/d	900		2,970
	------		-------
	3,970		3,970
	-------		-------
		By Balance b/d	900

B'S CURRENT ACCOUNT

To Drawings	6,000	By Interest on	750
" Interest on Drawings	50	Capital	750
" Balance c/d	680	" Salary	4,000
		"P&LAppropriation A/c	1,980
	--------		-------
	6,730		6,730
	---------		-------
		By Balance b/d	680

Fluctuating capital

A'S CAPITAL ACCOUNT

	Rs.		Rs.
To Drawings	3,000	By Bank	20,000
" Interest on drawings	70	" Interest on Capital	1,000
" Balance c/d	20,900	" P & L Appropriation A/c	23,970
	---------		---------
	23,970		23,970
	---------		---------
		By Balance b/c	20,900

B'S CAPITAL ACCOUNT

To Drawings	6,000	By Bank	15,000
" Interest on Drawings	50	" Interest on Capital	750
" Balance c/d	15,680	" Salary	4,000
		" P & L Appropriaton A/c	1,980
	----------		----------
	21,730		21,730
	---------		----------
		By Balance b/d	15,680

ADJUSTMENT OF CLOSED PARTNERSHIP ACCOUNTS

The partnership deeds of most firms provide for interest on capital, interest on drawings, salary and commission to some partners.In spite of such specific provisions, it may happen sometimes that the accounts of partnership are closed with giving effect to such adjustments. Further, even without any provision in the deed, or the absence of any recognised custom or trade usage, interest on capital might have been allowed. Again, interest on capital and on drawings might have been wrongly calculated.

If these omission and errors are allowed to continue, the financial interests of partners will be affected. It is, therefore, necessary to give effect to omissions and rectify the errors, whenever, they are discovered. In case these are discovered in the same year after the accounts are closed, a profit and loss appropriation account is opened for purpose. However if discovered during and subsequent year,it is customary to open a profit and loss adjustment accour

Illustration: 4.5

P;O and R started business in partnership on Ist January 1985 and their accounts prepared for the year showed a profit of Rs.16,000. This was credited in the agreed proportions of 2:2:1 to the partner's capital accounts, which thereafter had credit balances of Rs. 36,400, Rs. 32,400 and Rs. 21,200 respectively.

After closing the books it was released that the partnership deed provided for interest on capital to be allowed at 5% per annum and interest on drawings to be charged to partners being respectively Rs.380, Rs.360 and Rs.,260 .

Set right the capital accounts, and give the journal entry necessary for the same.

Solution

PARTNER'S CAPITAL ACCOUNTS

	P	O	R		P	O	R
To P & L Appropriation	6,400	6,400	3,200	By Balance b/d	36,400	32,400	21,200
" Interest on Drawings	380	360	260	" Interest on Capital		1,300	
				" P & L	1,500		900
" Balance c/d	36,440	32,260	21,300	Appropriation		5,320	
					5,320		2,660
	43,220	39,020	24,760		43,220	39,020	24,760
				By balance b/d	39,440	32,260	21,300

Adjustments

		P	O	R
a)	Original share of Profit	6,400	6,400	3,200
	Share after adjustments	5,320	5,320	2,660
	Difference	1,080	1,080	540
b)	Interest on capital	1,500	1,300	900
c)	Interest on drawings	380	360	260

Difference

a)	Profit difference	1,080	1,080	540	Debit
b)	Interest on Capital	380	360	260	Debit
		1,460	1,460	800	Total Debit
c)	Interest on Capital	1,500	1,300	900	Total Credit
		40	140	100	Net debit or credit
		Cr.	Dr.	Cr.	

Journal Entry :

O's Capital A/c Dr.	140	
Top's Capital		40
Top's Capital		100

GUARANTEE OF PROFITS

When a new partner is taken in, the old partners may, sometimes, give guarantee to such an incoming partner that he shall receive a certain minimum amount in case the normal share of profits to which he is entitled falls short of the guaranteed amount. Under such an arrangement,the amount guaranteed will be a first charge on the profits and the balance will be shared by the other partners.

Where such a guarantee is given, the allocation of profits will first be made amongst all the partners, in their profit - sharing proportions, and if the share of the new partner falls short of the guaranteed amount, the deficit would be made good by the partner who was undertaken the guarantee.

The need for guaranteeing profits arises specially when an employee of a partnership business is made a partner, or the relative of an existing partner is admitted into the business. If an employee is made a partner, the arrangement may be that a portion of his share of profit being the excess of his share over his former remuneration as an employee, is borne by any of the then partners.

It is necessary to remember, in this context, that the partner guaranteeing is entitled to recoup the amount made good by him out of the share of profits in future years of the partner to whom guarantee is given, if his share exceeds the amount guaranteed

Illustration: 4.6

A who has been carrying on a retail business with a capital of Rs.3,OOO admits'B and C into his business subject to the conditions that B to bring in Rs.1 ,000 as his capital; interest on capitals to be allowed at 5% per annum and B to receive a salary of Rs. 300 per annum. C is guaranteed by A that his minimum share of profit shall be Rs. 300 per annum. The profits are to be shared in proportions 1/2, 1/8 and *1/6* respec-, tively. The net profits of the business were Rs. 200 before charging B's salary and interest on capital. The, drawings of the partners were:A Rs. 500, B Rs. 400 and C Rs. 300

Prepare the profit and loss Appropriation Account and Capital Accounts of the Partners.

Solution

PROFIT AND LOSS APPROPRIATION ACCOUNT

		Rs.			Rs.
To Salary to B	300		By Profit and		
" Interest on			Loss a/c	200	
Capital A	150		" Net Loss : A	150	
B	50		B	100	
		200	C	50	300
		-------			-------
		500			500

A'S CAPITAL ACCOUNT

To Drawings	500	By Balance b/d	3,500
" Share of loss	150	" Interest	150
" C's share borne	350	" Balance c/d	2,150
" Balance b/d	2,150		
	---------		----------
	3,150		2,150
	---------		---------

B'S CAPITAL ACCOUNT

To Drawinigs	400	By Bank a/c	1,000
" Share of loss	100	" Salary	300
" Balance c/d	850	" Interest	50
	-------		----------
	1,350		1.350
	-----------		----------
		By Balance b/c	850

C'S CAPITAL ACCOUNT

To Drawings	300	By A's Capital a/c	350
" Share	50		
	-------		------
	350		350

Note A. who is the guarantor, has to bear not only the guaranteed amount of Rs. 300, but G's share of loss also.

PARTNERSHIP FINAL ACCOUNTS

Like the final accounts of a sole trader, partnership final accounts also consists of a trading account, profit and loss account and balance sheet. However, payments to partners, such as interest on capital and on drawings, salary, commission and shares of profit or loss are shown in the profit and loss appropriation account, instead of in the profit and loss account.

If capitals are fixed, separate current accounts are opened for the purpose of showing these items together with drawings, and the balances on these accounts are shown distinctly in the balance sheet, either on the assets side or the liabilities side, depending upon the nature of balance.

Illustration 4.7

Following is the Trial Balance of ABC Comipany, a partnership firm, as on 30th June 1987.

		Debit Rs.	Credit Rs.
Capital	Mr. A		40,000
	Mr. B		60,000
	Mr. C		50,000
Current Accounts	Mr. A	9,000	
	Mr. B	15,000	
	Mr. C	6,000	
Sales		12,00,000	
Purchases		7,20,000	
Returns inwards		7,000	
Salaries		1,11,000	
Rent		16,000	
Wages		73,000	
Insurance		4,300	
Lighting		6,500	
Telephones and Teles		12,000	
Repairs		9,000	
Discount earned		14,000	
Provision for depreciation (On hand and buildings Rs. 60,000 and on vechicls Rs. 12,000)		72,000	
Provision for doubtful debts		31,000	
Sundry Creditors			2,64,000
Trade debtors		3,31,000	
Stock (as on 1st July 1986)		93,000	
Land and Building (at cost)		2,12,000	
Vehicles (at cost)		79,000	
Investments		35,000	
Cash and Bank balances		21,000	
	Total	17,46,000	17,46,000

Partners have profits and losses in the ratio of their capital. Closing stock as on 30th June, 1987 was valued Rs. 1,31,000. Accured but unpaid salaries. Wages and rent are Rs. 5,000 Rs. 3,500 and Rs. 2,000 respectively. Prepaid insurance was Rs. 500. Depreciation on1and and buildings and vehicles is to be provided at 2 per cent and 20 per annum respectively on straight line methods. Investments include share in a limited company purchased for Rs. 3,000 and the partners decided to write off this investment as the company is under liquidation provision for doubtful debts is to be adjusted to 5 per cent of the outstanding debtors.

Prepare profit and Loss Account of the firm for the year ended 30th June. 1987 and Balance Sheet as on the date.

(C.a. II B Part I, Nov. 1987)

Solution :

ABC Company

PROFIT AND LOSS ACCOUNT for the year ended 30th June 1987.

		Rs.			Rs.
To Stock 1-7-1986		93,200	By Sales	12,00,000	
"Purchases		7,20,000	Less : Returns	7,000	11,93,000
" Wages	73,000		" Stock 30-06-87		1,31,000
" Accured	3,500	76,500	" Discount earned		14,000
"Salaries	1,11,000				
" Accured	5,000	1,16,000			
" Rent	16,000		" Provision for		
" Accrued	2,000	18,000	doubtful debts		16,500
" Insurance	4,300				
Less : Prepaid	500	3,800			
" Lighting		6,500			
" Telephones and Teles		12,300			
" Repairs		9,000			
" Depreciation :					
Land and Building @ 2%		4,244			
Vehicles @ 2%		15,900			
Net Profit :					
A 4/15	74,428				
B 6/15	1,11,643				
C 5/15	93.035	2,79,106			
		13,54,550			13,54,550

BALANCE SHEET OF ABC COMPANY AS AT 30TH JUNE 1987

		Rs.			Rs.
Trading Creditors		2,64,000	Cash and Bank		
Outstanding			balances		21,000
Creditors			Trade debtors	3,31,000	
Salaries	5,000		Less : Provision	14,450	

Wages	3,500					3,16,550
Rent	2,000					
		10,500				
Provision for				Less : Shares written off	3,000	32,000
Depreciation Capital				Prepaid Insurance		500
A	40,000			Vehicles at cost		79,500
B	60,000			Land and Buildings		
C	50,000	1,50,000		at cost		2,12,200
Current Accounts A (Dr.)	9,000					
Investment written off	800					
	9,800					
Net Profit B (Cr.)	74,428	64,628				
	15,000					
Investments written off	1,200					
	13,800					
Net Profit	1,11,643		1,25,443			
C(Dr.)	6,000					
Investment written off	1,000					
	7,000					
Net Profit	93,035		86,035			
			7,92,750			7,92,750

EXCERCISES

(Theory)

1. Define Partnership (B.com. Bharathidasan, Dec. 1987)
2. In the absence of any partnership, how would you deal with:
a) Interest on partner's loan;
b' Salary to an active partner? (B.Com., Madurai, Nov., 1988)
3 What is a partnership Deed? (B.Com., Kerala, April 1988)
4. Explain briefly the main rules that are applicable in the absence of any agreement in a partnership firm. (B.Com., Mahatma Gandhi; April 1988)
5 Explain briefly the main rules that are applicable in the absence on an agreement in a partnership firm.
6. Explain the objectives of preparation of profit and loss Adjustment Account. How is the balance in this account dealt with? (B.Com., Calicat, June 1988) ,
7. Distinguish between 'Fixed' and 'Fluctuating' Capital. (B.Com., Madurai, Nov., 1987)
8 Write short notes on:
a. Fixed and Fluctuating capital, (b) Profit and Loss Appropriation Account. (B. Com., Berhampur, 1986)

PROBLEMS

Profit Appropriation

1. X and Y are partners in a firm sharing 3.2., On 1st January 1986 their capitals stood at X Rs. 50,000 Y Rs. 40,000. The profit and loss Account for the year ended 31 st December 1986 showed a net, profit of Rs. 1,75,000 before taking into account the following adjustments.

a) Interest on capital at 5% per annum.

b) Interest of X's loan of Rs. 50,000 at 6% per annum (loan borrowed on 1st April 1986)

c) Interest on drawings of partners at 6% per annum. The drawings were X Rs. 15,000 and Y and Rs. 10,000.

d) Transfer 10% of the distributable profit, before distribution to the Reserve Fund

Prepare Profit and Loss Appropriation Account. (bCom., Madurai Nov. 1987)

(ANS: Interest on Capital X Rs. 25,000, Y Rs. 2,000; Interest on Drawings; calculated for the whole year, X Rs. 900; Rs.600; Interest on Loan for 9 months Rs. 2,250; Transfer to Reserve Fund Rs. 16,975; balance to X Rs. 90.665;Y Rs. 61,110)

GUARANTEE

8. Top, Middle and Bottom were in partnership sharing profits in the: ratio of 2: 1:1 respectively, it beings provided that in no year should Middle's share be less than Rs. 15,000. The profits for the year ended 31st March, 1982, amounted to Rs. 56.420. Show appropriation among the partners.(B.Com Mangalore, April 1988)

(Ans. Middle gets Rs. 15,000, Top gets Rs. 27,613 and Bottom Rs. 13,807)

Ommission and Adjustments

12. A and B agreed to share profits as follows :

First Rs. 8,000 to A and the balance in 2 : 1. The profits for the year are Rs. 11,000 the capitals being A Rs. 40,000 and B Rs. 36,000. interest on capital had been omitted from the books and is to be allowed as at 5% per annum. Adjust (B.Com., Bharthian, Dec. 1987)

(Ans :X has received Rs. 8,000 + Rs. 2,400 and Y is Rs. 1,200. After charging interest on capital of Rs. 2000 to X and Rs. 1,800 to Y. the balance left is only Rs. 7,800; this amount should first go to X; thus X has drawn Rs. 600 in excess; this to be adjusted by due debting X's capital and creating Y's capital)

Final Accounts

The Third Balance of M/s. R.S. Corporation on as 31st December 1979 was a undr

	Rs	Rs
Rejeev's Capital Account		80,000
Suresh Capital Accpunt		1,00,000
Stock as of 1-1-1979		
Raw Materials	2,500	
Finished Goods	6,500	
Purchases	64,500	
Sales	1,19,900	
Sales Returns	2,000	
Wages	16,000	
Manufacturing expenses	12,000	
Salaries	8,000	
Insurance	1,500	
Postage	100	

Advertisement	1,000	
Bad debts	300	
Bills Payable		12,000
Discount		500
Land and Buildings	90,000	
Plant and Machinery	70,000	
Furnitures	1,000	
Sundry Debtors	25,400	
Sundry Creditors		42,000
Drawings :		
Rajeev	1,800	
Suresh	1,400	
Cash in hand	500	
Cash at Bank	49,000	
	3,53,500	3,53,500

Rajeev and Suresh share profits and loss equally.

Prepare Trading and Profit and Loss Account for the year ended 31st December 1979 and also be Balance Sheet as on 31-12- 1979 after taking into consideration the following adjustments.

1. Stock on 31st December 1979 — Rs.
   Raw Materials — 4,000
   Finished Goods — 12,000
2. Provided depreciations
   Buildings
   @ 10% on Furniture
   @5% Plant and Machinery
3. Outstanding Rs.
   Salaries — 1,500
   Wages — 2,000
4. Insurance is paid for 15 months up to March 1980.
5. Write off bad debts of Rs. 400
6. Reserve for doubtful debts @ 5% on Debtors
7. Goods withdrawn by Rajeev for personal use Rs. 2,000

(Ans. Preparing only trading account without manufacturing account : Gross Profit Rs. 31,400. Net Profit Rs. 10,050. Rajive Capital Rs. 81,225 Suresh's Capital Rs. 1,03,625, Balance Sheet total RS. 2,42,450/-

Lesson 5
PARTNERSHIP ACCOUNT II
Admission and Retirement / death of a Partner

A. ADMISSION OF A PARTNER

Subsequent to the formation of a partnership, new partner may be admitted with the consent of all existing partners. A new partner may be admitted for different reasons such as more capital, influence or special skill. At the time of admission of new partner, certain adjustment are necessary in the books of account in respect of the fol1owing.

1. Adjustment in regard to Profit-sharing Ratio.
2 Adjustment in regard to Goodwill.
3. Adjustment in regard to Revaluation of Assets & Liabilities.
4. Adjustment in regard to Reserve & Surplus.
5. Adjustment in regard to Partner's Capitals.

1. Adjustment in Regard to Profit Sharing Ratio

When a new partner is admitted, according to partnership agreement, he is entitled to a share of future profits. In effect, the combined share of the old partners will be reduced. The new partner may acquire his share of future profit either from one partner or from all the partners. It should be noted in this conext that, unless otherwise agreed, the profit sharing ratio between the old partners will remain the same.

Illustration: 5:1

A and B are in partnership sharing profits and losses in the ratio of 3:2 C is admitted as a partner for 1/4 share. Now, after admission, the new profit sharing ratio will be as under.

Let the total share be I, C is coming for 1/4th share. So, 1-1/4=3/4 remains for A and B which they will share in the ratio of 3:2 (i.e. old ratio). The final profit sharing ratio will be.

A = 3/5 = 9/25; B=2/5 of 3/4= 6/20; C= 1/4; orA :B:C= 9:6:5. In the above example, if C is coming for I/3rd share, but A and B, as between themselves, decide to share profits and loss, equally.

Here, after giving 1/3 to c, the remaining 2/3 rd will be shared by Aand B equally (newly agreed ratio).

Therefore; the final profit sharing ratio will be:

A=1/2 of 2/3 =1/3; D = 1/2 of 2/3 = 1/3; or A:B::C 1 : 1 : 1

Illustration: 5:2

A and B are partners sharing profits an lossess in the ratio of 3:2 they admit C into the firmfor 3/7th share, of profit which he takes 2/7 from a and 1/7 from B.

Now, after admission the new proit-sharing ratio will be C=3/7 or A:B:C = 11 (15)

2. Adjustment in Regard to Goodwill

What goodwill is

Goodwill may be described as the agreegate of those intangible attributes of a business which contribute to. its superior earning capacity over a normal return on investment. It may arise from such attributes of as business as god reception, a favourable location, the ability and skill of its employees and management, nature of its products etc.,

From a different angle, goodwill may be viewed as a more or less permanent organization who continue to partronize that organization despite the high price of its product which leads the organization to earn a super-profit. So, goodwill is the outcome of an impression created in the mind of each customer.

Lord Lindley defines goodwill as under:

"The term goodwill can hardly be said to have any precise signification. It is generally used to denote the benefit arising from connection and reputation and its value is what can be got for the chance of being able to keep that connection and improve it. Upon the sale of an established business its goodwill has a marketable value, whether the business is that of a professional or of any other person. But it is plain the goodwill have no meaning except in connection with a contiuing busines, and the value of the goodwill of any busiess to a purchaser depends in some cases entirely, and in alJ.very much. On the absence of competition on the part of those by whom the business has been previously carried on".

There are various methods of treating goodwill in the books of the firm at the time of admission of a new partner. These include the premium method, the revaluation method and the memoranum revaluation method.

1) Premium Method

a) The new partner brings his share of goodwill in cash which is retained in the business.

Illustration: 5:3

A and B share profits and losses in the ratio of 3:2 C is admitted with 1/5 share of profits and he brings Rs. 2,500 towards his share of goodwill and Rs. 10,000 towards his capital. Pass Jousal entries

		Rs.	Rs.
Cash A/c	Dr.	12,500	
To C/s Capital A/c			12.500
(Being the case, through in by C towards capital and goodwill)			
C's Capital A/c	Dr.	2,500	
To A's Capital A/c			1,500
To B's Capital A/c			1,000
(Being the goodwill divided between A and B is the sacrificing ration of 3 :2)			

A and B share profits of on the ratio of 3:2, C gets 1/5 share. The balancing of Profit is 4/5 of which A gets 3/5 and B gets 2/5. Since the old ratio and the new ratio between A and B are the same 3 :2, the sacrificing ratio is also the same. The amount brought in by the new parner as goodwill is credited to the old partners in their sacrificing ratio and the amount is relained inthe business as additional capital.

Illustration 5 :4

A and B share profits in the ratio of 3:2; C is admitted with 1/5 share and the new ratio is : A-2/5; B-2/5; C-1/5 bring Rs. 2,500 towards goodwill. Pass Journal entries

Solution

		Rs.	Rs.
Cash A/	Dr.	12,500	
To C' Capital A/c			12,500
(Being the cash brought in by C towards capital and goodwill)			
C's Capital A/c	Dr.	2,500	
To A's Capital A/c			1,500
To B's Capital A/c			1,000
(Being the goodwill divided between A and B in the sacrificing ratio of 3:2)			

Note : A and B share profits of on the ratio of 3:2, C gets 1/5 share. The Balance of profits is 4/5 of which A gets 3/5 and B gets 2/5. Since the old ratio and the new ratio between A and B are the same 3:2 the sacrificing ratio is also the same. The amount brought in by the new partner as goodwill is credited to the old partners in their sacrficing ration and the amount is relained in the business as additional capital.

		Rs.	Rs.
Cash A/c	Dr.	2,500	
To C's capital A/c			2,500
(Being the goodwill brought in by C)			
C's Capital A/c	Dr.	2,500	
To A's Capital A/c			2,500
(Being the amount credited to A)			

Note :

In this case,

A's old share = 3/5

A's new share = 2/5

A's sacrifice = 3/5 – 2/5 – I (which goes to C)

B's old share = -2/5

B's new share . = 2/5

Illustration 5.5

A and B share profits in the ratio 3:2 C is admitted and the new ratio between A.B and C is 5/10" 3/10". C brings Rs. 3,000 towards goodwill. Pass Journal entries.

Solution :

A's old share = 3/5 or 6/10

A's new share = 2/10

Therefore A's

Sacrifice = 4/10

B's old share = 2/5 or 4/10

B/s new share = 5/10

Therefore B has benefied to the extend of 1/10 on the admission of ce's share = 3/10.

Hence, what is sacrificed by A 94/10) is obtained by B (1/10) and C (3/10) and therefore, B and C will have to compensate. A,C brings Rs. 3,000 towards has share of goodwill (3/10) and B's account will have to be debited with Rs. 1,000 for his share of (1/10) befnefits

		Rs.	Rs.
Cash A/c	Dr.	3,000	
To C's Capital A/c			3,000
(Being the cash brought in by C towards goodwill)			
C's Capital A/c	Dr	3,000	
B's Capital A/c	Dr	1,000	
To A's capital A/c			4,000
(Being the amount credited to A for his sacrifice)			

(b) The new partner bring his share of goodwill in cash the cash is withdrawn by the existing partners; In this case, the goodwill is received in cash from the new partner and is credited to the old partners' Capital account in their sacrificing ratio and the full amount of goodwill or part of it may be withdrawn by the old partners in cash. In such a case, in withdrawn by the old partners in cash. In such a case in addition to the entries for receiving goodwill and adjusting it, the capital accounts of the old partners will have one it, the capital accounts of the old partners will have one more entry for the withdrawal of cash. They entry will be:

Partners' capital Alc Dr.

To cash

(Being the cash withdrawn,

(c) The amount of goodwill is paid by the new partners to the old partners privately: In this case, the. goodwill is not brought into the partnership books at all put is paid by the new partnes to the old partner privately. As it is a matter outside the business, no account in entry is required.

(2) Revaluation Method

a) When there is no goodwill in the books:

If the new partner does not bring goodwill in cash, an alternative approach is adopted to compensate the old partners for their sacrifice. The goodwill of the firm is valued as per the agreement between the existing an new partners and is raised in the books as an asset. The goodwill so raised is credited to the old partners in their old ratio and will appear as an asset in the Balance Sheet until it is written off at a future date.

Illustration : 5.6

A and B share profits in the ratio of 3:2 C is admitted with 1/5 share. The goodwill of the firm is Rs.12,500. C was unable to bring his share of goodwill in cash. Pass entries.

Journal		RS.	Rs.
	Dr.		
Goodwill A/c		12,500	
To A's Capital A/c			7,500
" B's Capital A/c			5,000
(Being the goodwill credited to A and B in the old ratio)			

B) When the goodwill is already appearing in the books.

i) When the value of goodwill is overstated in the books; In this case, the excess amount over the real value of goodwill is written back by debiting the old partners in their old ratio and crediting the goodwill account. The Goodwill will appear in the Balance Sheet at its present value.

ii) When the value of goodwill is understand in the books; If the present value of the goodwill is greater than he book value, the difference is credited to the old partners in the old ratio, Goodwill Account being debited. The goodwill will appear in the Balance Sheet at its present value.

Illustration 5.7

A and B share profits in the ratio of 3 : 2 C is admitted and the goodwill of the firm is value at Rs. 12,500 What entry is to be made if the value of the goodwill appearing in the books is (a) Rs. 15,000 and (b) Rs. 10,000

Journal			Rs.
(a) A's Capital A/c	Dr.	1,500	
B's Capital A/c	Dr.	1,000	
To Goodwill A/c			2,500
(Being the excess of goodwill written of)			
(b) Goodwill A/c	Dr.	2,500	
To A's Capital			1,500
To B's Capital			1,000
(Being the additional goodwill adjusted)			

(3) Memorandum Revaluation Method

This is nothing but a revolution method, but the goodwill raised in the books is immediately written off so that no goodswill appears in the books or in the Balance Sheet in the future. The goodwill is credited to the existing partners in their old ratio and the admission of the new partner and is written off, as soon as admission is over, among all the partners, including the new partners in the new profit sharing ratio. The net effect will be that the old patners get a benefit equal to what they would have obtained had the new partner brought his share of goodwill in cahs; and the new partners capital is reduced to the extend of the share of goodwill due from him.

Illustration 5.8

A and B share profits in the ration of 3:2,C is admitted with 1/5 share and is required to bring

Rs. 2,500 towards his share of goodwill which is the unable to do. There is no goodwill appearing in the books. No Goodwill Account is to appear in the Balance Sheet in the future also.

C's 1/5 share of goodwill = Rs. 2,500

Therefore, the total goodwill of the firm = 2,500 x 5/1 = 12,500

Hence, the ratio in which goodwill is to be written off is 12 : 8 : 5 (secpmd step)

C's nes share = 1/5 or 5/25

A's new share = 4/5 x 3/5 = 1 12/25

B's new share = 4/5 x 2/55 = 8/25

Therefore The new ratio = 12 : 8 : 5

Journal		Rs.	Rs.
Goodwill A/c	Dr.	12,500	
To A's Capital A/c			7,500
To B's Capital A/c			5,000
(Being the goodwill written off)			
A's Capital A/c	Dr	6,000	
B's Capital A/c	Dr.	4,000	
C's Capital A/c	Dr.	2,500	
To Goodwill A/c		12,500	
(Being the goodwill written off)			

The net effect is A's Credit Rs. 1,500; B's credit Rs. 1,000; C's debit Rs. 2,500

3. Adjustment in Regard to revaluation of assets and Liabilities

Partners are entitled to share the assets of the firm in the proportions in which they share profits and loses. As such, when a partner is admitted, the profit proportions of the other partners get reduced, and their respective shares in the assets of the firm also get reduced. Although that is compensated by the capital contribution of the incoming partner, their interest may still be affected if the assets are shown in the accounting records at values quite different from their true values.

In case some assets are shwn at values much less than their true values, the incoming partner stands to gain at the expense of the other partners. The converse is true if some assets are over valued.

With a view, therefore, to preventing the incoming partner from getting a share in the appreciated value of assets, or making him suffer because of depreciation in the value of assets, at he old partners have to revalue their assets and liabilities, and show them at their true values at the time of admission.

For the purpose of recording increase or decrease in the value of assets and liabilities, a 'Revaluation Account' is opened. If the book values of assets are to be reduced and brought down to their true value, the revaluation account is debited and the concerned and assets account is credited. In the case of debtors and stock, however, a provision is created by debiting the revaluation account. Similarly, appreciation is recorded by debiting the concerned assets accounts and crediting the revaluation account The account is also debited and credited respectively for any increase of decrease in the amount of a liability.

The Net result of the revaluation account, being surplus or deficit on revaluation, is transfered to the capital, or current accounts of the old partners in their original profit sharing proportions.

Illustration: 5. 9

Raju and Jagadish are partners sharing profits and losses in the ratio of 3:2 Their Balance Sheet was as follows.

BALANCE SHEET OF RAJU AND JAGADISH as on 1-1-1989

Liabilities		Rs.	Assets	Rs.
Creditors		9,000	Cash at Bank	3,000
Capitals			Debtors	24,000
Raju	36,000		Buildings	20,000
Jagadish	27,000		Machinery	18,000
			Stock	7,000
	----------	63,000		
		----------		---------
		72,000		72,000
		----------		----------

At the time od admission of Shivu, the assets and liabilities were revalued as follows.

(1) Provide Reserve for Doubutful Debts on Debtors Rs. 2,400

(2) Building and Machinery were revalued at Rs. 22,250 and Rs. 20,000 respectively

(3) Creditors were paid at Rs. 8,000 in full settlement. Prepare Revaluation Account from the above details.

REVALUATION ACCOUNT

To Provision for Doubtful	2,400	By Buildings	2,250
Doubtful Debts		" Machinery	2,200
" Surplus on revaluation		" Creditors	1,000
" Raju's Capital a/c	1,710		
" Jagadish's Capital a/c	1,140		
	--------		-----------
	5.250		5,250
	--------		------------

Raju and Jagadish
BALANCE SHEET as on 1-1-1989

Creditors (assumed)		800	Cash at Bank		3,000
To be unpaid)			Debtors	24,000	
Capitals			Less : Provision	2,400	
Raju	36,000				
Surplus	1,710	37,710			
	-----------		Buildings		22,250
Jagaish	27,000		Machinery		20,000
Surplus	1,140	28,140	Stock		
		----------			---------
		73,850			73.850
	----------			----------	

WHERE BOOK VALUES ARE NOT TO BE ALTERED

In the above illustration, the old partners have revised the book value of assets for the purpose of admission of a partner. Where, however, all the partners agree that the values of assets and liabilities are not to be altered, a Memorandum Revaluation Account's is opened. The account is debited and credited, in the usual way, for decrease and increase in the value of assets, and increase and decrease in the value of liabilities, the corresponding credit and debit being given to the capital of current accounts of the old partners in their original' profit-sharing proportions.

Immediately the entries passed for recording increase and decrease in the value of assets and liabilities are reserved, and the net effect on the memorandum revaluation account is debited or credited to the capital or current accounts of all the partners, including the incoming partner, in their new profit-sharing ratios: This procedure leaves the assets and liabilities at their book values incorporating the net effect in the partner's capital or current accounts.

Illustration: 5.10

A and B are partners sharing profits and losses in the ratio of 3: I Their Balance Sheet on 31st December 1985 was as under.

Creditors		32,000	Cash at Bank	15,000
Bills Payable		8,000	Bills Receivable	10,000
Capital Accounts			Debtors	20,000
A	90,000		Stock	30,000
B	30,000	1,20,000	Furniture	10,000
			Machinery	25,000
			Building	50,000
		1,60,000		1,60,000

On 1.1.1986, They decided to admit C on the following terms:

(a) C should bring Rest. 30,000 for 1/4 share in profits.

(b) A provision of 5% should be made for doubtful debts.

(c) Furniture is to be written down by Rs. 1,000

(d) Creditors should be reduced by Rs.2,000

(e) Machinery to be depreciated by Rs. 5,000

(d) Buiiding to be appreciated by Rs. 8,500

Assuming that the firm had investment worth Rs.12,500 unrecorded in the bocks of accounts. Journalise the above and prepare the necessary accounts, assuming the partners (a) agree to alter the book value of assets and liabilities. and (b) agree not to alter the book value of assets and liabilities.

