PONDICHERRY UNIVERSITY

(A Central University)

DIRECTORATE OF DISTANCE EDUCATION

PRINCIPLES OF FINANCIAL ACCOUNTING

Paper Code:

BCOM1003/BBA1003

Bachelor of Commerce – B.Com.

Bachelor of Business Administration-B.B.A

I Year

DDE – WHERE INNOVATION IS A WAY OF LIFE

PONDICHERRY UNIVERSITY

(A Central University)

DIRECTORATE OF DISTANCE EDUCATION

PRINCIPLES OF FINANCIAL ACCOUNTING

(Paper Code: B.COM1003/BBA1003)

B.Com / BBA - I Year

Principles of Financial Accounting

Authors:

Units I - VI Written by

Dr .K. Mohan

School of Management

Pondicherry University

Pondicherry

Units VII - VIII Written by

B. Krishnamurthy

Assistant Professor in Commerce

Mahatma Gandhi Govt. Arts College

Mahe

TABLE OF CONTENTS

UNIT	LESSON	TITLE	PAGE NO.
I	1.1	Financial Accounting	5
	1.2	Accounting Principles	13
II	2.1	Books of Accounts	25
	2.2	Ledger	45
	2.3	Trial Balance	60
	2.4	Final Accounts	69
III	3.1	Receipts and Payments Account	104
	3.2	Income and Expenditure Account	107
IV	4.1	Depreciation Accounting	122
	4.2	Methods of Providing Depreciation	130
V	5.1	Consignment Accounts	157
	5.2	Joint Venture	169
VI	6.1	Branch Accounts	181
	6.2	Departmental Accounts	220
VII	7.1	Single Entry System	232
	7.2	Single Entry System - Conversion Method	239
VIII	8.1	Partnership Accounts	253
	8.2	Dissolution of a Firm	294

PAPER III – PRINCIPLES OF FINANCIAL ACCOUNTING

UNIT - I
Meaning and Scope of Accounting – Need for Accounting – Development of Accounting – Nature and objectives –Book keeping and Accounting - Accounting Principles – Accounting Concepts and Conventions – Accounting Standards – International Accounting Standards.
UNIT - II
Books of Accounts: Double Entry System of Book keeping - Journal – Ledger posting –– Trial Balance – Final Accounts – Preparation of Trading Account – Profit and Loss Account – Balance Sheet – Adjustments – closing stock, depreciation, bad debts and provision for bad debts, outstanding and prepaid expenses, advance and accrued income.
UNIT – III
Income and Expenditure Account & Receipts and Payments Account: – Nature – Preparation of Receipt and Payment Account and Income and Expenditure Account.
UNIT - IV
Depreciation Accounting: Meaning – causes – objectives – factors - Methods of Depreciation Accounting – Straight Line Method – Written Down Value Method – Sinking Fund Method – Annuity Method – Insurance Policy Method - Reserves and Provisions.
UNIT – V
Consignment Accounts – Entries in the books of Consignor and Consignee – Joint Venture Accounts – separate books and existing books.
UNIT – VI
Branch and Departmental Accounts: Meaning of Branches and Departments – Accounts of various types of branches – Departmental Accounts.
UNIT - VII
Single Entry System: Defects of Single Entry System – Ascertainment of profit – Statement of Affairs Method and Conversion Method – preparation of final accounts.
UNIT - VIII
Partnership Accounts: Admission – Retirement – Death of a Partner - Dissolution – Insolvency of a Partner – Piecemeal Distributions.

Note: Distribution of marks between problems and theory shall be 70% and 30%.

TEXT BOOK:
Jain & Narang, Financial Accounting
REFERENCES:
Arulanandam M.A.& Raman K.S., Advanced Accounting
Gupta R.L. & Gupta V.K., Advanced Accounting,
Reddy & Murthy T.S., Financial Accounting,
Tulsian P.C., Financial Accounting

UNIT – 1

Unit Structure:

Lesson 1.1 Financial Accounting

Lesson 1.2 Accounting Principles

LESSON 1.1 FINANCIAL ACCOUNTING

INTRODUCTION

Accounting refers to the discipline of recording and classifying the monetary effects of business transactions and events of an enterprise for the purpose of analyzing and finally reporting the result to a variety of interested parties. If the transactions are mostly financial in nature, the accounting system will be termed as financial accounting. On the other hand, if they relate to costing information, the system will be known as cost accounting. Financial accounting looks to the interests of external parties who have a financial stake in the concern's affairs -shareholders, creditors, debenture-holders, employees, regulatory bodies, etc., and cost accounting is mainly concerned with the cost information which is used by the management for cost ascertainment and cost control purposes. On the other hand, accounting which is concerned with providing information relating to the conduct of the various aspects of the business, like cost or profit associated with some portions of business operations, is called management accounting.

NEED FOR ACCOUNTING

Accounting has rightly been termed as the language of the business. The basic function of a language is to serve as a means of communication. It communicates the results of business operations to various parties who have some stake in the business viz., the proprietor, creditors, investors, government and other agencies. Though accounting is generally associated with business, it s not only business which makes use of accounting but persons like housewives, Government and other individuals also make use of accounting. For example, a housewife has to keep a record of the money received and spent by her during a particular period. She can record her receipts of money on one page of her "household diary", while payments for different items such as milk, food, clothing, house rent, education, etc. on some other page or pages of her diary in a chronological order. Such a record will help her in knowing about:

(i) The sources from which she received cash and the purposes for which it was utilised.

(ii) Whether her receipts are more than her payments or vice-versa?

(iii) The balance of cash in hand or deficit, if any, at the end of a period.

The need for accounting is all the more great for a person who is running a business. He must know: (i) what he owns? (ii) What he owes? (iii) Whether he has earned a profit or suffered a loss on account of running a business? (iv) What is his financial position i.e., whether he will be in a position to meet all his commitments in the near future or he is in the process of becoming a bankrupt.

DEVELOPMENT OF ACCOUNTING

Accounting is as old as money itself. In India, Chanakya in his Arthashastra has emphasized the existence and need of proper accounting and auditing. However, the modern system of accounting owes its origin to Pacioli who lived in Italy in the 18th Century. In those early days the business organizations and transactions were not so complex due to their being small and easily manageable by the proprietor himself. Things have changed fast during the last seventy years. The advent of industrial revolution has resulted in large scale production, cut-throat competition and widening of the market. This has also reduced the effectiveness of personal supervision resulting in the decentralization of authority and responsibility. Today there is a greater need for co-ordination and control. Old technique of management by intuition is no longer considered dependable in the situation in which the modern firm operates. Accounting today, therefore, cannot be the same as it used to be about half a century back. It has also grown in importance and change in its structure with the evolution of complex and giant industrial organizations. In the early stages accounting developed as a result of the needs of the business firms to keep track of their relationship with outsiders, listing of their assets and liabilities. In recent years changes in technology have also brought a remarkable change in the field of accounting. The whole concept of accounting has changed. It systematically writes the economic history of the organization. It provides information that can be drawn upon by those responsible for decisions affecting the organisations's future. This history is written mostly in quantitative terms. It consists partly of files of data, partly of reports summarizing various portions of these data, and partly of the plan established by management to guide its operations.

FINANCIAL ACCOUNTING

Financial Accounting is defined as the science and art of recording and classifying business transactions and making significant summaries for the determination of year-end profit or loss and their effect on owner's capital, assets and liabilities. The American Institute of certified Public Accountants has defined financial accounting as "the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the results thereof". Financial accounting is thus concerned with the compilation and communication of financial information.

OBJECTIVES OF FINANCIAL ACCOUNTING

An analysis of the above definition brings out clearly the objectives and functions of financial accounting. The following may be listed out as its main objectives:

(a) To ascertain the operating results of the enterprise.

(b) To reveal the financial position of the business and

(c) To enable control over the operations as well as the resources of the business.

FUNCTIONS OF FINANCIAL ACCOUNTING

An analysis of the above definition brings out the following functions of accounting:

1. **Recording:** This is the basic function of accounting. It is essentially concerned with not only ensuring that all business transactions of financial character are in fact recorded but also that they are recorded in an orderly manner. Recording is done in the book "Journal". This book may be further sub-divided into various subsidiary books such as Cash Journal (for recording cash transaction), Purchases Journal (for recording credit purchases of goods), Sales Journal (for recording credit sales of goods), etc. The number of subsidiary books to be maintained will be according to the nature and size of the business.
2. **Classifying:** Classification is concerned with the systematic analysis of the recorded data, with a view to group transactions or entries of one nature at one place. The work of classification is done in the book termed as "Ledger". This book contains on different pages individual's account heads under which all financial transactions of similar nature are collected. For example, there may be separate account heads for Travelling Expenses, Printing and Stationery, Advertising, etc. All expenses under these heads after being recorded in the Journal will be classified under separate heads in the Ledger.