Solution : (Book values altered)

JOURNAL

Particulars		Dr.	Cr.
Revaluation a/c	Dr.	7,000	
To Provision for Doubtful Debts			1,000
" Furniture		1,000	
" Machinery		5,000	
(Being the entry for provision and reduction in assets values)			
Creditors a/c	Dr.	2,000	
Building a/c	Dr.	8,500	
To Revaluation a/c			10,500
(Being the entry for increase in assets value and decrease in liability)			
Investment a/c	Dr.	12,500	
To Revaluation a/c		12,500	
(Being the entry for bringing into account unrecorded investments)			

Revaluation a/c	Dr.	16,600	
To A's Capital a/c			12,000
To B's Capital a/c			4,000
(Being the entry for dividing surplus on revaluation)			
Bank a/c Dr.		30,000	
To C's Capital a/c			30,000
(Being the entry for C's Capital contribution)			

REVALUATION ACCOUNT

	Rs.		Rs.
To Provision for D.D.	1,000	By Creditors	2,000
" Furniture	1,000	" Buildings	8,500
" Machinery	5,000	" Investments	12,500
" A's Capital a/c	12,400		
" B's Capital a/c	4,000		
	23,000		23,000

A'S CAPITAL ACCOUNT

	Rs.		Rs.
To Balance c/d	1,02,000	By Balance b/d	90,000
		" Revaluation a/c	12,000
	1,02,000		1,02,000

B'S CAPITAL ACCOUNT

	Rs.		Rs.
To Balance	34,000	By Balance b/d	30,000
		" Revaluation a/c	4,000
	34,000		34,000

C'S CAPITAL ACCOUNT

	Rs.		Rs.
To Balance c/d	30,000	By Bank a/c	30,000
	30,000		30,000

BALANCE SHEET OF A,B, AND as at 1st January 1986

Creditors	30,000	Cash at Bank		45,000
Bills Payable	8,000	Bills Receivable		10,000
Capital Accounts		Debtors	20,000	
A	1,02,000	Less : Provisoin	1,000	
	34,000			19,000
		Stock		30,000
		Furniture		9,000
		Machinery		20,000
		Building		58,500
		Investments		12,500
	2,04,000			2,04,000

JOURNAL

Particulars	L.F.	Dr. Rs.		Cr. Rs.	
Memoranduk Revaluation a/c	Dr.	7,000			
To Provision for Doubtful Debts				1,000	
" Furniture				1,000	
" Machinery				5,000	
Creditors a/c	Dr.	2,000			
Building a/c	Dr.	8,500			
To Memorandum Revaluation a/c	Dr.			10,500	
Investment a/c		12,500			
To Memorandum Revaluation a/c	Dr.			12,500	
Memorandum Revaluation a/c	Dr.	16.000			
To A's Capital a/c				12,000	
To B's Capital a/c				4,000	
Provision for Doubtful Debts a/c	Dr.	1,000			
Furniture a/c	Dr.	1,000			
Machinery a/c	Dr.	5,000			
To Memorandum Revaluation a/c				7,000	
(Reversing entry for provision and Reduction in asset values)					
Memorandum Revaluation a/c	Dr.		10,500		
To Creditors					2,000
To Building					8,500
(Reversing entry for increase in the value of building and decrease in creditors)					
Memorandum Revaluation a/c	Dr.		12,500		
To Investments					
(Reversing entry for unrecorded asset)					
A's Capital a/c	Dr.		9,000		
B's Capital a/c	Dr.		3.000		
C's Capital a/c	Dr.		4,000		
To Memorandum Revaluation a/c					16,000
(Being the reversing entry for dividing surplus on revaluation in the new profit – sharing ratios)					

MEMORANDUM REVALUATION ACCOUNT

	Rs.		Rs.
To Provision for D.D	1,000	By Creditors	2,000
To Furniture	1,000	" Building	8,500
To Machinery	5,000	" Investments	12,500
To A's Capital a/c	12,000		
To B's Capital a/c	4,000		
	23,000		23,000

	Rs.		Rs.
To Creditors	2,000	By Provision for D.D.	1,000
" Building	8,500	" Furniture	1,000
" Investments	12,500	" Machinery	5,000
		" A's Capital a/c 9/16	9,000
		" B's Capital a/c 3/16	3,000
		" C's Capital a/c 4/16	4,000
	23,000		23,000

A'S CAPITAL ACCOUNT

	Rs.		Rs.
To Memorandum Revaluation a/c	9,000	By Balance b/d	90,000
" Balance c/d	93,000	" Revaluation a/c	12,000
	1,02,000		1,02,000
		By Balance b/d	93,000

B's CAPITAL ACCOUNT

	Rs.		Rs.
To Memorandum Revaluation a/c	3,000	By Balance b/d	30,000
" Balance c/d	31,000	" Revaluation a/c	4,000
	34,000		34,000
		By Balance b/d	26,000

C'S CAPITAL ACCOUNT

	Rs.		Rs.
To Memorandum Revaluation a/c	4,000	By Bank a/c	30,000
" Balance c/d	26,000		
	30,000		30,000
		By Balance b/d	26,000

BALANCE SHEET OF A,B. AND C as at 1st January 1986.

		Rs.		Rs.
Creditors		32,000	Cash at Bank	45,000
Bills Payable		8,000	Bills Receivable	10,000
Capital Accounts			Debtors	20,000
A	93,000		Stock	30,000
B	31,000	1,50,000	Furniture	10,000

		Machinery	25,000
		Building	50,000
	----------		----------
	1,90.000		1,90,000
	----------		----------

(4) RESERVE AND UNDISTRIBUTED PROFITS

Some Partnership concerns build up reserves for strengthening their financial position by the partners of such concerns for going a portion of their respective the shares of profit. The amount represented by the reserves is usually invested with the object of earning interest. It may also happen that at the time of admission of a partner, the profits of partnership business left undistributed amongst the partners might appear on the liabilities side of its balance sheet.

Reserves and undistributed profits, appearing on the liabilities side, belong whole to the old partners. The incoming partner has no claim on them. It is, therefore, necessary at the time of admission to transfer these to the capital or current or current accounts' of old partners in their old ratios. They entry for the same is to debit the reserve or profit and loss account and credit the old partners capital or current accounts.

(5) Adjustment of Capitals between the partners

It may be agreed between the partners that the capital Accounts of the partners should be made proportionate to their profit sharing ratio, on the admission of a new partner. This may be done in two ways:

(a) When the Capitals of the existing partners are to be adjusted on the basis of the new partner's capital; In this case, the exitsting partners, Capital Accounts are adjusted on the basis of the capital brought in by the new partner for his share of profit so that the capitals of the existing partners are made proportionate to their share of profit. The total capital and the excess of capital, if any, may be agreed to be paid to in cash or transferred to the partners Current Accouts, if there, is a deficiency the necessary cash may be brought in by the concerned partner of his current Account may be debited to that extent.

Illustration 5.11

Deepak, Harish, and Farokh were equal partners in a firm named ' Enterprises' and their balance sheet is given below.

Balance of Enterprises as on July 1, 1977

			Rs.	Rs.
Fixed Assets :				
Goodwill			1,10,000	
Building			1,95,000	
Furniture			24,000	
			----------	3,38,000
Working Capital	Rs.	Rs.		
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				

Capital Account		Rs.	
	Deepak	2,17,000	
	Harish	1,66,000	
	Farokh	90,000	
		-------------	4,73,000

			4,73,000

On July 1, 1977, they agreed to take Ram an equal partner on the following terms :

(1) Ram should bring in Rs. 1,50,000 as his capital and goodwill. His share of good-will was evaluated at Rs. 50,000

(2) The goodwill Account is to be written off before admission

(3) Provision for loss on stock and provision for debtors was to be made at 10% and 5% respectively

(4) The value of building was to be taken at Rs. 2,70,000

(5) The total capital of the new firm was fixed at Rs. 4,00,000 and this partners's Capital accounts to 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 and the Balance sheet of the new firms and partners' Capital Account.

Solution :

Profit and Loss Adjustment Account (Revalution Account)

	Rs.			Rs.
To Stock	11,400	By Building		75,000
" Debtors	5,400	" Loss		
" Goodwill	1,19,000	Deepak	20,266	
		Harish	20,267	
		Farokh	20,267	60,800
	----------		----------	----------
	1,35,800			1,35,800

(b) When the new partner's Capital is calculated on the basis of the existing partner's captals; In this case, the total capital of the existing partners is calculated after all adjustments. This capital is maintained by the existing partners for the remaining share of profit after deducting the new partner's share from the whole share. On this basis, the total capital of the whole firm may be calculated, and the partner's capital arrived at, which will be in proportion to his share of profit.

Illustration 5.12

Reghava and Veera were partners in a firm sharing profits and losses in the ratio of 3 :1 respectively. Their Balance Sheet as on December 31,1983 was

BALANCE SHEET

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	40,000	Plant & Machinery	75,000
Reserved fund	60,000	Stock	40,000
Reghava's Capital A/c	50,000	Sundry debtors	60,000
Veera's Capital A/c	40,000	Cash at Bank	15,000
	---------		---------
	1,90,000		1,90,000

They agree to admit Patel as partner on the following terms :

(1) The assets of the firm were to be revalued as follows; Plant and Machinery to be depreciated by 10% stock to be increased to Rs. 45,000; bad debts reserve to be created in the books at 21.2% . The reserve fund of the firm to be closed to the old partners' capital Accounts.

(2) Patel was to introduce Rs. 20,000 as a premium for goods will for a fourth share of the future profit. He was also required to contribute a capital equal to 1/3 of the combined capitals of the partners, after adjustment

Prepare the Revaluation Account, Cash Account, Capital Accounts and the Balance Sheet of the new firm

Solution :

Revaluation Account

	Rs.			Rs.
To Plant and Machinery	7,500	By Stock Account		5.000
"Reserve for bad debts	1,500	" Loss		
		Raghava	3,000	
		Veera	1,000	4,000
	9,000			9,000

WORKINGS :

Capital to be introduced by patel :

Total Capital of Rajava & Veera	=	Rs.	90,000
Add : Reserve Fund	=	Rs.	60,000
" Goodwill brough by patel	=	Rs.	20,000
		Rs.	1,70,000
Less : Loss on revalution	=	Rs.	1,40,000
Capital for ¾ share	=	Rs.	1,66,000
Capital of Patel	=	1,66,000 x 1/3 = 53,333	

(1/3 of he combined capital of Raghave & Veera)

B. RETIREMENT OF A PARTNER

For variety of reasons (Such as old age, better business opportunity, difference with the other partners, etc) a partner may retire from the firm. According to Sec. 32(1) of the Indian retire from the firm. 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 limplied 1/4.

(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. At the time of retirement of a partner, certain adjustment are necessary in respect of the following for determining the true claim of the ex-partner.

1. Adjustment is regard to Goodwill.
2. Adjustment is regard to Revaluation of Assets and Liabilities.
3. Adjustment in regard to undistributed profits.

1. Adjustment in Regard to Goodwill

A retiring partner is entitled to his share in the goodwill of the firm as per the agreement between the partners; but in the absence of any agreement, it should be in the profit-sharing ratio. The valuation of the goodwill is done in the agred manner (methods have already been discussed in the chapter on admission).

Adjustment entries in respect of goodwill depend upon the following situations.

Situation 1:

When there is no goodwill in the last Balance Sheet and goodwill is raised in the books of the firm at all value.

In this situation, the following entry should be passed:

Goodwill *A/c.* Dr. (Full value)

To All Partners' Capital A/cs (Old ratio)

(Being goodwill raised in the books on retirement)

Situation 2:

When there is no goodwill in the last Balance Sheet and goodwill is raised in the books of the firm at full value but it is written-off immediately.

In this situation, the following entries should be passed:

(i) Goodwill *A/c* Dr. (Full value)

To All Partner's CapitalAic (Old ratio)

(Being the goodwill raised in the books in the on retirement)

(ii) Contributing Partner's Capital A/cs Dr. (New Ratio

To Goodwill *A/c*

(Being goodwill written-off after retirement)

Situations 3:

When there is no goodwill in the last Balance Sheet, only the share of retiring partners is brough into books and then written-off.

In this situation, the following entries shold be passed.

(i) Goodwill *A/c* Dr. (Share ofi-etiring Partner)

To Retireing partner's Capital *A/cs*

(Being retireing Partner's share of goodwill raised in the books)

(ii) Continuing Partner's Capital ales Dr. (Gaining ratio)

To Goodwill *A/c*

(Being the goodwill written-off in the gaining ratio to . remaining partners)

Alternative entry

Continuing Partner's Capital As/cs Dr. (Gaining ratio)

To Retireing partner's Capital *A/c* (Share of retiring Partner)

(Being the adjustment for goodwill of retired partner)

Calculation of gaining ratio

New Profit sharing ratio

Less: Old Profit sharing ration

Calculation of gaining ratio

New Profit sharing ration —

Less : Old Profit sharing ration --------

It should be noted that if there is any goodwill in the Balance Sheet, goodwill should be raised for the balance only.

For Example: Value of goodwill at the time of retirement is Rs. 60,000 and goodwill should in the Balance Sheet is Rs. 40,000. Now goodwill to be raised in the books to the extent of Rs. 60,000 - Rs.40,000 = Rs.20,000. In this example, if the new value of goodwill is Rs. 30,000 Rs. 10,000 to be written-off before retirement by debting all partners in the old ratio.

ILLUSTRATION: 5.13

Ram, Shyam and Rahim are partners sharing profits in the ratio of 4:3:2,. Shyam retires and the goodwill is valued to Rs.21 ,600. No goodwill appears as yet in the books of the firm. Assuming that Ram and Rahim will share profits in the profits in the future in the ratio of 5:3, pass entries for goodwill a separately under the following conditions.

(a) When goodwill Account is raised

(b) When goodwill Account is raised but written-off

(c) When only Shyam's Goodwill Account is raised and then written- off.

Solution:

In the books of Ram, Shym and Rahim

Journal

	Date	Particulars		Rs.	Rs.
(a)	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)			
(b)	(i)	As above (a)			
	(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)			
(c)		Goodwill A/c	Dr.	*7,200	
		To Shyam Capital A/c			7,200
		(Being Shyam s share of goodwill raised)			
		Ram Capital A/c	Dr.	3,900	
		Rahim Capital A/c	Dr.	*3,900	
		To Goodwill A/c			7,200
		(Being Shyam s share of goodwill written-off but debting remaining partners in the gaining debts ratio, 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

Shyam s share of goodwill =Rs. 21,600 X 1/3 =Rs. 7,200. The gaining ratio of Ram and Rahim is 1/3 : 1

Illustration 5.14

Pass Journal entries under the following circumstances.

(a) A, B and C are partners sharing Profits and losses in the ratio 3:2: 1. B retires. His share of goodwill is Rs. 10,000. Goodwill appears at is hal value.

(b) A, B and C are partners sharing Profits and Losses in the ratio 2:2: 1. A retires. His share of goodwill is Rs. 6,000. Goodwill appears in the book at is full value and it has been decided not to show goodwill in the books. Band C decided to share profit and lossess in the ratio 3:2.

(c) A, Band C are partners sharing profits and losses equally. A retires. Band C decided to share profits' and losses in the ratio 4: I. The value of the goodwin is Rs. 45,000. Goodwill does not appear in the books. The continuing partners decide not to show' goodwill in the books.

(d) A.B and C are partners sharing profits and losses in the ratio 4:3:2 . B retires. -The value of the goodwill is Rs.45,000. Goodwill appears in the books at Rs. 27,000 and it wiJI remain at that figure. A and C decide to share profits nd losses in ratio of 3:2.

Solution

In the books of A,B and C Journal

Data Particulars	Dr.	Cr. Rs.	Rs.
(a) Goodwill A/c	Dr.	15,000	
To A Capital A/c			7,500
To B Capital A/c			5,000
To C Capital A/c			2,500
(Being goodwill raised to its full value)			
(b)B Capital A/c	Dr.	9,000	
C Capital A/c	Dr.	6,000	
To Goodwill A/c			15,000
(Being goodwill written off from the books after A s retirement)			
(c) 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 throughout the capital accounts of the partners)			
(d) Goodwill A/c	Dr.	1,800	
To A Capital A/c			8,000
To B Capital A/c			6,000
To C Capital A/c			4,000
(Being the goodwill raised to is full valuable before B;s retirement)			
A Capital A/c	Dr.	10,800	
C Capital A/c	Dr.	7,200	
To Goodwill A/c			18,000

(Being the goodwill written down
to its old figure B s retirement by
debting A and B in the ratio of 3:2)

Illustration 5.15

A and B and C are equal parners. B retires. His shares of goodwill is Rs. 9,000. The ramianing partners have decided to continue the business sharing profit in the ratio of 3:2 Goodwill is not be shown in the Balance Sheet. Give Journal entry.

Solution :

In the Books of A,B and C Journal Dr. Cr.

Date	Particulars		Dr.	Cr.
	A Capital A/c	Dr.	7,200	
	B 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 Rs.	16,200	---	10,800
Gain (+) /Sacrifice(-) Rs.	(+) 7,200	(-) 9,000	(+) 1,800

2. Adjustment in Regard to Revaluation of Assets and Liabilities.

Unless otherwise agreed, on retirement, a partners is entitled to have the assets and liabilities of a firm revalued on a paper basis at the date of retirement. So that he gets his fair share of the firm net assets The purpose of revaluation is to, convenient 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 Partner's 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 for loss or revaluations is transferred to ALL PARTNERS' CAPITAL ACCOUNTS IN THE OLD RATIO.

3. Adjustment in Regard to Undistributed Profit .

A the time of retirement, if there is any reserve or credit balance of Profit and Loss Account, it should be distributed amongst all the partners in the old Profit-sharing ratio. The entry will be.

Reserve/Profit and loss Nc Dr.
To All Partner's Capital Nc (Old Profit-sharing ratio)
(Being the distribution of Profit in the old ratio)

Conversel, if there is any accumulated loss, it should be treated in the similar way. The entry will be:

All partners 'Capital Ncs . Dr. (Old profit-sharing ratio)

(Being the distribution of accumulated loss in the old profit-sharing ratio).

Computation of Retiring Partners
Interest in the Firm.

For calculating the amount of money payable to the retiring partner, the following items should be taken into consideration.

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 land interest due to the retiring partner till the date of his retirement.
7. The drawing and interest thereon, of the retiring, partner.

Modern of Payment of Retiring Partner's Interest

The total amount due to a retiring partner can be paid off in one of the following manner. But what basis should be taken in a particular case, depends upon the partnership deed. If there is no agreement, the partners should decide it mutually.

1. IN ONE LUMP SUM: This method is suitable when the amount payable to the retiring partner is small. Under this method The total amount is paid off at a time.
2. IINSTALLMENTS: This method is suitable when the amount payable to the retiring partner is sub stantial. Under this method payment is made in installments. The number of instalments, the time and amount of each instalment, can be be decided in advance. Generally, total amount payable to the retiring partner is transferred to his Loan Account. The Loan Account is credited to his Loan Account. The Loan Account is credited with the agreed rate of interest and it is debited with the instalments paid.
3. BY WAY OF AN ANNUITY: The continuing partners may-agree to settle the claim of the retiring partner by paying him a fixed annual sum called an annuity either for a certain term of years or for the life-time of the retiring partner. Under this method; the total amount. Payable to able to the retiring partner is transferred to an "Annuity Suspense Account", which much be credited with interest at a fixed rate p.a. on the diminishing balance and debited with the annuity paid. In the event of the retiring partner dying before this amount is exhausted, the balance of the "Annuity Suspense Account" is transferred to the continuing partners Capital Account in the profit-sharing rato. If the credit balance of the anuity Suspense Account is exhausted before the death of the retiring partner, subsequent instlment of annuity should be charged to Profit and Loss Appropriation Account. Alternatively, it can be transferred to the partner's current Account.

Illustration 5- 16

x, y and z were partners, sharing profits in the ratio os 3 : 2 : 1 respectively. The firm's Balance Sheet on 31-12-1988 was as follows.

	Rs.			Rs.
Creditors	24,000	Cash		2,500
Reserve Fund	12,000	Debtors	16,000	
		Less : Provision	500	15,500

Capital	40,000	Stock		25,000

X	30,000	Motor Van	8,000
Y	25,000	Machinery	35,000
Z	25,000	Building	45,000
	----------		----------
	1,31,000		1,31,000
	----------		----------

Y retires on the above date and the following adjustments are made.

1. Goodwill of the firm is valued at Rs. 18,000
2 Manchinery and Motor Van to be reduced by 10% and 5% respectively.
3. Stock and Buildings were appreciated by 20% and 10% respectively 6.
4 The provision against Debtors was to be raised by Rs. 1,200.

Assuming that the goodwill account has to be written off after Y's retirement, draf journal entries and prepare the new Balance Sheet.

Solution :

In the Books of x.y and z

JOURNAL ENTRIES

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Goodwill a/c Dr.	Dr.	18,000	
	Tx x's Capital a/c			9,000
	To Y's Capital a/c			6,000
	To Z's Capital a/c			3,000
	(for raising goodwill of the firm and crediting the partners with their respective shares of it)			
	Revaluation a/c.	Dr.	5,000	
	To Machinery a/c			3,500
	To Motor Van a/c			1,200
	To Provision for Doubtful Debts			
	(for writing down assets and creating provision for doubtful debts)			
	Stock a/c	Dr.	5,000	
	Building a/c	Dr.	4,500	
	To Revaluation a/c			9,000
	(for recording appreciation in the value of assets)			
	Revaluation a/c	Dr.	3,600	
	To X's Capital a/c			1,800
	To Y's Capital a/c			1,200
	To Z's Capital a/c			600
	(for dividing profit on revaluation)			
	Reserve Fund a/c	Dr.	12,000	
	To X's Capital a/c			6,000
	To Y's Capital a/c			4,000

To Z's Capital a/c			2,000
(for dividing reserve fund amoung partners in their profit ratios)			
Y's Capital a/c Dr.	Dr.	41,200	
To Y's Loan a/c			41,200
(for transferring the amount due to Ye to his loan account)			
X's Capital a/c	Dr.	13,500	
Z's Capital a/c	Dr.	4,500	
To Goodwill a/c			18,000
(for wiping off goodwill in 3 : 1 ratio)			

BALANCE SHEET OF X AND Z as on 11-1-1989

		Rs.			Rs.
Creditors	24,000		Cash		2,500
Y's Loan a/c	41,200		Debtors	16,000	
			Less : Provision	1,700	14,300
Capital Account					
X	40,000		Stock		
Add: Goodwill	9,000		Motor Van	8,000	
Revaluation			Less :		
Profit	1,800		Depreciation	1,200	
Reserve Fund	6,000				6,800
	56,800		Machinery	35,000	
Less : Goodwill			Less :		
Written of	13,500		Depreciation	3,500	31,500
Z	25,000		Building		49,500
Add : Goodwill	3,000				
Revaluation					
Profit	600				
Reserve Fund	2,000				
	30,600				
Less : Goodwill Vritten of	4,500	26,100			
		1,34,600			1,34,600

Simultaneous retirement and admission does not involve any new priciples or according, but only entails the recording of the two sets of transactions in combination.

ILLUSTRATION 5.17

X, Y and Z carry on business in partnership sharing profits and losses in the proportions of their capital. Their Balance Sheet on 31st March 1987 was as follows.

	Rs.			Rs.
Bills Payable	5,000	Cash		5,000
Creditors	15,000	Bills Receivable		3,250
Loan	20,000	Debtors	35,500	
		Less : Provision	5,000	30,500
Capitals		Stock	20,750	
X	30,000	Furniture		2,500
Y	20,000	Plant and		
Z	10,000	Machinery		38,000
	1,00,000			1,00,000

On 1 st April, 1987, Y retires and his share is ascertained on the folowing revaluation of assets:

" Stock to be taken at Rs. 26,750 and Reserve for Doubtful Debts be maintained at Rs. 2,000. The amount of goodwill of Y's share is agreed upon at Rs. 10,000. X and Z payout Y bringing necessary amount of cash required to do so in their capital proportions ..

Then they admit A on the basis of the adjusted Balance Sheet. A is to take a fifth share in the profits and bring in proportionate amount of capital. He is to bring his share of goodwill in cash which is withdrawn by X and Z.

Give necessary entries to record the above arrangements and prepare the Balance Sheet of the firm after A's admission.

Date	Particulars	L.F.	Debit Rs,	Credit Rs.
	Stock a/c	Dr.	6,000	
	Provision for doubtful Debts a/c	Dr.	3,000	
	To Revaluation a/c			9,000
	(for appreciation the value of stock and wriing beack excess of provision)			
	Revaluation a/c	Dr.	9,000	
	To X's Capital a/c			4,000
	To Y's Capital a/c			3,000
	To Z's Capital a/c			1,500
	(for dividing surplus on revaluation)			
	X's Capital a/c	Dr.	7,500	
	Z's Capital a/c	Dr.	2,500	
	To Y's Capital a/c			10,000
	(for Y's share of goodwill written back to X and Z and in 3 : 1 ratio)			
	Bank a/c	Dr.	28,000	
	To X's Capital a/c			21,000

To Y's Capital a/c			7,000
(for X and Z bringing in the necessary cash to pay off Y) Y's Capital a/c	Dr.	33,000	
To Cash a/c			5,000
To Bank a/c			28,000
(for paying off Y the amount due)			
Bank a/c	Dr.	22,000	
To A's Capital a/c			22,000
(for a's contribution to capital Rs. 16,000 and Goodwill Rs. 6,000)			
A's Capital a/c	Dr.	6,000	
To X's Capital a/c			4,500
To Y's Capital a/c			1,500
(for dividing goodwill amount between X and Z in the sacrificing ratio of 3 : 1)			
X's Capital a/c	Dr.	4,500	
Z's Capital a/c	Dr.	1,500	
To Bank a/c			6,000
(for X and Z with drawing the goodwill amount brought in by A)			

BALANCE SHEET OF X, AND Z as on 1-4-1987

	Rs.			Rs.
Bills Payable	5,000	The Bank		16,000
Creditors	15,000	Bills Receivable		3,250
Loan	20,000	Debtors	35,000	
		Less : Provisions	2,000	
			-------	33,550
Capitals Accounts		Stock		
X	48,000	Furniture		
Y	16,000	Plant and		
Z	16,000	Machinery		
	1,20,000			1,20,000

Goodwill: For Y's Share ofl/3, goodwill is Rs. 10,000

Hence, the value of goodwill of the firm is Rs. 30,000

A bings in his proportionate share, i.e. 1/5 of Rs. 30,000 = Rs. 6,000

Capital : Total Capital of X and Z after Y's retirement is Rs. 64,000. Since A is given 1/5 share, New rations are: 3/5 and 1/5 and 1/5.

C. DEATH OF A PARTNER

Like retirement, death of a partner also brings about the termination of partnership relationship. However, the only point of differences between retirement and deth is that death is sudden, and may occur at anytime during the course of the accounting period. As such, it is necessary to ascertain the share of the deceased partners in the profits of the firm up to the date of his death. For this purpose, the partnership deed should be consuled, and the amount so arrived at should be credited to his capital account, besides his share of goodwill, interest on capital, if any, salary, commission etc.

The amount due to the deceased partner, as reduced by his drawings, should be transferred to a loan account opened in the name of his executors. and paid off immediately or business instalments with interest depending upon the arrangement of the continuing partners with the executors of the deceased.

ILLUSTRATION: 5:18

X, Y and Z were partners in a business sharing profits 3/4 1/8 and 1/8 respectively and their Balance Sheet as on 31st December 1985 was as follows.

	Rs.		Rs.
Creditors	25,000	Plant	50,000
Capital Accounts		Debtors	35,000
	50,000	Stock	20,000
	30,000	Bank	25,000
	1,30,000		1,30,000

z died on 30th September 1985 and the partnership deed provided the following.

a) The deceased partner will be entitled to his share of profit up to the date of death, calculation on the previous year's profits.

b) He will be entitled to his share of goodwill of he firm, calculated, on the basis of 3 year's purchase of the average profits of the last four year years. The net profits for the last four years were 1981 Rs. 80,000. 1982 Rs. 60,000, 1983 Rs. 40,000 and Rs. 20,000. His drawings amounted to Rs. 1,800 up to the date of death. Interest on capital was to be allowed and on drawings to be charged as 5% respectively. (in case of drawings on the total amount) per annum.

Ascertain the amount payable to the legal representatives of the deceased partner.

Solution

Share of profit :

Previous year's profit, i.e. 1984 20,000

Z's share = 1/8 of Rs. 20,000 2,500

For 9 months to date of death = Rs. 1,875

Share of goodwill :

Last four year's profits	1981	80,000
	1982	60,000
	1983	40,000
	1984	20,000
	Total Rs.	2,00,000

$$\text{Average profit } \frac{2,00,000}{4} = \text{Rs. } 50,000$$

Three year's purchase of the average = Rs. 50,000 X 3 = Rs. 1,50,000

Z's share is 1/8 of Rs. 1,50,000 = R. 18,750

INTEREST ON CAPITAL

$$\text{5\% on Rs. 25,000 for 9 months. } \frac{25,000 \times 5 \times 9}{100 \times 12} = \text{Rs. } 937.50$$

Similary, interest on drawings on Rs. 1,800 for 8 months = Rs. 67.50

Z's CAPITAL ACCOUNT

	Rs.		Rs.
To Drawings	1,800	By Balance c/d	25,000
To Interest on Capital	68	By Profit and Loss a/c	1,875
To Z's Executors a/c	44,694	By Goodwill	18,750
		By Interest on Capital	937
	------------		----------
	46,562		46,562

Exercises

1. The following was the Balance Sheet of D.E. and F who were equal partners on 1st June, 1985

	Rs.		Rs.
Bills payable	3,300	Cash	600
Creditors	6,000	Debtors	10,800
Capital Accounts :		Stock	11,400
D	16,800	Furniture	2,400
E8	12,600	Building	19,500
F7	6,000		
	----------		----------
	44,700		44,700

They agreed to take H into partership and give him a fourth s... in the profits on the following terms:

a) That H should bring in Rs. 9,000 for goodwill and Rs. 15,000 as capital.

b) That one-half of the goodwill shall be withdrawn by the old pa... s

c) The Stock and Furniture be depreciated by 10 percent

d) That a provision of 5 percent on Debtors be created for doubtful debts.

e) That a liability of Rs.1,080 be created against bills discounted ..

f) That the value of the building having appreciated, the buildings should be valued at Rs. 27,000.

g) The values of liabilities and assets other than cash are not be altered.

give the entries necessary of give effect to the above arrangement, prepare the Profit and Loss Adjustment Account, and the opening Balance Sheet of the firm as newly constituted; (B.Com., Kerala, April 1986)

(Ans: Revaluation profit Rs. 4,500; prepare memorandum Revaluation a/c and debit all capitals with Rs. 1,125' d's Capital Rs. 18,675, E's Capital Rs. 14,475 F's Capitals F's Capitals Rs. 7,875 and H's Capital Rs. 13,875 ; Balance Sheet total Rs.64,200)

2. Following is the Balance Sheet as on 31-12-1986 of Aject, Arti and Amit sharing profits and losses in the ratio of 4:3:2.

	Rs.		Rs.
Capital Accounts		Building	50,000
Aject	48,000	Machinery	30,000
Arti	50,000	Goodwill	28,000
Amit	50,000	Stock	30,000
Worker's Compensation		Debtors	20,000
Fund	6,000	Profit and Loss Acccount	9,000
Creditors	22,000	Cash	9,000
	----------		----------
	1,76,000		1,76,000

On Art's retirement on 31-12-1985, it was decided as under.

(i) The appreciate value of Building by 20%, to depreciate the value of Machinery nbby 10% and of Stock by 15%

(ii) To reduce Creditors Rs. 3,000 and to create Bad Debt Reserve @ 5% on Debtors.

(iii) Goodwill of the firm is valued Rs. 10,000

Capital of the new firm is decided to be kept at Rs. 1,75,000. Actual cash is to be contributed or withdrawn by the continuing partners so as to have their capitals proportionate to their new profit sharing ratio which is 3:2.

Draw revaluation account, capital accounts of the partners and Balance Sheet of the new firm.

(B.com., Baroda, April 1988)

(Ans: Revaluation loss Rs. 7,500 after writing back Workers' Compensation Fund and writing off goodwill by the amount of fall invalue: Aject's Capital Rs. 1,05,000 Amit's Capital Rs. 70,000; Aject brings in Rs. 64,333 and Amit Rs.23,667. Arti is paid off Rs. 44,500: Balance Sheet total Rs. 1,95,000 with goodwill recorded at Rs.10,000.

SIMULTANEOUS RETIREMENT AND ADMISSION

3. Amar and Balu were partners sharing profits and losses in the ration of 3 : 2 Their Balance Sheet as on 3-12-1987 was as follows.

	Rs.		Rs.
Creditors	10,000	Goodwill	10,000
Bills payable	5,000	Buildings	45,000
Bank Overdraft	5,000	Furniture	8,000
Amar's Capital	50,000	Stocks	7,000
Balu's Capital	30,000	Debtors	30,000
	---------		---------
	1,00,000		1,00,000

On the above date, it was decided that Amar should retire and his son Chandan should join the firm for a third share of profits.

For the purpose of Amar's retirement, firm's goodwill was valued at Rs.30,000 buildings at Rs.60,000 and Furniture at Rs. 5,000 while a provision for bad debts is to be made At. Rs. 2,000.

Chandan was admitted on the condition that enough money should be introduced to enable Amar to be paid out and leave Rs. 5,000 cash for working capital, after clearing Bank Overdraft, Balu and chandan were to provide such sum as would made make their capitals proportionate to their share of profit. Amar agreed to transfer from his capital 50% of the amount required to be brought by Chandan, as a gift to Chandan.

Show ledger accounts and the Balance Sheet of Balu and Chandan.

(B.Com., Mysore, April 1988) (Ans:

Revaluation Profits. 30,000 Amar is paid of Rs. 48,000

Balu brings in Rs. 38,000 and Chandan Rs. 20,000 Balance Sheet total Rs. 1,35,000)

4. A, Band C are partners sharing profits and losses in the ratio of 5:3:2. The Balance Sheet as on 31-12 1985 was as follows.

	Rs.		Rs.
Capital		Goodwill	1.00.000
A	2,00,000	Machinery	1,00,000
B	1,50,000	Debtors	1,00,000
C	1,00,000	Stocks	2,00,000
Reserves	50,000	Cash	50,000
Creditors	2,50,000		
	7,50,000		7,50,000

A Dies on 1-4-1986, Profit up to the date of death is Rs. 90,000. Each of the current assets except cash is estimated to have gone up by 20%. Machinery was valued Rs. 80,000. Goodwill is to be calculated at 2 years purchase of the average profits of three years. The profits for three years were Rs. 1,80,000 and 20,000 and Rs. 2,20,000; prepare A's Executors Account.

(B.Com., Bangalore Nov, 1987)

(Ans. Share of profit Rs. 11,250; Goodwill Rs. 1,50,000; revaluation surplus Rs. 40,000; Total amount due Rs. 4,26,250.

Captial Account

	Deepa Rs.	Harish Rs.	Farokh Rs.	Ram Rs.		Deepa Rs.	Harish Rs.	Farokh Rs.	Ram Rs.
To P&L Adjustment A/c	20,266	20,267	20,267	-----	By Balance c/d	2,17,000	1,66,000	99,000	---
To Deepak's Capital A/c	-----	-----	-----	16,666	" Cash	-----	-----	-----	1,50,000
To Harish Capital A/c	-----	-----	-----	16,667	" Ram's Capital	---	-----	16,667	
To Farokh's Capital Ac	-----	-----	-----	16,667	" Cash	16,666	16,667	13,600	
To Current A/c	1,13,400	62,400	-----	-----					
To Balance A/c	1,00,000	1,00,000	1,00,000	1,00,000					
	2,33,666	1,82,667	1,20,267	1,50,000		2,33,666	1,82,667	1,20,267	1,50,000

Balace Sheet as on July 1, 1977

Liabilities		Rs.	Assets	Rs.
Creditors		33,000	Assets	1,69,690
Bills Payable		60,000	Cash (1,08,000 – 5,400)	1,02,600
Capital Accounts			Stock (1,14,000 – 11,400)	1,02,600
Deepak	1,00,000		Furniture	24,000
Harish	1,00,000		Buildings	2,70,000
Farokh	1,00,000			
Ram	1,00,000	4,00,000		
Current Accounts :				
Deepak	1,13,400			
Harish	62,400	1,75,800		
		6,68,800		6,68,000

Capital Account

	Raghava Rs.	Veera Rs.	Patel Rs.		Raghava Rs.	Veera Rs.	Patel Rs.
To Revaluation A/c	3,000	1,000	------	By Balance c/d	50,000	40,000	---
" Balance b/d	1,07,000	59,000	55,333	" Goodwill	15,000	5,000	---
				" Reserve Fund	45,000	15,000	----
				" Cash	----	------	55,333
	1,10,000	60,000	55,333		1,10,000	60,000	55,333

Cash Account

Liabilities	Rs.	Assets	Rs.
To Balance b/d	15,000	By Balance	90,333
" Goodwill	20,000		
" Patel's Capital A/c	55,333		
	90,333		90,333

Balance Sheet as on July, 1977

Liabilities	Rs.	Assets		Rs.
Sundry Creditors	40,000	Cash at banks		90,333
Raghava's Capitala A/c	11,07,000	Debtors	60,000	
Veera's Capital A/c	59,000	Less : Reserve	1,500	
Patel's Capital A/c	55,333	Stock		58,500
	2,61,333			2,61,333

Lesson 6

PARTNERSHIP – AMALGAMATION AND DISSOLUTION

A. AMALGAMATION

Two or more business concerns are said to amalgamate when they come together, pool their resources and carry on business as a single ntegrated unit. Amalgamation is thus a form of combination.