This will help in finding out the total expenditure incurred under each of the above heads.

3. **Summarising:** This involves presenting the classified data in a manner which is understandable and useful to the internal as well as external end –users of accounting statements. This process leads to the preparation of the following statements, viz. Trial Balance, Income Statement and Balance Sheet.
4. **Interpretation:** This is the final function of accounting. The recorded financial data are interpreted in a manner that the end-users can make a meaningful judgment about the financial condition and profitability of the business operations. The data are also used for preparing the future plans and framing of policies for executing such plans.

PARTIES INTERESTED IN FINANCIAL ACCOUNTING INFORMATION

Accounting is of primary importance to the proprietors and the managers. However, the following other persons are also interested in the accounting information.

1. **Proprietors:** A business is done with the objective of making profit. Its profitability and financial soundness are, therefore, matters of prime importance to the proprietors who have invested their money in the business.
2. **Managers:** In a sole proprietary business, usually the proprietor is the manager. In case of a partnership business, they, therefore, act both as managers, since either some or all the partners participate in the management of the business and as owners. In case of joint stock companies, the relationship between ownership and management becomes all the more remote. In most cases the shareholders act merely as suppliers of capital and the management of the company passes into the hands of professional managers. The accounting disclosures greatly help them in knowing about what has happened and what should be done to improve the profitability and financial position of the enterprise in the period to come.
3. **Creditors:** Creditors are the persons who have extended credit to the company. They are also interested in the financial statements because they will help them in ascertaining whether the enterprise will be in a position to meet its commitment towards them both regarding payment of interest and principal.
4. **Prospective investors:** A person who is contemplating an investment in a business will like to know about its profitability and financial position. A study of the financial statements will help him in this respect.

5. **Government:** The Government is interested in the financial statements of business enterprises on account of taxation, labour and corporate laws. If necessary, the Government may ask its officials to examine the accounting records of a business.
6. **Employees:** The employees are interested in the financial statements on account of various profit-sharing and bonus schemes. Their interest may further increase in case they purchase shares of the companies in which they are employees.
7. **Citizen:** An ordinary citizen may be interested in the accounting records of the institutions with which he comes in contact in his daily life e.g. Bank, temple, public utilities such as gas, transport and electricity companies. In a broader sense, he is also interested in the accounts of a Government Company, a public utility concern, etc., as a voter and a tax payer.

BOOK-KEEPING AND ACCOUNTING

Some people take book-keeping and accounting as synonymous terms, but they are different from each other. Book-keeping is mainly concerned with recording of financial data relating to the business operations in a significant and orderly manner. A book-keeper may be responsible for keeping all the records of a business only of a minor segment, such as a portion of the Customers' accounts in a departmental store. A substantial portion of the Book-Keeper's work is of a clerical nature and is increasingly being accomplished through the use of mechanical and electronic devices.

Accounting is primarily concerned with designing the systems for recording, classifying and summarizing the recorded data and interpreting them for internal and external end users. Accountants often direct and review the work of the book-keepers. The larger the firm, the greater is the responsibility of the accountant. The work of an accountant in the beginning may include some book-keeping. An accountant is required to have a much higher level of knowledge, conceptual understanding and analytical skill than what is required for a book-keeper.

LIMITATIONS OF FINANCIAL ACCOUNTING

The financial accounting is mainly concerned with the preparation of final accounts i.e Profit and Loss Account and Balance Sheet. The modern business has become so complex that mere final accounts information is not sufficient in meeting information needs. The management needs information for planning, controlling and co-ordinating business activities. It is because of the limitations of financial accounting that cost accounting and management accounting have developed. Some of the limitations of financial accounting are discussed below:

1. **Historical Nature:** Financial accounting is historical in nature in the sense that is a record of all those transactions which have taken place in the business during a particular period of time. The impact of future uncertainties has no place in financial accounting. As management needs information for future planning, the financial accounting can only give information about what has happened and not about what will happen. It does not suggest what should be done to increase the efficiency of the concern.
2. **Provides Information about the concern as a whole:** In financial accounting, information is recorded for the whole concern. One can find information about total expenses total receipts only. The information is not recorded product-wise, department-wise or any other line of activity. It is essential to record information activity-wise so as to be helpful for cost determination and cost control purposes.
3. **Not helpful in Price Fixation:** Financial accounting is not helpful in fixing prices of products. The cost of product can be obtained only when all expenses have been incurred. It is not possible to determine the price in advance. The concern may be required to quote a price for the supply of goods in the near future (for submitting tenders, etc.) Financial accounting cannot supply all this information, so it is not helpful in price determination. Price fixation requires information about variable and fixed costs, direct and indirect costs. Indirect expenses are estimated on the basis of past records for price determination purposes.
4. **Cost Control Not Possible:** Cost control is not possible in financial accounting . The cost figures are known only at the end of a can be done to control it. There is no technique in financial accounting which can help to ascertain whether the cost is more or less while the expenses are being incurred. There is no procedure , to assign responsibility for higher costs, if any. The costing process requires a constant review of actual costs from time to time and this is not possible in financial accounting.
5. **Appraisal of Policies not Possible:** It is not possible to evaluate various policies and programmes in financial accounting. There is no technique for comparing actual performance with budgeted targets. Whether the work is going on as per schedule or not, cannot be determined. The only criterion for determining efficiency

is to see the profits at the end of a financial period. The profitability is the only yardstick for evaluating managerial performance. Profits of an enterprise are influenced by a number of outside factors also. So it is not a reliable test for ascertaining efficiency of the management.

6. **Only Actual Costs Recorded:** Financial accounting records only actual cost figures. The amount paid for purchasing materials, property or other assets is recorded in account books. The prices of goods and assets go on varying from time to time. The present prices of assets may be absolutely different from the recorded costs. Financial accounts do not record price level changes. The recorded costs cannot provide correct information or exact values of assets.
7. **Not Helpful in taking Strategic Decisions :** Management is to take strategic decisions like replacement of labour by machinery, introduction of a new product, discontinuation of an existing line of production, expansion of capacity, etc. The impact of these decisions and cost involved will have to be ascertained in anticipation. Various alternative suggestions are to be studies before taking a final decision. Financial accounts cannot provide necessary information for taking important decisions because information is recorded for the whole concern and it is available only when the event has taken place.
8. **Technical subject:** Financial accounting is a technical subject. The recording of transactions and making their use requires knowledge of accounting principles and conventions. A person who is not conversant with accounting subject has little utility of financial accounts.
9. **Quantitative Information:** Financial accounting records only that information which can b quantitatively measured. Anything which cannot be quantitatively measured will not form a part of financial accounting even though it is important for the business. The policies and plans of the government have a direct bearing on the working of the business. It is essential to determine the impact of government decisions on the entrepreneurial policies. Financial accounts will avoid qualitative factors because they cannot be quantitatively measured.
10. **Lack of Unanimity about Accounting Principles:** Accountants differ on the use of accounting principles. Despite the efforts of International Accounting Standards Committee, there is a lack of unanimity on the use of accounting principles and procedures. The methods of valuing inventory and methods of charging depreciation are the most controversial issues on which unanimity has not been

possible. The preference for the use of different accounting principles brings in an element of subjectivity and human basic needs. The use of different accounting methods reduces the usefulness and reliability of accounts.

11. **Chances of Manipulation:** There are chances of using financial accounts to suit the whims of management. The over-valuation or under-valuation of inventory may change the figures of profits. More profits may be shown to get more remuneration, issue more dividends or to raise the prices of company's shares. Less profits may be shown to save takes or for not paying bonus to workers, etc. The possibility of manipulating financial accounts reduces their reliability.

QUESTIONS

1. Define Accounting. Explain the value and scope of accounting.
2. Trace the development of Accounting as Information Systems over the years.
3. Explain the various objectives and functions of Financial Accounting.
4. State how Accounting differs from Book-Keeping.
5. Elucidate who are the parties interested in Financial Accounting information.
6. Briefly summarise the various limitations of Financial Accounting.

LESSON 1.2 ACCOUNTING PRINCIPLES

INTRODUCTION

Accounting is an art and a science of recording business transactions in a systematic manner. To convey the language of business, certain principles are required to be followed for maintaining business transactions. In the absence of common principles there will be a chaotic situation and every accountant will have his own principles. Not only the utility of accounts will be less but these will not be comparable even in the same business. It becomes essential therefore, that common principles should be followed for measuring business revenues and expenses.

Accounting principles may be defined as those rules of action or conduct which are adopted universally while recording accounting transactions. “They are a body of doctrines commonly associated with the theory and procedures of accounting, serving as an explanation of current practices and as a guide for selection of conventions or procedures where alternatives exist”. These principles can be classified into two categories:

I. Accounting concepts.

II. Accounting conventions.

ACCOUNTING CONCEPTS

The term “concepts” includes those basic assumptions or conditions upon which the science of accounting is based. The following are the important accounting concepts:

1. Separate entity concept.(Business Entity Concept)
2. Going concern concept.
3. Money measurement concept.
4. Cost concept.
5. Dual aspect concept.
6. Accounting period concept.
7. Periodic matching of cost and revenue concept.
8. Realization concept.

The following are the important accounting concepts:

1. **Business Entity Concept:** In accounting, business is treated as a separate entity from its owners. A distinction is made between business transactions and personal transactions. A bicycles dealer may purchase bicycles for the business and also for personal use. The bicycle purchased for trading purpose will become a part of business transactions and the bicycle purchased for personal use will not become a part of business transactions, even though the payment may be paid from business. It will be a form of drawings. A distinction is also made in private property and business property of owners. For example, it A owns

a property of Rs. 5 lakhs, out of which he invests R.2 lakhs in business, then Rs. 3 lakhs will be his personal property and Rs. 2 lakhs will be his business investment. The "business" and "Owner" are taken as two separate entities. The accountant is interested to record transactions relating to business only. The private transactions of the owner will be recorded separately and will have no bearing on the business transactions. However, the private transactions of the owner which are related to business will be recorded because they become business transactions; these transactions can be introducing a capital, drawing of money for personal use, payment of personal taxes from the business, taking of goods for private use, etc. The record of all these transactions will be maintained in the business because they have some bearing on the business, the capital introduced by a person is credited to a capital account opened in his name and cash account will be debited with this figure. Similarly, cash or goods withdrawn for personal use will decrease his capital in the business. Though, the capital belongs to the owner and is not payable to anyone still it is considered as a liability of the business. Assets are always equal to equities. The equities may be owner's equity or/and outsider's equity. The equation will be :

Capital + Liabilities = Assets

The business entity concept is necessary to ascertain the results of business operations. In case the private and business transactions are not segregated, it will not be possible to determine profitability of the concern. The business is taken as a separate person. The transactions of the business are recorded separately and profit and loss account and balance sheet are prepared to find out efficiency of the concern.

2. **Going Concern Concept:** It is presumed that the concern will continue to exist indefinitely or at least in the near future. The present resources of the concern are utilized to attain the objectives of the business. This concept is very important in relation to the preparation of financial statement, while preparing final accounts of the concern, fixed assets are shown in the balance sheet at a diminishing balance methods i.e., going concern valve. There is no need to show assets at their market value because these have been purchased for use in future and earn revenues and not for sale purposes. If the business is not to continue or it is to be liquidated then market value will have significance. Since business is to continue, fixed assets will be shown at cost less depreciation basis. The going concern concept also implies that existing liabilities will be paid at maturity. The purchases and sales made in the ordinary course of time are written off in the same year. Only unsold goods (stock) are taken to the next year. The assets which are to be used over a number of years for producing

revenues are taken to next years. They are written off over the estimated life of these assets. This is possible only when business is taken as a continuing one.

A concern may incur heavy expenditures on advertisements, etc. The benefit of this expenditure may be derived over a numbers of years say, 5 years. This expenditure will be amortized (written off) during next five years and the unwritten-off balance will be shown as an asset in the balance sheet. The accountant will make a distinction between expenditures whose benefits will be drawn in a short period (within a year) and expenditures whose benefit will be drawn in a longer period more than a year). The second category of expenditures will be shown as assets because they will be useful for the owner in future. The first category of expenditures will be written off in the year in which they have been incurred. The distinction between revenue and capital expenditures has been possible in the going concern concept. The expenses paid in advance are not treated in the profit and loss account of that year but are taken to the next period. Similarly, income received in advance is not taken as income of the year of receipt but it is taken to the next period. This is possible only when the business is taken as a going concern and it is to be run in the coming years. A person will also be willing to invest money in a concern when he knows that the concern will continue.

3. **The cost concept:** Business involves exchange of goods and services. The exchanges take place through the medium of money. The money paid for the exchange becomes the cost of goods. The cost of an item to a business if the amount of money paid in acquiring it. The price which is actually paid is recorded in account books. If a piece of land is purchase for Rs.50,000 this amount will be recorded as cost of land even though the person was willing to pay Rs.75,000 for the same price of land.

   The accounting records are based on cost concept. This concept is closely related to the going concern concept. The assets and liabilities of a business are shown at a cost which has been paid or agreed upon between the parties. The figures are recorded on objectivity basis. There is no room for personal assessment or bias in showing the figures. If subjectivity is followed in records, then, same assets will be valued at different figures by different individuals. Everybody will have his own views about various assets. So cost concept is helpful in making truthful records. The records become more reliable and comparable.

Though assets are valued on cost basis, it does not mean that they are always shown at the same figures. Every year these assets diminish in value by wear and tear, so these are shown at cost less depreciation. The life of the assets is estimated and depreciation is based on this basis. So, approximation can also avoided from this concept.

4. **Dual Aspect Concept:** This concept lies at the heart of the whole accounting system. Modern accounting system is based on dual aspect concept. It is based on the principle that for every debit transaction, there is a corresponding credit transaction. There must be a giver of benefit and also a taker of it. Suppose, A purchases building for Rs.20,000, he will get the building and will part with the cash for similar amount. So one account will be debited and another account will be credited. The debits will be equal to credits. The dual aspect concept has created the system of double entry book-keeping.

The resources owned by the business are known as assets and claims of various parties are known as equities. The assets and equities of a business will always be equal. This can be explained with the help of an example:

Jerome started business with a capital of Rs.1,00,000. Cash amount will be debited and Jerome's capital account will be credited.

Capital	= Cash
Rs.1,00,000	= Rs.1,00,000

If Jerome purchases a building for the business for Rs.50,000 and pays cash for it then Building account will be debited and Cash account will be credited, the situation will be :

Capital	= Building + Cash
Rs.1,00,000	= Rs. 50,000 + Rs.50,000

If Jerome purchases goods on credit for Rs.20,000, the position will be as follows :

Liabilities side	Assets side
Capital + Creditors	= Building + Cash + Stock
Rs.1,00,000 + 20,000	= Rs. 50,000 + Rs.50,000 + Rs.20,000
Rs.1,20,000	= Rs.1,20,000

5. **Money Measurement Concept :** According to this concept only those transactions are recorded in accounting which can be expressed in terms of money. Money provides a

mechanism by which real resources can be transferred among different individuals. Money is accepted as a medium of exchange for goods and services. One is prepared to sell one's property in exchange for money. The debtors and creditors are willing to pay and receive money in near future. Thus, money acts as a medium for immediate exchange for goods and services and also as a standard for deferred payments. Money measurement concept provides a yardstick against which different forms of wealth can be measured. Heterogeneous factors can be easily expressed in terms of money. Suppose the following figures of assets are given:

Bills Receivable	Rs.20,000
Sundry Debtors	Rs.30,000
Cash in hand and at bank	Rs.15,000
Production during the year	10,000 units
Building	2,000 sq.metres
Delivery Vans	2 in number

In this example, first three assets are expressed in monetary terms while others are expressed in heterogeneous units. In the absence of a common denominator, it will not be possible to find out the value of all assets in the business. If assets like stock, building and delivery vans are also expressed in money then it will be possible to determine the amount of assets with the concern. These assets may be expressed in monetary terms as follows:

	Rs.
Production of 10,000 units	50,000
Building 2, 000 sq. metres	1,00,000
Delivery Vans-2	35,000

All the assets of the business totaled together will amount to Rs.2,50,000 (20,000+ 30,000+15,000 +50,000 +1,00,000 +35,000).