The main objectives of amalgamation are :

a. To avoid competition
b. To carry on a large scale business,
c. To secure economy in finance
d. To reduced advertisement expenditure
e. To secure technical and managerial economy
f. To achieve recognition as a 'big' unit.

ACCOUNTING TREATMENT

1. Each firm should revalue its assets and liabilities including goodwill and transfer the profit or loss to the partners in their profit sharing ratio

2. The reserves and losses are transferred to the partners in their profit sharing ration.
3. Assets and liabilities not taken over by the new firm should be transferred to the partners in their capital ratio.
4. The assets and liabilities taken over are closed in the books of the old firm and transferred to the next firm- assets are individually credited, liabilities debited and the difference debited to the newfirms's account.
5. Finally, the partners Capital Accounts are also closed and transferred to the new firm.

The opening entry for incorporating the assets and liabilities taken over by the new firm will be as follows.

(a) Debit assets taken over at agreed values.

(b) Credit liabilities taken over.

(c) Credit individual partners 'Capital Accounts'

Illustration 6.1

The Balance Sheet of M/s A & B AND M/S C & D as on December 31, 1968, were as follows.

Balance Sheet

	A & C Rs.	C & D RS.		A & B Rs.	C & D Rs.
Capital Accounts			Land and		
A	10000		Workshop	10000	12000
B	10000		Machinery and		
C	10000		tools	17000	8000
D	10000		Furniture and		
Creditors	15000	10000	Fixtures	3000	3500
Loan	----	10000	Debtors	6000	8500
Outstanding			Cash at Bank	3000	1000
Expenses	2000	3000	Stock	8000	10000
	37000	43000		37000	43000

The two firms decided to amalgamate to form ABCD & Co, on January 1, 1969. The partners continue to share profits equally as they were doing before the merger. Prior to amalgamation the following revaluation of assets and liabilities should be made.

	A & B Rs.	C & D Rs.
Land and workshop	10000	10000
Machinery and Tools	7000	8000
Furniture and fixtures	2500	2500
Debtors	2500	2500
Stock	8000	8000
Outstanding expenses	2000	3500

In addition the following things are to be carried out.

(a) The new firm will not take over the loan of C an D

(b) The goodwill of A and B and that of C and D should be valued initially at Rs. 10000 and Rs. 5000 respectively. But for the purpose of the new firm the combined goodwill of the firm should be Rs. 10000

(c) Each partner should have Rs. 14000 as capital in the new firm and that cash should be brought in if necessary.

Solution :

(i) The two Revaluation Accounts.

(ii) Capital Accounts before and after the amalgamation.

(iii) The Opening Balances Sheet of the new firm

Solution :

In the Books of A & B Revaluation Account

		Rs.		Rs.
To Furniture & Fittings		500	By Goodwill	10000
" Debtors		500		
" Profit				
A	4500			
B	4500	9000		
	-------	-------		--------
		10000		10000
		--------		--------

Capital Account

	A Rs.	B Rs.		A Rs.	B Rs.
To ABCD & Co. A/c	14500	14500	By Balance c/d	10000	10000
			Revaluation A/c		
			Profit	4500	4500
	---------	--------		---------	---------
	14500	14500		14500	14500
	---------	----------		--------	----------

In the Books of C & D Revaluation Account

	Rs.			Rs.
To Land and Workship	2000	By Good will		5000
" Furniture and fittings	1000	" Loss		
" Debtors	1500	C	1000	
" Stock	2000	D	1000	
" Outstanding expenses	500		-------	2000
	-------			--------
	7000			7000
	------			--------

CAPITAL ACCOUNTS

	C Rs.	D Rs.		C Rs.	D Rs.
To Revaluation A/c	1000	1000	By Balance b/d	10000	10000
" ABCD & Co.	14000	14000	" Loan A/c	5000	5000
	15000	15000		15000	15000

In the Books of ABCD & Co.

	A Rs.	B Rs.	C Rs.	D Rs.		A Rs.	B Rs.	C Rs.	D Rs.
To Goodwill	750	750	750	750	By Sundries	14500	14500	14500	14500
" Balance c/d	14000	14000	14000	14000	" Cash	250	250	250	250
	14750	14750	14750	14750		14750	14750	14750	14750

Balance Sheet of ABCD & Co. as on January 1, 1969

	Rs.		Rs.
Capital Account		Goodwill	12000
A	14000	Land and workshop	20000
B	14000	Machinery and tools	15000
C	14000	Furniture and fixtures	2000
D	14000	Debtors	12500
Creditors	25000	Stock	16000
Outstanding expenses	5500	Cash	6000
	86500		86500

B. Dissolution of Partnership

When a partnership ceases to exist, it is said to be dissolved. The dissolution takes place due to any one of the following events.

1. In constituted for a fixed term, by the expiry of that term.
2. If constituted to carry out one or more ventures or understandings, by the completion thereof.
3. By the death of partner.
4. By the adjudication of a partner as an insolvent.

In the above mentioned cases, the 'partnership' is dissolved but the remaining partners may continue the firm if there is any agreement to that effect. If the partners do not continue, then the firm is also dissolved.

In addition to the dissolution of the partnership, the firm is also dissolved under the following circumstances.

1. When all the partners agree to the dissolution of the firm.
2. When all the partners, except one, have become insolvent.

3. When the business becomes illegal.

4. When the court orders the dissolution.

Accounting Treatment

A new account called the Realisation Account, is opened for the purpose, arriving at the profit or loss made by the firm while dissolving the firm.

In brief, the following accounting entries are made for closing the books of accounts.

1. To Transfer assets (except cash and bank) to the Realisation Account, at their book values.
   Debit Realisation a/c
   Credit Asset a/c

   Goodwill appearing in the Balance Sheet on the date of dissolution requires no special treatment. It is also transferred to the Realisation Account along with other assets.

2. To Transfer the liabilities to third parties to the Realisation Account.
   Debit Liabilities A/c
   Credit Realisation A/c

3 .. When the assets are taken over by the partners: .
   Debit Cash A/c
   Credit Realisation A/c

4. When the assets are taken over by the partners.
   Debit partners Capital A/c
   Credit Realisation A/c

5. When the liabilities are discharged by the firm.
   Debit Realizaion A/c
   Credit Cash A/c

   If the liabilities are taken over by the partners:
   Debit Realisation A/c
   Credit Partner's Capital A/c

6. For any unrecorded liability paid by the firm ..
   Debit Realisation A/c Credit
   Cash A/c

7. For any extra given or sale of unrecorded assets:
   Debit Realisation A/c
   Credit Realisation A/c

8. For payment of realisation expenses:
   Debit Realisation A/c
   Credit Cash A/c

9. Prepare the Realisation Account and find out the profit or loss made by the firm and transfer the same to the Partner's Capital Accounts according to their profit sharing ratio.
   For transferring the realisation profit.
   Debit Realisation A/c
   Credit Partners Capital A/c
   For Transferring the realisation loss.
   Debit Partner's Capital A/c
   Credit Realisation A/c

10. The loan from a partner if any, is now paid and the entry will be
    Debit Partner's Loan A/c
        Credit Cash A/c
11. Balance standing in the Reserve Account or profit and Loss Account are transferred to the Partner's Capital Accounts in their profit sharing ratio.
12. The partner Current A/c balances are transferred to their Capital A/c and the Capital A/c. are closed either by receiving or paying cash to them. The Cash or Bank Account will be closed automatically. The entry for receiving cash in settlement will be.
    Debit Cash A/c
    Credit Partners' Capital A/c (OR)
    Debit Partner's Capital A/c
    Credit Cash A/c

Illustration 6.2

Ram and Shyam were partners sharing profits and losses in the ration of 3.2

Balance Sheet of Ram and Shyam as on December 31,1983

Liabilities	Rs.	Assets		Rs.
Sundry Creditors	20000	Cash in hand	5000	
Mr. Shyam's loan	10000	Furniture	5000	
Ram's Loan A/c	10000	Stock	10000	
Ram's Capital A/c	30000	Sundry Debtors	10000	
Shyam's Capital A/c	20000	Less : Provision for bad debts	1000	
			--------	9000
Ram's Capital A/c	5000	Plant and Machinery		35000
Reserve Fund	5000	Buildings		25000
		Shyam's Current A/c		1000
		Goodwill		10000
	---------			--------
	100000			100000
	---------			---------

The firm was dissolved on December 31, 1983 and the following information is available

1. Furniture and stock were realized 10% less than the book value
2. Debtors realized Rs. 9500
3. Plant and Machinery was sold for Rs. 36,000 and building was taken over by Ram at Rs. 40000
4. Sundry creditors have allowed a discount of 2%
5. Realisation expenses amounted to Rs. 1000

Pass necessary Journal entries to close the books of the firm and show the Realisation Account, Partner's Capital Accounts and the Cash Account

JOURNAL

			Dr Rs.	Dr. Rs.
1983				
Dec. 31	Realisation A/c	Dr	95000	
	To furniture			5000
	To stock			10000
	To Debtors			10000
	To Plant and Machinery			35000
	To Building			25000
	To Goodwill			10000
	(Being the assets transferred to Realisation A/c at their book values)			
	Sundry creditors	Dr.	2000	
	Mrs. Shyam's loan	Dr.	1000	
	Provision for bad debts	Dr.	1000	
	To realization A/c			31000
	(Being the liabilities and provision for bad debts transferred to realization A/c)			
	Ram's Loan A/c	Dr.	10000	
	Ram's Current A/c		5000	
	To Ram's Current A/c			15000
	(Being Ram's Loan a/c and Current A/c transferred to his Capital A/c)			
	Shyam's Capital A/c	Dr.	11000	
	To Shyam's Current A/c			
	(Being Shyam's Current A/c transferred to his capital A/c)			
	Reserve Fund	Dr.	5000	
	To Ram's Capital A/c			3000
	To Shyam's Capital A/c			3000
	(Being the reserve transferred)			
	Cash A/c	Dr.	5900	5900
	To Realisation A/c			
	Furniture 5000 – 500 = 4500			
	Stock 10000 – 1000 = 9000			
	Debtors = 9500			
	Plant & Machinery = 36000			
	(Being the assets realized)			
	Ram's Capital A/c		40000	40000
	To Realisation A/c			40000
	(Being the building taken over by Ram)			
	Realisation A/c	Dr.	29500	
	To Cash			

Sundry Creditors	20000		
Less 2 1/2 % Discount	500		

	19500		
Mrs. Shyam's Loan	10000		

(Being the liabilities paid off)			
Realisation a/c	Dr.	1000	
To Cash a/c			
(Being the realization expenses paid)			
Realisation A/c	Dr.	4500	
To Ram's Capital A/c			2700
To Shyam's Capital A/c			1800
(Being realization profit transferred to partners' Capital Accounts)			

REALISATION ACCOUNT

Dr.		Rs.			Dr.
1983	To Sundry assets		1983	By Sundry Creditors	20000
Dec. 31	Furniture	5000	Dec. 31	By Mrs. Shyam's loan	10000
	Stock	10000			
	Debtors	10000		By Provision for bad debts	1000
	Plant and Machinery	35000		By Cash-assets realised	59000
	Building	25000		By Ram's Capital A/c Building	40000
	Goodwill	10000			
	To Cash Sundry Creditors And Mrs. Shyam's Loan paid	29500			
	To Cash-expenses	1000			
	To Ram	2700			
	Shyam	1800			
	Profit transferred	4500			
		130000			130000

CAPITAL ACCOUNT

DR	Ram Rs.	Shyam Rs.		Ram Rs.	CR Shyam Rs.
To Realisation A/c	40000	—	By Balance b/d	30000	20000
To Buildingq			By Loan a/c	10000	

Current A/c	----	1000	By Current A/c	5000	
To Cash	10700	22800	By Reserve Fund	3000	2000
			By Realisation A/c		
			Profit	2700	1800
	---------	---------		--------	--------
	50700	23800		50700	23800

CASH ACCOUNT

Dr			Cr
To Balance b/d	5000	By Realisation A/c	
To Realisation A/c		Sundry Creditors mrs.	19500
(Assets realized)	59000	Shyam loan	10000
		Expenses	1000
		By Ram's Capital A/c	10700
		By Shyam's Capital A/c	22800
	---------		---------
	64000		64000
	---------		---------

INSOLVENCY OF A PARTNER

In the event of dissolution of a firm, if the amount realised by way of sale of assets is not sufficient to pay off the liabilities, partners have to contribute to the deficiency in their profit-sharing proportions. This is in accordance with the principle of unlimited liability applicable to partnership concerns.

It may so happen that after paying off all the external liabilities the capital account of a partner may show debit balance, either because of heavy realisation loss or because of excessive drawings. In such a case, he has to contribute towards his capital deficiency in the form of cash to enable the other partners, whose capital accounts show credit balances, to receive whatever is due to them towards their investment. .

However, if such a partner is insolvent, he cannot pay anything or only as much as his estate realises. In such an event, the solvent partners have to bear the capital deficiency of the insolvent partner. This deficiency is of the nature of klos to the solvent partners, similar to realisation loss. But yet, realisation loss is to be distinguished from loss due to capital deficiency of an insolvent partner. In cash no distinction is made by the partners, difficulty arises with regard to the mode of sharing the capital deficiency of the insolvent partner.

Decision in Garner vs Murray

The decision in the famous case Garner Vs Murray, is quoted quite often in the contex of distinguishing between ordinary trading loss and capital loss arising from the insolvency of a partner. The facts of the case were as under.

Liabilities	Rs.	Assets	Rs.
Capital Account		Cash	1916
Garner	2500	Wilkins	253
Murray	314	Deficiency	645
	--------		--------
	2814		1824
	--------		---------

Wilkins was insolvent and unable to pay anything. In a dispute between the solvent partners regarding the method of sharing Wilkins' capital deficiency of $ 262, it was contended that if the firm's deficiency and Wilkins Capital deficiency should treated alike and divided between the solvent partners. Murray would be debited with $ 449. His capital being $ 314 only. He should bring $ 135 to enable Garner to get the full amount of $ 2051. If the extraordinary loss is not treated as an ordinary trading loss, and is shared by the Solvent partners in their capital ratios, it would be less severe on Murray.

This contention was upheld by Justice Joyce who gave the ruling that (a) the solvent partners should bring in cash towards their respective shares of realisation loss and, (b) the loss due to the insolvency of a partner should be shared by the solvent partners in proportions to their last agreed capital.

The implication of this decision is that trading loss should be distinguished from capital loss. Loss on realisation, being a trading loss, should be divided amongst all the partners including the insolvent partner, in profit-sharing proportions. If, after such a division the capital account of a partner is in debit and the cannot pay anything, the solvent partners have to bring in cash towards their respective shares of realisation loss. and then treat the debit balance of the insolvent partner's capital account as a fictitious asset, and divide the same between themselves in the ratio of their last agreed capitals.

Its Applicability to India

It is necessary to point out, at the very outset, that no English decision is binding on the Indian Courts, and, however important they might be, they are only persuasive in nature. In fact, even in England, the applicability of the decision was subject to any agreement to the contrary. As such of the partnership deed contains a specific clause with regard to the mode of division of the capital loss of an insolvent partner, the clause should be followed. Further, no Indian Court has, as yet, given any ruling on such a point. In the absence of any agreement to the contrary, it is therefore, necessary to apply the provisions of Section 48 of the Partnership Act which is based wholly on the English Partnership Act.

Accordingly, unless excluded by a clause in the partnership deed, or section 48 of the Act is interpreted in an Indian Court in a way so as to exclude the applicability of the decision, the Garner Vs Murray decision may safety be applied in India.

Illustration 6.3

A,B and C were partnership sharing profits and losses in the ratio of 3:2:1. There Balance sheet as on 31st December, 1988 was as follows.

	Rs.			Rs.
Sundry Creditors	26000	Bank		2000
Loan From A	15000	Debtors	12000	
Reserve	12000		--------	
		Less provision stock	1000	
			--------	13000
Capital Accounts				
A	20000	Plant and Machinery		30000
B	10000	Profit and Loss A/c		24000
C	2000	Stock		18000
	--------			---------
	865000			85000
	---------			---------

The assets were realized as follows :

Sundry Debtors Rs. 9000 plant and Machinery Rs. 20000 stock was taken over by A at Rs. 12000 the Creditors were paid off Rs. 19000 in full settlement. Realisation expenses amounted to Rs. 1000

C became insolvent and his private estate could contribute only Rs. 500 Pass journal entries and prepare the necessary dissolution accounts applying Ganer Vs Murray decision.

In the Books of A.B and C

JOURNAL ENTRIES

Particulars	L.F.	Debit Rs.	Credit Rs.
Realisation A/c	Dr.	60000	
To Debtors			12000
To Stock			18000
To Plant and Machinery			30,000
(for transfer of assets to realization a/c)			
Sundry creditors Dr.	26000		
Provision for Doubtful Debts A/c	Dr.	1000	
To realization a/c			27000
(or transfer of creditors and provision to realization a/c)			
Bank A/c	Dr.	29000	
To realization A/c			29000
(for sale of assets)			
A's Capital a/c	Dr.	12000	
To realization a/c			12000
(for stock taken over by A)			
Realisation a/c	Dr.	20000	
To Bank a/c		20000	
(for payin off creditors and expenses)			
A'Loan A/c	Dr.	15000	
To Bank A/c		15000	
(for paying off A's Loan)			
A's Capital a/c	Dr.	6000	
B's Capital a/c	Dr.	4000	
C's Capital a/c	Dr.	2000	
To Realisation a/c			12000
(for dividing loss on realisation)			
Reserve a/c	Dr.	12000	
To A's Capital a/c			6000
To B's Capital a/c			4000
To C's Capital a/c			2000
(for dividing reserve amongst partners)			
A's Capital A/c	Dr	12000	
B's Capital A/c		8000	
C's Capital A/c		4000	
To Profit and Loss A/c			24000
(for dividing trading loss amongst partners)			
Bank A/c	Dr	10000	
To A's Capital A/c			6000
To B's Capital A/c			4000

(for A and B bringing in cash towards their realisation loss)			
Bank A/c	Dr.	500	
To C's Capital A/c			500
(for realising money from the insolvent estate)			
A's Capital a/c	Dr.	1050	
B's Capital a/c		450	
To C's Capital a/c			1500
(for C's capital deficiency home by A and B) in the ratio of their last agreed capitals			
A's Capital A/c	Dr.	950	
B's Capital A/c		5550	
To Bank A/c		6500	
(for final payment to partners)			

REALISTION ACCOUNT

	Rs.		Rs.
To Debtors	12000	By Creditors	26000
To Stock	18000	By Provision for doubtful debs	1000
To Plant and Machinery	30000	By Bank A/c	29000
To Bank A/c	20000	By A's Capital A/c	12000
		By realization Loss :	
		A's Capital A/c	6000
		B's Capital A/c	4000
		C's Capital A/c	2000
	80000		80000

A's CAPITAL ACCOUNT

To Realisation a/c	12000	By Balance b/d	20000
"Realisation a/c	6000	Reserve a/c	6000
Profit and Loss a/c	12000		
" C's Capital a/c	1050	Bank a/c	6000
" Bank a/c	950		
	32000		32000

B'S CAPITAL ACCOUNT

To Realisation a/c	4000	By Balance b/d	10000
" Profit and Loss a/c	8000	" Reserve a/c	4000
" C's Capital a/c	450	" Bank a/c	4000
" Bank a/c	5550		
	18000		18000

C'S CAPITAL ACCOUNT

	Rs.		Rs.
To Realisation a/c	2000	By Balance b/d	2000
" Profit and Loss a/c	4000	" Reserve a/c	2000
" Bank a/c	500	" A's Capital a/c 14/20	1050
		" B's Capital a/c 6/20	450
	6000		6000

BANK ACCOUNT

To Balance b/d	2000	By Realisation a/c	20000
" Realisation a/c	29000	" A's Loan a/c	15000
" A's Capital a/c	6000	" A's Capital a/c	950
" C's Capital a/c	500	B's Capital a/c	5550
	41500		41500

INSOLVENCY OF ALL PARTNERS

When all the partners of a firm become insolvent, the firm's liabilities would be more than the firm's assets as well as private assets of the partners. In such a an event, since the firm's liabilities cannot be paid in full, it is necessary to give an altogether different treatment to liabilities.

Assuming that liabilities consist only of creditors, the same is not transferred to realisation account. The available cash, together with whatever that is received from the private estates of partners, is paid to creditors. The unpaid balance is transferred to a deficiency account opened for the purpose. Since in a situation such as this, there is final payment to any partner, the capital balances are also transferred to the profit and loss account, This step will close not only the deficiency account but the capital account also.

Alternatively, realisation loss my be transferred to deficiency account instead of being debited to capital accounts in profit-sharing, proportions. In case any capital account shows credit balance, the same should be transferred to the other capital accounts showing debit balances.

Illustration 6.4

Given below is the Balance Sheet of M/s A,B and C as on 31st December 1985.

		Rs.		Rs.
Creditors		40000	Cash at Bank	1000
A's Loan		1000	Stock	24000
Capital Accounts			Debtors	20000
A	5000		Furniture	3000
B	3000	8000	C's Capital Account	10000
		58000		58000

Owing to the inability of the firm to pay of its creditors, the partners decided to dissolve the firm as from the above date. Stock realised Rs. 15000. Debtors Rs. 16000 and Furniture Rs. 1000 Expenses amounted to Rs. 3000 B and C cannot pay anything. A can contribute only Rs. 1500 from his private estate.

Prepare accounts to close the books of the firm

Solution

REALISATION ACCOUNT

	Rs.		Rs.
To Stock	24000	By Bank-realisation	32000
" debtors	20000	" A's Capital a/c	6000
" Furniture	3000	" B's Capital a/c	6000
" Bank – expenses	3000	" C's Capital a/c	6000
	50000		50000

BANK ACCOUNT

To Balance b/d	1000	By Realisation a/c	3000
" Realisation a/c	3200	" Creditors	31500
" A'S Capital a/c	1500		
	34500		34500

CREDITORS ACCOUNT

To Bank	31500	By Balance b/d	10000
" Deficiency a/c	8500		
	40000		40000

DEFICIENCY ACCOUNT

	Rs.		Rs.
To B's Capital a/c	3000	By Creditors	8500
To C's Capital a/c	16000	" A's Capital a/c	10500
	19000		19000

A'S CAPITAL ACCOUNT

To Realisation a/c	6000	By Balance b/d	5000
" Deficiency a/c	10500	" A's Loan a/c	10000
		" Bank a/c	1500
	16500		16500

B'S CAPITAL ACCOUNT

To Realisation a/c	6000	By Balance b/d	6000
" Deficiency a/c	3000		
	6000		6000

C'S CAPITAL ACCOUNT

To Balance b/d	10000	By Deficiency a/c	16000
" Realisation a/c	6000		
	16000		16000

Exercise

1. Two firms P,Q and R, S agreed to amalgamate their business. Their position as on 31st December 1988 were as follow

BALANCE SHEET OF P AND Q AS ON 31ST DEC. 1988

Creditors	104000	Cash at Bank	156000
Capitals		Debtors	130000
P	182000	Stock in trade	42000
Q	130000	Office Building	78000
		Furniture	10000
	208000		208000

Creditors and Debtors were not taken over by the new firm. Officer Building was retained by P and Q. The cash balance was not taken over by the new firm, but the cash required by the new firm was estimate at Rs. 1,30,000 to be provided by the partners in their profit sharing proportions which were, P3/10, Q3/10, Rs/10 and S2/10

Give the Journal entries in the books of PQ and RS and give the Balance Sheet of the new firm PQRS. PRS 69333 QRS 48750 RRS 48750 SRS 42250 Balance Sheet total Rs. 2210000).

2. A and B are partners sharing profits and losses equally. Their Balance Sheet on 31st December 1987 is as follows:

		Rs.			Rs.
Creditors		22,400	Cash		7000
Bills Payable		3600	Stock		35600
A's Loan		10000	Debtors		27600
Reserve Fund		12000	Less Provision	2800	
Capital Accounts					24800
A	30000		Furniture		5600
B	40000				
		70000	Plant and Machinery		45000
		118000			118000

They decide to dissolve the firm. The assets realized as follows:

	Rs.
Stock	36400
Debtors	21200
Furniture	3600
Plant and Machinery	38000

Creditors allowed a discount of 2% and expenses of realization amounted to Rs. 1008.

Give Journal entries and the necessary ledger account to close the books of the firm.

(Ans. Loss on realization Rs. 12369; Bank Balance Rs. 69640 a Gets Rs. 39820 and B get Rs. 39820)

Insolvency

3. On 1st Dec. 1986 the Balance Sheet of A and C showed the following positions.

Creditors	10000	Bank	200
Bills Payable	3200	Debtors	16000
Reserve	9000	Stock	25000
Capital Accounts :		Bills Receivable	5000
A	21000	Machinery	
B	13000		
C	5000		
	---------		-----------

On this day, Mr. C. Become insolvent and could pay only Rs. 100 . The firm was dissolved. Assets realized Rs. 31,000 Realisation expenses came to Rs. 600 Partners share profits and losses equally. Prepare necessary ledger accounts to close the books of the firm applying the decision given in Garner vs Murrary case.

(Ans : Loss on realisatoin Rs. 30000 C's Capital deficiency shared by A and b in 3:2 Bank Rs. 37,900 A gets Rs. 22,740 and B Rs. 15,160)

Lesson 7

PARTNERSHIP ACCOUNTS

Dissolution and Piecemeal Distribution

In a partnership concern is dissolved it is not possible to sell all the assets and get cash immediately. It will take same like to sell some fixed assets like land, buildings, and plant and machinery. There may be a gap of few months between realisation of two assets. Some assets are sold gradually to realise the best price for them.

The cash realised should be used to pay off the liabilities as on the date of dissolution. The liabilities may be partners loan, sundry, creditors, bills payable, liabilities for expenses, and partners capitals. A problem arises as to whom the first realisation is to be paid or the order of payment. Everybody will be interested in getting their dues at the earliest possible.

According to the partnership Act the following is the order of payment to be followed in the case of dissolution of a partnership firm.

I. The liabilities of secured creditors should be paid firstly.

a) The liabilities to third parties like sundry creditors, B/P, expenses payable should be paid next.

2. If any amount is left over after payable liable to third parties, the loan from partners should be paid next.

3. The remaining amount should be distributed among its partners, for their dues on capital account.

PICEMEAL DISTRIBUTION

The amount payable to partners can be determined only after considering its profit or loss or realisation. This means that the partners can be paid only after the last realisation. But the partners would not like to wait until last realisation. They would like to be paid as and when cash is realised. There are two methods of determining the cash payable in different realisation They are.

(a) Proportionate capital method

(b) Maximum loss method

Proportionate Capital Method:

In partnership concerns, the profit or loss will be shared according to the ratio mentioned in to partnership deed. So it is genuine to have the capitals also in the ratio of profit sharing. If any partner has excess capital, then he will be paid. In other words cash is to be distributed in such a way that the final amount left unpaid should be in the profit sharing ratio. This can be explained with the following example.

Illustration 7.1

A and B are partners sharing profits and losses in the ratio of 3:2 having capital of Rs,2,00,000 and 1,00,000. The assets realised are as follows.

I realisation	35,000
II realisation	20,000
III realisation	20,000
IV realisation	25,000

Partners	**A**	**B**
Profit sharing ratio	3	2
Capital	2,00,000	1,00,000
Taking B's capital as its basis		
A's Capital should be 1,00,000/2 x 3	1,50,000	-------
	------------	------------
Excess of A'S Capital	50,000	

STATEMENT SHOWING DISRIBUTION OF CASH

Particulars	**A's Capital**	**B's Capital**
Balance due	2,00,000	1,00,000
I realization Excess capital paid to A	35,000	
	------------	------------
	1,65,000	1,00,000
II realization Excess capital paid to A	15,000	
	------------	------------
	1,50,000	1,00,000
III realization (Remaining 5000 in profit sharing ratio)	3,000	2,000
	------------	------------
	1,47,000	98,000
III realization (in P.S. ratio)	12,000	8,000
	------------	------------
	1,35,000	90,000
IV realization (in P.S. ratio)	35,000	10,000
	------------	------------
Balance left unpaid	1,20,000	80,000
	------------	------------

Illustration 7.2

Menon, Mitra and Mehra share profits of a firm in the proportion of ½ and ¼ respectively. On the date of dissolution their.

Liabilities		Assets	
Creditors	1,00,000	Sundry Assets	6,00,000
Menon's Loan	50,000	Cash. In hand	10,000
Mitra's Loan	30,000		
Menon's Capital	2,00,000		
Mitra's Capital	1,50,000		
Mehra's Capital	80,000		
	6,10,000		6,10,000

The assets realized Rs. 4,50,000 which were received in installment of Rs. 1,50,000 Rs. 1,60,000 and Rs. 1,40,000 show now the proceeds should be distributed as and when received by following the proportionate capital method.

Particulars	Creditor	Menon	Mitra	Menon	Mitra	Menon
Amount due give in B/s	1,00,000	50,000	30,000	2,00,000	1,50,000	80,000
LESS Cash in hand paid to creditors First Realization of Rs. 1,50,000	10,000	----	---	---	----	----
Balance due	90,000	50,000	30,000	2,00,000	1,50,000	80,000
Gash paid to Crs.	90,000	---	----	-----	----	---
		50,000	30,000	2,00,000	1,50,000	80,000
Balance of Rs. 60,000 Discharge partners loans Liability in the ratio of Partners loans i.e. Rs. 50,000 Rs. 3,000 (5 : 3)		37,500	22,500			
		12,500	7,500	2,00,000	1,50,000	80,000
Partners loans paid		12,500	7,500	2,00,000	1,50,000	8,000
				2,00,000	1,50,000	80,000
Paid to Mitra to Make capital equal to His profit sharing ratio				-------	50,000	-------
				2,00,000	1,00,000	80,000
Amount paid to Menon and Mitra to Make their capitals In accordance with their Profit sharing arrangement With Mehra				40,000	20,000	
				1,60,000	80,000	80,000

Balance paid to Menon, Mitra and Mehra in their profit ratio 1/2 : 1/4 : 1/4			15,000	7,500	7,500
			1,45,000	72,500	72,500
Third Realisation of Rs. 1,40,000 distributed in the ratio of 1/2 : 1/4 : 1/4			70,000	35,000	35,000
Amount un paid or loss or realisation			75,000	37,500	37,500

X Y and Z are in partnership sharing profit and losses in ratio of 3 : 2 : 1 respectively. They decide to dissolve their business on the date of 31st Dec. 1989 on which date their balance sheet was as below.

B/s on 31st Dec 1989.

Liabilities			Assets	
X's Capital	38,700		Plant & Machinery	30,810
Y's Capital	10,680		Buildings	5,160
Z's Capital	11,000	60,480	Investments	1,080
Loss account Z		3,000	Free hold goods	19,350
Creditor		10,320	Shares in "A" Co Ltd.	11,280
			Cash	5,940
		73,800		73,800

The assets were realized piecemeal as below and which was accepted that cash should be distributed as and when realized.

18-01-1990	Rs. 10,380
29-02-1990	Rs. 27,900
22-03-1990	Rs. 3,600
14-04-1990	"Z" took over the investment at the value of 1,260 and paid cash
28-02-1990	Rs. 19,200

Dissolution expenses originally (18-01-1990) provided for an estimated amount of Rs. 2,700 but actual
amount spent on 29-12-1990 was Rs. 1,920.

The Creditors were settled for Rs. 10,080. You are needed to prepare a statement show in distribution of cash among the partners followings.

Surplus capital basis

Solution

"X" Rs. 38,700 / 3 = Rs. 12,900

"Y" Rs. 10,680 / 2 = Rs. 5,340

"Z" Rs. 11,100 / 1 = Rs. 11,100

The lowest unit of capital is that of "Y" i.e. Rs. 5,340 working from this the proportional capital of other partner are :

"X" Rs. 5.340 X 3 = Rs. 16,020

"Y" Rs. 5,340 X 1 = Rs. 5,340

Balance of capital ever those proportional capitals, are as below.

	X	Y	Z
Actual capital	38,200	10,680	11,100
LESS proportional capital	16,020	10,680	5,340
	----------	----------	----------
	22,680	-------	5,760

The highest relative capital as between "X" and "Z" in respect of balance of capitals can be determined the following way.

"X" Rs. 22,680 / 3 = 7,560

"Z" Rs. 5,760 / 1 = 5,760

In this "Z" is having the lowest units of capital i.e. Rs. 5,760. The proportional capital of "X" accordingly would be Rs. 5,760 X 3 = 17,280, "X" is therefore having the highest relative capital as shown below.

	Z	X
Balance capital	22,680	5,760
LESS Proportional capital	17,280	5,760
	----------	----------
Excess capital	5,400	-------
	----------	----------

On distribution, the refund of capital in the order of preference would be in the following means.

1. I repayment to "X" Rs. 5,400
2. II repayment to "X" Rs. 17,280 and I Rs. 5,760
3. III repayment to "X" Rs. 16,020 "Y" Rs. 10,680 and I Rs. 5,340.

	Crs.	Z'sloan	X	Y	Z
Balance due as on 31-12-89	10,080	3,000	38,700	10,680	11,100
Cash paid to Crs.	5,940				
	----------	----------	----------	----------	----------
	4,140	3,000	38,700	10,680	11,100
18-01-90 Realisation of Rs. 10,380					
A) Paid to Crs.	4,140				
B) Paid to the Z loan		3,000			
c) Paid to the Expenses of Dissolution Rs. 2,700					
D) Balance paid to "X" 10,380-(4.14 + 3,000 + 2,700)			540		
	----------	----------	----------	----------	----------
	---	-----	38,160	10,680	11,100

ADD Profit on settle			
Amount with Crs. Rs. 240 (3:2:1)	120	80	40
29-2-90 realisation of Rs. 27,900			
A) Rs. 4,860 (5,400-540) paid to "X"	4,860		
B) Balance Rs. 23,040 (27,900-4,860)			
Paid to X and Z in ratio 3 : 1	17,280	-----	5,760
Balance due	16,140	10,760	5,380
22-3-90 Realisation of 3,600			
Distributed ratio 3 : 2 :1	1,800	1,200	600
	14,340	9,560	4,780
Balance due ADD profit on sale of			
Investment Rs. 180 (3:2:1)	90	60	30
	14,430	9,620	4,600
14.4.90 Realisation RS. 1,260 (3:2:1)	630	420	210
28.4.90 Realisation of	13,800	9,200	4,600
Rs. 19,200 + Rs. 780 (excess provision over			
Actual dissolution expenses 19,980 (3:2:1)	9,990	6,660	3,330
Unpaid balance (LOSS)	3,810	2,540	1,270

Maximum Loss Method

Under this method all liabilities except partners capital account will be settled as in the case of proportionate capitals method. After paying all other outside liabilities, partners capital account will be paid. Under his method is every stage is assumed that there is no further realization. Maximum loss is calculated by comparing the cash in hand at that time and the amount due to partners.

Maximum loss = Amount due to partners – cash available

Maximum loss is distributed to partners in their profit sharing ratio, and it will be deducted from the amount due to partners. The amount thus available will be equal to the cash available in hand. This will be distributed to partners.

Sometimes the partners capital account, (after adjusting maximum loss) may show a negative balance. This should be transferred to other partners capital account in their capital ratio.

Rama, Siva, Muthu were three partners, and their profit sharing ratio was 3:2:1 respectively. The partnership was dissolved on 31st Dec. 1980/ The following is balance sheet of the firm on that date.

Balance Sheet

Liabilities			**Assets**	
Capital				
Rama	1,05,000		Cash in hand	21,000
Siva	52,500		Sundry Debtors	2,20,500
Muthu	10,500		Stock in trade	84,000
	--------	1,68,000		
Creditors		1,57,500		
		----------		-----------
		3,25,500		3,25,500
		----------		-----------

There was a bill for Rs. 7,500/- due on 31st May 1981, under discount. It was agreed that the net realization should be distributed in their due order (at the end of each month) but as safely as possible. The realizations are follows.

	Stock & Debtors	Expenses
31st Jan. 1981	63,000	5,250
28th Feb 1980	94,500	4,050
31st March 1980	52,500	3,675
30th April 1980	57,750	2,625
31st May 1980	26,625	2,625

The stock was complete disposed and amounts due from debtors were realized, the balance being irrecoverable. The acceptor of the bill under discount met bill on due date.

Find out statement for piecemeal distribution of cash

STATEMENT OF DISTRIBUTION OF CASH

	Creditors	**Rama**	**Siva**	**Muthu**
Balance due	1,57,500	1,05,000	52,500	10,500
1) Cash in hand on 31st Dec. 1980 paid to Crs.	21,000			
	----------	----------	----------	----------
Balance outstanding	1,36,500	1,05,000	52,500	10,500
2) First realization on 31.1.81 (Rs. 63,00-5250)	57,750			
	----------	----------	----------	----------
Balance outstanding	78,750	1,05,000	52,500	10,500
3) Second realisation on 28.2.81 (Rs. 84,500-4,050 – 90,450) Rs. 87,750 paid to creditors RS, 7,500 retained for contingent liabilities		78,750		
	----------	----------	----------	----------
Balance outstanding	--	1,05,000	52,500	10,500
Balance available for distribution (Rs. 94,500-86,250 = 4,200)		8,1900	54,600	27,300
Maximum loss (Rs. 1,68,000-4,200=1,63,800) in profit sharing ratio				
	----------	----------	----------	----------
Balance		23,100	-2,100	-16,800
LOSS of Siva and Muthu capital (to be loan by Rama)		18,900	+2,100	+16,800
	----------	----------	----------	----------
Cash paid to Rama		4,200		

Balance due after II realization Rama	1,00,800	52,500	10,500
4) Third realisation (Rs. 52,500 on 31.3.81 (52,500 – 3,675 = 48,825_	57,488	38,325	19,163
Loss of Muthu is divided in Rama and Siva in profit sharing ratio	43,312	14,175	-8,663
Cah Paid	-,5,198	-,3,465	+8,663
	38,115	10,710	--
Balance outstanding Rama (1,00,800-38115) Siva (52500-10710)	62,685	41,790	10,500
5) Forth realization on 30.4.81 (Rs. 57,750-2, 625-55, 125) Maximum loss (Rs. 14,975-55 125-59, 850)	29,925	19,950	9,975
6) Fifth realisation on 31.5.81 (Rs. 26,625-2,625=24,000) ADD Rs. 7,500 keep a side for contingent liability 31,500 Maximum loss (Rs. 59,850 –31, 500 = 28,350	14,175	9,450	4,725
Cash paid	15750	10,500	5,250
Balance left unpaid being loss on realisation	14,175	9,450	4,725

X, Y and Z conducted a business sharing profits and losses in the proportion of 4:5:1 respectively. The balance sheet of the business, as on the date of dissolution was as follows:

Liabilities		Assets	
Sundry Crs.	20,000	Cash in hand	6,000
A's Loan	12,000	Other Assets	1,12,000
B's Loan	6,000		
Reserve Fund	12,000		
Contingency Reserve	8,000		
A's Capital	30,000		
B's Capital	24,000		
C's Capital	6,000		
	1,18,000		1,18,000

The partnership is dissolved, and the assets are realized as bellows.

First realization	20,000
Second realization	40,000
Third realization	34,000

On the date of the dissolution, there was a contingent liability of Rs. 2,000 against the firm which was settled at Rs. 1.400 at the time of second realization/ Realisation expenses were estimated at Rs. 4,000/- but these actually amounted to 13,000/- 'C' took stock worth Rs. 1,000/- at the time of third realization. The firm was forced to pay Rs. 1,200 out of third realization for which no provision was made in books.

You are required to prepared a statement of distribution of cash by following the maximum loss method.

STATEMENT SHOWING PIECEMEAL DISTRIBUTION OF CASH

Particulars		Crs.	A's Loan	B's Loan	A's Cap	B's Cap.	C's Cap.
Amount due as per balance sheet		20,000	12,000	6,000	30,000	24,000	6,000
Add Reserve fund 4:5:1					4,800	6,000	1,200
		----------	----------	----------	----------	----------	----------
		20,000	12,000	6,000	34,800	30,000	7,200
Add Contingency Reserve	8,000						
Less Expected liability	2,000						
	6,000						
If profit sharing ratio					2,400	3,000	600
		----------	----------	----------	----------	----------	----------
		20,000	12,000	6,000	37,200	33,000	7,800
Cash	6,000						
LESS : Amount kept for Realisation exp.	4,000						

	2,000						
Less amount kept For contingent liability	2,000						

First realization	20,000						
Paid to Crs.	20,000	20,000					
		----------	----------	----------	----------	----------	----------
Balance due			12,000	6,000	37,200	33,000	7,800
ADD profit on contingent liability			--	--	240	300	60
Amount due			12,000	6,000	37,440	33,300	7,860
Second realization	40,000						
contingent liability	600						
	40,600						
LESS Partner's loan	18,000						

	22,600		12,000	6,000			
		----------	----------	----------	----------	----------	----------
					37,440	33,300	7,860
		----------	----------	----------	----------	----------	----------
Amount due to partner					37,440	33,300	7,860

Maximum loss 56,000 (37,440+33,300+7,860-22,600)	---------	---------	---------	22,400 ---------	28,000 ---------	5,600 ---------
Amount paid				15,040	5,300	2,260
	---------	---------	---------	---------	---------	---------
Balance due after II realization				37,440	33,300	7,860
LESS cash paid out of II realization				-15,040 ---------	-5,300 ---------	-2,250 ---------
Balance due after II realization				22,400	28,000	5,600
Third realization		34,000				
ADD cash available due to saving in realisation expenses	1,000					
ADD stock taken by 'C'		1,000 ---------				
		36,000				
LESS payment of a new liability for which no provision was made	1,200	---------				
		34,800				
Maximum loss Rs. 21,200 (22,400+28,000+5,600-34,800				8,480 ---------	10,600 ---------	2,120 ---------
Cash paid our of III realisation			13,820	17,400	3,480	
				---------	---------	---------

Meena, Ratha & Sutha were partners in Subaitha theatures. Their balance sheet is given below as on 31st Dec. 1979/ They decided to dissolve their partnership.

Capital			Cash in hand	7,500
Meena	30,000		Other assets	97,500
Ratha	45,000			
Sutha	15,000	90,000		
Creditors		15,000		
		1,05,000		1,05,000

The partnership deed provided that the loss arising on account of unrecovered deficiency of any partner should be born by others in the time of dissolution. Their profit sharing ratio was 1:2:1 respectively. Other assets were realized as follows

Date	Book value of Assets	Amount realized
31.1.80	31,500	13,500
28.2.80	54,000	6,000
31.3.80	12,000	6,000

You are required to show necessary working, the accounts of the partners and cash

In this Sutha was insolvent, who was not able to contribute any deficiency losses. Use maximum loss method.

Solution

REALISATION A/C

		Dr.				Cr.
1980	To other asset	97,500	1980	By. Crs.		15,000
Jan1	To cash paid to crs	7,500	Jan1	By cash A/c		13,500
Jan31	To cash balance to crs. Paid	7,500	Feb.28	By Cash A/c		6,000
			Mar31	By Cash A/c		6,000
			Mar 31	By loss transferred to		
				Meena	18,000	
				Ratha	36,000	
				Sutha	18,000	72,000
		1,12,500				1,12,500

STATEMENT SHOWING DISTRIBUTION CASH

Particulars		Crs.	Ratha	Meena	Sutha
Balance		15,000	30,000	45,000	15,000
LESS cash in hand paid to Crs 1.1.80		7,500			
		7,500	30,000	45,000	15,000
31.1.80 realisaiton Rs.	13,500				
a) Paid to Crs	7,500				
b) Balance	6,000				
LESS(Total loss=Total capital-variable cash)					

Particulars	Ratha	Meena	Sutha
(90,000-6,000 = 84,000)	21,000	42,000	21,000
Sutha's deficiently is allocated	9,000	3,000	-6,000
To Meena and Ratha their ratio 2:3	2,400	-3,600	+6,000
Ratha's deficiendy allotted to mean	6,600	-600	--
	-600	+600	--
	6,000	--	---
Pay cash Rs. 6,000 to mean	6,000		
Balance capital after payment of crs			
LESS cash paid (31.1.80)	30,000	45,000	15,000
	6,000		
Balance unpaid after I realization	24,000	45,000	15,000
28.2.80 realisation of Rs. 6,000			
LESS Maximum loss (84,000-6,000=78,000)			
Distributed ratio 1:2:1	19,500	39,000	19,500
	4,500	6,000	-4,500
Sutha's deficiency met by Meean & Ratha ratio 2:3	-1,800	-,2700	+4,500
Pay cash to Meena & Ratha out of II realization	2,700	3,330	--
Balance capital after payment of RS. 6,000	24,000	45,000	15,000

LESS cash paid (28.2.80) as above	2,700	3,300	--
Balance unpaid	21,300	41,700	15,000
31.3.80 Realisation RS. 600			
LESS maximum loss (78,000-6,000=72,000)	18,000	36,000	18,000
Ration 1:2:1			
	3,300	5,700	-3,000
Sutha's deficiency met by Meena and Ratha into 2:3	1,200	1,800	+3,000
Cash payable out of III realization	2,100	3,900	--
Balance of capital after payment on 28.2.80 (II realization)	21,300	41,700	15,000
LESS cash paid as above (II realization)	2,100	3,900	--
Amount unpaid after III realization	91,200	37,800	15,000

Capital A/c

31.1.80	Meena	Ratha	Sutha	1.1.80	Meena	Ratha	Sutha
To Cash	6,000			By balance	30,000	45,000	15,000
28.2.80 to cash	1,700	3,300					
31.3.80 to cash	2,100	3,900					
To realization A/c loss	18,000	36,000	18,000	31.3.80			
				By meena's capital A/c			
				Sutha's capital A/c			1,200
Sutha Capital A/c							
Sutha deficiency of s.3,000 in ratio of capital of Meena & Ratha i.e. 2:3	1,200	1,800					
	30,000	45,000	18,000		30,000	45,000	18,000

CASH A/C

1980 Jan	To balance	7,500	Jan1	By realisation A/c Crs	7,500
Jan 31	Realisation A/.c	13,500	Jan 31	Realisation A/c	7,500
Feb 28	Realisation A/c	6,000	Feb.28	Meena's capital A/c	6,000
Mar 31	Realisation A/c	6,000	Feb. 28	Meena's Capital A/c	2,400
			Feb. 26	Ratha's capital A/c	3,600
			Mar. 31	Meena's capital A/c	2,100
			Mar. 31	Ratha's capital A/c	3,900
		33,000			33,000

Exercise

Arun Balance and Chandran are in partnership sharing profits and losses in the ratio of 3:2:1. They decide to dissolve the business on December 31, 1989

Balance Sheet as on Dcember 31. 1989

Liabilities		Rs.	Assets	Rs.
Capital accounts			Land & Buildings	30,810
Arun	38,700		Motor car	5,160
Balan	10,680		Investments	1,080
Chandra	11,100	60,480	Stock in Trade	19,530
Loan A/c		3,000	Debtors	11,280
Cash		5,940		
Creditors		10,320		
		73,800		73,800

The assets were realized as follows and it was agreed that cash shold be distributed as and when realized

1990	Rs.
January. 15	10,380
February 26	27,900
March 20	10.320

On April 14, 1990, Chandran took over investment at an agreed value of Rs. 1,260. On April 29, 1990, Rs. 19,200 was realized

Dissolution expenses were originally provided for an estimated sum of Rs. 2,700 but the actual amount spent on March 25, 1990, was Rs. 1920 only. Creditors were settled for Rs. 10.080.

Prepared a statement showing distribution of cash among the partners

Following is the balance sheet of M/s A,B and C who share profits and losses in the ratio of 2:2:1

		Rs.		Rs.
Sundry Creditors		15,000	Cash in hand	2,000
Capitals :	Rs.		Sundry Debtors	12,000
A	15,000		Stock	22,000
B	12,000		Furniture & Fixture	10,000
C	4,000	31,000		
		46,000		46,000

The firm was dissolved and the assets were realized gradually; Rs. 10,000 were received once, Rs. 15,000 another time and Rs. 9,000 finally. Show how each installment is to be distributed

A,B and C share profits in the proportion of 1/2 : 1/3 : 1/6

Balance Sheet of A,B,C

Liabilities		Rs.	Assets	Rs.
Capital accounts			Less liabilities	80,000
A	30,000			
B	30,000			
C	20,000	80,000		
		80,000		80,000

The partnership is dissolved and the assets are realised as follows

	Rs.	Rs.
First Installment	10,000	
Second Installment	15,000	
Third and Final Installment	25,000	50,000

Prepared a statement showing how the distribution should be made applying Garner Vs. Murray principle.

Lesson 8

CONVERSION OF A PARTNERSHIP INTO A LIMITED COMPANY OR SALE TO A COMPANY

With a view to availing itself of the advantage of a joint stock company, a partnership may either be converted into a company or sell its business to an existing company. In either case, the firm is dissolved and the books of account are closed. For this purpose, a realisation account it opened, and all the assets and liabilities actually taken over by the company are transferred to it. The entries for transfer are the same as those already passed under dissolution.

While transferring assets to realization account, no exception should be made with regard to cash and bank, if they are also acquired by the purchasing company. If any asset is not taken over, the same should be disposed of by the firm itself and the amount realized should be debited to cash or bank account, crediting at the same time, the concerned asset account. Similarly, if a liability is not taken over, the same should be paid off by the firm by debiting the liability account and crediting bank account. In either case, any loss or profit on realization or on payment respectively, should be transferred to realisation account.

The account payable by the purchasing company for the acquisition of business is know as purchase consideration. The amount, which usually includes payment for good will, is settled by agreement between the vendors and the purchasing company. In case the a amount is not speficicaly mentioned in the agreement but left to be certained according to the usual customy trade principle, it can be arrived at by the net assets method, ie assets taken over minus the liabilities taken over. For calculating the purchase consideration under the net assets method, book values of assets and liabilities should be ignored.

The purchasing company may pay the amount agreed upon, or arrived at by the net assets method, partly in shares and debentures and partly in cash. After transferring realisaiton profit or loss amongst the partners, it is necessary to effect final settlement by dividing shares, debtors and cash which the partners have received from the purchasing company.

The mode of distribution of shares, debentures and cash will necessarily depend upon a specific clause to that effect, in the partnership agreement. In the absence of any such clause, the division should be in ratio of partner final claims, i.e. in the ratio of what is due to partners. This is, in fact, what is contemplated by Section 48 (b) (iii) of the partnership Act To that extent, there is no room for any agreement with regard to the mode of distribution.

Illustration 8.1

Bright Ltd., was formed to acquire the partnership business of prakash and Ramesh who share profits and losses in proporation of 3/4 ands 1/4 respectively. Their Balance Sheet as on 31.12.1987 was as follows:

	Rs.		Rs.
Bills Payable	8,000	Land and Buildings	30,000
Sundry Creditors	22,000	Furniture	8,000

Mrs. Prakash Loan	5,000	Stock	12,000
Prakash Capital	40,000	Debtors	20,000
Ramesh's Capital	25,000	Investments	12,000
		Profit and Loss A/c	8,000
		Cash	5,000
		Good will	15,000
	----------		--------
	1,00,000		1,00,000

It was agreed by the company to take over the assets at book value with the exception of Land and Building and Stock which are taken over at Rs. 41,000 and Rs. 41,000 and Rs. 15,000 respectively. The value of the goods will fixed at Rs. 25,000. Investment were sold by the firm of Rs. 10,000. The company also agreed to take over the liabilities except Mrs. Prakash's Loan by the firm for Rs. 10,000. The company also agreed to take over the liabilities except Mrs. Prakash loan which was discharged by the firm by paying Rs. 4,500. The cost of dissolution of the firm came to Rs. 500.

The purchase consideration was discharged by the company by the allotment of 4,450 shares of Rs. 10 each and the balance in each cash.

Show ledger accounts to close the books of the firm, assuming that the shares are distributed among the partners in proportion to the amount due to them.

	Rs.		Rs.
To land and building	30,000	By Bills payable	8,000
Furniture	8,000	Sundry Creditors	22,000
Stock	12,000	Bright Ltd.,	79,000
Debtors	20,000	Mrs. Praksah losn	500
Good will	5,000		
Bank A/c	500		
Investments – Loss	2,000		
Realisation profits			
Prakash'c capital A/c	21,000		
Ramesh Capital a/c	8,000		
	1,09,500		1,09,500

BRIGHT LTD

To Realisation A/c	79,000	By shares in Bright Ltd.,	44,500
		Bank A/c	34,500
	-------------		-------------
	79,000		79,000
	-------------		-------------

PRAKASH'S CAPITAL ACCOUNT

To profit and Loss a/c	6,000	By Balance b/d	40,000
Shares in Bright Ltd	29,000	Realisation A/c	24,000
Bank A/c	29,000		
	-------------		-------------
	64,000		64,000
	-------------		-------------

RAMESH' CAPITAL ACCOUNT

To Profit and Loss A/c	2,000	By B alance b/d	25,000
Shares in Bright Ltd.,	15,500	Realisation a/c	8,000
	15,000		
	33,000		33,000

SHARES IN BRIGHT LTD

To Bright Ltd	44,500	By Prakash Capital A/c	29,000
		Ramesh's Capital A/c	15,500
	44,500		44,500

BANK ACCOUNT

To Cash a/c	5,000	By Realisation A/c	500
Bright Ltd	34,500	Mrs. Prakash Loan A/c	4,500
Investment	10,000	Prakash's capital a/c	29,000
		Ramesh capital A/c	15,500
	49,500		49,500

PURCHASE IN CONSIDERATION

Assets Taken over land and buildings		41,000	
Furniture		8,000	
Stock		15,000	
Debtors		20,000	1,09,000
Goodwill		25,000	
Less : Liabilities taken over : bills payable			8,000
Creditors		22,000	30,000
Payable in 4,450 shares of Rs. 10/- each Rs.	44,500		
Cash : (Rs 79,000 – Rs. 44,500)	34,500		79,000

Note : Shares and Cash have been divided between the partners in the ratio of their final claims, i.e. 58:31

Exercises

Gopal and Shyam are partners in a firm, sharing profits and losses in the ratio of 3:2 respectively. The balance sheet of the firm as on 31.12.1987 was under :

Liabilities	Rs.	Assets	Rs.
Capital Accounts		Land and buildings	60,000
Gopal	64,000	Machinery	20,000
Shyam	16,000	Furniture	7,000
General Reserve	8,000	Stock	30,000

Smt. Shyam's loan	30,000	Debtors	60,000
Creditors	60,000	Bills receivable	10,000
Bill payable	12,000	Cash balance	3,000
	--------		---------
	1,90,000		1,90,000

The firm was converted into a limited company, in the name of Indraprash ltd

1. The company took up the following (except cash and stock) at the valuation shown below.

	Rs.		Rs.
Goodwill	50,000	Furniture	5,000
Land and building	75,000	Debtors	54,000
Machinery	15,000	bills Receivable	10,000

1. The company agreed to pay all the liabilities except loan
2. The stock was taken over by Gopal at a discount of 10%
3. Shyam agreed to pay Smt. Shyam's loan
4. Realization expenses amounted to Rs. 1,000

The company paid in 12,000 equity shares of Rs. 10 each and the balance in cash, as purchase consideration. The share of the company to be distributed among the partners in the profit sharing ratio,

Difference to be adjusted in cash

Prepare in the books of the firm,

(1) Realisaiton Account

(2) Partners's capital accounts and

(3) A cash account (B.Com., Sourashtra, Jun 1988)

(Ans : Purchase consideration Rs. 1,27,000; Realistion profit Rs. 38,000; Gopal Rs. 72,000 in shares; Shyam get Rs. 48,000 in shares and Rs. 16,4000 in cash)

2. The Sunshine Company, Ltd. Was formed to acquire the business of Anand and Balan who share profits 2/3 and 1/3 respectively. The balance sheet of Anand and Balan was as under on December 31, 1986.

Bills payable	7,200	Land and Buildings	40,000
Sundry Creditros	21,600	Machinery	20,000
Mrs. Anand's Loan	3,200	Stock	24,000
Capitals		Debtors	23,200
Anand	64,000	Bills Receivable	6,400
Balan	40,000	Investments	4,800
		Cash at Bank	9,600
		Good will	8,000
	-----------		---------
	1,36,000		1,36,000

It was agreed by the company to takeover the assets at books value with the exception of land and buildings and stock which are taken over at Rs. 45,000 and Rs. 20,000 respectively. The investments were retained by the firm and sold by them for Rs. 4,000. They also discharge the loan of Mrs. Anand. The company takes over the remaining liabilities. The value of goods will is fixed at Rs. 28,000

The purchase consideration is discharged as follows

10,000 equity shares of Rs. 10 each and balance in cash

Close the books of the firm (B.com, Mangalore, Oct. 1987)

(Ans : Purchase consideration Rs. 1,24,200; Profit on realization Rs. 21,000; Anand gets Rs. 78,000 in cash and shares and Balan Rs. 47,000 shares Rs. 1,00,000 cash Rs. 25,000)

Lesson 9
BRANCH ACCOUNTS

A large business concern may explore the possibility of diversifying its business by opening a number of sections, divisions or establishment in different parts of the country. Such division or establishment are known as branches.

Types of Branch :

Branches may generally be classified into three types from the account point of view

1. Dependent branches
2. Independent branches
3. Foreign branches

Accounting in respect of Dependent branches

Dependent branches are those branches which are not keeping a separate set of books of accounts of their own. All the transactions connected with the branch are recorded only in the books of the Head Office. The branch maintains certain Memorandum recorus only such as Stock Register or Debtor's registers. These records do not continue books of accounts. Dependent branches generally depend upon the Head office for supply for goods, for meeting the day-to-day expenses and for general control and direction. Collection will be remitted to the Head Office immediately or deposited into a Bank account opened in the name of the Head office.

The dependent branches may be classified into the following types on the basis of accounting treatment.

i) Branch selling for cash only; This type of branch gets the supplies only from the Head Office, sells only for cash, remits the cash collected to the Head Office immediately or deposits the proceeds into a bank account opened in the name of the Head Office, the Head Office meets all the expenses of the branch by making the necessary remittances.

ii) Branch selling for cash and credit : Similar to the previous cash but the branch is permitted to sell for cash and credit.

iii) Branch supplied with goods at invoice price : Same as the above two types but with the difference that goods are invoiced by the Head Office to the Branch at loaded price, i.e. selling price.

Branch selling goods of the head office for cash. For the purpose of opening an account in respect of each branch of this type, the head office has to pass the following journal entries.

For sending goods to branch :

Particulars branch a/c Dr.

To Goods sent to branch a/c

For return of goods by the branch

Goods sent to branch a/c Dr

To Branch a/c

For sending cheque to branch towards expenses

Branch a/c - Dr.

To Bank a/c

For receiving proceeds of cash sale

Bank a/c Dr.

To Branch a/c

For recording closing balance of stock and petty cash

Branch stock a/c Dr.

Branch Petty cash Dr.

To Branch a/c

For profit made by the branch Dr.

Branch a/c

To general profit and loss a/c

For closing goods sent to branch a/c

Good sent to branch a/c Dr.

To purchase a/c

Branch stock and petty cash balances at close are shown in the Head Office balance sheet. At the commencement of the next accounting period, the following entry becomes necessary for writing up the Branch account.

Branch a/c Dr.

To Branch stock a/c

To branch petty cash a/c

Illustration 9.1

The Bangalore Shoe Company has a branch at Mysore

	Rs.		Rs.
Stock at branch on 1st Jan 1986	750	Petty cash	300
petty cash at branch on 1st Jan. 1986		Cash remitted to head office	
Cheque sent to branch :		Goods received from Head office	13000
Salaries	1000	Stock on 31st Dec. 1986	1000
Rent	1200	Petty cash on 31st Dec. 1986	150

Give Journal entries and prepare the Mysore Branch Account in the Books of the Head Office.

Solution

In the books of the Bangalore Shoe co.,

MYSORE BRANCH ACCOUNT

Jan1. To Balance b/d		Dec. 31 By Bank-Cash sales	18000
Stock	750		
Petty Cash	200	Balance c/d	1000
Goods sent to		Stock	

Goods sent to branch a/c Dr
To Branch a/c

For sending cheque to branch towards expenses

Branch a/c - Dr.
To Bank a/c

For receiving proceeds of cash sale

Bank a/c Dr.
To Branch a/c

For recording closing balance of stock and petty cash

Branch stock a/c Dr.
Branch Petty cash Dr.
To Branch a/c

For profit made by the branch Dr.

Branch a/c
To general profit and loss a/c

For closing goods sent to branch a/c

Good sent to branch a/c Dr.
To purchase a/c

Branch stock and petty cash balances at close are shown in the Head Office balance sheet. At the commencement of the next accounting period, the following entry becomes necessary for writing up the Branch account.

Branch a/c Dr.
To Branch stock a/c
To branch petty cash a/c

Illustration 9.1

The Bangalore Shoe Company has a branch at Mysore

	Rs.		Rs.
Stock at branch on 1st Jan 1986	750	Petty cash	300
petty cash at branch on 1st Jan. 1986		Cash remitted to head office	
Cheque sent to branch :		Goods received from Head office	13000
		Stock on 31st Dec. 1986	1000
Salaries	1000	Petty cash on 31st	
Rent	1200	Dec. 1986	150

Give Journal entries and prepare the Mysore Branch Account in the Books of the Head Office.

Solution

In the books of the Bangalore Shoe co.,

MYSORE BRANCH ACCOUNT

Jan1. To Balance b/d		Dec. 31 By Bank-Cash sales	18000
Stock	750		
Petty Cash	200	Balance c/d	1000
Goods sent to		Stock	

The head office, on this part, prepares the branch account in the same way as it does in te case of a branch selling ghoods only for cash. However it records only the opening and closing balances of debtors without showing returns, bad debts, discount and allowanees. In order to prove the accuracy of the closing balance of debtors it may, if it desires, open branch debtors account as a memorandum account.

Illustration 9.2

The Bombay Trading Company invoiced goods to its branch at Delhi at cost. The Head office paid all the branch expenses from its bank, except petty cash expenses which were met by the branch. At the cash collected by the branch was banked on the same day to the credit of the Head Office account. The following is a summary of the transactions of the branch during the year ended December 31, 1986.

	Rs.		Rs.
Stock, January 1	7000	Bad debts	600
Debtors, January 1	12600	Goods returned by customers	500
Petty cash January 1	200	Salaries and wages	6200
Goods sent to branch	26000	Rend and Rates	1200
Branch	1000	Sundry expenses	800
Cash sales	17500	Cash received on ledger accounts	28500
Credit sales	28400	Stock December 31	65000
Allowances to customers	200	Debtors, December 31	9800
Discount to customers	1400	Petty cash, Dec. 31	100

From the above particulars, prepare the Delhi Branch Account in the Head office Books.

Solution

In the books of the Bombay Trading Company

DELHI BRANCH ACCOUNT

		Rs.			Rs.
To Balance b/d 1.1.1986			By bank		
Stock		7000	Cash sales	17500	
Debtors		12600	Cash received on Ledger a/c	28500	
Petty cash		200		----------	46000
Goods sent o Branch a/c			Returns to head office		1000
Bank			Balance c/d 31.12.1986		
Salaries and wages	6200		Stock		6500
Rent and Rates	1200		Debtors		9800
Sundry expenses	800	8200	Petty cash		100
General profit & Loss a/c		9400			
		63400			63400

MEMORANDUM BRANCH DEBTORS ACCOUNT

	Rs.		Rs.
To balance b/d. 1.1.1986	12600	By returns	500
Credit Sales.	28400	Cash	28500
		Discount	1400
		Allowance	200
		Bad debts	600
		Balance c/d 31.12.1986	9800
	41000		41000

Note : The branch account, as prepared above, is a nominal account showing profit or loss made by the branch. If it desired to prepared a trading and profit and loss account for ascertaining profit or loss, the accompanying branch account will only be a personal account showing the total of closing balances as the differences between the two.

IN THE BOOKS OF THE BOMBAY TRADING COMPANY
TRADING AND PROFIT AND LOSS ACCOUNT OF THE DELHI BRANCH

For the year ended 31st December 1986

To stock 1.1.1986		7000	By sales		
Goods sent to branch	26000		Cash sales	17500	
LESS : Returns	1000	25000			
Gross profit c/d		19900	Credit sales 28400		
			LESS : Return 500	27900	45400
			Stock 31.12.1986		6500
		51900			51900
To salaries and wages		6200	By Gross Profit b/d		19900
Rent and Rates		1200			
Sundry expenses		800			
Petty cash expenses		100			
Allowances		200			
Discount		1400			
Bad debts		600			
Net profit		9400			
		19900			19900

DELHI BRANCH ACCOUNT

To Balance b/d			By Bank		
1.1.1986					
Stock		7000	Cash sales	17500	
Debtors		12600	Cash received on		
Petty cash		200	Ledger accounts	28500	46000

Goods sent to branch		26000	Returns to head office		
Bank			Balance c/d		
Salaries & Wages	6200		(Rs. 6500+9800+100)		
Rent and Rates	1200				
Sundry expenses	800				
	------	8200			
Profit		9400			
		------			-------
		63400			63400
		-------			-------

(iii) Where goods are charged to branch at loaded or inflated price or invoice price, the following accounts are maintained under the stock and debtor methods.

(a) Branch Stock Account to record all transactions relating to goods at loaded price. In this case, the branch stock account does not reveal profit or loss, but only stock on hand at close. In the absence of any deficiency of stock, the difference between the two sides of this account should be equal to the invoice of stock on hand

(b) Branch debtors Account being the same as that opened already

(c) Branch Adjustment Account used for adjusting the load on opening and closing stock, goods sent to branch and returns from branch, deficiency of stock due to leakage, spoilage, pilferage, etc. Subject to these adjustments, the account reveals gross profit or gross loss.

(d) Branch expenses account

(e) Branch profit and loss account, and

(f) Goods sent to branch account

Illustration 9.3

Anand Stores had a branch at Calcutta. The goods supplies to the branch were invoiced at a selling price of Rs. 25000 which was 25% over the cost. The branch paid all expenses from cash takings and remitted the balance of Rs. 21050 to the Head Office. Credit sales for the year amounted to Rs. 15500. The expenses of the branch during the year were : Rent Rs. 1200 Salaries Rs. 2400 and Sundry Expenses of Rs. 1010. The other balances relating to th branch as on 1st January and 31st December were :

Cash on hand on 1st Jan Rs.	200	and on 31st Dec. Rs.	240
Debtors	1300		1100
Stock	4000		3000

There was a fire at the branch in which some stocks were destroyed, but their value was not as certained. Pass journal entries and prepare the necessary ledger accounts in the books of the Head Office.