6. **Accounting Period Concept:** The concern is considered as a going concern. As per going concern concept, the assets are realisable only at the time of dissolution and creditors will be paid off at the time. According to this concept, the owners will be able to ascertain how much money is left with them after paying off all the liabilities. For practical purposes, financial position and profitability of the concerns are assessed at a regular interval. The owners, creditors, investors, government departments are interested in knowing the profitability at the end of a specific financial period i.e., six months or a year. The accountant will prepare revenue account for the specified period. All the expenditure items

are taken to the debit side of profit and loss account and all income items are taken to the credit side of the profit and loss account. All revenue items relating to that period are taken into consideration irrespective of the fact that these items are paid for, or are payable. The account will reveal profit or loss for that period. The profit is used to pay dividends to shareholders and taxes to the government. A balance sheet is prepared on a particular date. It gives figures of assets and liabilities on that date and it helps in determining the financial strength of the concern.

7. **Realization Concept:** This concept is related to the realization of revenue. The revenue is realized either from sale of products or from rendering of services. The sale of products involves a number of stages i.e., (i) Receipt of order (ii) Production of goods (iii) Dispatch of goods (iv) Receipt of money.

   A question arises as to when should the revenue be considered? As a general principle, revenue is considered to be realised when sale is made in case of goods and when service is performed in case of service contracts. The sale is treated when goods are delivered or title to goods is changed. Some persons take a different view of realisation of revenue. One view is that cash or near cash assets should to taken. Another view is that receipt of any asset in exchange constitutes realisation. The majority view is that realisation involves an exchange of goods (with actual delivery of goods) for cash or near cash assets with the intention of consummating the sale. It is general principle and not a universal one.

8. **Matching of Cost and Revenue Concept:** The aim of every business is to produce profits. The costs are matched to revenues. The difference between income from sales and cost of producing the goods will be the profit. The profit is measured by the process of matching expenditure against income. When business is taken as a going concern then it becomes necessary to evaluate its performance periodically.

   A correct statement of income requires a distinction between present, past and future expenditures. A distinction between capital and revenue expenditure is also necessary. The revenues and costs of some periods are matched. When income of a particular accounting period is taken to profit and loss account then all expenses of that period whether paid or not are also debited to profit and loss account. Similarly, if expenditure is paid for a future period, it will be taken to profit and loss account of the period for which it has been paid and not to the period in which it has been paid. The expenditures whose utility is derived over a number of years are taken to balance sheet as deferred expenditures. Capital expenditures become a part of cost over a number of years i.e, through depreciation.

The costs may be associated with a particular product or service. In this case the revenue earned from the sale of that product or revenue received for providing a service is matched to the cost of production of that product or cost incurred in providing that service. There may be another situation where revenue and cost can be determined according to an accounting period and not according to a product. In such cases the costs are matched according to the period.

ACCOUNTING CONVENTIONS

The term "conventions" includes those customs or traditions which guide the accountant while preparing the accounting statements. Certain accounting conventions are followed by the accountants while preparing financial records. These conventions are not only useful to the business but also to those who want to deal with the business. Some of the conventions are:

1. Convention of Disclosure.
2. Convention of Consistency.
3. Convention of Conservatism.
4. Convention of Materiality.

1. **Convention of Disclosure:** The disclosure of all significant information is one of the important accounting conventions. It implies that accounts should be prepared in such a way that all material information is clearly disclosed to the reader. This information should not only include figures given in the final accounts but also information which occurs after the preparation of balance sheet but before the presentation of financial statements. The idea behind this convention is that anybody who wants to study the financial statements should not be prejudiced by concealing any facts. He should be able to make a free judgment.

2. **Convention of Consistency:** The Convention of consistency means that some accounting principles should be used for preparing financial statements for different periods. It enables

the management to draw important conclusions regarding the working of the concern over a longer period. It allows a comparison in the performance of different periods. If different accounting procedures and processes are used for preparing financial statements of different years, then the result will not be comparable because these will be based on different postulates.

The concept of consistency does not means that no change should be made in accounting procedures. There should always be a scope for improvement but the changes should be notified in the statements. The impact of changes in procedures should be clearly stated. It will enable the reader to analyse information according to new procedures. In the absence of any information regarding change, it will be presumed that old methods have been used this time also. Whenever consistency is not followed this fact must be fully disclosed. For example, if a change in the method of taking depreciation is made (from diminishing method to straight line method or vice-versa) or a change is made in the method of allocating overhead expenses to different products, a foot note to the financial statement should be given indicating the extent of change. If possible net monetary effect of these changes should also be given.

3. **Convention of Conservatism:** The convention of conservatism means a cautious approach or policy of ‘play safe’. This convention ensures that uncertainties and risks inherent in business transactions should be given a proper consideration. If there is a possibility of loss, it should be taken into account at the earliest. On the other hand, a prospect of profit should be ignored unto the time it does not materialize. Whenever there is a choice before the accountant, he should use it for the lower side. The principle of ‘anticipate no profit and provide for all possible losses’ is followed. Whenever, there is a doubt, the policy of understanding the facts should be taken. It is an important modifier of cost concept and is generally applied to current assets rather than fixed assets.

Conservatism should not mean under-estimating of earnings of assets. Both over-statement and understatement of earnings and assets are bad. Under-statement in one year will mean over-statement in the subsequent year. For example, if closing stock of a year is understated, it will reduce the profit of that year. The closing stock of that year will become opening stock of next year; it will increase profit because Trading Account will be debited with a lower figure. Similarly if income statements are stated less than they are, the purchaser will gain because the worth of the shares will be more than it has been shown.

On the other hand, seller will be at a disadvantage because he will be selling the shares at a lesser figure than their worth. There should be a cautious approach in using conservatism too. This attitude is generally defended by saying that erring in the direction of conservatism has less severe implications than erring in the direction of overstating of net income.

4. **Convention of materiality:** According to this convention, only those events should be recorded which have a significant bearing and insignificant things should be ignored. The avoidance of insignificant things will not materially affect the records of the business. It should be seen that the efforts involved in recording the events should be worth the labour involved in it. There is no formula in making a distinction between material and immaterial events. It is a matter of judgment and it is left to the accountant for taking a decision.

INTERNATIONAL ACCOUNTING STANDARDS

International Accounting refers to accounting systems and procedures of identifying, measuring and communicating international economic transactions taking place between nations with a view to permitting informed judgments and decisions by the nations concerned. Here, international transaction means nay business interchange between residents of two countries and inter-governmental dealings. These transactions may either be 'real' involving trade in goods and service or they may be 'financial' involving transfers of purchasing power.

Development of transport and communication facilities has geared up the international business. In order to cope with the international business, accounting must also be internationalized, Since the Second World War, there has been marked expansion in international markets which has led accounting information to travel across national frontiers more and more widely. A number of international capital markets to facilitate trade in securities of different counties were established during the period. The international agencies such as IDA, IFC, World Bank, etc., granted financial assistance for such projects which were deemed essential for upliftment of the masses. In this situation, the need for international accounting standards for analysis was being increasingly felt. With this end in view, an Accountant International Study Group (AISG) was formed in 1967 by three countries i.e., America, Canada and U.K. This group published many papers which resembled International Accounting Standards. At a meeting of this group in 1972 at Sydney, a need for co-operation on international level was felt on accounting matters. It was proposed to set up an international body which will lay down international accounting standards.

A Committee known as International Accounting Standards Committee (IASC) was formed on 29th of June, 1973 with headquarters at London. As a result of an agreement, sixteen leading professional bodies from nine countries, i.e., U.S.A., Canada, U.K., Australia, France, Germany, Japan, Mexico and Netherlands, signed the constitution for its formation. A revised agreement and constitution was signed on 10th of October, 1977 whereby accountancy bodies which were Associate Members became Members of IASC and other accountancy bodies may also become Members. The business of the committee is conducted by a Board comprising representatives of founder member bodies and not more than two other member bodies. There was a rapid increase in the membership of the committee as is evident from the fact that by March 1985, 90 accounting organizations from 70 countries representing 9,00,000 professional accountants had already accepted the membership of the committee.