Solution :

In the Books of Anand Stores
JOURNAL ENTRIES

		Rs.	Rs.
Calcutta Branch Stock a/c			
To opening Stock a/c	Dr.	4000	
(Being the entry for transfer of opening			400
stock branch stock a/c			
Calcutta Branch stock a/c	Dr.	25000	
To Good sent to Branch a/c			25000
(Being the entry for goods sent to branch)			
Cash a/c	Dr.	10000	
To calcutta branch stock a/c			10000
(Being the entry for credit sales by branch)			
Calcutta branch expenses a/c	Dr.	4610	
To cash a/c			4610
(Being the entry for branch expenses)			
Calcutta Branch closing stock a/c	Dr.	3000	
To calcutta branch stock a/c			3000
(Being the entry for branch expenses stock)			
Stock destroyed a/c	Dr.	400	
Branch Adjustment a/c	Dr.	100	
To Calcutta branch stock a/c			500
(Being the entry for stock destroyed)			
Branch profit and loss a/c	Dr.	400	
To stock destroyed a/c			400
(Being the entry for transfer of loss of stock			
to profit and loss a/c)			
Stock Reserve a/c	Dr.	800	
To Branch adjustment a/c			800
(Being the entry for loading on opening stock)			
Goods sent to branch a/c	Dr.	5000	
To Branch Adjustment a/c			5000
(Being the entry for loading on goods sent)			
Branch Adjustment a/c	Dr.	600	
To Stock Reserve a/c			600
(Being the entry for loading on closing stock)			
Branch profit and loss a/c	Dr.	4700	
To General profit and Loss a/c			4700
(being the entry for transfer of branch net profit)			

BRANCH STOCK ACCOUNT

	Rs.		Rs.
To Balance b/d		By Cash – Cash sales	1000
Opening Stock	4000	Branch debtors credit sales	15500
Goods sent to branch a/c	25000	Balance stock	
		Closing stock	
		"Stock destroyed a/c	3000
		(Balancing fiture)	500
	29000		29000

BRANCH DEBTORS ACCOUNT

	Rs.		Rs.
To Balance b/d	1300	By Cash (balancing figure)	15700
Goods Stock a/c sales	15500	"Balance c/d	1100
	16800		16800

BRANCH ADJUSTMENT ACCOUNT

	Rs.		Rs.
To branch stock a/c on goods destroyed	100	By stock reserve a/c loading on opening stock	800
Stock Reserve a/c loading closing stock	600	Goods sent to branch a/c loading on goods sent	5000
Branch profit & loss a/c	5100		
	5800		5800

BRANCH PROFIT AND LOSS ACCOUNT

	Rs.		Rs.
To stock destroyed a/c	400	By branch adjustment a/c	5100
General profit and loss a/c	4700		
	5100		5100

BRANCH CASH ACCOUNT

	Rs.		Rs.
To balance b/d	200	By Branch expenses	4610
Branch Debtors a/c	15700	Head office cash a/c	21050
Branch stock a/c cash sales balance figure	10000	Balance b/d	240
	25900		25900

INDEPENDENT BRANCHES

A Branch is said to be independent when it maintains a separate set of book of accounts and keeps a full system of accounting. In other words, the branch carried on business as an independent unit, records all the transactions in its own books, extracts it own trial balance and prepareS its own Trading and Profit and Loss Account. A copy of the trial balance so prepared will be forwarded to the head office and the head office will incorporate the same in its books of accounts so that a consolidated profit and loss account and a Balance Sheet can be prepared for the business as a whole independent branches generally do not depend upon the head office for supplies of goods and for meeting the expenses and they are not required to remit their collections to the head office daily as in the case of dependent branches. However, periodical transfer of goods and remittance of money may take place between the head office and the branch.

Accounting Treatment

The head office will open it its books a 'Branch Account' which is a running account between the head office and the branch and all transactions taking place between the head office and the branch will be recorded therein. Thus, the goods sent to branch, expenses branch paid by the head office etc., will be debited to this account. Cash received from the branch, goods returned by the branch etc. Will be credited. The balance in this account shows the amount due from or due to the branch by the head office.

Corresponding to the 'Branch Account' in the head office, the branch opens a 'Head Office Account' wherein the same transactions between the branch and head office are recorded and the balance is the amount due to or due from the head office.

Since the 'Branch Account in the branch books are only reciprocal accounts, the balance shown by these acçounts would generally agree, if all the transactions between the head office and branch have been recorded on the same date in both the books, However because of certain errors or pending adjustments there may be difference between the balances shown by the books of accounts on any date.

The following adjustment may be remembered:

I. Purchase of Branch fixed assets :

Its usual fo rthe head office to open and maintain the fixed asssets of the branch in its own book, though the asets are in use with the branch. This is done for the purpose of preparing the consolidated Balance Sheet by the Head office. In such cases, the following transactions may take place;

(i) Purchase of a machinery for use at the branch, say for Rs. 10000 and paid by the branch. The branch will make an entry in its books.

	Rs.	Rs.
Branch machinery A/c	10000	
To Bank Cash A/c		10000
(Amount paid for machine purchases for branch use)		

(ii) If the same asset is purchased and paid for by the branch but the accounts for the same is to be opened in the head office books

		Rs.	Rs.
The entries will be			
In the branch books			
Head office Account	Dr.	10000	
To bank cash a/c			10000

(Amount paid for machinery purchase, account to be opened in the Head office books)

In the head office books:

Branch machinery a/c	Dr.	10000	
To branch A/c			10000
(Being the branch machinery Account opened)			

2. Depreciation of Branch fixed assets :

If the branch assets account is opened in the books of the head office as shown above, the depreciation in respect of the asset for the year has to be adjusted in the books of the head office and branch. For examples, if the depreciation to be charged at 10% on the branch

Machinery whose book value is Rs. 10000 the entries will be:

In the branch books, for charging deprecation :

		Rs.	Rs.
Deprecation A/c	Dr.	1000	
To Head office a/c			1000
(Depreciation written off)			

In the head office books, for writing Down the value : Branch A/c	Dr.	1000	1000
(Depreciation on the branch machinery provided)			

3. Goods in Transit:

When the head office sends goods to the branch, it makes an entry debting the 'Branch Account' and crediting the goods sent to the branch account with the value of goods sent. If the same goods have been received by the branch before the date of account closing, a the branch debits, the 'goods received form the Head Office Account' and credits the 'Head Office Account'. But it may so happened that a consignment of goods sent by the head office to branch though entered in the books of the head office might not have reached the branch before the date of account closing. The goods are said to be in transit, and hence no entry would appeal in the books of the branch. Hence the balance shown by the head office account in the branch books will not agree with the balance shown by the 'branch account' in the head office book. The head office will have to make the following entry to adjust the goods in transit.

Goods in Transit Account	Dr.	--	
To Branch account			---

There will be no entry in the books of the branch/ Goods in transit is an asset and will be shown in the balance sheet.

4. Cash in Transit

Just like goods in transit, the cash remitted by the branch might not have reached the head office before the date of account closing. It known as 'Cash Transit' and the following adjustment is made in the branch books.

Cash in Transit Account	Dr.	----	
To Head Office Account			----

(Cash in transit adjusted)

The branch credit he Head Office Account because though it has already debited the Head Office Account when the cash was sent, the cash has not yeat been received by the head office: There will be no entry in the head office books. The cash in transit is an asset and appears in the balance sheet.

However cash in transit may be adjusted in the head office books instead of in the branch books as explained above. In such case, the entry in the books of the head office will be.

Cash in Transit Account	Dr	---	
To branch account			---
(Cash in transit adjusted)			

If there is a difference between the Head Office Account and branch account it means that either there is goods in transit or cash in transit or both and the necessary adjustments should be made.

5. Head Office Expenses Account :

The head office might have rendered some service to the branch or the branch might have been benefited by the expenditure incurred by the Head office. At the end of the year, the head office may charge the branch will a reasonable amount for the services so rendered or benefit given. The entry in the books of the head office will be.

Branch Account	Dr.	----	
To profit and Loss Account			---
To Salaries Account			
(Being the service / expenses charged to the branch)			

If the benefit received by the branch is because of the service rendered by the branch is because of the service rendered by the staff of the head office, it is better to credit the Salaries Account in the head office books. If the benefit obtained is of general nature and cannot be specified, the profit and loss account is to be credited.

The entry for the same in the branch			
Books will be	Dr		
Head office expenses account	Dr.	----	
To Head office accounts			---
(Amount due to head office For services received)			

The head office expenses account ill be closed and transferred to the branch profit and loss account

6. Inter Branch transactions :

Frequently goods are transferred from one branch to another under instructions from the head office, to meet the urgent requirements of the branch. Similarly, cash also may be transferred from one branch to another. For example, if the Cochin branch of the Madras Head Office transfer goods with Rs. 4000 to the Mangalore branch, the entries will be :

In the books of the Cochin Branch :

Madras Head office account	Dr.	4000
To goods sent to branch account		4000
(Goods supplies to Mangalore branch under		

instruction from Head office)

In the books of Mangalore branch 4000

Goods received from the Head office

Account Dr. 4000

(Goods received from Cochin branch
under instruction from Head office)

In the Madras Head office Books

Mangalore Branch Account	Dr.	4000	
To Cochin Branch Account			4000

(Goods transferred from Cochin branch
to Mangalore branch)

It is to be noted that the Head office debits the branch receiving the benefit and credits the branch. Giving the benefit. In the books of the concerned branches, only the head office account is either debited or credited since a branch has only the account for the head office in its books and not for the other branches. If each branch has to maintain accounts of all other branches, accounting any become unwidely and cumbersome.

Illustration 9.4

Give the entries to adjust the following in the books of the Bombay Head Office and Baroda Branch.

(a) Goods work RS. 5000 purchased by Baroda branch but payments made by the Bombay head office. The Bombay office debited the amount to its own purchase account.

(b) Goods Rs. 3000 sent by Bombay head office to Baroda branch have not yet reached the branch.

(c) An amount of Rs. 5000 sent by the Baroda branch to the head office has not yet been received.

(d) The Baroda branch paid Rs. 2500 as salary to a visiting head office official. This was debited to the Salaries account by the branch

(e) Expenses Rs. 2000 to be charged to the Baroda branch for service rendered to it by the head office.

(f) Baroda branch purchased a plant and machinery for Rs. 20000 and paid the amount the amount is to be opened in the head office books.

(g) Depreciation of Rs. 1000 in respect of the above machinery has not yet been provided.

(h) The Baroda branch paid Rs. 700 dividend to a local shareholder on behalf of the head office

IN THE BOOKS OF BOMBAY H.O

(a) Baroda Branch A/c	Dr.	5000	
To purchase A/c			5000
(Wrong debit to purchases a/c for goods purchases by branch rectified)			
(b) Goods in Transit A/c	Dr.	3000	
To Baroda Branch A/c			3000
(c) No entry			
(d) Salaries	Dr.	2500	
To Baroda Branch A/c			2500

(Salaries paid by the Baroda Branch)			
(e) Baroda Branch	Dr.	3000	
To P & L A/c			3000
(Expenses charged to branch)			
(f) Branch plant & Machinery A/c	Dr.	20000	
To Baroda Branch A/c			20000
(Branch machinery account opened)			
(g) Baroda Branch Account	Dr.	1000	
To Branch plant and Machinery A/c			1000
(Depreciation on branch machinery)			
(h) Dividends A/c		700	
To Baroda Branch A/c			700
(Dividend paid by the branch on our behalf)			

IN THE BOOKS OF BARODA BRANCH

(a) Purchase A/c	Dr.	5000	
To Head Office A/c			5000
(Purchase paid by H.O)			
(b) No entry			
(c) Cash in Transit A/c	Dr.	5000	
To Head Office A/c			5000
(Cash in transit adjusted)			
(d) Head Office A/c	Dr.	2500	
To salaries A/c			2500
(Wrong debit to salaries A/c of salary paid to the head office officially rectified)			
(e) Head Office Expenses A/c	Dr.	3000	
To Head office A/c			3000
(Amount due to H.O. for services received)			
(f) Head Office A/c	Dr.	20000	
To Bank A/c			20000
(Plant and Machinery purchased and account to be opened in the H.O. Books)			
(g) Depreciation A/c	Dr.	1000	
To Head office A/c			1000
(Depreciation written off)			
(h) Head Office A/c	Dr.	700	
To Bank A/c			700

Incorporation of Branch Trail Balance in the Head office Books

An independent branch prepares its own trial balance and send a copy of the same to the head office to be incorporated in the books of the head office so that a profit and loss account for the branch and a consolidated balance sheet can be prepared for the business as a whole. There are two ways in which it can be done.

Method I

Under this method, all the figures found in the branch on trial balance are incorporated in the books of the head office by means of a set of incorporating entries, as shown below :

1. To incorporate all items on the debit side to the branch trading account

Branch Trading Account	Dr.	---	
To Branch Account			---

(Opening Stock, Goods from H.O. and direct expenses incorporated)

2. To incorporate all items on the credit side of the

Branch account	Dr.	---	
To Branch Trading Account			---

(Sales and closing stock incorporated)

The gross profit / Loss can now be as certained

3. To transfer the gross profit to profit and loss account

Branch Trading Account	Dr.	---	
To Branch P & L A/.c			---

(Gross Loss Transferred)

If it is a Gross Loss :

Branch P & L Account	Dr.	---	
To Branch Trading Account			---

(Gross Loss transfered)

4. To incorporate all the items on the debit side of the branch P & L Account

Branch P & L Account	Dr.	---	
To Branch Account			---

(Expenses and losses incorporated)

5. To incorporate the items on the credit side of the P & L Account

Branch Account	Dr.	---	
To Branch P & L Account			---

(Incomes and gains incorporated)

6. Branch Profit and Loss Account would now show the net profit or loss. To transfer the profit or loss

Branch Account	Dr.	----	
To General P & L Account			---

(Net profit transferred)

The entry will be reserved if there is a loss

The above entries will complete the branch Trading and Profit and Loss Account

7. To incorporate the branch assets

Individual Assets	Dr.	---	
To Branch Account			---

(Assets incorporated)

8. To incorporate branch liabilities

Branch Account Dr. ---

To individual liability A/c --

(Liabilities incorporated)

The last two entries enable the head office to prepared a balance sheet for the branch by the head office. The effect of all above incorporating entries is to close the branch account in the books of the head office, since all items have been transferred to the head office books, If the head office has to prepared the Trading and Profit and Loss Account only, it does not pass the last two entries, with the effect that the branch account will show a balance equal to net assets, ie. Total assets minus liabilities at the branch on that date.

In the subsequent accounting period, that last two entries will be reversed so that the branch assets and liabilities can be closed in the head office books and transferred to the branch books.

Method II

Under the method, the branch trading and profit and loss account is prepared as a memorandum account and entry is passed only for incorporating the net profit or loss at the branch, instead of incorporating all the items of the trial balance. The entry to incorporated the net profit or loss will be.

If is net profit

Branch Account Dr. ---

To General P & L Account ---

(Net Profit incorporated)

It is net Loss:

General P & L Account Dr. --- ---

To Branch account --

(Net loss incorporated)

In addition to the above entry, entries incorporating the branch assets and liabilities will be made, as shown already.

Just like entries are made in the books of the head office for incorporating the branch figures, branch will make closing entries to close its books and transfer the balance to the head office.

Illustration 9.5

Madurai Head Office has an independent branch at Madras. From the following particulars, give :

(i) Journal entries to incorporate the branch trial balance in H.O. Books

(ii) Madras Branch Account as it would appear in the Head Office Books

(iii) Entries to close the books of the Madras branch account : and

(iv) Madurai Head Office Account in the branch books

MADRAS BRANCH

TRIAL BALANCE AS ON DECEMBER 31 1983

	Rs.		Rs.
Stock on January1,1983	8200	Creditors	2700
Purchase	12800	Sales	34950
Wages	6550	H.O. Account	14000

8. To incorporate branch liabilities

Branch Account Dr. ---

To individual liability A/c --

(Liabilities incorporated)

The last two entries enable the head office to prepared a balance sheet for the branch by the head office. The effect of all above incorporating entries is to close the branch account in the books of the head office, since all items have been transferred to the head office books, If the head office has to prepared the Trading and Profit and Loss Account only, it does not pass the last two entries, with the effect that the branch account will show a balance equal to net assets, ie. Total assets minus liabilities at the branch on that date.

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If is net profit

Branch Account Dr. ---

To General P & L Account ---

(Net Profit incorporated)

It is net Loss:

General P & L Account Dr. --- ---

To Branch account --

(Net loss incorporated)

In addition to the above entry, entries incorporating the branch assets and liabilities will be made, as shown already.

Just like entries are made in the books of the head office for incorporating the branch figures, branch will make closing entries to close its books and transfer the balance to the head office.

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MADRAS BRANCH

TRIAL BALANCE AS ON DECEMBER 31 1983

	Rs.		Rs.
Stock on January1,1983	8200	Creditors	2700
Purchase	12800	Sales	34950
Wages	6550	H.O. Account	14000

Rs. 1700+150+=1850 Salaries			
Rs. 5500. Depreciation Rs. 2650=Rs. 12000)			
Madras Branch A/c	Dr.	150	
To Branch P & L A/c			150
(Discount Received)			
General P & L A/c	Dr.	400	
To Branch P & L A/c			400
(Branch loss transferred)			
Branch Cash A/c	Dr.	750	
Branch Debtors A/c	Dr.	4000	
Branch Stock A/c	Dr.	14350	
To Madras Branch A/c			19100
(Branch Assets incorporate)			
Madras Branch A/c	Dr.	2850	
To Branch Creditors A/c			2700
To Rent			150
(Liabilities incorporated)			

MADRAS BRANCH ACCOUNTS

		Rs		Rs.
1983 Dec. 31	To balance b/d	20000	By Gods in transit	20000
	"Branch Machinery	2500	"Cash in transit	4000
	"Branch Trading A/c	49300	"ranch Trading A/c	37850
	"Branch P & L A/c	150	"Branch Asset A/c	19100
	"Branch Liabilities	28150	"Branch Profit & Loss A/c	1200
	"Branch Furniture	150		
		74950		74950

IN THE MADRAS BRANCH BOOKS

1983	Depreciation A/c	Dr.	2650		
Dec. 31	To Head Office A/c			2650	
	(Depreciation written off)				
	Rent A/c	Dr.	150		
	To Outstanding Expenses A/c				150
	(Outstanding rent provided)				
	Madurai Head Office A/c	Dr.	50150		
	"To Opening Stock			8200	
	"Purchase			12800	
	"Wages			6550	
	"Manufacturing expenses			3400	
	"Rent				1850
	"Salaries				5500
	"General expenses				2000
	"Goods from Head Office A/c				7200

	"Depreciation				2650
	(Transfer of the revenue items)				
	Sales A/c		Dr.	34950	
	Closing Stock A/c		Dr.	14350	
	Purchase Returns A/c		Dr.	300	
	Discount Received		Dr.	150	
	To Madurai Head Office A/c				49750
	(Transfer of credit balance in Revenue Accounts)				
	Madurai Head Office A/c		Dr.	19100	
	To Closing Stock				14350
	To Debtors				4000
	To Cash at Bank				750
	(Transfer of assets)				
	Creditors A/c		Dr.	2700	
	Outstanding Rent A/c		Dr.	150	
	To Madura Head Office A/c				2850
	(Liabilities transferred)				

MADURAI HEAD OFFICE ACCOUNT

1983 Dec.31	To Sundry Expenses	50150	To Balance C/d	14000
	"Sundry Assets	19100	"Depreciation	2650
			"Sundry Revenue A/c	49750
			"Sundry Liabilities	2850
		69,250		69,250

FOREIGN BRANCHES

A foreign branch is nothing but an independent branch but located in a foreign country. It maintains accounts in a foreign currency. The trial balance of the foreign branch will have to be incorporated in the books of the head office at the end of the year for purposes of a certaining the branch trading results and also be prepare of as certaining the branch trading results and also be prepare the balance sheet for the business. The main problem is to convert the branch train balance which is in foreign currency into that of the head office currency in order to incorporate the figures in the books of the head office.

The following points may be remembered for the purpose of conversion.

(1) If the rate of exchange is stable, then all the items in the Trial Balance will be converted at the stable rate.

(2) When there is violent fluctuation in the rate of exchange the head office and branch will adopt a standard rate for conversion and all items in the Trial Balance will be converted at the standard rate only.

(3) If there is a moderate fluctuation in the rate of exchange, the following rates will be applied for the purposes of conversion.

	Items	**Rates of conversion**
a)	Goods from head office	Actual rate after adjustment
b)	Goods returned to head office	of in transit, items, etc.
c)	Remittance to head office	
d)	Remittance from head office	

e)	Head office account	
f)	Purchase	Average rate ; if not given, Average rate = $\frac{\text{opening rate + Closing rate}}{2}$
g)	Sales	
h)	Expenses	
i)	Income	
j)	Opening Stock	Opening rate
k)	Current assets including closing stock	Closing rate
l)	Current liabilities	
m)	Fixed assts	Actual rate at the date of purchase or opening rate.
n)	Long term liabilities	Rate at the date of contracting the liability
o)	Depreciation	The rate that applies to the concerned fixed assets

Depreciation and closing stock are not normally found in the branch Trial Balance as they are adjustment items. But they may also be converted applying the above rules for getting a completely converted position. The difference in a converted Trial Balance arising simply due to application of different a rates is transferred to a Difference in Exchange account. If the difference is small, it is closed by transfer to the profit and loss account, but if the difference is big, it is taken to an exchange fluctuation account and will be shown in the balance sheet either as an asset or as a liability depending on whether the balance is debit or credit.

Alternatively, instead of converting every item and then preparing the branch trading and profit and loss account, in the head office books, it is possible to prepare first the branch trading and profit and loss account in the branch currency and then to convey the abridged train balance following the rules already given.

If there is a devaluation of either the head office currency or the branch currency in any year, the revenue item will also be converted at the closing rate only to show the fair picture of the branch profit.

Illustration 9.6

Covert the following Trial Balance as on December 31, 1982 of the London Branch of a Madurai Head office.

	£	£
Stock in hand	900	---
Purchase and sales	6250	9375
Debtors and creditors	3000	2500
Bills receivable and bills payable	800	1070
Wages and salaries	400	---
Rent, rates, etc	300	---
Sundry charges	125	---
Furniture	350	---
Cash at bank	3700	---
Madurai H.O. A/c	---	2880
	15825	15825

Stock on December 31, 1982 was £ 2500. The London branch A/c in Madurai. H.O. books was Rs. 33200 furniture appeared in H.O books at Rs. 5000. The rate of exchange on January 1, 1982 was Rs. 14 and on December 31, 1982 Rs. 9. The average rate for the year 1982 was Rs. 12.

Prepare the profit and Loss Account and Balance Sheet of the London branch in the H.O Books, showing how you would deal with the difference in exchanges.

Solution

IN THE BOOKS OF MADURAI HEAD OFFICE

Converted Trial Balance as on December 31, 1982

Particulars	Dr. £	Cr. £	Rate	Dr. £	Cr. £
Stock in hand	900	--	1£ =Rs.14	12600	--
Purchase and sales	6250	9375	1£ =Rs. 12	75000	112500
Debtors and creditors	3000	2500	1£ = Rs. 9	27000	22500
B/R and B/P	800	1070	1£ = Rs.9	7200	9630
Wages and Salaries	400	--	1£ = Rs.12	4800	--
Rent, rate etc.	300	--	1£ = Rs.12	3600	--
Sundry charges	125	--	1£ = Rs.12	1500	--
Furniture	350	--	Actual	5000	--
Cash and Bank	3700	--	1£ =Rs. 9	33300	--
Madurai H.O. A/c	--	2880	Actual	--	33200
Exchange Fluctuation A/c	---	---	---	7830	--

Closing Stock £ = 2500 = Rs. 22500

LONDON BRANCH

Profit and Loss Account for the year ended December 31, 1982

	Rs.		Rs.
To opening stock	12600	By Sales	112500
Purchase	75000	"Closing Stock	22500
Gross Profit	47400		
	135000		135000
Wages and Salaries	4800	"Gross Profit	47400
Rent, rates etc	3600		
Sundry charges	1500		
Net profit	37500		
	47400		47400

2. A head office in Bombay sends goods to its branch at Madras marked 20 per cent above cost. From the following particulars show how the branch account will appear in the head office books, give also the journal entries necessary for the head office to adjust the branch account for arriving at the profit or loss made by the branch

		Rs.
Stock on 1.17.1982		1800
Debtors		3000
Petty cash in hand		30
Goods supplied to the branch		30000
Remittance from the branch	5000	
Cash sales	21000	26000
Cash received from debtors		
Cheque sent to branch		
Salary	900	
Rent and Taxes	150	
Petty cash	110	1160
Stock at Branch on 31.12.1982		3000
Debtors at the Branch on 31.12.1982		4800
Petty cash		20
(Ans : Net profit)	Rs.	3630

3. A Madurai Head Office has in independent, branch Madurai. From the following particulars, given journal entries to close the books of the Madras branch. Show also the Madurai Head Office Account in the branch books.

Madras Branch

TRIAL BALANCE AS ON 31.12.1983

	Rs.		Rs.
Stock on January 1	8200	Creditors	2700
Purchase	12800	Sale	34950
Wages	6550	H.O.	14000
Manufacturing Expenses	3400	Discount	150
Rent	1700	Purchase Returns	300
Salaries	5500		
Debtors	4000		
General Expenses	2000		
Goods received from H.O	7200		
Cash at Bank	750		
	52100		52100

(a) Closing stock at Branch was RS. 14350

(b) The Branch fixed assets maintained at H.O. books were : Machinery RS. 25000. Furniture Rs. 1000 and Depreciation are to be allowed at 10 per cent on machinery and 15 per cent on furniture.

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Manufacturing Expenses	3400	Discount	150
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Salaries	5500		
Debtors	4000		
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Goods received from H.O	7200		
Cash at Bank	750		
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(a) Closing stock at Branch was RS. 14350

(b) The Branch fixed assets maintained at H.O. books were : Machinery RS. 25000. Furniture Rs. 1000 and Depreciation are to be allowed at 10 per cent on machinery and 15 per cent on furniture.

(c) Rent payable was Rs. 150.

(d) A remittance or Rs. 4000 made by branch on Dcember 28, 1983, was received by the Head Office on January 4, 1984

5. On December 31, 1981, the following balances appeared in the books of the Madras branch of a firm having its head office in London.

	Dr.	Cr.
Stock in hand on 1.1.81	12600	
Purchases and sales	75000	112500
Sundry debtors and creditors	39000	26000
Bills received and bills payable	10400	9100
Wages and salaries	4800	
Rent, rates and taxes	3600	
Sundry charges	1500	
Fixture and fittings	4910	
Cash at bank	28900	
London account	33200	
	--------	---------
	180800	180800

Stock on December 31, 1981 was Rs. 32500 Madras Branch Account in the London books showed a debit balance of £ 2680 on December 31, 1981 and fixtures and fittings appeared in the head office books at £ 350.

The rate of exchange on December 31, 1980, was Rs. 14 and on December 31, 1981 Rs. 13. The average rate for the year was Rs. 12.

Prepared in the head office books, the profit and loss account and the balance sheet of the Madras branch.

(Ans : Difference in exchange £ 400, Gross Profit £ 4,725; Net Profit £ 3900 B/S Total £ 9280)

LESSON 10

Departmental Accounts

Traders dealing with different kinds of mercandise may have departmental business. Many types of goods like medicines, textiles, stationary, crockery may be sold under one roof. Such businessman may like to know the profit or loss in each and every department. So accounts should be prepared to show the sales purchase, stock etc., of every department.

Preparation of departmental accounts help to know the efficiency of departments. So departments giving higher profit can be expanded and departments giving higher profit can be expanded departments giving lower profit can be closed or steps can be taken to improve the efficiency.

Purchase book, sale book, purchase returns book, sales returns book can be kept in columnar form, So trading account can be easily prepared. While preparing the departmental profit and loss account, expenses, common to all the departments should be allocated to different departments.

ALLOCATION OF EXPENSES

There are some expenses which are incurred specifically for a department and they are called as direct expenditure. For example salaries for the staff working in the department. Such expense can be debited to the profit and loss account.

Some expenses like depreciation, lightings salaries of general manager, cannot be easily allocated to different departments. Such expenses are to be allocated on a suitable basis. The following table may be useful for such allocation.

	EXPENSES	BASIS OF ALLOCATION
1.	Rent and rates	Floor space occupied by each department
2.	Repairs to machines	Value of machinery
3.	Electric lighting	Light points
4.	Power for machinery	Horse power of machinery
5.	Depreciation	Value of plant and machinery
6.	Selling expenses	Departmental sales
7.	Labour welfare expenses	No. of workers
8.	Works manager's salary	Time spent for each department

Some expenses like debenture interest,, directors fee, income tax etc. cannot be easily allocated to different departments. They can be debited to general profit and loss account.

INTER – DEPARTMENTAL TRANSFERS:

Different departments may transfer goods or service among themselves. The department receiving the benefit should be debited and the department giving the benefit should be credited.

The transfer may be made at cost price or selling price. If the transfer is made at selling price, stock reserve should be created for unsold stock. Stock reserve is the difference between cost price and selling price, of unsold stock.

Illustration 10.1

Gayathri textile had two departments, cloth and ready made clothes. The ready made clothes were made by the firm itself out of cloth supplied by the cloth department at its usual selling price. From the following figures prepared departmental trading and profit and loss accounts for the year 1994.

	Cloth Departments Rs.	Readymade Cloth Rs.
Opening stock on 1st Jan. 1994	3,00,000	50,000
Purchases	20,00,000	15,000
Sales	22,00,000	4,50,000
Transfer to Readymade cloths Department	3,00,000	--
Expenses – Manufacturing	--	60,000
Selling	20,000	6,000
Stock on 31st December 1994	2,00,000	60,000

The stocks in the ready made clothes department may be considered as consisting of 75% cloth and 25% other expenses. The cloth department earned gross profit at the rate of 15% in 1993 General expenses of the business as a whole came to Rs. 1,10,000/-

DEPARTMENTAL TRADING AND PROFIT AND LOSS ACCOUNTS FOR THE YEAR ENDING DECEMBER 1994

	Cloth	Ready made clothes	Total		Cloth	Readymade clothes	Total
	Rs.	Rs	Rs.		Rs	Rs.	Rs.
To opening stock	3,00,000	50,000	3,50,000	By sales	22,00,000	45,00,000	26,50,000
To purchase	20,00,000	15,000	20,15,000	By transfer to ready made	3,00,000	60,000	
				Clothes	2,00,000		3,00,000
				By closing stock			2,60,000
To transfer from			3,00,000				
cloth department		3,00,000					
To manufacturing			60,000				
Expenses		60,000	4,85,000				
To gross profit	4,00,000	85,000					
	27,00,000				27,00,000	5,10,000	32,10,000
To selling expenses		20,000		By Gross profit	4,00,000	85,000	4,85,000
To net profit Departmental		3,80,000					
		4,00,000		By Net profit	4,00,000	85,000	4,85,000
To general expenses			1,10,000				4,59,000
To stock reserve			1,575				
To net profit			3,47,425				
			4,59,000				4,59,000

CALCULATION OF STOCK RESERVE

Cloth content in closing stock of readymades

60,000 X 75 / 100 = 45,000/-

Rate of Gross profit in cloth department $\frac{4,00,000}{25,00,000} \times 100 = 16\%$

Reserved Required for closing stock 45,000 X 16 / 100 = 7,2000

Old reserve i.e. reserve in opening stock

50,000 X 75 / 100 X 15 / 100 = 5,625

Reserve needed for closing stock	=	7,200
Old reserve in opening stock	=	5,625

Reserve to be created		1,575

Illustration 10.2

Mathipa hotels limited had two departments viz., apartment and attendance department and meals department following is the trial balance of the business as on 31st December 1993

	Dr.	Cr.
Income from apartment and attendance		4,60,000
Income from meals department		3,20,000
Provisions	1,55,000	
Stock of provision in the beginnings	10,200	
Cash in hand and at bank	1,00,000	
Capital		22,00,000
Customers debit balance supplier's accounts		98,000
Buildings (1/10 the is used for meals department)	21,00,000	
Provision for depreciation on buildings		2,40,000
Furniture and equipments	6,00,000	
General expenses	2,74,100	
Interest		11,300
Interest accured	2,000	
Income tax	4,000	
Life insurance premium	16,000	
Wages	60,000	
	---------	----------
	33,29,300	33,29,300

Additional Information

1) The servants in the apartment department had occupied a room worth Rs. 1,200 and took meals worth RS. 600/- similarly servants in the meals department had occupied a room worth Rs. 1,500/- and took meals worth Rs. 900.
2) Wages are charged in the proportion of #1/2 to the apartment Department 1/4th to the provision department and remaining to the general profit and loss account.
3) Increase provision for depreciation on buildings to Rs. 3,00,000
4) A sum of Rs. 8,000 representing accommodation Rs. 2,400 and means Rs. 5,600 to be charged to proprietor of the hotel.

   You are required to prepare final accounts for the year ending 31st December 1993.

PROFIT AND LOSS ACCOUNT
For the year ending 31st December 1993

	Apartment	Meals		Apartment	Meals
To stock	--	10,200	By income	4,60,000	3,20,000
To provisions	--	1,55,000	By Prop's Account	2,400	5,600
To depreciation on Buildings	54,000	6,000	Income by Servants (Note 2)	2,700	1,500
To wages	30,000	15,000			
To expenses of Servant (note 1)	1,800	2,400			
To net profits	3,79,000	1,38,000			
	4,65,100	3,27,100		4,65,100	3,27,100

GENERAL PROFIT AND LOSS ACCOUNT

	Rs.		Rs.
To wages	15,000	By Net profits Apartments	3,79,300
To General Expenses	2,70,100	Meals	1,38,500
To Net profit	2,40,000	By Interest	11,300
	5,29,100		5,29,100

BALANCE SHEET AS ON 31ST DECEMBER 1993

		Rs.		Rs.
Capital Balance		2,00,000	Buildings	21,00,000
LESS : Drawings	4,000		Furniture and equipment	6,00,000
Income Tax	16,000		Customers account	8,000
Premium	5,600		Interest accured	2,000
Apartment	2,400	28,400	Cash in hand and at land	1,00,000
		21,72,000		
ADD : Net profit		2,40,000		
Supplier's account		24,12,000		
Provision for		98,000		
Depreciation		3,00,000		
		28,10,000		28,10,000

Calculation of expenses by servants (note 1)

	Apartment	Meals
Rom Rent to be charged	1,200	1,500
Meals take by servant	600	900
	1,800	2,400

Calculation of income by servants (Note 2)

	Apartment	Meals
Room Rent for Servants in apartment	1,200	
Room Rent for Servants in meals	1,500	
Meals for servants in Apartment		600
Means for servant in meals Department		900
	2,700	1,500

Illustration : 10.3

In the month of January 1994 the following purchase were made by a business house having three departments.

Department A 1000 Units
Department B 2000 Units
Department C 2400 Units at a total cost of Rs. 1,00,000
Stocks on 1st January were :
Department A 120 Units, Department b 80 units and
Department C 152 Units. The sale of the month were
Department A 1,020 Units a Rs. 20 each
Department B 1920 units at Rs. 22.50 each
Department C 2496 units at Rs. 25 each

The rate of gross profit is the same in each case. Prepare Department Trading Accounts.

DEPARTMENT TRADING ACCOUNT FOR THE MONTH OF JANUARY 1994

	A Dept. Rs.	B Dept Rs.	C Dept Rs.	Total		A Dept Rs.	B Dept Rs.	C Dept Rs.	Total
To stock	1920	1440	3040	6400	By Sales	20400	43200	62400	126000
To purchase	16000	36000	48000	100000	By Stock	1600	2880	1120	5,600
To Gross				25200					
Profit	1080	8640	12480						
	22000	46080	63520	131600		22000	46080	63520	131600

CALCULATION OF PURCHASES

Assume all the purchased goods are sold : then Total sales will be

Dept	Units	S.P. Per unit	Sales
A	1,000	20	20,000
B	2,000	22.50	45,000
C	2,400	25	60,000
			1,25,000

Profit 1,25,000 – 1,00,000 = 25,000/-

$$\text{Rate of Gross profit on sales} = \frac{25,000}{1,25,000} \times 100 = 20\%$$

Cost of each Unit = Selling price – profit

Cost of each unit in Dept. A = 20 (20/100X 20)	=	20 – 4	= 16
Dept. B = 22.50 – (20 / 100 X 22.50)	=	22.50 – 4.50	= 18
Dept. C = 25 – (20 / 100 X 25)	=	25 – 5	= 20

CALCULATION OF CLOSING STOCK IN UNITS

Closing Stock = Opening Stock + Purchase – Sales

Dept. A.	= 120 + 1,000 – 1,020	= 100 Units
Dept. B	= 80 + 2,000 – 1,920	= 160 Units
Dept C	= 152 + 2,400 – 2,496	= 56 Units

Illustration 4

Valli Ltd had 3 departments A, B & C The following information is provided

	A	B	C
Opening Stock	30,000	40,000	60,000
Consumption of direct materials	80,000	1,20,000	–
Wages	50,000	1,00,000	–
Closing Stock	40,000	1,40,000	80,000
Sales	–	----	3,40,000

Stocks of each department are valued at cost to the department concerned. Stocks of A department are transferred to B department at a margin of 50% above department cost. Stocks of B department are transferred to C department at a margin of 10% above departmental cost.

	Rs.
Other expenses were salaries	20,000
Printing and Stationary	10,000
Rent	60,000
Interest paid	40,000
Depreciation	30,000

Allocate expenses in the rate of departmental gross profits. Opening figures of reserves for unrealized profits on departmental stock were :

Department B	Rs. 10,000
Department C	Rs. 20,000

Prepare departmental Trading and Profit and Loss Account

VALLI LTD
DEPARTMENTAL TRADING AND PROFIT AND LOSS ACCOUNT

To Opening stock	30,000	40,000	60,000	1,30,000	By Sales	--	--	1,80,000	3,40,000
To direct materials consumed	80,000	1,20,000	--	2,00,000	By Transfer	1,80,000	3,30,000	--	5,10,000
To wages	50,000	1,00,000	--	1,50,000	By closing stock	40,000	1,40,000	80,000	2,60,000
To transfer	--	1,80,000	3,30,000	5,10,000					
To Gross profit C/d	60,000	30,000	30,000	1,20,000					
	2,20,000	4,70,000	4,20,000	11,10,000		2,20,000	4,70,000	4,20,000	11,10,000
To salaries	1,000	5,000	5,000	20,000	By Gross profit b/d	60,000	30,000	30,000	1,20,000
To printing & stationary	5,000	25,000	2,500	10,000	By Loss C/d	20,000	10,000	10,000	40,000
To Rent	30,000	15,000	15,000	60,000					
To Interest	20,000	10,000	10,000	40,000					
To depreciation	15,000	7,500	7,500	30,000					
	80,000	40,000	40,000	1,60,000		80,000	40,000	40,000	1,60,000
To Loss b/d	--	--	--	4,000	By stock	--	--	--	--
To stock	--	--	--	--	Reserve	--	--	--	--
Reserve	--	--	--	--	B.	--	--	--	10,000
Required	--	--	--	21,000	C	--	--	--	20,000
B	--	--	--	18,180	By Net	--	--	--	49,180
C	--	--	--	--	Loss	--	--	--	--
				79,180					79,180

CALCULATION OF STOCK RESERVE

Department B

Transfer from Dept B	= 1,80,000
Cost in Dept B	= 2,20,000
Rs.	4,00,000

Preparation of closing stock in Dept B

(Transfer from Dept A. = $\frac{1,80,000}{4,00,000}$ X 1,40,000 = 63,000/-

Stock Reserve = 6,000 / 18,000 X 63,000 = 21,000/-

Department C :

Closing Stock (All transferred from Dept. B)

Un realized profit by dept B.. = $\frac{3,000}{33,000}$ X 80,000 =7,270

= 72,730

Preparation of transfer from Dept A

$\frac{18,000}{40,000}$ X 72,730 = 32730

Un realized profit by dept A.. = $\frac{6,000}{18,000}$ X 32,730 =10,910

Total Reserve = 7270 + 10910 = 18180

Calculation of Transfer From Dept. A to Dept B

Cost of Dept. A = 30,000 + 80,000 + 50,000 – 40,000	= 1,20,000
ADD 50% profit	= 60,000
	1,80,000

Calculation of Transfer From Dept. B to Dept C.

Cost of Dept B = 1,80,000 + 40,000 + 1,20,000+ 1,00,000 - 1,40,000	= 3,00,000
ADD 10% for profit	= 30,000
	3,30,000

Exercises:

1. Alamu departmental stores carries on its business through five departments A,B,C,D, and E

i) The following information for 1984 is now made available to you

Salaries and commission Rs. 11,020; Rent and Rates Rs. 2,900/-; Insurance Rs. 1,160; Miscellaneous Expenses Rs. 2,610/-

All these expenses are chargeable to each department in proportion to the cost of the articles sold in the respective department

ii) The following balances as at 31.12.1984 were as certained.

	A	B	C	D	E
Opening Stock at cost	10,000	6,000	15,000	8,000	9,000
Purchase	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 accounts to show the final result of each department and also the combined results with respective percentage on sales.

Answer :

(Profit : Dept. – a. Rs. 3,693; B Rs. 462; Loss : Dept C Rs. 11, 769; D Rs. 15, 538 & Rs. 1,538)

2. From the following data, prepare departmental Trading and Profit and Loss Account and thereafter the comibed Income account revealing the concerns true results for the year ended 31st December 1994.

Department	A	B
Stock (January 1)	40,000	--
Purchase from outside	2,00,000	20,000
Wages	10,000	1,000
Transfer of goods from Department A	--	50,000
Stock (Dec.31) at cost to the department	30,000	10,000
Sales to outsiders	2,00,000	7,1000

B's entire stock represents goods from department A which transfers them to 25% above its cost. Administrative and selling expenses amount of Rs. 15,000/- which are to be allocated between departments A and B in the rates of 4:1 respectively.

Answer :

Gross profit - A Rs. 30,000 B – Rs. 10,000
Profit - A Rs. 18,000 B – Rs. 7,000
Combined net profit Rs. 23,000

The directors of Janaki Departmental Stores Ltd wish to ascertain, approximately, the net profits of the "A", "B", "C" departments separately for the quarter ended July 31,1994. It is found impraticable actually to take stock on that date but an adequate system of departmental accounts is in use and the normal rates of gross profit for the departments concerned ar 40%, 30% and 20% on turnover respectively. Indirect expenses are charged in proportion to departmental turnover.

	A	B	C
Stock as on 1.1.994	30,000	35,000	15,000
Purchase to July 31, 1994	35,000	37,500	23,500
Sales to July 31, 1994	60,000	50,000	30,000
Direct Expenses	10,100	7,250	3,550

Total indirect expenses for the period (including those relating other departments) were Rs. 21,000 on total sales of Rs. 4, 20, 000

Prepare a statement shown gross profit net profit after making reserve for stock at 10% in respect of each department

Answer

(Gross profit : A Rs. 24,000 B Rs. 15,000 C Rs. 6,000
Net profit : A Rs. 17, 090 B. Rs. 8,025 and C Rs. 2,695)

4. Vinya Ltd has a factory which has to manufacturing departments A and B part of the output of 'A' department is transferred to "B" department for further processing and balance is directly transferred to the selling department inter department stock transfers are made as follows :

"A " Department to "B" Department at 20% over departmental cost. " A" Departmental to selling Department at 30% over departmental cost "B" Department to selling Department at 25% over Departmental cost.

The following information is given for the year ending 31st December 1980

	Department A		Department B		Department C	
	MT	RS	MT	RS	MT	RS
Opening stock	60	60000	20	40000	50	160000
Raw material consumption	1001	10000	30	30000		
Labour charges						
Sales	40	6000		60000		
Closing Stock					60	6000000

Out of total production in "A" department 30 MT were for transfer to the selling department and the balance to "B" department. The per tone material and labour consumption in "A" department on production to be transferred directly to the selling department is 200 per cent of the labour and material consumption on production meant for "B" Department. Prepare Departmental profit and loss account.

Lesson 11
HIRE PURCHASE SYSTEM

Hire purchase is a system of sale of durable consumer goods in which tl e buyer pays the price of goods purchased by him in convenient installments. Unlike cash sale in the case of which the price should be paid in lumpsum on taking delivery of the goods, and credit sale in the case of which the price should be paid after the expiry of period of credit but in lumpsum again, in the case of hire purchase system the buyer is enabled to pay the price in convenient installments agreed to by both the seller and buyer.

Purchase and sale of goods under a hire-purchase agreement is governed by the Hire purchase Act of 1972 which came into force from September 1973. The Act applies to the whole of India except the state of Jammu and Kashmir. The act defines the hire purchase agreement as, "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". The agreement includes the following terms.

1. The goods are delivered by the owner thereof to person on condition that such a person pays the agree amount in periodical installments
2. The property in the goods is to pass to such a person on payment of the last of such installment
3. Such a person has a right to terminate the agreement at any time before the property so passes.

CALCULATION OF INTEREST

Depending upon the availability of information, the interest may be calculated by adopting different techniques.

When case price, hire purchase price, number of installments and rate of interest, etc. are given, the interest is calculated on the outstanding balance of the cash price at the rate specified. When payment is made for the final instalment, the interest is not calculated by applying the percentage as stated already but by deducing the balance of cash price from the installment to be paid.

When the rate of interest is not given, the amount of interests included in each installment is calculated by apportioning the hire charges in proportion to the installments outstanding at the beginning of each period.

Illustration 11.1

Purchase a motor care from Q whose cash price is Rs. 56,000 on January 1, 1981. Rs. 15,000 is paid at signing of the contract and the balance is to be paid in three equal annual installment of Rs. 15,000 each. The rate of interest is 5% per annum.

Calculate the amount of interest included in each installment.

Solution	Rs.
Cash price of the motor car	56,000
LESS : down payment made	15,000

	41,000
ADD Interest @5% p.a. for 1981 (41,000 X 5/100)	2,050

	43,050
LESS installment paid at the end of 1981	15,000

	28,050
ADD : Interest @ 5% p.a. for 1982 (28,050 X 5 / 100)	1,403

	29,453
Less installments paid at the end of 1982	15,000

	14,453
ADD interest for 1983 (15,000 – 14,453)	547
(Installment – Balance of cash price)	-------
	15,000
Less Installment paid at the end of 1983	15,000

Illustration 11.2

Continuing the previous illustration, supposing the rate of interest is not given, the amount of interest included in each installment is calculated as follows:

	Rs.
Hire purchase :	
Dowm Payment	15,000
3 Equal annual installments of Rs. 15,000 each (3X 15,000)	45,000

Hire purchase price	60,000
Less : Cash price – given	56,000

Hire purchase charges or interest	40,000

Amount outstanding (including interest)

At the beginning of the …….. First Year Rs. 45,000 (60,000 – 15,000)

Second Year Rs. 30,000 (45,000 – 15,000)

Third Year Rs. 15,000 (30,000 – 15,000)

The interest, Rs. 4,000 is divided in the ratio of 45 : 30 : 15

3: 2 : 1

Interest for the First year 4,000 X 3/6 = Rs. 2,000

Second year 4,000 X 2/6 = Rs. 1,333

Third year 4,000 X 1/6 = Rs. 667

CALCULATION OF CASH PRICE

If the cash price of the property is not given and all other information like hire purchase price, down payment, annual installments, and the rate of interest are available, the each price of the property may be calculated as follows :

When the annual payments are uniform, the case price can be calculated by applying a formula or by preparing a table.

Illustration 11.3

Hire purchase price of the machine	Rs.	50,000
Down payment	Rs.	10,000
Four annual installments, at the end of each year	Rs.	10,000

Rate of interest 5% p.a.

Calculate the cash price of the machine by

(1) applying the formula and

(2) Preparing a table showing the calculations.

Solution

(1) By applying the formula :

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

Where, V = cash price less down payment made

A = annual installment

N = number of annual installment

I = interest rate per rupee

$$V = 10,000 / .051 \quad \frac{1}{(1+.05)} = 2,00,000 \quad \frac{1}{(1.05)\ 4}$$

$= 2,00,000\ 1 – 1/1,\ 21,506^2 = 2,00,000\ (1-.82270225)$

$= 2,00,000\ (.17772975) = 35459.5$ or 35460

CASH PRICE OF THE MACHINE

	Rs.
Cash price less down payment made	35,460
Calculated as above	10,000

ADD : Down payment	45,460

Note : Instead of applying the formula, the cash price can be calculated on the basis of the present value of the annuity of Rs. 1 per annum for a given number of years./ For this problem, the present value of annuity of Rs. 1 per annum for four years at 5% is Rs. 3.5460

Hence the present value of 10,000 will be 10,000 X 3.546035, 460

Add : Down payment	10,000

Cash price of the machine	45,460
	---------

(2) By preparing a table :

TABLE SHOWING THE CALCULATION

Year	Amount due at the end the year	Installment of paid	Total amount due to end of the year	Interest at 5/105	Principal of amount due at the beginning of the year
1	2	3	4	5	6
	Rs.	Rs.	Rs.	Rs.	Rs.
4th Year	Nil	10,000	10,000	476	9,524
3rd Year	9,524,	10,000	19,524	930	18,594
2nd Year	19,594	10,000	28,594	1,362	27,232
1st Year	27,232	10,000	37,232	1,773	35,459

CASH PRICE TO THE MACHINE

	Rs.
Cash price less down payment made	
Beginning of the 1st year calculated as above	35,459
Add : Down payment	10,000

	45,459

Note :

Column 4 includes the amount in the beginning of the year plus interest calculated at the rate of 5% per annum on the balance in the beginning of the year. Hence, the interest 5/105 of the total amount due at the end of the year.

CALCULATION OF CASH PRICE ANNUAL PAYMENT ARE NOT UNIFORM

When the annual payments are not uniform, the cash price can be arrived at only by preparing a table showing the calculations;

In the following illustration the installments are not uniform. Hence the cash price of the machine is arrived at only by preparing a table, which has been shown already.

Illustration 11.4

A purchased a machinery by the hire purchase system for Rs. 30,000 to be paid as follows.

	Rs.
Down payment	5,000
At the end of the firs year	7,000
AT the end of the second year	6,500
At the end of the Third year	6,000
At the end of the fourth year	5,500

Interest is charged on the cash value at 10% per annum. At what value the machine be capitalized.

TABLE SHOWING THE CALCULATIONS

Year	Amount due at the end the year	Instalment of paid	Total amount due to end of the year	Interest at 5/105	Principal of amount due at the beginning of the year
1	2	3	4	5	6
	Rs.	Rs.	Rs.	Rs.	Rs.
4th Year	Nil	5,500	5,500	500	5,000
3rd Year	5,000	6,000	11,000	1,000	10,000
2nd Year	10,000	6,500	16,500	1,500	15,000
1st Year	15,000	7,000	22,000	2,000	20,000

Principal amount due at the Beginning of the 1st year	20,000
Add : Down payment	5,000

Cash price of the machines	25,000

Note :

Column 4 includes the amount in the beginning of the year plus interest at the rate of 10% per annum calculated on the balance at the beginning of the year. Hence, the interest is 10/110 of the total amount due at the end of the year.

ACCOUNTING TREATMENT

There are two methods of recording transactions in the books of the hire purchaser. Under the first method, the hire purchaser debits the asset account equivalent to its cash price, and credits the hire vendor for the same As the when the interests becomes due the interest account is debited and the hire vendor account is credited. While payment is made, the hire vendor account is debited and the bank account is credited.

Under the second method, the hire purchaser debits the asset account only when the principal is paid. Whenever instalments are paid, it is divided into two parts, the amount paid for the principal and for interest,. The principal amount is debited to the asset account and the interest is debited to the interest account and the total is credited to the hire vendor. Then the hire vendor is debited with the instalment paid and the bank is credited for the payment.

DEPRECIATION

The hire purchaser charges depreciation for the asset under use. The depreciation is calculated on the cash price of the asset whether the hire purchaser passes the entry under the first method or under the second method.

After making the final payment to the hire vendor, the Asset Account in the books of the hire purchaser shows similar balance irrespective of the method followed by the hire purchaser while recording the transactions in his books.

ACCOUNTING ENTRIES

Method 1

In the books of the hire purchaser	In the books of the Hire vendor
1. For the purchase / sale Debit Asset Account	Debit Hire Purchaser Credit Hire Purchase / Sales
2. For down payment Debit hire vendor Credit bank	Debit bank Credit Hire purchaser
3. For interest Debit Interest Credit Hire vendor	Debit Hire Purchaser Credit Interest
4. For payment of installments Debit hire vendor Credit bank	Debit bank Credit Hire Purchaser
5. For Depreciation Debit Depreciation Account Credit Asset Account	No entry

In the firs t year all the above entries are passed and in the subsequent years entries, 3,4 and 5 are repeated.

Method 2

In the books of the Hire Purchaser

1. For the purchaser :
   No entry
2. (a) For down payment due :
   Debit Asset Account
   Credit hire vendor
   (b) For the amount paid :
   Debit hire vendor
   Credit bank
3. (a) For installment due
   Debit Asst Account
   Debit Interest
   Credit hire vendor
   (b) For the amount paid :
   Debit hire vendor
   Credit Bank
4. For depreciation :
   Debit depreciation Amount
   Credit Asset Account

As far as hire vendor is concerned only one set of entries are passed by him irrespective of the method followed by the hire purchaser.

Illustration 11.5

Purchased 4 cars of Rs. 14,000 each on the hire purchase system. The hire purchase price for all the 4 cars was Rs. 60,000 to be paid as Rs. 15,000 down payment and three is installments of Rs. 15,000 each at the end of each year. Interest is charged at the 5% per annum. The buyer depreciates cars at 10% per annum on the straight like method.

Give Journal entries and relevant account : (1) in the books of P, under method 1 and 2 and (2) in the books of the hire vendor.

Solution :

TABLE SHOWING THE CALCULATIONS

	Total Cash price Rs.	Instalment paid Rs.	Interest Rs.	Cah price paid (i.e. instalment paid – interest paid) Rs.
Down payment	56,000	--	--	--
	-15,000	15,000	--	15,000
	41,000			
End of the 1st year	-12,950	15,000	2,050	12,950
	28,050			
End of the 2nd year	-13,597	15,000	1,403	13,597
	14,453			
End of the 3rd year	14,453	15,000	547	14,453
	Nil	60,000	4,000	56,000

Method 1

In the books of p

JOURNAL

			Dr. Rs.	Cr. Rs.
1st year	Cars A/c			
	To Hire vendor		Dr.	56,000
	(Being the cars purchase on Hire Purchase basis)			
	Hire Vendor A/c	Dr.	15,000	
	(Being the down payment made)			
At the end of 1st year	Interest A/c	Dr.	2,050	
	To Hire Vendor			
	(Being the interest payable)			2,050
	Hire Vendor A/c	Dr	15,000	
	To Bank			15,000
	(Being the 1st Instalment paid)			

	Depreciation A/c		5,600	
	To cars A/c			5,600
	(Being the cars depreciated)			
At the end of 2nd year	Interest A/c	Dr	1,403	
	To Hire Vendor			1,403
	(Being the interest payable)			
	Hire Vendor A/c	Dr	15,000	
	To bank			15,000
	(Being the 2nd installment)			
	Paid Depreciation A/c		5,600	
	To Cars A/c			5,600
	(Being the card depreciated)			
At the end of 2nd year	Interest A/c	Dr	1,403	
	To hire vendor			1,403
	(Being the interest payable)			
	Hire vendor A/c	Dr	15,000	
	To Bank			15,000
	(Being the 2nd Installment paid)			
	Paid Depreciation A/c		5,600	
	To cars A/c			5,600
	(Being the cars depreciate)			
At the end of 3rd year	Interest A/c	Dr	547	
	To Hire vendor			547
	(Being the Interest payable)			
	Hire vendor A/c	Dr	15,000	
	To bank			15,000
	(Being the Third and final installment paid)			
	Depreciation A/c		5,600	
	To Cars A/c			5,600
	(Being the cars depreciated)			

CARS ACCOUNT

		Rs.		Rs.
1st Year	To hire vendor	56,000	By Depreciation A/c	5,600
			By balance c/d	50,400
		56,000		56,000
2nd year	To balance b/d	50,400	By Depreciation A/c	5,600
			By Balance c/d	44,800
		50,400		50,400

3rd year	To balance b/d	44,800	By Depreciation a/c	5,600
			By balance c/d	39,200
		44,800		44,800

HIRE VENDOR ACCOUNT

	Rs.		Rs.
To Bank down payment	15,000	1st year by cars A/c	56,000
To Bank	15,000	By interest A/c	2,050
To balance c/d	28,050		
	58,050		58,050
To bank	15,000	2nd year by balance b/d	28,050
To Balance c/d	14,453	By interest a/c	12,403
	29,453		29,453
To Bank	15,000	3rd year By balance b/d	14,453
		By interest	547
	15,000		15,000

INTEREST ACCOUNT

1st Year to Hire vendor	2,050	By profit and loss A/c	2,050
2nd year to Hire vendor	1,403	By profit and loss A/c	1,403
3rd year to hire vendor	547	By profit and loss A/c	547
	4,000		4,000

IN THE BOOKS OF THE HIRE VENDOR JOURNAL

			Dr.	Cr.
1st year	P's A/c	Dr.	56,000	
	To Hire purchase sales			
	(Being the sale made on hire purchase basis)			56,000
	Bank A/c			
	To P's A/c	Dr.	15,000	
	(Being the down payment received)			15,000
At the end of the 1st year	P's A/c	Dr.	2,050	
	To interest			2,050
	(Being the interest charged to P)			
	Bank A/c	Dr.	15,000	
	To P's A/c			15,000
	(Being the first instalment received)			

At the 1st And 2nd year	P's A/c	Dr.	1,403	
	To Interest			1,403
	(Being t he interest charged to P)			
	Bank A/c	Dr.	15,000	
	To P's A/c			15,000
	(Being the second instalment received)			
At the end Of the 3rd year	P's A/c	Dr.	547	
	To Interest			547
	(Being the interest charged to P)			
	Bank A/c	Dr.	15,000	
	To P's a/c			15,000
	(Being the third instalment received)			

P'S ACCOUNT

		Rs.		Rs.
1st Year	To Hire purchases Sales	56,000	By Bank	15,000
			By Bank	15,000
	To Interest	2,050	By balance c/d	28,050
		58,050		58,050
2nd year	To balance c/d	28,050	To Bank	15,000
	To interest	1,403	To balance c/d	14,453
		29,453		29,453
3rd year	To balance b/d	14,453	To bank	15,000
	To interest	547		
		15,000		15,000

RETURN OF GOODS

In the hire purchaser fails to pay the instalments due to some reason or other, he has to forfeit the amount paid so far and the hire vendor takes back the goods sold under the hire purchase agreement for the non-payment. If the entire property is taken by the hire vendor for the dues, then the account of the hire vendor in the books of the hire purchaser is debited to the extent of the balance in his account and the concerned Asset. Account is credited. Any balance in the Asset Account reflects the loss or profit due to repossession and the same is transferred to the profit and loss account.

At times the hire vendor may take over only a portion of the asset sold for the amount due, at an agreed value, leaving the balance of the asset with the hire purchaser. If the agreed value of the asset taken over is less than the book value of the asset, it is a loss for the hire purchaser and the same is transferred to the profit and loss account.

Illustration 11.6

Ram purchased a van for Rs. 42,000. Payment is made as Rs. 10000 down and four instalment of Rs. 10,000 each at the end of each year. Interest is charged at 10% per annum. Buyer depreciates the van at 10% per annum of written down value method.

Ram after having paid the down payment and the first instalment at the end of the first year could not pay the second instalment and the hire vendor took possession of the van. The hire vendor after spending Rs. 1,280 on repairs of the van, sold it for Rs. 31,000.

Show the Ledger Accounts in the books of both the parties, under both methods of accounting treatment.

Solution

Method I

IN THE BOOKS OF TAM VAN ACCOUNT

		Rs.		Rs.
1st Year	To Hire vendor	42,000	By Depreciation	4,200
			Balance C/d	37,800
		--------		---------
		42,000		42,000
		--------		---------
2nd year	To balance c/d	37,800	Depreciation	3,780
			Hire Vendor	27,720
			Profit and loss A/c (Balancing figure)	6,300
		--------		---------
		37,800		37,800
		--------		---------

HIRE VENDOR ACCOUNT

		Rs.		Rs.
1st year	To Hire vendor	10,000	By Depreciation	4,200
	Hire vendor	6,800	Balance C/d	12,600
		--------		---------
		16,800		16,800
		--------		---------
2nd year	To balance c/d	12,600	By Depreciation	3,780
			Profit and Loss A/c	8,820
		--------		---------
		12,600		12,600
		--------		---------

HIRE VENDOR ACCOUNT

		Rs.		Rs.
1st Year	To bank	10,000	1st Year By van A/c	10,000
	Bank	10,000	Van A/c	6,800
			Interest	3,200
		--------		---------
		20,000		20,000
		--------		---------

The loss suffered by Ram is Rs. 6,300 in addition to Rs. 2,520 interest payable for the second year total Rs. 8,820

IN THE BOOKS FO THE HIRE VENDOR HIRE PURCAHSE'S (RAM'S) ACCOUNT

		Rs.			Rs.
1st Year	To Hire purchase	42,000	1st year	By Bank	10,000
	Sales	3,200		Bank	10,000
	Interest			Balance C/d	25,200
		45,200			45,200
2nd year	To balance b/d	25,000	2nd year	"Repossessed	
	Interest	2,720		Stock A/c	27,720
		27,720			27,720

REPOSSESSED STOCK ACCOUNT

		Rs.			Rs.
2nd Year	To Ram's A/c	27,720	2nd Year	By Bank-Sale	31,000
	Bank repaids	1,280			
	Profit transferred	2,000			
		31,000			31,000

Illustration 11.7

Purchased 4 cars of Rs. 14,000 each by the hire purchase system. The hire purchase price for all the 4 cars was Rs. 60,000 to be paid as Rs. 15,000 down payment and three installment of Rs. 15,000 each at the end of the each year. Interest is charged at 5% per annum. Buyer depreciates cars are 10% per annum on the Straight Line method.

After having paid the down payment and the first instalment, the buyer could not pay the second instalment and the seller took possession of three cars at an greed value to be calculated after depreciating cars at 20% per annum on Written down value method. One car was left with the buyer.

Seller, after spending Rs. 1,200 on repairs, sold all the 3 cars to X for Rs. 35,000

Open Ledger Accounts in the books of the Hire Purchaser and the hire vendors

Method I

IN THE BOOKS OF 'P' (HIRE PURCHASER) CARS ACCOUNT

		Rs.			Rs.
1st Year	To Hire vendor	56,000	1st year	By depreciation	5,600
				By Balance c/d	50,000
		56,000			56,000
2nd year	To balance b/d	50,400	2nd Year	By Depreciation	5,600
				By Hire vendor A/c	26,880
				By profit and loss A/c	6,720
				By Balance c/d	11,200
		50,400			50,400

HIRE VENDOR'S ACCOUNT

		Rs.		Rs.
1st Year	To Bank	15,000	1st Year By Cars a/c	56,000
	To bank	15,000	By interest A/c	2,050
	To Balance c/d	28,050		
		58,050		58,050
2nd year	To cars A/c	26,880	2nd year By balance b/d	28,050
	To balance c/d	2,573	By interest	1,403
		29,453		29,453

CALCULATION OF LOSS ON REPOSSESSION

	Value as per Hire purchaser 10% straight line method Rs.	Value as per Hire vendor 20% written down value Rs.
3 cars –original value	42,000	42,000
1st year depreciation	4,200	8,400
	37,800	33,600
2nd year depreciation	4,200	6,720
	33,600	26,880

Difference between the two value 933,60026,800) is the loss for the hire purchaser due to repossession.

Method 3

CARS ACCOUNT

		Rs.		Rs.
1st Year	To Hire vendor	15,000	1st Year By Depreciation	5,600
	Hire vendor	12,950	Balance c/d	22,350
		27,950		27,950
2nd Year	To balance b/d	22,350	2nd year By Depreciation	5,600
	Hire Vendor		Profit and Loss A/c	8,123
	Amount due			
	(See Method I)	2,573	Balance c/d	11,200
		24,923		24,923
3rd year	To balance b/d	11,200		

HIRE VENDOR'S ACCOUNT

		Rs.			Rs.
1st Year	To bank	15,000	1st Year	By cars a/c	15,000
	Bank	15,000		Car A/c	12,950
				Interest A/c	2,050
		30,000			30,000
2nd year	To balance c/d	2,573	2nd year	By cars a/c	2,573
		2,573			2,573
				By balance c/d	2,573

The loss suffered by P is Rs. 6,720 in addition to Rs. 1,403 interest payable for the second year total Rs. 8,123

IN THE BOOKS OF THE HIRE VENDOR P'S ACCOUNT

		Rs.		Rs.
1st Year	To hire purchase	56,000	By bank	15,000
	Interest	2,050	Bank	15,000
			Balance c/d	28,050
		50,050		58,050
2nd year	To balance b/d	28,050	By Repossessed	
	Interest	1,403	Stock A/c	26,880
			Balance c/d	2,573
		29,453		29,453

	Rs.		Rs.
To P's A/c	26,880	By X A/c sale of 3 cars	35,000
Bank-expenses	1,200		
Profit and Loss A/c	6,920		
	35,000		35,000

HIRE PURCAHSE TRADING ACCOUNT

When the vendor has numerous sales on hire purchase basis in addition to the normal sales it is impracticable on his part to calculate the interest for every sale. To overcome this difficulty and to find out the profit made on hire purchase sales any one of the following methods be adopted.

1. Debtors method
2. Stock and Debtors method
3. Interest Suspense method

Method 1

Debtors Method :

Under this method a Hire Purchase Trading account is prepared to ascertain the amount of profit or loss made on goods sold on hire purchase. This Hire Purchase Trading account is more or less similar to the Consignment Account or Branch Accounts. The accounting entries are as follows :

(a) For sale of goods on hire purchase :
Debit Hire Purchase Trading a/c and Credit goods sold on Hire Purchase with the hire purchase price. On the date or Balancing, goods sold in hire purchase a/c is debited and purchases a/c debited.

(b) For receipt of instalments.
Debit bank a/c and Credit Hire purchase trading a/c

(c) For instalments due but not yet received

(d) For Goods repossessed owing to customer's default
Debit goods repossessed a/c and Credit Hire Purchase Trading a/c with the estimated value of goods taken back.

(e) For goods with customers in respect of which instalments are not yet due.
Debit Hire Purchase Stock a/c and Credit Hire Purchasing Trading a/c, at hire purchase price

(f) For offsetting, loading on opening stock
Debit Stock Reserve a/c and Credit Hire Purchase trading a/c

(g) For offsetting loading on hire purchase sales:
Debit goods sold on hire purchase a/c and credit hire purchasing trading a/c

(h) For offsetting loading on closing stock:
Debit Hire Purchase trading a/c and credit stock reserve a/c. The balance left on the hire purchase trading account shows profit or loss.

Illustration 11.8

A trader sells goods on hire purchase adding 60% to cost. From the following particulars prepare hire purchase trading account and ascertain profit or loss made by him.

1985	Jan1. Stock with customers at selling price	21,600
	Dec. 31 Goods sold on hire purchase during the year at selling price	87,120
	Cash received during the year	57,720
	Stock with customers at selling price	48,000
	Instalments due but not received	5,000

Solution

HIRE PURCHASE TRADING ACCOUNT
For the year ended 31st December 1985

	Rs.		Rs.
To Opening stock	21,600	By cash	57,720
To Goods send on H.P.	87,120	By Instalments due	5,000
To Stock Reserve	18,000	By closing stock	48,000
To profit & Loss A/c	24,770	By stock reserve	8,100
		By Goods sent on H.P	32,670
	1,51,490		1,51,490

Notes

Cost	Rs. 100	
Profit	Rs. 60	
Selling price	Rs. 160	
If Selling price is	Rs. 160	Cost is Rs. 100
If selling price is	Rs. 21,600	

$$\frac{100 \times 21,600}{160} = \text{Rs. } 13.500$$

Selling	Rs. 21,600
Cost	Rs. 13,500
Unrealised profit	8,100

Similarly for goods sent on H.P. and closing stock to remove the load

STOCK AND DEBTORS SYTEM

This system is similar to branch stock and debtors system and provides an alternative to the preparation of H.P. trading account. Under this methods the following ledger accounts are opened.