The objects of IASC are "to formulate and publish in the public interest, standards to be observed in the presentation of audited financial statements and to promote their world-wide acceptance and observance. International Accounting Standards Committee has laid down standards regarding the following accounting matters

Number of IASC Standard	**Name**	**Month in which issued**
IAS 1	Disclosure of Accounting Policies	Jan, 1975
IAS 2	Valuation and Presentation of Inventories in the context of Historical Cost System	Oct, 1975
IAS 3	Consolidated Financial Statements	June, 1976
IAS 4	Depreciation Accounting	Oct, 1976
IAS 5	Information to be disclosed in Financial Statements	Oct, 1976
IAS 6	Accounting Responses to Changing Prices (Superceded by IAS 15)	
IAS 7	Statement of Changes in Financial Position	Oct, 1977
IAS 8	Unusual and prior period items and changes in Accounting Policies	Feb, 1978
IAS 9	Accounting for Research and Development Activities	July, 1978
IAS 10	Contingencies and events occurring after the Balance Sheet Date	Oct. 1978
IAS 11	Accounting for Construction Contracts	March, 1979
IAS 12	Accounting for Taxes on Income	July, 1979
IAS 13	Presentation of Current Assets and Current Liabilities	Nov. 1979
IAS 14	Reporting Financial Information by Segment	Aug. 1981
IAS 15	Information reflecting the effects of changing prices	Nov. 1981
IAS 16	Accounting for property, Plant and Equipment	Mar, 1982

IAS	17	Accounting for Leases	Sept. 1982
IAS	18	Revenue Recognition	Dec, 1982
IAS	19	Accounting for Retirement Benefits in the Financial Statements for Employers	Jan. 1983
IAS	20	Accounting for Government Grants and disclosure of Government Assistance	April, 1983
IAS	21	Accounting for the effects of changes in Foreign Exchange Rates	July, 1983
IAS	22	Accounting for Business Combinations	Nov. 1983
IAS	23	Capitalization of Borrowing Costs	March,1984
IAS	24	Related Party Disclosures	
IAS	25	Accounting for Investment	July, 1984

The IASC has been able to issue 25 standards. The progress of other institutions in framing such standards has been slow. So the performance of IASC is fairly satisfactory. With a view to improve standards some conceptual framework should be developed. In the absence of such concepts, it will be difficult to ensure consistency in rules of procedures to be developed in future.

INDIA AND THE INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE

The Institute of Chartered Accountants of India and the Institute of Cost and Works Accountants of India are both members of the International Accounting Standards Committee. The Institute of Chartered Accountants of India established an Accounting Standards Board (ASB) on 22nd April, 1977. The objective of ASB is to formulate accounting standards taking into consideration the international accounting standards and applicable laws, customs, usages, business environment in India, etc.

The ASB has so far issued three definitive standards:

AS 1. Disclosure of Accounting Policies

AS 2. Valuation of Inventories

As 3. Changes in Financial Position

Besides the above mentioned standards, the ASB has following draft exposures:

1. Contingencies and events occurring after the balance sheet date (Exposure draft 4).
2. Prior period and extra-ordinary items and changes in accounting policies (Exposure draft 5).

The Exposure draft 6 on Depreciation Accounting has also been finalized by the ASB. The ASB is working on more draft standards and is trying to establish accounting standards by keeping in view the business environment in India.

QUESTIONS

1. Describe the meaning of “Accounting Principles”. What are their essential features?
2. What do you understand by basic accounting concepts and conventions? Describe important concepts in brief.
3. Discuss briefly some of the important conventions of Accounting.
4. The use of same accounting principles may give varying results’ Discuss.
5. What do you understand by International Accounting Standards? Discuss the role of International Accounting Standards Committee in developing uniform standards.
6. How far India has been affected by International Accounting standards Movement ?

UNIT – II

Unit Structure:

Lesson 2.1 Books of Accounts
Lesson 2.2 Ledger Accounts
Lesson 2.3 Trial Balance
Lesson 2.4 Final Accounts

LESSON 2. 1 BOOKS OF ACCOUTNS

DOUBLE ENTRY SYSTEM OF BOOK-KEEPING

Book-Keeping – Introduction: Book-keeping is the art of recording business transactions in appropriate set of account note-books. If you turn a dictionary the meaning of book-keeping is given as the "art of keeping accounts in a regular and systematic manner'.

Definitions: R.N. Carter defines Book-Keeping as follows: "Book-keeping is the science and art of correctly recoding in books of account all those business transactions that results in the transfer of money or money's worth".

According to L.C. Cropper, Book-keeping may be described as the science of recording transactions in money or money's worth in such a manner that at any subsequent date their nature and effect may be clearly understood and that when required a combined statement of their result may be prepared.

BOOK-KEEPING AND ACCOUNTING

The task of recording business transactions is described as the art of book-keeping. But, to be useful for a businessman, the information contained in the books of accounts must be classified, analysed and properly interpreted. He must know whether his financial position is sound. On a particular date he would also like to know what his assets are and what his liabilities are. Accounting is the task of preparing appropriate statements for the purposes noted above. It also provides analysis and interpretation of the figures available out of book-keeping. That is why accounting is known as the language of the businessman. In short, book-keeping is the art of maintaining the books of accounts of a business whereas accounting is the science of converting figures contained in the books into information useful for a businessman.

OBJECTIVES OF BOOK-KEEPING

The important objectives of Book-Keeping may be summarized as follows:

i) To have a permanent record of all the business transactions;

ii) To ensure the accurate recording of all financial transactions; and

iii) To know the effect of each transaction and to know the total effect of all the transactions.

ADVANTAGES OF BOOK-KEEPING

A number of advantages will be available if a proper system of Book-Keeping is followed. It will be understood that these advantages will accrue only if the Double Entry System is adopted.

1. A firm can know whenever it wants, how much profit it has earned or how much loss it has incurred in a particular period. This knowledge is naturally essential in order to know whether one is on the right path or not; otherwise one will merely grope in the dark.
2. The exact reasons leading to the profit or loss can also be ascertained. This knowledge will enable the firm to take the necessary action to increase profits and to convert losses into profits.
3. At the end of every trading period (usually a year), a Balance Sheet can be prepared which will disclose the financial state of affairs. Thus it will be known whether the firm is fully solvent or not. A comparative study of the balance sheets for various years shows a firm's progress.
4. Through accounts properly kept, losses of assets will be apparent without delay. This will help in avoiding such losses.
5. Reminders can be sent regularly to those customers who fail to pay in time. This will reduce bad debts.
6. A strict watch can be kept on the amount owing to outsiders, so that the firm will know what amounts are to be paid and when.
7. Accurate recording of transactions can be assured under the Double Entry System. Existence of errors is revealed by the preparation of what is known as "Trial Balance" – a statement containing balances in various accounts.
8. Proper accounting not only prevents and discovers errors, it also prevents and discovers frauds.
9. Management derives good guidance from accounts properly kept for the purpose of making decisions.

10. From the income tax and sales tax points of view, it is essential to follow a good accounting system; otherwise the authorities may impose heavy tax liabilities.

SYSTEMS OF BOOK-KEEPING

Book-Keeping, as explained earlier is the art of recording pecuniary or business transactions in a regular and systematic manner. This recording of transactions may be done according to any of the following two systems:

1. **Single Entry System:** An incomplete double entry system can be termed as a single entry system. According to Kohler, "it is a system of book-keeping in which, as a rule, only records of cash and personal accounts are maintained, it is always incomplete double entry, varying with circumstances". This system has been developed by some business houses, who for their convenience keep only some essential records. Since all records are not kept, the system is not reliable and can be used only by small business firms. The working of this system has been discussed in detail later in a separate chapter in unit VIII.

2. **Double Entry System:** The system of "double entry" book-keeping which is believed to have originated with the Venetian merchants of the fifteenth century is the only system of recording the two fold aspects of the transaction. This has been, to some extent, explained while discussing the 'dual aspect concept' in an earlier chapter. The system recognizes that every transaction has a twofold effect. If someone receives something then either some other person must have given it, or the first mentioned person must have lost something, or some service etc, must have been rendered by him. The accounting equation very well explains the working of this system. This has been further explains below :

Assets = Equities

The properties owned by a business are called assets. The rights to the properties are called equities. Equities may be sub-divided into two principal types: the rights of the creditors and the rights of the owners. The equity of creditors represents debts of the business and is called liabilities. The equity of the owners is called capital, or proprietorship of owner's equity. Thus:

Assets = Liabilities + Capital

Assets – Liabilities = Capital

SYSTEM OF ACCOUNTING

There are basically two systems of accounting:

(i) **Cash System of Accounting:** It is a system in which accounting entries are made only when cash is received or paid. No entry is made when a payment or receipt is merely due. Government system of accounting is mostly on the cash system. Certain professional people record their income on cash basis, but while recording expenses they take into account the outstanding expenses also. In such a case, the financial statement prepared by them for determination of their income is termed as Receipts and Expenditure Account.