1. Hire purchase stock account
2. Shop stock account
3. Goods on hire-purchase account
4. Hire purchase adjustment account

Under this method the following entries are made :

1. Goods made available for Hire purchase sale	Debit Shop Stock A/c Credit purchases A/c	at cost price
2. Goods sold during the year on hire purchase	(i) Debit Hire-Purchase stock A/c Credit goods sold on hire purchases A/c	at sale price
	(ii) Debit Goods sold on hire purchase a/c	At Sale Price
	Credit shop stock A/c	at cost price
	Credit –Hire – Purchase adjustment A/c	Loading
3. Instalments becoming due for the period	Debit Hire-purchase Debtors A/c Credit Hire purchase stock a/c	
4. Cash received against instalments due	Debit cash account Credit Hire-purchase debtors A/c	
5. The loading included in the unmatured instalments	Debit Hire purchase adjustment A/c Credit Stock reserve A/c	
6. Unpaid instalments of repossessed goods	Debit Repossessed Goods A/c Credit hire-purchase Debtors A/c	

7. Profit disclosed by Hire-purchase Adjustment	Debit-Hire-purchase adjust A/c Credit profit and loss A/c

Notes:

1. The repossessed goods will be either sold or valued and the difference in the account will be transferred to H.P. adjustment account.
2. The balance of shop stock account represents stock at shop at cost price
3. The balance of hire-purchase stock account represent hire purchase stock with customers at selling price. This is the reason why this method is called alternatively as 'stock out at sale price' and H.P. trading account where stock out with customers is shown at cost price as 'stock out-cost price' method.
4. The balance in the H.P. debtors account represents instalments due and unpaid.

Illustration 11.9

M/s Vivek & Company sell consumer durables on hire-purchase at cost plus 33%. From the following particulars prepare the necessary ledger accounts for the year ending 31st December 1980.

	Rs.
January 1	
Stock out on hire at hire purchase price	40,000
Stock at shop at cost	5,000
Installment due	3,000
December 31	
Cash received from customers	80,000
Goods repossessed (Installments due Rs. 2,000)	500
Stock at Shop, at cost (excluding repossessed goods)	7,000
Installment due	8,000
Goods purchased during the year	68,000

Solution

Stock and debtors method.

HIRE PURCHASE DEBTORS ACCOUNTS

Dr.	Rs.	Cr.	Rs.
Jan.1 To Balance b/d	3,000	Dec. 31. By cash	80,000
Dec.31 To sales (Balancing figure)	87,000	By Goods repossessed	2,000
		By Balance c/d	8,000
	90,000		90,000
Jan1 To balance b/d	8,000		

SHOP STOCK ACCOUNT

Jan1. To balance b/d	5,000	Dec.31 By Goods on H.P. Dec.31 A/c (at cost)	66,000
Dec. 31 To purchases	68,000	By balance c/d	7,000
	73,000		73,000

HIRE PURCHASE STOCK ACCOUNT

Jan.1	Balance b/d	40,000	Dec.31	By sales	87,000
Dec.31	To Goods on H.P.	88,000		By Balance c/d (Balancing figure)	41,000
		1,28,000			1,28,000
Jan1	To balance b/d	41,000			

GOODS SOLD ON HIRE – PURCHASE ACCOUNT

To shop stock account	66,000	By hire purchase stock account sale price of	88,000
To H.P. adjustment account Loading @ 3311/3 on cost	22,000		
	88,000		88,000

HIRE PURCHASE ADJUSTMENT ACCOUNT

To Goods repossessed Account-loss on goods Repossessed (Rs. 2,000- Rs.500)	1,500	Jan1	By balance b/d (1/4 of Rs. 40,000)	10,000
To profit and loss account (balancing figure)	20,250		By Goods sold on Hire purchases	22,000
To balance c/d 1/4 of Rs. 41,000)	10,250			
	32,000			32,000

GOODS REPOSSESSED ACCOUNT

Dec. 31	To H.P. Debtors	2,000	Dec. 31. By H.P. adjustment Loss on repossession	1,500
			By Balance c/d	500
		2,000		2,000

Alternatively

HIRE-PURCHASE TRADING ACCOUNT

Jan1		Dec.31	
To stock at shop	5,000	By cash received	80,000
To stock out with Customers at cost	30,000	By instalments due	8,000
To instalments due	3,000	By Repossessed goods	
		By stock the shop	500
Dec. 31		By stock with customers	7,000

To purchase	68,000	at cost (3/4 of 43,000)	
To. N.P, (as per H.P. Adjustment account)	20,000		30,750
	--------		---------
	1,26,250		1,26,250
	---------		---------

INTEREST SUSPENSE METHOD

This method is followed by concerns having numerous transactions under hire purchase sale with the instalment being payable over a fixed period. Under this method the hire purchase customers are debited with the hire purchase price, and the Hire Purchase Sale Account is credited with the cash price and the hire charges (interest) are credited to the Interest Suspense Account. The entry is

Hire purchase customers	Dr. Hire purchase price
To hire purchase sale	cash price
To interest suspense account	Interest

The hire charges credited to the Interest Suspense Account are transferred to the trading account profit and loss account proportionately over the length of the installment period,.

The entry is

Interest suspense account	Dr. With the amount
To Trading / Profit and Loss Account	of proportionate Interest

Inspite of the fact that several methods (Actuarial method, sum of digits method, etc) are available for transferring the interest to the trading / profit and loss account, the selling concerns may like to minimise the calculations, by apportioning and spreading the interest over the whole period on a percentage basis which is arrived at on the basis of past experience.

Illustration 11.10

A company sells goodson hire purchase on the basis of 25% down payment, the balance, with 20% interest thereon being payable in 8 equal quarterly instalments on March 31, June 30, September 30 and December 31, 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 January1. 1976	Rs.	
Hire purchase debtors		975,375
Hire purchase interest suspense	9,000	

Hire purchase sales (exclusive of interest) which have evenly occurred over which of the three calendar years, are :1947 – Rs. 80,000; 1975 Rs. 1,00,000; 1976 – Rs. 76,000

All dues were promptly paid in each year

Make out for the year 1976

(1) Hire Purchase Debtors Account

2. Hire Purchase Interest suspense Account and Prove the opening and closing balances of the latter account.

Solution

Hire Purchase Debtors Account

1976		Rs.	1976		Rs.
Jan1			Dec. 31		
To balance b/d		75,375	By Bank down		
Hire purchases					
Sale	76,000		Payment	19,000	
Interest suspense	11,400		Installment	79,875	98,875
A/c		87,400	By balance c/d		63,900
		--------			---------
		1,62,775			1,62,775
1977					
Jan1. * balance b/d	63,900				

HIRE PURCHASE INTEREST SUSPENSE ACCOUNT

1976	Rs.	1976	Rs.
Dec. 31		Jan1	
To profit and loss A/c	12,600	By balance b/d	9,900
Balance c/d	8,700	Hire purchase	11,400
	--------		---------
	21,300	By balance b/d	21,300

The difference between instalment sale and hire purchase may be tabulated as follows:

Instalment sale	Hire purchase
1. The ownership in the goods possess to the buyer as soon as the transactions completed.	1. The agreement stipulates the time at which his ownership passes to the buyer. Its is usually on the payment of last installment
2. The seller has right only to use for the unpaid balance. He has no right to reposses the goods for default in payment of instalment.	2. The seller can repossess the goods on default of payment of installment. He is not about to return the amounts already received as they represent hire charges
3. The buyer has to right to terminate the agreement by returning the goods. Therefore, he cannot escape his liability for payment of future instalments	3. The buyer has the option to return the goods and terminate the agreement. The consequence of his is that he escape from the payment of future installments. However, he has to forfeit the payments already made to vendor.
4. The buyer, as the owner of the goods, has the right of disposing of the goods in any manner he likes	4. As the buyer is in the legal position of bailee, he has no right of disposal of goods.
5. Any loss of goods should be brone by the buyers as risk lies with the ownership	5. So long as the buyer has taken reasonable care of goods expected from bailee, any loss occurring to goods has to be borne by the seller

Exercises

Theory

1. Give any two points of difference between Hire Purchase and Instalment system of sale. (B.Com., Madras, March 1989)
2. State the difference between Hire Purchase and Instalment systems. (B.Com., Madurai, Nov. 1988)
3. Can a seller size goods under the Hire Purchase system? State with reasons. (B. Com., Bangalore April 1998)
4. Explain how Hire-Purchase system differs from the instalment system. (B., Com. Calicut April 1989, Kerala April 88)
5. Distinguish between Hire purchase and instalment systems (B.Com., Kerala, April 1988)
6. What is meant by Hire-purchase system? How dies it differ from instalment system? (B.Com., Mangalore Oct. 1987)
7. Briefly explain the difference between Hire Purchase system and instalment system? (B.Com., Mangalore, Oct, 1988)
8. Point out two differences between Hire-Purchase System and Instalment system ? (B.Com.,Kerala, April 1988)
9. What is right of repossession? (B.Com, calicutt Oct 1988)
10. Distinguish Hire purchase and Instalment Purchase sys tem (B.Com Osmania April 1988)
11. Explain the special features of Hire-purchase trading accounts. (B.Com Calicut Oct. 1988)

PRACTICAL

Hire purchase system

As certainment of interest when cash price, credit price and rate % given

1. A purchased a truck from B whose cash price is Rs. 60,000 on 1st January 1981. Rs. 20,000 paid on signing the agreement and the balance is to be paid in three equal annual instalment of Rs. 20,00 each. The rate of interest charged is 22 per cent per annum.
   Calculate the amount of interest included in each instalment (B.Com., Calicut, April 1988)
   (Ans : Rs. 8,800, Rs. 6,336 and Rs. 4,864; total Rs. 20,000)
2. On 1.1.89 Ravi purchased a machine from Rahim on hire purchase basis. The particulars are as follows.
   a) Cash price Rs. 10,000
   b) Rs. 40,00 to be paid on signing the contract
   c) Balance in three annual instalment of Rs. 2,000 each plus interest
   d) Interest charged on outstanding balance at 5%
   e) Depreciation at 10% p.a. on straight line method
   Give journal entries in the books of Ravi. (B.Com Bharathidasan Oct, 1989)
   (Ans. Rs. 300; Rs. 200; and Rs. 100; Credit price Rs. 10,600)

ASCERTAINMENT OF INTEREST WHEN CASH PRICE IS NOT GIVEN

3. A Machine was purchased for a hire purchase price of Rs. 17,200 payment was made as follows. Rs. 4,000 at the time of agreement, Rs. 4,66 at the end of first year, Rs. 4,400 at the end of second year and Rs. 4,200 at the end of third year. Interest was charged at 5% Calculate the cash price of the machine and the amount of interest paid on each instalment.

(Ans Rs. 200, Rs, 400 and Rs. 600; each price Rs. 16,000)

ASCERTAINMENT OF INTEREST WHEN RATE IS NOT GIVEN

4. Purchased a radio on hire purchase system. The cash price of the radio was Rs. 3560. He agrees to pay four quarterly instalments of Rs. 100 each. Calculate interest for each quarter.
   (B.Com (Pass) Delhi 1987)
   (Ans. Total interest Rs. 40 apportioned in 4:3:2:1. Rs. 16, Rs. 12, Rs. 8, Rs,. 4)

DEFAULT AND RE-POSSESSION

5. Mangalore Dry Cleaners purchased from the Vendor two machines of Rs. 10,500 each on hire purchases system. The payment was to be made Rs. 6,000 down and the remainder in three equal instalments of Rs. 5,000 each together with interest at 5% per annum. The Dry clearners write off depreciation at 10% per annum on written down value. They could not pay their second instalment. After negotiations, it was agreed that vendors would leave one machine with the purchaser, adjusting the value of the other against amount due treating the machines at 20% depreciation on diminishing balance. Show Machine Account and Vendor's Account in the books of Mangalore Dry Cleaners. (B.Com., Mangalore 88)
   (Ans: Loss on re-possession Rs. 1,785; Interest ; Rs. 750, Rs, 500; Rs. 250)
6. Exe. Ltd., has a hire purchase department. Goods are sold on hire purchase at cost plus 60 percent. From the following particulars, find out the profit or loss made in this department.

1985		Rs.
Jan1.	Goods out on Hire purchase (at hire-purchase price)	16,000
Dec.31	Goods sold on hire purchase during the year (at hire purchase price)	80,000
	Cash received bank (hire purchase instalments unpaid Rs. 2,000) valued at	300
	Goods received during the year	56,000
	Goods with hire-Purchase customers (at hire-purchases price)	36,000

Lesson 12

INSTALMENT SYSTEM

The basiC features of instalment system are the same as those of hire purchase. An agreement is entered into between the seller and the buyer. The buyer makes down payment as it prevails in practice. The seller gives up possession of the goods. The amount of each instalment and rate of interest and rate of interest is made known to the buyer. Finally the buyer takes delivery of the goods agreeing to pay the instalments.

However, while in the case of hire purchase legal little to the goods vests with that the seller until payment of the last instalment by the buyer, in the case of instalment system legal little is immediately passed onto the buyer on signing the agreement. As a consequence of this, even if the buyer fails to pay any one of the instalments the seller cannot reposses the goods. His only remedy is to enforce payment of the unpaid instalments through a court of law.

Further, in the case of hire purchase, the buyer can terminate the contract by returning the goods if he does not want to continue to pay the unpaid instalments. In the case of instalment system, however the buyer cannot exercise the option of returning the goods and terminate the contract unless the same becomes void or viodable under the general principles of the law of contract.

Again, not being the legal owner of goods, the buyer cannot, in the case of hire purchase, confer legal title on a third party by sale, exchange, transfer or disposition of the goods which from the subject mater of a hire purchase contract. In the case of instalment system, however, the buyer can dispose of the goods in any manner he like the moment he acquires legal title to the same.

ACCOUNTING FOR INSTALMENT SYSTEM

Transactions relating to instalment system of sale are recorded in the books of both the parties in the same way as under hire purchase. However, there is only one method accounting in the books of the buyer i.e. taking legal title into consideration and debting the asset with the full cash price. Further, in the books, of both the parties an interest suspense account is opened and the total interest is transferred to this account, by a debit in the buyer's books and a credit in the seller's books. As and when interest falls due, the amount of interest applicable to the instalment is transferred from the interest suspense account to interest account. The balance on the interest suspense account is shown in the balance sheet in the books of both the parties.

Illustration 12.1

Caravan Company purchases a motor can from Madurai motor Company on the instalment system on January 1, 1971, paying cash Rs. 10,000 and agreeing to pay three further instalments of RS. 10,000 each on December 31, each year. The cash price of the car is Rs. 37,250 and the Madurai Motor company charges interest at 5% per annum. Caravan company writes off 10% pe annum as depreciation on the written down value system.

Journalise these transactions in the books of Caravan company and Madurai motor company. Also show the various items in the Balance Sheet of Caravan Company.

Solution

TABLE SHOWIN THE CALCULATIONS

	Total cash price	**Installment paid**	**Interest**	**Cash price (i.e. installment paid interest paid**
	Rs.	Rs.	Rs.	Rs.
Down payment	37,250	--	--	---
	10,000	10,000	10,000	10,000
	27,250			
End of the 1st year	8,637	10,000	10,000	10,000
	18,613			
End f the 2nd year	9,069	10,000	931	9,069
	9,544			
End of the 3rd year	9,544	10,000	456	9,544
	Nil	40,000	2,750	37,250

IN THE BOOKS CARAVAN COMPANY
JOURNAL

1971			Dr. Rs.	Cr. Rs.
Jan1	Motor Car A/c	Dr.	37,250	
	Interest suspense		2,750	
	To Madurai Motor Company			40,000
	(Being the motor car purchased on instalment system-cash price R. 37,250)			
	Madurai Motor Company	Dr.	10,000	
	To bank			10,000
	(being the down payment made)			
Dec.1	Interest A/c	Dr.	1,363	
	To interest suspense			1,363
	(Being the 1st year interest transferred)			
	Madurai Motor company	Dr.	10,000	
	To bank			10,000
	(Being the1st Installment paid)			
	Depreciation A/c	Dr.	3,725	
	To Motor Car			3,725
	(Being the motor car depreciated)			
1972	Interest	Dr.	931	
Dec. 31	To Interest suspense			931
	(Being the 2nd year interest transferred)			
	Madurai Motor Company	Dr.	10,000	
	To bank			10,000
	(Being 2nd Instalment paid)			
	Depreciation A/c	Dr.	3,353	
	To Motor Car			3,353
	(Being the motor car depreciated)			
1973	Interest A/c	Dr.	456	
Dec.31	To interest suspense			456
	(Being the 3rd year interest transferred)			
	Madurai Motor company	Dr.	10,000	
	To bank			10,000
	(Being the 3rd and final instalment paid)			
	Depreciation A/c	Dr.	3,017	
	To Motor Car			3,017
	(Being the motor car depreciated)			

BALANCE SHEET AS ON DECEMBER 31 1971

Liabilities	Rs.	Assets	Rs.	Rs.
Madurai Motor company	10,000	Motor Car	37,250	
		Less depreciation		
		Interest	3,725	33,525

		Suspense A/c		1,387

BALANCE SHEET AS ON DECEMBER 31, 1972

Liabilities	Rs.	Assets	Rs.	Rs.
Madurai Motor	10,000	Less Depreciation	33,525	
		Interest	3,353	30,172

		Suspense A/c		456

BALANCE SHEET AS DECEMBER 31, 1973

Liabilities	Rs.	Assets	Rs.	Rs.
		Motor Car	30,172	
		Less Depreciation	3,017	
				27,155

IN THE BOOKS OF MADURAI MOTOR COMPANY JOURNAL

			Dr Rs.	Cr. Rs.
1971	Caravan Company	Dr.	40,000	
Jan1/.	To sales			37,250
	To interest suspense A/c			2,750
	(Being the sale made –cash price Rs. 37,250 for a total payment of Rs. 40,000)			
	Bank	Dr.	10,000	
	To Caravan Company			10,000
	(Rs. 10,000 received down)			
Dec.31	Interest suspense A/c	Dr.	1,363	
	To interest A/c			1,363
	(Being the First year Interest transferred)			
	Bank		10,000	
	To Caravan Company			10,000
	(Being the 1st installment received)			
1972	Interest suspense A/c	Dr.	931	
	To Interest A/c			931
	(Being the 2nd year's Interest transferred)			
	Bank A/c		10,000	
	To Caravan Company			10,000
	(Being the 2nd Instalment received)			
1973	Interest suspense A/c	Dr.	456	
	To Interest A/c			456

(Being the 3rd year's interest transferred)		
Bank	10,000	
To Caravan Company		10,000
(Being the 3rd and final instalment received)		

Exercises

1. The Mopeds limited sold a motor cycle on instalment to system to Electricals Limited. The cash price was Rs. 7,500, Rs. 2,000 was to paid on delivery and the balance in three instalments of Rs. 2.000 each at the end of each year. The seller charges interest at the rate of 5%. Buyer depreciates the asset at 10% p.a on the reducing balance basis. Write up the ledger accounts in the books of the Electrical Limited.
2. Ramu purchased a television set on instalment system. He paid Rs. 2,400 on signing the agreement and paid Rs. 1,300 at the end of the first year and Rs. 1,200 at the end of the second years and Rs. 1,100 at the end of the third year, which cleared all his dues.

   Interest at 10% is included in the above instalments. Calculate each price as well as the interest included in the instalment for the television set.

   (B.Com, Calicut, Oct88)

   Ans : Interest Rs. 300, 200 and Rs. 100., Cash price Rs. 5,400

Lesson 13
INSURANCE CLAIMS
LOSS OF STOCK AND PROFIT

Any loss suffered by a business due to fire, theft and loss of profit can be compensated by taking an appropriate policy with the Insurance company. The Chapter deals with the loss a stock and other assets due to fire and the loss of profit due to fire or breakdown of machinery.

In majority of the business houses separate stock account is not maintained and at the end of the accounting year the stock takings is done in order to prepare the final accounts for the year. In the event of fire, it is very difficult to ascertain the balance of stock on the date of fire to prefer a claim against the loss of stock. In order to find out the loss of stock due to fire for the purpose of making the claim to be lodged with the insurance company a memorandum trading account is prepared. In this memorandum trading account, the items like opening stock, net purchased, manufacturing expenses, net sales are entered and the approximate gross profit that would have been earned by the business is calculated by applying the previous year's gross profit rate to the current years (year of fire) sales up to the date of the fine and the same is entered on the memorandum trading account. The balancing figure on the credit side of the memorandum trading account reveals the value of stock on hand on the date of fire.

However, if there is an increase or decrease in trend is noted in the previous years profits the trend is considered for fixing the grass profit rate for the purposes of calculating the gross profit rate to be applied. For example, if the gross profit for 1984-10%. 1985-15% and for 1986-20% then for the year 1987, the reasonable rate would be 25%. Similarly the rate would be decreased where there is decrease in trend in the previous years profits.

The salvaged stock if any is deduced from the stock on the date of fire as arrived at already and the balance is treated as loss of stock due to fire and a claim is preferred for the same with the insurance company.

Memorandum Trading Account

To opening stock		By sales	
To purchase		By stock (closing)	
To wages		(Balancing figure)	
To Gross profit	---------		--------

Value of stock on hand on the date of fire
LESS Salvaged stock
Claim to be lodged

Average clause

In General Insurance policies thee is a clause known as average clause and by this clause the insured entitled to claim a proportion of the loss suffered by him where the property is underinsured. It is explained as below:

Value of policy	2,00,000
Stock on hand in the godown on The date of fire	2,50,000
Stock destroyed by fire	1,00,000

$$\text{Claim} = \text{Value of the stock destroyed} \times \frac{\text{Value of insurance policy}}{\text{Value of stock on hand on the date of fire}}$$

= 1,00,00 X 2,00,000 / 2,50,000 = 80,000

In the above case, even though the loss due to fire being Rs. 1,00,00 which is loss than the policy value of Rs. 2,00,000 the insured is not entitled to get the entire loss of Rs. 1,00,000 because the policy covers only 80% of the stock in the godown on the date of fire (2,00,00 / 2,50,000 X 100 = 80%) So the insured is entitled to get only Rs. 80,000 which is 80% of Rs. 1,00,000/ The provision of average clause is included in the insurance policy is to discourage under insurance.

Illustration 13.1

A fire occurred on September 30, 1986, in the godown of Mr. Anad. From the following figures ascertain the claim to be lodged.

	Rs.
Stock on January 1, 1986	17,000
Purchase from January 1, 1986 to date of fire	1,70,000
Wages and other manufacturing expenses	17,000
Sales from January, 1,1986 to date of fire	2,00,000

Solution

Memorandum Trading Account up to September 30, 1986

	Rs.		Rs.
To opening stock	17,000	By sales	2,00,000
Purchase waged and other	1,70,000	Closing Stock	44,000
Manufacturing expenses	17,000	(Balancing Figures)	
	(on)		
Gross profit 25% cost $2,00,000 \times \frac{25}{125}$	40,000		
	2,44,000		2,44,000

Value of stock on hand On the date of fire	44,000
Less Stock salvaged claim to be lodged	4,000
	40,000

Illustration 13.2

A fire occurred on September 15, 1974 in the premises of X Co., Ltd From the following figures, calculate the amount of claims to be lodged with the insurance company for loss of stock

Stock at cost as on January 1, 1973	20,000
Stock at Cost as on January 1, 1974	30,000
Purchases 1973	40,000
Purchases for January1, 1974 to September 15, 1974	88,000
Sales 1973	60,000
Sales from January 1, 1974 to September 15, 1974	1,05,000

During the current year cost of purchases have risen by 10% above last year levels. Salvage prices have gone up by 5%.

Salvage value of stocks after fire was Rs. 2,000. Th policy was for RS. 55,000 and was subject to the average clause adopted.

(C.A. inter Nove. 1974 modified)

Solution

Trading Account

For the year ending 31st December, 1973

	Rs.		Rs.
To opening stock	20,000	By sales	60,000
Purchase	40,000	Closing stock	30,000
Gross profit (50% on sales)	30,000		
	90,000		90,000

Memorandum Trading Account
From 1st January 1974 to 15th September 1974

	Actuals	AT last year's rate		Actuals	At last Year's rates
To opening stock	30,000	30,000	By sales	1,05,000	1,00,00
Purchase	88,000	80,000	Closing stock	66,000	60,000
Gross profit	53,000	50,000			
	1,71,00	1,60,000		1,71,000	1,60,000

Value of stock on hand on the date of fire	66,000
Less Salvaged stock	2,000

	64,000

Claim to be lodged

Amount of claim admitted by applying the average clause:

$$64,000 \times \frac{55,000}{66,000} = 50,333 \text{ or say RS. } 50,330$$

Illustration 13.3

On July 1, 1981 the godown of M/s. A Ltd was destroyed by fire, The records of the company revealed the following particulars

Stock on January 1, 1980	95,000
Stock on Dec. 31, 1980	80,000
Purchases during 1980	3,10,000
Sales during 1980	4,00,000
Purchase from January 1, 1981 to the date of fire	75,000
Sales from Jan1 1981 to the date of fire	1,00,000

In valuing the Godown stock of 1980, Rs. 1,000 was written of whose cost was Rs. 4,800 part of this stock was sold in 1981 a ta loss of Rs. 400 whose cost was Rs. 2,400. Stock salvaged was Rs. 5,000 the godown was fully insured.

Indicate from the above the amount of claim to be made against the insurance company.

(C.A.I.I.B Modified)

Solution

Trading Account for 1980

	Rs.			Rs.
To opening stock	95,000	By sales		40,000
Purchase	3,10,000	By stock (closing)	80,000	
Gross profit	76,000	Add amount already written of	1,000	81,000
	-----------			--------
	4,81,000			4,81,000
	----------			-----------

$$\text{Rate of Gross profit} = \frac{76,000}{4,00,000} \times 100 = 19\%$$

Memorandum Trading Account upto July 1, 1981

	Normal items	Abnormal items	Total		Normal items	Abnormal items	Total
To opening stock	76,200	4,800	81,000	By sales	98,000	2,000	1,00,000
To purchase	75,000		75,000	By P & L A/c Loss		400	400
To Gross profit 19% on 98,000	18,620	18,620		By closing	71,820	2,400	74,220
	1,69,820	4,800	1,74,620		1,69,820	4,800	1,74,620

Value of Stock on hand on the date of fire	74,220
Less stock salvaged	5,000
Claim to be lodged	69,220

Consequential loss of profits. In the event of fire, it not only destroyes the properties but also affects the earnings capacity of the business for some time due top decrease in the production rate. Decrease in production rate leads to decrease in sales and due to the shortage of sales the profit that would have been earned is also affected and the reduction in the profit is called loss of profit. This loss of profit increases further to the extend of non-recovery of standing charges. To cover such losses, a separate policy is taken to indemnify the loss due to non-recovery of standing charges and loss of profit due to short sale.

Before calculating the claim, it is better to be conversant with the following terms:

Indemnity period : any period not exceeding twelve months from the date of damage during which the results of the business shall be affected due to fire is know as indemnity period. The indemnity period is selected by the insured and the policy must be in force on the date of the closure of the business activity.

Standard turnover : Standard turnover refers the turnover effected in the actual turnover. Short sales refers to the loss of sales due to fire which has resulted in dislocation of the business.

Loss due to short sales : This is calculated by applying the rate of gross profit to short sales. The rate of gross profit is calculated in different ways for this purpose.

Rate of gross profit : Here, the term rate of gross profit is not used in the sense as it has been understood commonly. It has different meaning in various circumstances and the same being explained as follows:

1. $$\text{G.P. Rate} = \frac{\text{Net profit + insured standing charges}}{\text{Turnover}} \times 100$$

2. G.P. Rate = $\dfrac{\text{Insured standing changes – Net loss}}{\text{Turnover}} \times 100$

Where the amount of loss is arrived at as follows when only a portion of the standing charges are insured.

$$\frac{\text{Amount actually insured}}{\text{Amount ought to have been insured}}$$

The gross profit rate is calculated by taking the previous year's figure

Increased cost of working. This expenditure is an additional expenditure incurred by the insured in order to carry on the business during the indemnity period. The insured is entitled to get such additional expenses subject to the lowest of the following two calculations

1. $\dfrac{\text{Net profit + Insured standing charges}}{\text{Net profit + All standing charges}}$ X increased cost of working and
2. Short sales avoided through increased cost of the working X Rate of gross profit

In addition to the above two limits, there is an overall limit also i.e. the loss of profit plus the allowable additional expenses as calculated by applying the above two limits shall not exceed the gross profit in adjusted standard turnover.

Saving in Expenses : Any saving in expenses will have to be deducted before arriving the claim for loss of profit and increased working expenses.

Average Clause : As it has been explained already, the insured is entitled to get only a proportion of his clam. Where the policy covers a portion of the loss this is ascertained by first calculating the amount of profit for which insurance policy ought of have been taken and then allowing the claim only proportionately.

1. Amount to be insured : Adjusted turnover for 12 months before fire X G.P, rate
2. Claim allowed : Loss X $\dfrac{\text{Amount actually insured}}{\text{Amount ought to have been insured}}$

Illustration 13.4

Items related to the previous year rate of gross profit	25%
	Rs.
Insured standing charges	10,000
Total standing charges	15,000
Net profit	25,000
Items related to the current year	
Short sales	20,000
Increased working expenses	2,000
Saving in expenses	500
Short sales avoided through increased cost of working	5000
Amount of policy	20,000

Sales during 12 month immediately proceeding the fire being Rs, 1,00,000 the sales of the current year up to the date of fire has increased by 10% over the sales of the same period in the previous year.

Calculate the amount of claim to the admitted by the insurance company.

Solution

Calculation of the allowable limit of the increased working expenses

1. $\dfrac{\text{Net profit + Insured standing charges}}{\text{Net profit + All standing charges}}$ X increased working expenses

25,000 + 10,000 / 25,000 + 15,000 X 2,000 = 1,750

2. Short sales avoided through increased cost of working x

Rate of gross profit 5,000 X $\dfrac{20}{100}$ = 1,000

Rs. 1,000 being the lowest of the above two calculations is allowed by the insurance company

Loss of profit due to short sale $\left[20000 \text{ X } \dfrac{25}{100}\right]$	50,000
Increased working expenses	1,000
	6,000
Less: Saving in expenses	500
Clain for loss of profit and increased working expenses	5,500
Sales during 12 months immediately preceeding the fire	1,00,000
Add increase in trend	10,000
	1,10,000

Amount for which the policy should have been taken (1,10,000 X 25/100)

Amount of claim to be admitted the insurance company

Amount of claim X $\dfrac{\text{Amount of policy taken}}{\text{Amount of policy ought to have been taken}}$

5,500 X 20,000 / 27,500 X 4,000

Illustration 13.5

The premises of a company were partly destroyed by fire which took place on 1st March 1982, and as a result of which the business was disorganized from 1st March to 31st July 1982. Accounts are closed on 31st December every year. The company is insured under a loss of profits policy Rs. 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 profits policy.

	Rs.
Turnover for the year 1981	40,00,000
Net profit for the vear 1981	2,40,000

Insured standing charges	4,80,000
Uninsured standing charges	80,000
Turnover during the period of dislocation i.e. from 1.3.82 to 31.7.82	
Standard turnover for the corresponding period in the Preceding Year i.e. from 1.3.81 t o 31.7.81	2,00,000
Annual turnover for the year immediately preceeding the Fire i.e. from 1.3.181 to 28.2.82	44,00,000
Increased cost of working	1,50,000
Savings in insured standing charges	30,000
Reduction in turnover avoided through increased working cost	4,00,000

Owing to reasons acceptable to the insure, the 'special circumstances clause' stipulates for

(a) Increase of turnover (standard and annual) by 10% and

(b) Increase of rate of gross profit b y 2%

(C.A. inter N.S. may 1983)

Solution

1. Gross profit Ration = $\frac{\text{Net profit + Insured standing charges}}{\text{Turnover}} \times 100$

= 2,40,000 + 4,80,000 / 40,00,00 X 100

= 18%

Increased in rate of Gross profit = 2%

20%

---

2. Calculation of short sales :

	Rs.
Standard turnover during 1.3.81 to 31.7.81	20,00,000
Add : 10% increase of turnover	2,00,000
	22,00,000
Less : Sale during 1.3.82 to 31.7.82 short sales	8,00,000
	14,00,000

3. Calculation of the allowable limit of the increased working expenses:

i. $\frac{\text{Net profit + Insured standing charges}}{\text{Net profit + all standing charges}} \times \text{increased working expenses}$

$\frac{2,40,000 + 4,80,000}{2,40,000 + 5,60,000} \times 1,50,000$

7,20,000
---------- X 15,000 = 1,35,000
8,00, 000

ii) Short sales avoided through increased cost of working X
Rate of Gross profit 4,00,000 X 20 /100 = 80,000
Rs. 80,000 being the lowest of the above two calculations is allwod by the. insurance company

4. Loss of profit
Short sales X G.P. Rate

14,00,000 X 20%	2,80,000
Add : Increased cost of working	80,000
	3,60,000
Less : savings expenses	30,000
Gross claim	3,30,000

5. Claim to be admitted

Sales during the preceding 12 months form the date of fire	44,00,000
Add : Increase in turnover 10%	4,40,000
	48,40,000
Policy ought to have been taken 20% of 48,40,000	9,68,000
Policy taken for	7,50,000

Claim to be admitted

$$\text{Gross claim X } \frac{\text{Policy taken}}{\text{Policy ought to have been taken}}$$

3,30,000 X 7,50,000 / 9,68,0000 = 2,55,681.80 or 2,55,680

Extries in the books of accounts. As soon as the claim is admitted by the insurance company the insured should debit the insurance company and credit the various assets such as stock, buildings, machinery, etc. stock damaged and destroyed are debited in their respective accounts and the credit is given to the trading account. In case, the claim admitted is less than the amount claimed for the stock the difference will be transferred to the profit and loss account as loss suffered. The difference between the book value of the other assets and the amount admitted by the insurer is treated as profit or loss and the same is transferred to the profit and loss account.

As a matter of fact, when the loss is compensated by the insurer on the basis of total loss, then the salvaged stock, if any, belongs to the insurer and no entry is required in the books of the insured. Sometimes the salvaged stock is handed over to the insured by the insurer and in such case, the insured debits his stock account and credits the insurance company. In case of partial loss, salvaged stock belongs to the insured and for which no entry is required as ti will be included in the inventory.

Illustration 13.6

Vikaram Limited suffered loss by fire in 1986. Claims made against and admitted by Bharat Insurance company limited and expenditure incurred were:

	Claimed	Admitted
Loss of profit	48,000	32,000
Stock damage	32,000	16,000
Stock destroyed	40,000	32,000
Building damaged	9,600	8,000
Fittings destroyed	8,000	7,000
Fire expenses	1,000	1,000

Repairs to buildings cost Rs. 9,000 and fittings were replaced at a cot fo Rs. 7,500. For expenses amounted to Rs. 1,000.

The insurance company paid the sum admitted on Dec.1 1996 show the journal entries in the books of Vikram limited.

Notes :

Increase fittings amount claimed is considered as book value and the loss is arrived at by deducting the amount admitted from the book value,.

Exercise

A. Question

1. Explain the accounting procedure for ascertaining the loss of stock by fire
2. What do you understanding by the 'average clause' in the policy?
3. What is consequential loss? How is it compute?
4. Explain
   (1) G.P. Ratio
   (2) Short sales
   (3) Standard Turn over
   (4) Indemnity period
   (5) Standing charges
5. Explain the computation of the amount allowable for additional working expenses, in the case of loss of profit policy.

B. Problems

1. A fire occurred on September 15, 1965 in the godown of M/s. A and B from the following figures ascertain the claim to be lodged.

	Rs.
Stock on April 1, 1965	25,300
Purchase from April, 1,1965 to date of fire	50,400
Manufacturing expenses and wages sales from April 1, 1965 to date of fire	60,000
Goods used by partner themselves (at cost)	1,56,000
The rate of gross profit is 30 percent on cost	2,500

The stock salvaged was valued in RS. 3,600

2. Due to fire the godown of a company on 31st December, 1978 the entire stock was burn except of the value of Rs. 5,723. The following information is available form the books.

	Rs.
Creditors for goods purchased	
On 31,12,77	10,992
On 31.12.78	11,461
Debtors for goods sold	
On 31.12.77	16,105
On 31.12.78	15,271
Payment to supplies in 1978	85,877
Receipts from customer in 1978	1,21,437
Stock in trade at cost in 31.12.77	26,304

The company sells its goods at prices yieldings a gross profit of 50% on purchase prices. The stock was insured for Rs. 24.186

Calcualte the amount of stock lost by fire and the amount of claim to be lodged with the insurance company

(A.C.S. Inter, June 1979)

(Ans. Claim Rs. Rs. 26,525)

3. (a)Explain what do you understand by the average clause in an insurance policy

(b)A fire destroyed the stock of a firm on October 1, 1978. The business records were saved and from them, the following particulars were ascertained

Stock at cost on April 30, 1977	88,600
Stock at cost on April 30 1978	75,100
Purchase for the year to April 30, 1978	2,07,700
Sales for the year to April 30, 1978	3,05,000
Purchase from May 1, 1978 to Sept. 30,1978	74,700
Sales from may 1, 1978 to Sept. 30, 1978	1,18,000

In valuing the stock on April 30, 1978 Rs. 1,600 had been written off a particular line of goods which had originally cost Rs. 3,600 and which were sold in June 1978 for Rs. 3,500. Except this transactions the ratio of gross profit remained unchanged throughout.

The value of stock salvaged from, the fire was Rs. 10,210. You are required to find the amount of the claim to be presented to the insurance company in respect of the loss stock.

(A.C.S. Inter Dec. 1978)

(Ans. Claim Rs. 55,150)

4. A fire occurred in the premises of Shir. Romesh on 1st April 1986, and a considerable part of the stock as destroyed. The stock salvaged was Rs. 1,12,000. Shri Romesh had taken a fire insurance policy for Rs. 6,84,ooo to cover the losses of stock by fire.

You re required to ascertain in the insurance claim due from the insurance company for the loss of stock by fire. The following particulars are available

Purchase for the year 1985	37,52,000
Sales for the year 1985	46,40,000
Purchase for 1st Jan. 1986 to 1st April 1986	7,28,000
Sales from 1st Jan 1986 to 1st April 1986	9,60,000
Stock on 1st Jan 1985	5,76,000
Stock on 31st Dec,. 1985	9,68,000

Wages paid during the year 1985	4,00,000
Wages paid during 1st Jan 1986, to 1st April 1986	72,000

Shri Romesh had in June 1985 consigned goods worth Rs. 2,00,000 which were lost in an accident As there was no insurance then loss was borne by him in full.

Stock at end of each year for and till the end of Calendar year 1984 had been valued at cost loss. 10% from 1985 however, there was a change in the valuation of closing stock which was ascertained by adding 10% to its cost.

Solution

Journal of Vikram Limited

1986			Dr. Rs.	Cr. Rs.
	Bharath Insurance Co. Ltd			
	To profit and Loss A/c			
	"Stock Damaged A/c			
	"Stock Destroyed A/c			
	"Building Repair			
	"Fittings			
	"Fire expenses			
	(Being various claims admitted by the insurance Co)			
Dec.1	Bank A/c	Dr.	96,000	
	To Bharat Insurance Co. Ltd			96,000
	(Being payment received from the insurance Co)			
Dec. 31	Stock damaged A/c	Dr.	32,000	
	Stock Destroyed A/c	Dr.	40,000	
	To Trading A/c			72,000
	(Being full value of stock credited to trading A/c)			
	Profit and Loss A/c	Dr.	24,000	
	To stock damaged A/c			16,000
	To stock destroyed A/c			8,000
	(Being loss on account of difference Between full value of stocks and amounts admitted Transferred to profit and loss account)			
	Buildings Repair A/c	Dr.	9,000	
	Fittings A/c	Dr.	7,500	
	Fire Expenses A/c	Dr.	1,000	
	To Bank A/c			17,500
	(Being the amount spent on repairs of building and replacement of fittings and for fire expenses)			
	Profit and Loss A/c	Dr.	2,000	
	To building repairs A/c			1,000
	To fittings			1,000
	(Being the loss suffered on building			

repair and the loss on fittings are
transferred to profit and loss account)

(C.A. Inter Nov 1986)
(Ans. Claim Rs 6,00,000)

5. On September 80, 1978, the stock of Fred Perry was lost in a fire accident., From the available records, the following information is made available to you to enable you to prepare a statement of claim on the insures.

	Rs.
Stock at cost on 1.4.77	37,500
Stock at cost on 31.3.78	52,000
Purchase less returns for year ended 31st march 1978	[illegible]
Sales less returns for year ended 31st march 1978	[illegible],15,000
Purchase less returns up to 30th September 1978	1,45,000
Sales less returns up to 30 the September.	1,84,050

In valuing the stock on 31st march, 1987 due to obsolescence, 50% of the stock which originally cost Rs. 6,000 had been written off. In may 1978 three – fourths of this stock had been sold at 90% fo the original cost and its is now expected that the balance of the obsolete stock would also realize the same price. Subject to the above, gross profit had remained uniform throughout.

Stock to the value of Rs. 7,200 was salvaged

(C.A. Inter, nov, 1978)
(Ans. Claim Rs. 53,150)

6. On 19th May 1985 the premises of alpha ltd, were destroyed by fire but sufficient records were saved, wherefrom the following particulars were asceratained

Stock at cost on 1.,1.84	36,750
Stock at cost on 31.1.84	39,800
Purchase less returns during 1984	1,99,000
Sales less returns during 1984	2,43,500
Purchase less returns during 1.1.85 to 19.5.85	81,000
Sales less returns during 1.1.85 to 19.5.85	1,15,600

In valuing the stock for the balance sheet as at 31.12.85 Rs. 1,150 had been written off certain stock which was poor selling having cost Rs. 3,450. A portion of these goods were sold in march 1985 at a loss of Rs. 125 on original cost of Rs. 1,725. 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. The stock salvaged was Rs. 2,900.Show the amount of the claim for s tock destroyed by fire.

(C.A. Inter, Nov. 1985)
(Ans. Claim Rs. 26,125)

7. Koustub Fair Price shop suffered loss of stock due to fire on August 20,1977 From the following particulars calculate claim to be made by the shop.

	Rs.
(1) Stock on December 31.1975 (including stock purchased during the year Rs. 8000 valued at Rs. 4,000 because of poor Selling price)	1,00,000

(2) Wages paid – 1976 (including wages paid for the construction of a showroom for which workers of the factory worked, RS. 2,000. Manufacturing wages Rs. 1,500 were outstanding)	30,000
(3) Freight inwards – 1976	5,000
(4) Purchase 1976 (including purchases of furniture of Rs. 1,500 wrongly posted through invoice book)	1,20,000
(5) Sales 1976 (including sale of ¼ of the stock at. RS. 1,000 which had a poor selling line and which was valued at Rs. 4,000 on Dec. 31.1975)	2,46,000
(6) Stock on Dec. 31, 1976 (including remaining stock which had a poor selling line at the same value)	42,000
(7) Purchase up to August 20. 1977	1,42,000
(8) Sale up to August 20, 1977 (including sale of the 1/3 remaining stock which had poor selling line at Rs. 800)	1,42,900

The remaining stock which had a poor selling line, was considered at 80% of the original cost for the purpose of claim. The salvage was Rs. 47,400. The shop had taken the policy of Rs. 40,000. There was no average clause in the policy.

(A.C.S. Inter June 1978)

(Ans. Loss of st ock Rs. 15,800; Claim Rs. 10,000)

8. The premises of Fire proof ltd., were destroyed by fire on 30.6.1979. The following figures were ascertained

You are required to prepare a statement of claim in respect of loss of stock to be submitted to the insurance company

	1976 Rs.	1977 Rs.	1978 Rs.	1.1.1970 to 31.6.1979
Opening stock	2,000	2,200	1,180	3,402
Purchase	16,000	14,600	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 1976 while valuing closing stock, some defective goods costing Rs. 500 were valued at Rs. 400. These were sold for Rs. 450 in 1977

In 1977 an item costing RS. 600 was wrongly valued at Rs. 700/. This was sold for Rs. 500 in 1978.

In 1978 items cost in RS. 1,200 were valued at Rs. 1,000. 50% of these items was sold in June 1979, for Rs. 600

Subject to this the gross profit rate is more or less uniform

The value of salvage was Rs. 800

(C.A. Inter, Nov. 1979)
(Ans. Claim Rs. 4,202)

9. From the following particulars, prepare a claim for loss of profit covering consequential loss:
   (a) Accounts are prepared on 31st December, the net profit for 1978 amounted to Rs. 65,000 after debting constant expenses totaling Rs. 75,000. sales for 1978 were RS. 11,20,000
   (b) Fire occurred on June 1,979 and affected sales for four months
   (c) Sales for four months ending sept. 30 in 1978 and 1979 were respectively Rs. 3,00,000 and Rs. 40,000
   (d) The policy was Rs. 2,00,000 the sales for the year ending on may 31, 1979, were Rs. 12,50,000
10. A fire occurred in the premises of a businessman on Jan 31, 1980 which destroyed stock. However, stock worth Rs. 5,940 was salvaged. The company's insurance policy covers the following

Stock	Rs.	6,00,000
Loss of Profit (including standing changes)	Rs.	3,75,000
Period of indemnity	Six months.	

The summarised Profit and Loss Account for the year ended Dec. 31, 1979 is as follows.

	Rs.	Rs.
Turnover		30,00,000
Closing Stock		7,87,500

		37,87,500
Opening Stock	6,18,750	
Purchases	27,18,750	
Standing Charges	2,51,250	
Variable Expenses	1,20,000	
		37,08,750

Net Profit		78,750

Turnover	Rs. 1,50,000
Payment to Creditors	RS. 1,60,020
Trade Creditors	
1.1.80	Rs. 2,26,000
31.1.80	Rs, 2,30,980

The company's business was disrupted unto 30.4.80 during which period the reduction in the turnover amounted to Rs.2,70,000 as compared with the turnover of the same period corresponding to the previous year.

You are required to submit the claim for insurance for loss of stock, and loss of profits.

11. From the following claim, compute a consequential loss claim:

Financial year ends on December 31, Turnover Rs.2,00,000

Idemnity period - 6 months.

Period of interruption --July I to October 31.

Net Profit - Rs. 18,000

Standing Charges --Rs.42,000 outof which Rs.10,000 have not been insured.

Sum assured -- Rs.50,000

Standard turnover -- RS.65,000 .

Turnover in the period of interruption -- Rs.25,000 out of which Rs.6,000 was from a rented place at Rs. 600 per months.

Annual turnover Rs. 2,40,000 Savings in standing charges -- Rs. 4,725 per annum Date. of the fire-night 30th June.

It was agreed to between the insurer and the insured that the business trends would lead to an increase of 10% in the turnover.

(C.A. Inter, May 1979)

(Ans. Claim Rs. 8,750)

12. From the following information; find the claims under a Loss of Profit policy:

Sales in 1971		1,00,000
Sales in 1972		1,20,000
Sales in 1973		1,44,000
Sales in 1974		1,72,000
Net profit in 1974 (All insured) Standing charges in		10,000
1974		7,280
Date of dislocation by fire period of dilocatioin	1.1.75	
Sales from 1.1.74 to 31.3.74	3 months	43,200
Sales from 1.1.75 to 31.3.75		11,840
Indemnity period	9 months	
Policy value		50,000

There was no reduction in standing charges during the dislocation period no were there any additional cost

(C.A. Inter, Nov. 1975)

(Ans. Claim Rs. 4,(00)

13. Hiro Idnani effected a policy of insurance covering a loss of profits and standing charges to the extent of Rs.46,000 (based on the previous year's profits) plus an allowance of Rs.8,000 for profits and Standing Charges expected to accrue from increased turnover, the period of indemnity being three months. The turnover for the previous year ended 28th February, was R. 1,12,500 and for the ensuring year was estimated at Rs. 1,35,000. A fire occurred on 1st October.

The following relative figures have been ascertained.

Month	Sales (Previous year) Rs.	Sales Budget Current year Previous year Rs. +20%	Actual Sales Rs.
October	9,750	11,700	Nil
November	10,500	12,600	Nil
December	9,000	10,800	2,100

Upon investigation, it was found that the increased sales for the past seven months are overestimated by 50% and that the ratio of expense was consistent with such reduction.

The additional expenses of carrying on the business during partial disablement amounted to Rs. 850 Prepare statement of claim against the insurance company and show workings.

(A.C.S. Inter, Dec. 1977)

(Ans. Claim Rs. 12,998)

14. On 31.12.83 a fire damaged the premises of Shanker Ltd. and the business of the company was disorganised until 31.3.84. . The Company was insured under a loss of profits for Rs. 1,95,000 with a six-month period of indemnity.

The Company's account for the year ended 31.12.83 showed a turnover of Rs. 5,25,000 with a net profit of Rs. 60,000. The amount of standing charges covered by the insurance and debited in that year was Rs. 1,50,000.

The turnover for the twelve months ended on 31.12.83 was Rs. 5,85,000. The turnover during the period the business was dislocated amounted to Rs. 60,000 while during the corresponding period in-the preceding year it was Rs1, 27 ,500.

A sum of Rs. 15,000 was spent as additional expenses to mitigate the effect of the loss, there being however no saving in standing charges as a result of fire.

Prepare a claim to be submitted to respect of the consequential loss policy.

(C.A. Inter, May 1985)

(Ans. Claim Rs. 7,(00)

ROYAL ACCOUNTS

MEANING:

Royalty means the amount payable by one person to another person for using the right by the former, which belongs to the latter. The person who pays the amount is called "lessee", and the person receives the royality is called "lessor': or "landlord", The amount may be paid periodically say once in a year.

Royalities are usually payable by a

1. Lessee of a mine to the landlord for extracting Coal, Oil etc.,
2. Publisher of a book to the author of a book
3. Manufacturer to the patentee.

Accounting Treatment

The person making the payment i.e. the lessee treats it as an ordinary business expenditure Royality is a nominal account. So lessor debits royalities account, when he makes payment. At the year, end, if the royalities, are based on production, then it will be transferred to manufacturing or trading account. . If the royalities are based on sales, then it will be transferred to profit and loss account.

Similarly the person who receiving the payment credits royalities account. At the year end the amount will be transferred to profit and loss account.

Similarly the person who receiving, the payment credits royalities account. Ai the year end of the amount will be transferred to profit and loss account.

Minimum Rent

The other names for minimum rent are "dead rent", 'rock rent' "fixed rent". This is the minimum amount payable by the lessee to the landlore, whatever may. be the production or sales. The fixation of minimum rent helps the landlord to receive a minimum amount even if the output or sales is low. It gives an incentive to the lessee to increase the production, or sales. If the actual royalities is more than the minimum rent, then the lessee has to pay the actual royalties.

For example, Subaitha publishers, published a book on Business correspondence at a royality of Rs.10 per book, and minimum rent is Rs: 10000. If the sales in a particular year is 700 books, then the amount payable is Rs. 10,000 (minimum rent) and not the actual royalties (700 xI0 = 7,000) Suppose if the sales is 1200 books, then the amount payable)s Rs. 12,000/- (1200 xI0) and not the minimum rent.

Short Workings:

The term short, workings means the excess of minimum rent over actual royality calculated on the basis of output or sales. In the above example, the short workings in the first case, i.e., when 700 books are sold is 3000 (10,000 minimum rent - 7,000 actual royalities.) There is no sport workings in the Second case, i.e, when 1200 books are sold, because actual royalities are more than minimum rent.

Recoupment of Short Workings:

Usually in the first few years of leasing agreement, there may be short workings, because a lot of preparation work like construction of house making advertisement, collecting necessary machinery may be there. So the landlord may promise to return the excess amount paid in the initial years, out of the excess in the later years. The right of getting, back the excess amount paid in earlier years is called recoupment of short workings.

If the lessee can recoup the short workings only in the first few years of the lease (Say three or four years), then it can be called as fixed or restricted right of recoupment. After this time the lessee cannot recoup any short workings. But if the lessee can recoup within two or three subsequent years, in which the short workings occur, it is called floating or unrestricted right of recoupment.

Accounting Entries in the books of Lessee:

I. When the production is less than the minimum rent

a)	Royalties a/c short working a/c	Dr. (actual royalties)
	short working a/c	Dr. (Minimum ent-actual royalties)
	To landlord a/c	(The minimum rent)
b)	Landlord a/c	Dr. (The amount actually paid i.e. Minimum rent)
	To Bank alc	
c)	Profit & Loss A/c (or) To Trading A/c	Dr. (Actual royalties)
	To Royalties A/c	

If the minimum rent or dead rent account is to be opened, then instead of first entry, the following two entries will have to be passed.

a) Minimum rent a/c Dr.
To Landlord a/c

b) Royalties A/c Dr.
To Short workings A/c Dr.

2. **when Actual royalities are more than the minimum rent.**

a) Royalities A/c Dr. (with actual royalities)
To landlord

b) Landlord A/c Dr. (wit h actual royalities)
To short working A/c (Amount recouped)
To bank (amount paid)

c) Profit & Loss A/c (or)
Trading Account
To Royalties A/c

Illustration 18.1

The Lakshmi Mines Ltd., took from D a lease of a mine for a period of 25 years from 1st April 1994 on a royalty of Rs. 5.00 per tonne of mineral got with a Dead Rent of Rs. 20,000 and power to recoup short workings during the first five years of the lease.

The annual outputs were as follows.

For the year ended 31 st March, 1990	2,000 tonnes
For the year ended 31st March, 1991	3,000 tonnes
For the year ended 31 st March, 1992	4,000 tonnes
For the year ended 31 st March, 1993	4,500 tonnes
For the year ended 31 st March, 1994	5,000 tonnes

Give journal entries in the books of the company and in the books of D.

Lakshmi Mines Co. Ltd's Journal

				Dr. Rs.	Cr. Rs.
1990	Royalties Account	Dr.		10,000	
Mar.31	Short workings Account	Dr.		10,000	
	To Account				20,000
	(Royalties Rs.5,00 per ton.on 2,000 tonnes subject to a minimum of Rs. 20,000)				
1990	D A/c	Dr.		20,000	
Mar.31	To Bank A/c (Payment of the sum due)				20,000
	Profit & Loss Account	Dr.		10,000	
	(Transfer of the Royalties Account to the Profit & Loss Account)				10,000
1990	Royalties Account	Dr.	10,000		
Mar.31	Short workings Account	Dr.	10,000		
	To A Account				20,000
	(Royalties Rs.5.00 per tonne on 2,000 tonnes subject to a minimum of Rs. 20,000)				

1990	D A/c	Dr.	20,000	
Mar.31	To Bank A/c (Payment of the sum due)	Dr.		20,000
	Profit & Loss Account	Dr.	10,000	
	To Royalties Account			10,000
	(Transfer of the Royalties Account to the Profit & Loss Account)			
1991	Royalties Account	Dr.	15,000	
31st Mar.	Short workings Account	Dr.	5,000	
	To D A/c			20,000
	(Royalties Rs.5,00 per tonne on 3,000 tonnes subject a minimum of Rs. 20,000)			
	D A/c	Dr.	20,000	
	To Bank A/c			20,000
	(Payment of the sum due)			
	Profit & Loss Account A/c	Dr.	15,000	
	To Royalties Account			15,000
	(Transfer of the Royalties Account to the Profit & Loss Account)			
1992	Royalties Account	Dr.	20,000	
Mar.31	To D A/c			20,000
	(Royalties Rs. 5.00 per ton on 4,000 tonnes)			
1992	D A/c	Dr	20,000	
Mar 31	to Bank A/c			20,000
	(Payment of the sum due)			
1992	Profit and loss account	Dr.	20,000	
mar 31	To royalties account			20,000
	(Transfer of the royalties account to the profit and loss account)			
1993	Royalties Account	Dr.	22,500	
Mar.31	To short working account			2,500
	To D			20,000
	(Royalties Rs. 5,00 per tone on 4,500 tones Rs. 2,500 recovered against short workings)			
	D /Ac	Dr.	20,000	
	To bank A/c			
	(Payment of sum due)			
	Profit & Loss Account	Dr.	32,500	
	To royalties Account			25,000
	To Short working Account			7,000
	(Transfer of royalties account to profit and Loss account and writing off the balance in The short workings acocunt)			

Journal Entries in the books of D

1990	Lakshmi Mines to Ltd	Dr.	20,000	
.Mar31	to Royalties Receivable account			10,000
	To Royalties suspense Account			10,000
	(Royalty Rs. 5,00 per tonne on 2,000 tones subject to a minimum of Rs. Rs. 20,000)			
	Bank A/c	Dr.	20,000	
	To lakshmi mines Co. Ltd			20,000
	(Receipts of the sum due)			
	Royalties receivable account	Dr	10,000	
	To profit & loss account			10,000
	(Transfer to Royalties Receivable Account to the profit & Loss account)			
1991				
Mar.31	Lakshmi Mines Co Ltd	Dr.	20,000	
	To royalties receivable account			15,000
	To royalties suspense account			5,000
	(Royalties Rs. 5.00 per tonne on 3,00 tones subject to a minimum of Rs. 20,000)			
	Bank Account -	Dr.	[illegible]	
	To Lakshmi Mines Co.Ltd.,			20,000
	(Receipt of the sum due)			
	Royalties Receivable Account	Dr.	15,0[illegible]	
	To Profit and Loss Account			15,000
	(Transfer of Royalties Receivable Account to the Profit and Loss Account)			
1992	Lakshmi Mines Co.Ltd.,	Dr.	20,[illegible]	
Mar.31	To Royalties Receivable Account			20,000
	(The Royalty Rs.5.00 per tonne on 4,00 tonnes)			
	Bank Account	Dr.	20,000	
	To Lakshmi Mines Co. Ltd.			20,000 .
	(Receipt of the sum due)			
	Royalties Receivable Account	Dr.	20,000	
	To Profit & Loss Account			20,000
	(Transfer of Royalties Receivable Account to the profit & Loss Account to the Profit & Loss)			
1993	Lakshmi Mines Co.Ltd.,	Dr.	20,000	
Mar.31	Royalties suspense Account		2,500	
	To Royalties Receivable Account			22,500
	(The Royalty Rs.5.00 per tonne on 4,500 tonnes Rs. 2,500 recovered by the enant against short workings)			

	Bank Account	Dr.	20,000	
	To Lakshmi Mines Co.Ltd. .			20,000
	(Receipt of the sum due)			
	Royalties Receivable Account	Dr.	22,500	
	To Profit and Loss Account			22,500
	(Transfer of Royalties Receivable Account to Profit and Loss Account)			
1994	Lakshmi Mines Co.Ltd.,	Dr.	20,000	
Mar. 31	Royalties suspense Account		5,000	
	To Royalties Receivable Account			25,000
	(Royalty Rs.5.00 per tonne on 5,000 tonnes Rs. 5.00 recovered by the tenant against short workings)			
	Bank Account	Dr.	20,000	
	To Lakshmi Mines Co.Ltd.,			20,000
	(Receipt of the sum due)			
	Royalties Receivable account	Dr.	25,000	
	Royalties suspense account	Dr.	75,000	
	To profit and loss account			32,500
	(Transfer of Royalties receivable account and the balance in the royalties suspense account, being not longer recoverable, to the profit and loss account)			

Working notes :

Year ended	Output Tonnes	Royalty	Dead Rent	Short working arising	Short workings recovered	S.W.Iree converable	Payment
		Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
31.3.1990	2,000	10,000	20,000	10,000	--	--	20,000
31.3.1991	3,000	15,000	20,000	5,000	--	--	20,000
31.3.1992	4,000	20,000	20,000	--	--	--	20,000
31.3.1993	4,500	22,500	20,000	--	2,500	--	20,000
31.3.1994	5,000	25,000	20,000	--	5,000	7,500	20,000

Illustration 18.2

Mathipa owned the patent of safety lock. Ruby and Co acquired the right to manufacture and sell locks for seven year on the following tems

(a) Ruby and Co. to pay mathipa a royalty of Rs. 5 for each lock sold with a minimum annual payment of Rs. 50,000 accounts are to be settled annually on 31st December

(b) If in any year the royalty calculated on locks sold amounted to less than Rs. 50,000. Ruby and Co., is to have the right to deduct the deficiency from the royality payable in excess of that sum in the two following years.

The number of locks sold was as follows

Year ended 31st December

1991	8,000
1992	9,000
1993	11,000
1994	18,000

You are required to prepare the necessary including minimum rent a/c, ledger accounts including minimum rent account to record the above royalty transactions in the books of Ruby and Co., which are closed annually on 31st December

Solution :

Analytical Table

Year ended	Output Unit s	Shortword Ings	Surpolus	Recoupment	Royalties	ort workings not recoverable	Paid to landlord
		Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
1991	8,000	10,000			40,000		50,000
1992	9,000	5,000			45,000		50,00
1993	11,000		50,00	5,000	55,000	5,000	50,000
1994	18,000		40,000	5,000	90,000		85,000

Ruby and Co's Ledger

Royalties Account

1991 Dec. 31	To maximum Rent Account	40,000	1991 Dec. 31	By profit & loss account	40,000
1992 Dec. 31	To minimum Rent account	45,000	1992 Dec. 31	By profit & loss account	45,000
1993 Dec. 31	To mathipa	55,000	1993 Dec. 31	By profit & loss account	55,000
1994 Dec. 31	To Mathipa	90,000	1994 Dec. 31	By profit & loss account	90,000

Minimum Rent Account

1991 Dec. 31	To mathipa	50,000	1991 Dec. 31	By Royalties Account	40,000
				By short-working account	10,000
		50,000			50,000
1992 Dec. 31	To Mathipa	50,000	1992 Dec. 31	By Royalties Account	45,000
				By short-working account	5,000
		50,000			50,000

Short – working account

1991 Dec. 31	To minimum Rent Account	10,000	1991 Dec. 31	By Balance C/d	10,000
		---------			---------
	To balance B/d	10,000		By balance C/d	15,000
1992 Jan 1	To Minimum Rent account	5,000	1992 Dec. 31		
		---------			---------
Dec. 31		15,000			15,000
		---------			---------
1993 Jan1	To balance b/d	15,000	1993	Mathipa	5,000
			Dec. 31	By profit and Loss A/c	5,000
			Dec. 31	By balance c/d	5,000
		---------			---------
		15,000			15,000
		---------			---------
1994 Jan1	To balance b/d	5,000	1994 Dec.31	By Mathipa	5,000

Mathipa's account

1994 Dec.31	To bank Account	50,000	1994 Dec.31	By Minimum Rent A/c Account	50,000
		---------			---------
		50,000			50,000
		---------			---------
1992 Dec.31	To Bank Account	50,000	1992 Dec.31	By Minimum Rent A/c	50,000
		---------			---------
		50,000			50,000
		---------			---------
1993 Dec. 31	To bank account	50,000	1993 Dec.31	By Royalties A/c	55,000
	To short working account	5,000			
		---------			---------
		55,000			55,000
		---------			---------
1994 Dec, 31	To short working Account	5,000			
Dec. 31	To bank Account	85,000	1994	By Royalties A/c	90,000
		90,000			90,000
		---------			---------

Profit and Loss Account

1991	Dec. 31	To royalties Account	40,000

1992	Dec. 31	To Royalties Account	45,000

1993	Dec. 31	To royalties Account	55,000
		To short-working Account	5000

1994	Dec. 31	To royalties Account	90,000

Problem 18.3

The X Co., Ltd. Leased a property from A at a royality of ... 10 per tonne with a minimum rent of Rs. 20,000 annum, each year excess of mninimum rent over royalties is recovaerable out of the royalties of the next five years. In the event of a struck and the mini um rental not being reached the lease provided that minimum rent would stand reduced proportionate to time actually worked. Account are closed on 31st March every year.

The results of the working were as follows

	Actual royalties		Actual Royalties
	Rs.		Rs.
1987 – 1988	Nil	1991 – 1992	35,000
1988 – 1989	6,000	1992 – 1993	12,000
1989 – 1990	18,500	(Strike for 4 months)	
1990 – 1991	22,500	1993 – 1994	30,000
	---------		-------

Write up the Minimum Rent, Royalties and Short-working accounts. Show the amount charged to profit and loss account each year.

Minimum Rent Account

		Rs.			Rs.
1988 Mar. 31	To A	20,000	1988 Mar. 31	By Short-working A/c	20,000
		--------			---------
		20,000			20,000
		--------			---------
1989 Mar. 31	To A	20,000	1989 Mar. 31	By Royalties A/c	6,000
				By Shortworking A/c	14,000
		--------			---------
		20,000			20,000
		--------			---------
1990 Mar. 31	To A	20,000	1990 Mar. 31	By Royality A/c	18,500
				By Short-working A/c	1,500
		--------			---------
		20,000			20,000
		--------			---------

Mar. 31				Account	
		--------			----------
1992 Mar. 31	To A	35000	1992	By profit & Loss Account	[illegible]
		-------			----------
1993 Mar. 31	To Minimum Rent Account	12000	1993	By profit & Loss Account	12,000
		-------			----------
1994 Mar. 31	To A	30000	1994	By profit & Loss Account	30,000

Short-Working Account

1988 Mar31	To Minimum rent Account	20,000	1998 Mar. 31	By balance c/d	20,000
		--------			----------
		20,000			20,000
		--------			---------
1988 Apr. 1	To balance b/d	20,000	1989 Mar. 31	By balance c/d	34,000
1989 Mar31	To Minimum rent Account	14,000	1990 Mar. 31	By balance c/d	34,000
		--------			---------
		34,000			34,000
		--------			---------
1989 Apr1	To balance B/d	34,000	1991 Mar 31	By A By balance c/d	2,500 33,000
1990 Mar31	To minimum Rent Account	1,500			
		--------			----------
		35,000			35,000
		--------			----------
1990 Apr1	To Balance b/d	35,000	1992 Mar 31	By A By balance c/d	15,000 18,000
		-------			---------
		35,000			
1991 Apr1	to balance b/d	33,000	1992 Mar 31	By Profit & Loss Account By balance C/d	2,500 16,833
		----------			---------
1992 Apr1	to balance b/d	18,000			19,333
1993 Mar31	To minimum Rent Account	1,333			

		19,333			

1993 Apr1	To balance b/d	16,833	1994	By A	10,000
			Mar 31	By profit & Loss A/c	4,000
				By balance C/d	2,833
		-------			--------
		16,833			16,833
		--------			--------

Profit and loss account

Dr.		Cr.
1989 Mar 31	To Royalties Account	6000

1990 Mar 31	To Royalties Account	18,500

1991 Mar 31	To Royalties Account	22,500

1992 Mar 31	To Royalties Account	35,000

1993 Mar 31	To Royalties Account	12,000
	To Short- working Account	2,500

		14,500

1994 Mar 31	To Royalties Account	30,000
	To short working account	4,000

		34,000

Working Notes

Year ended	Royalties Rs.	Minimum Rents	Short-working arising	Short-working recovered	Short workings irrecoverable
	Rs.		Rs.	Rs.	Rs.
31.3.88	Nil	20,000	20,000	--	---
31.3.89	6,000	20,000	14,000	--	--
31.3.90	18,500	20,000	1,500	---	--
31.3.91	22,500	20,000	--	2,500	--
31.3.92	35,000	20,000	--	15,000	--
31.3.93	12,000	13,333	13,333	---	2,500
31.3.94	30,000	20,000	---	10,000	4,000