(ii) **Mercantile or Accrual System of Accounting:** It is a system in which accounting entries are made on the basis of amounts having become due for payment or receipts. This system recognizes the face that if a transaction or an event has occurred, its consequences cannot be avoided and therefore should be brought into book in order to present a meaningful picture of profit earned or loss suffered and also of the financial position of the firm concerned.

The difference between "Cash and mercantile system" of accounting will be clear with the help of the following example.

A firm closes its books on 31^{st} December each year. A sum of Rs.700 has become due for payment on account of rent for the year 1994. The amount has, however, been paid in January, 1995.

In this case, if the firm is following cash system of accounting, no entry will be made for the rent having become due in the books of accounts of the firm in 1994. The entry will be made only in January 1995 when the rent is actually paid. However, if the firm is following mercantile system of accounting, two entries will be made: (i) on 31^{st} December, 1994, rent account will be debited while the landlord's account will be credited by the amount of outstanding rent; (ii) In January, 1995 landlord's account will be debited while the cash account will be credited with the amount of the rent actually paid. (This has been discussed in detail later while dealing with adjustments relating to final accounts).

The 'mercantile system' is considered to be better, since it takes into account the effects of all transactions already entered into. This system is followed by most of the industrial and commercial firms.

ANALYSIS OF TRANSACTIONS

Every commercial transaction involves an exchange. An exchange has two sides. You cannot receive unless somebody gives. When goods come into your godown it has to come out from the godown of some other businessman. The income you get is the expenditure of the other man.

Therefore in every business transaction there are two aspects. From the point of view of a businessman one may call it the benefit gaining aspect and benefit losing aspect. Technically they are called the “debit” aspect and the “credit” aspect of the transaction.

Consider the following transaction: -

Kumar purchases a Radio for cash from a shop’.

This transaction involves an exchange. The two aspects in this transaction are (1) Kumar gets a Radio and (2) Cash goes out from Kumar’s pocket. The first is the debit aspect and the second is the credit aspect.

It is fundamental to note that every commercial transaction contains a debit as well as a credit aspect. Under the double entry system of book keeping, both the debit and credit aspects are taken into account and recorded.

For the purpose of double entry the business transactions should be analyzed. The debit and credit aspects of the transaction have to be located. Then they have to be entered in the proper set of accounting books. Understanding the debit and credit aspects is as fundamental as understanding the alphabet while learning a language. The first step in the process is to find out the two accounts which every transaction must contain. Let us see some examples.

Example I: ***Purchases Goods for cash.***

The two accounts in the above transaction are a) goods account and b) cash account.

Example II: ***Received Cash from Rama***

Here the two accounts are a) Cash account and b) Rama’s account.

Example III: ***Paid Cash for Office Rent***

a) Cash account and b) office rent account are the two accounts in the transaction.

CLASSIFICTION OF ACCOUNTS

The second step in the analysis is to classify accounts which are already located.

Accounts are classified into three categories. They are 1) Personal accounts 2) Real or property accounts 3) Nominal or Factitious accounts. Items 2 and 3 put together is also known as Impersonal accounts. The following chart shows the accounts are classified.

Accounts

(1) Personal Accounts | **Impersonal Accounts**

Impersonal Accounts: (2) Real or Properly Accounts | (3) Nominal or Fictitious Accounts

Personal Accounts are those concerning the individuals or business institutions such as partnership firms, companies, etc. In Example II given above, Rama's account is Personal Account. Other examples of personal Account: V.S.T & Sons Account, ALPA Co. Account, etc.

Real or Property Accounts are accounts dealing with property or material objects such as goods, cash, furniture, buildings etc. The item 'Cash Account' in Example I, II and III belongs to Real Account.

Nominal or Fictitious Accounts are accounts dealing with business expenses, losses, gains, profit and income. The items office rent account in example III is a nominal account. Salary account, Interest account, Commission account are some of the examples of nominal account.

RULES OF DEBIT AND CREDIT

After finding out the two accounts in every transaction and classifying them the third and final step is to ascertain which account is to be debited and which account is to be credited. This is the most importance step. To simplify the task, one can use certain rules. These rules are known as the rules for Journalizing. The rules are given in the following chart.

Class of Account	Rule of Accounting
1. Personal Account	Debit the receiver Credit the giver
2. Real or Property Account	Debit what comes in Credit what goes out
3. Nominal or Fictitious Account	Debit expenses and losses Credit incomes and gains

To record the transactions you must follow the under-mentioned steps:

a. Find out the two accounts in the given transaction.
b. Classify the accounts and determine whether it belongs to Personal, Real or Nominal Accounts.
c. Use the rules and ascertain whether a particular account it debit or credit.

Examples I: ***Purchased goods for cash.***

a. First ask yourself what are the two accounts in the transaction?
   You will find they are i) Goods account and ii) Cash account.
b. Now there are two questions:
   i) What is the classification for goods account?
      Answer: Real Account
   ii) What is classification cash account?
      Answer: Real Account
c. Now you must think about the nature of the transaction. What happens when we purchase goods for cash? The answer is, goods comes in and cash goes out. Using the rule for Real Account "What Comes in" is debited. Therefore, Goods Account is debit. As the cash goes out, Cash Account is credit.

   In a similar way the debits and credits for other examples can be ascertained. You can now do it yourself and check whether you follow the steps correctly.

Example II. ***Received cash from Thomas***

Step (a) – Cash account (i)
Thomas Account (ii)

Step (b) i) Cash – Real account
ii) Thomas – Personal account

Step (c) - When we receive – cash comes in, therefore using the rule for real account, cash account is debit.

- As we receive cash Thomas is giving it.

According to the rule for personal account given is credited. Therefore Thomas's account is credit.

Example III: ***Paid cash for office salary***

Step (a) – (i) Cash Account

(ii) Office Salary Account

Step (b) – (i) Cash – Real Account

(ii) Office Salary – Nominal Account

Step (c) – When we pay cash it goes out and using the rule for Real Account which states what goes out is credited - cash account is credit.

- Office salary is an expense. All expenses are debited according to the rule under Nominal Account. Therefore, office salary account is debit.

Example IV

Sold goods for Cash

(Goods goes out – cash comes in)

Goods account – credit (Real A/c)

Cash account – debit (Real A/c)

Example V

Paid Cash to Prasana

(Cash goes out – Prasana receiver)

Prasana account – debit (Personal A/C)

Cash account – credit (Real A/C)

Example VI

Received cash for interest

(Cash comes in-interest is an income)

Cash account – (real A/C)

Interest Account – Credit (Nominal A/C)

Example VII

Purchase goods from Surya

(Goods comes in – Surya is the giver)

Goods account – debit

Surya account – credit

Example VIII

Sold good to Krithika

(Goods goes out – Krithika is the receiver)

Kirthika account – debit

Goods account – credit

Example IX

Paid cash for interest on loan borrowed

(Cash goes out – interest is an expense)

Interest account – debit

Cash account – credit

Cash and Credit Transactions: Business transactions may be either cash transaction or credit transaction. In cash transaction the exchange is complete. In credit transaction the payment or receipt of cash is posted to a later date. For example, purchased goods for cash is a cash transaction. On the other hand, purchased goods from Mohan, is a credit transaction. Here, as the name of the person is mentioned we assume that the money has not been paid immediately. Hence, it is a credit transaction. In credit transaction, personal accounts are important. It must be debited or credited depending upon whether the person is receiver or giver. In cash transactions we have to ignore the personal account. The reason is the payment or receipt of cash completes the exchange. Therefore, the personal accounts should be debited or credited. Carefully study the following examples.

Example I*: Purchased goods for cash from Jaya*

Here, there are three accounts. Under double entry principle there can be only two accounts. But as the transaction is a cash transaction, we should ignore Jaya's account. In fact, the words 'from Jaya' is not necessary for the purpose of recording the transaction in accounts, Therefore, the debit and the credit in the transaction are, Goods Account (debit) and Cash Account (credit). We should not wrongly credit Jaya's account.

Example II: *Cash paid as salary to Sekar*

Here also there are three accounts. As it is cash transaction, the words "to Sekar" can be ignored. Therefore, the correct debit and credit are - Salary account (debit) and cash account (credit).

But you must note that we are not saying that in all cash transactions personal accounts should be ignored. Study the following example.

Example III*: Cash paid to Mani*

Here there is no problem. There are only two accounts. Therefore, the debit and credit in the transaction are, Siva account (debit) and cash account (credit).

Transactions between the business and the proprietor: The transactions between the proprietor and the business require careful attention. The business as an entity is different from the proprietor. Transactions are recorded from the view point of the business. Take note of the following examples.

Examples I: *Rajesh brings in cash to provide capital for his business.*

Cash comes into business. Therefore, cash account is debit. Which account is to be credited? Rajesh is the giver. But one should not debit or credit the proprietor's account. The credit in the transaction is Capital account.

Example II*: Rajesh withdraws from business cash for his personal use.*

Here cash goes out from the business. Therefore cash account is credit. As receiver, we should not debit Rajesh's account. Because, he is the proprietor. Therefore, a special account under the title 'Drawings account' should be debited, indicating withdrawal.

STAGES OF ACCOUNTING

As has been already explained that Accounting is the art of recording, classifying and summarising the financial transactions and interpreting the results thereof, the accounting cycle involves the following stages:

1. Journal	- Recording of transactions takes place in this book.
2. Ledger	- Transactions relating to similar/same accounts are grouped and classified in the book ledger.
3. Trail Balance	- In this statement, the arithmetical accuracy of various ledger balances are verified.
4. Trading Account 5. Profit and Loss Account 6. Balance Sheet	- These are called "Final Accounts". These accounts are prepared for summarising the transactions and interpreting the results thereof to know the profitability and financial position of the business for a given period.

In the above cycle, the first three stages are called Book-keeping and the remaining three cycles are known as Final Accounts. The above stages of accounting truly represent the act of recording, classifying, summarizing and interpreting.

JOURNAL

The Journal records all daily transactions of a business in the order in which they occur. A Journal may therefore be defined as a book containing a chronological record of transactions.

It is the book in which the transactions are recorded first of all under the double entry system. Thus, Journal is the book of original record. A Journal does not replace but precedes the Ledger. The process of recording transactions in a Journal is termed as 'Journalizing'.

A proforma of Journal is given below:

Journal

Date	**Particulars**	**L.F.**	**Debit**	**Credit**
(1)	(2)	(3)	(4)	(5)

1. **Date:** The date on which the transaction takes place is recorded here.
2. **Particulars:** The two aspects of the transaction are recorded in this column i.e, the details regarding accounts which have to be debited and credited.
3. **L.F:** Means Ledger Folio. The transactions entered in the Journal are later on posted to the Ledger. Procedure regarding posting the transactions in the Ledger has been explained in the succeeding Chapter.
4. **Debit:** In this column, the amount to be debited is entered.
5. **Credit:** In this column, the amount to be credited is shown.

The account to be debited is written first. It is written close to the line starting the particulars column. The word Dr. is written at the end of the particular column. The amount is written in column No.4. Then, in the next line the account to be credited is written. It is always preceded by the word "To". Amount is written in the credit column i.e., column No.5. A short explanation of why the entry has been made is given just below the entry. This explanation is known as 'narration'. A journal entry without narration will not be meaningful. To separate one entry from another, a line is drawn below every entry to cover particulars column only; the line does not extend to amount columns.

Tutorial Notes

The following points may be taken note of by the students while recording transactions:

Grouping of items: While recording the business transactions, it is necessary to group the items under a common heading. A trader may be dealing in different articles. All the articles purchased for resale may be grouped and debited under the common heading "Purchases". If a chair is purchased for use and then a table is purchased, both of them may go under the common heading “Furniture”. Similarly, ink purchased and paper purchased need not be separately debited to “Ink Account” and “Paper Account” but should be debited to a common “Stationery Account”.

Combined Entries: We have noted the rule that for every debit there should be a corresponding credit. The debit amount should be equal to the credit amount. But a credit for an item may be given against a group of debit items put together for the same amount. Fox example, if Rent Rs.300 is paid and a salary of Rs.700 is also paid on the same date, the debit goes to the Rent A/c and Salary A/c. The credit, however, goes to the Cash A/c only. Here, Rs.1,000 credit under Cash A/c represents Rs.300 debit for Rent Account and Rs.700 debit for Salary Account. If separately recorded the Journal entries for the two transactions would appear as follows:

Date	Particulars	L.F	Debit	Credit
?			Rs.	Rs.
	Rent A/c. Dr.		300	
	To Cash A/c			300
	(Being the rent paid)			
	Salary A/c. Dr.		700	
	To Cash A/c			700
	(Being the salary paid)			

These two entries may be combined in the following form:

Date	Particulars	L.F	Debit	Credit
?			Rs.	Rs.
	Rent A/c. Dr.		300	
	Salary A/c. Dr.		700	
	To Cash A/c			1,000
	(Being the rent and salary paid)			

The following important points should be borne in mind while passing combined entries. First of all, the transaction for the entry should have taken place on the same date. Secondly, either the debit or the credit for the two transactions should be for a common account. There is no meaning in combining entries with two different debits and two different credits.

A combined entry is more useful, when payments are made at a discount or when receipts are subject to a discount. Such a discount is known as cash discount. They are allowed for prompt cash payments or receipts.

Opening Entry: The first entry passed in the books of a trader to commence his business in known as the opening entry.

A combined entry is useful when the commencement of a business by a trader is to be recorded in his books. Usually business is opened with the proprietor bringing in cash for his capital. But at times a proprietor may bring in other items of assets such as buildings, machinery, furniture, stock of goods etc., as contribution towards his capital. In such a case all the assets brought in by the trader are debited and the total value is credited to the capital account by means of a combined entry. On 1st January 1995 Ramanan commenced business with a capital of Rs.75,000. He has brought in Furniture Rs.10,000, Machinery Rs.25,000 and Buildings Rs.37,000. The balance required for his capital is paid in by him as cash. Pass the opening journal entry. The opening journal entry is given below.

Date		**Particulars**	**L.F**	**Debit**	**Credit**
1995	1	Furniture A/c Dr.		10,000	
Jan.		Machinery A/c Dr.		25,000	
		Building A/c Dr.		37,000	
		Cash A/c Dr.		3,000	
		To Capital A/c (Being the capital brought in by the proprietor in the form of assets and cash)			75,000

Note: Cash to be brought in is ascertained as follows:-

	Rs.
Total capital required	75,000
Assets brought in (10,000 + 25,000 + 37,000)	72,000
Balance in cash	3,000

Illustration 1

Journalise the transactions given below in the books of Suresh.

1985 April

1. Suresh starts business with Rs. 20,000. Suresh opens account with bank and deposits Rs.18,000.
2. Suresh purchases furniture, Rs. 850, and typewriter, Rs.1,500. Payment made by cheque.
3. Goods purchased from M/s. Rao and Murty on credit, Rs. 5,600.
4. Goods purchased from M/s. Khan & Singh for cash, Rs. 1,100
5. Goods sold on credit to M/s. Mohan Lal& Co., Rs.1,500.

6. Goods sold on credit to M/s. Basu& Co., Rs. 2,800.
7. Paid for office stationery, Rs. 250.
8. Paid rent for April, Rs.200
9. Installed neon sign at a cost of Rs. 1,000.Paid for postage stamps, Rs. 10.
10. Received cash from M/s. Mohanlal & Co. Rs. 1,470; allowed them discount, Rs. 30.
11. Issued cheque for Rs.5,500 in full settlement (i.e., nothing more is due from them) to M/s. Rao & Murty.
12. Deposited Rs.1,200 in bank.
13. Received bill for two table fans, Rs. 300 from M/s. Electrician Bros.
14. One electric fan stolen.
15. Paid insurance premium, Rs. 450, by cheque.

Solution

Date	**Particulars**	**L.F**	**Dr. Rs.**	**Cr. Rs.**
1995	Cash Account Dr. To Capital Account (Business commenced with Rs.20,000)		20,000	20,000
1	Bank Account Dr. To Cash Account (Cash deposited in Bank)		18,000	18,000
April 2 *	Furniture Account Dr. To Bank Account (Furniture purchased for Rs. 850 against cheque)		850	850
2 *	Typewriter Account Dr. To Bank Account (Typewriter purchased for Rs. 1,500 against cheque)		1,500	1,500
3	Goods Account Dr. To M/s. Rao and Murty. (Goods purchased on credit from M/s. Rao&Murty, vide Bill No. . .)		5,600	5,600
4	Goods Account Dr. To Cash Account (Goods purchased from M/s Khan & Singh for cash, vide Memo No. .)		1,100	1,100
5	Mohan Lal& Co. Dr. To Goods Account (Goods sold to M/s. Mohan Lal & Co., on credit vide Invoice No. . .)		1,500	1,500

6	M/s. Basu& Co. Dr. To Goods Account (Goods sold on credit to M/s. Basu& Co.,vide Invoice No.)		2,800	2,800
7	Stationery Account Dr. To Cash Account (Paid for Stationery, vide Cash Memo No. . .)		250	250
8	Rent Account Dr. To Cash Account (Paid rent for April, vide Landlord's receipt No. . . .)		200	200
9	Fixtures Account Dr. (or Neon sign Account) To cash Account (Amount paid for neon sign)		1,000	1,000
**10	Cash Account Dr. To M/s. Mohan Lal& co. (Cash received from M/s. Mohan Lal& Co. vide receipt No. . . .)		1,470	1,470
** 10	Discount Account Dr. To M/s. Mohan Lal& co., (The amount given up in favour of M/s. Mohan Lal on their prompt payment of amount due.)		30	30

*Entries for similar transactions on the same date may be combined, thus-

April 2	Furniture Account Dr. Typewriter Account Dr. To Bank Account (Purchase of furniture and typewriter against cheque)		850 1,500	2,350
April 9	Postage Account Dr. To Cash Account (Postage stamps worth Rs.10 purchased)		10	10
11	M/s. Rao & Murty Dr. To Bank Account To Discount Account (The amount paid to M/s. Rao & Murty by cheque to clear the amount due to them Rs. 5,600 -see transaction on 3rd April): Rs. 100 waived by them credited to Discount Account. (See entries on April 10 if you find it difficult to follow this entry).		5,600	5,500 100
12	Bank Account Dr. To Cash Account (Amount deposited in Bank.)		1,200	1,200
13	Furniture Account Dr. To M/s. Electrician Bros.		300	300

	(Two table fans purchased vide bill No. . . .)			
14	Loss by Theft Account Dr. To Furniture Account (Loss of one table fan by theft)		150	150
15	Insurance premium A/c. Dr. To Bank Account (Insurance premium paid by cheque)		450	450
	Total		**62,010**	**62,010**

• It is better to combine such entries thus-

April 2	Cash Account Dr. Discount Account Dr. To M/s.,MohanLal& Co., (Amount received from and discount allowed to M/s. Mohan Lal& Co., vide receipt No. . . .)		1,470 30	1,500

Illustration 2 Journalise the following transactions in the books of a trader.

Debit Balance on Jan. 1994:

Cash in hand Rs. 8,000, Cash at Bank Rs. 25,000, Stock of goods Rs. 20,000 Furniture Rs. 2,000, Buildings Rs. 10,000, Sundry Debtors-Vijay Rs. 2,000, Anil Rs. 1,000 and Madhu Rs. 2,000.

Credit Balance on Jan.1994: Sundry creditors – Anand Rs. 5,000, Loan from Bablu Rs.10,000.

Following were the further transactions in the month of January, 1994:

2. Jan.1, Purchased goods worth Rs.5,000 for cash less 20% trade discount and 5% cashdiscount.
3. Jan.4, Received Rs.1,980 from Vijay and allowed him Rs.20 as discount.
4. Jan.6, Purchased goods from Bharat Rs.5,000
5. Jan.8, Purchased plant from Mukesh for Rs.5,000 and paid Rs.100 as cartage for bringing the plant to the factory and another Rs.200 as installation charges.
6. Jan.12, Sold goods to Rahim on credit Rs.600.
7. Jan.15, Rahim became an insolvent and could pay only 50 paise in a rupee.
8. Jan. 18, Sold goods to Ram for cash Rs. 1,000.
9. Jan. 20, Paid salary to Ratan Rs. 2,000.
10. Jan. 21, Paid Anand Rs. 4,800 in full settlement.
11. Jan. 26, Interest received from Madhu Rs. 200.
12. Jan. 28, Paid to Bablu interest on loan Rs. 500.

13. Jan. 31, Sold goods for cash Rs. 500.

14. Jan. 31, Withdrew goods from business for personal use Rs. 200.

Solution

Sl. No	Date	Particulars	L. F	Debit Rs.	Credit Rs.
1.	1994 Jan. 1	Cash A/c Dr. Bank A/c Dr. Stock A/c Dr. Furniture A/c Dr. Building A/c Dr. Vijay A/c Dr. Anil A/c Dr. Madhu A/c Dr. To Anand A/c To Bablu's Loan A/c To Capital A/c (Being balances brought forward from last year)		8,000 25,000 20,000 2,000 10,000 2,000 1,000 2,000	 5,000 10,000 55,000
2.	Jan. 1	Purchases A/c Dr. To Cash A/c To Discount received A/c (Being purchase of goods for cash worth Rs. 5,000 allowed 20%trade discount and 5% cash discount on Rs. 4,000)		4,000	 3,800 200
3.	Jan. 4	Cash A/c Dr. Discount allowed A/c Dr. To Vijay A/c (Being cash received from Vijay, allowed Rs. 20 as cash discount)		1,980 20	 2,000
4.	Jan. 6	Purchases A/c Dr. To Bharat A/c (Being purchase of goods from Bharat)		5,000	5,000
5.	Jan. 8	Plant A/c. Dr. To Mukesh A/c To Cash A/c (Being purchase of plant for Rs. 5,000 and payment of Rs. 100 as cartage and Rs. 200 as installation charges)		5,300	 5,000 300
6.	Jan.12	Rahim A/c Dr. To Sales A/c (Being goods sold on credit to Rahim)		600	 600
7.	Jan. 15	Cash A/c Dr. Bad Debts A/c Dr. To Rahim A/c (Being cash received from Rahim after his being declared as an insolvent. 50% of the amount due has		300 300	 600

		been received and the rest has been taken as a bad debt)			
8.	Jan. 18	Cash A/c Dr. To Sales A/c (Being cash sales)		1,000	 1,000
9.	Jan. 20	Salary A/c Dr. To Cash A/c (Being Salary paid)		2,000	 2,000
10.	Jan. 21	Anand A/c Dr. To Cash A/c To Discount received A/c (Being cash paid to Anand and he allowed Rs. 200 as discount)		5,000	 4,800 200
11.	Jan. 26	Cash A/c Dr. To Interest Received A/c (Being receipt of interest)		200	 200
12.	Jan. 28	Interest on Loan A/c. Dr. To Cash A/c (Being payment of interest on loan)		500	 500
13.	Jan. 28	Cash A/c Dr. To Sales A/c (Being goods sold for cash)		500	 500
14	Jan. 31	Drawings A/c Dr. To Purchases A/c (Being goods withdrawn for personal use)		200	 200
		Total		**96,900**	**96,900**

Tutorial Notes

Transaction 2: Trade discount is not shown in the books. Goods purchased or sold are shown at the amount remaining after deducting trade discount. Goods worth Rs.5,000 were purchased and trade discount was 20%. It means goods have been purchased only for Rs.4,000. Cash discount is allowed for prompt payment of cash. It means, it will be allowed on Rs.4,000 (the purchase price of the goods) at 5%

Transaction 5: It has already explained earlier that any expenditure incurred for acquisition of an asset for long-term use in the business is a capital expenditure. Moreover, the expenditure incurred in bringing an asset and making it fit for use will also be taken as a capital expenditure. On account of this reason, Plant Account, has been debited not only with the price at which it was purchased from Mukesh but also with the amount of cartage and installation charges paid.

Transaction 7: Rahim was to pay a sum of Rs.600. He became an insolvent and could pay only 50% of the amount due from him. It means that the other 50% could be taken as a bad debt. Bad debt is a nominal account and, therefore, it has been debited. Rahim gets full credit of Rs. 600 because by paying Rs. 300, he gets free from the liability of paying Rs. 600.

QUESTIONS

1. Define Book-Keeping and explain the need for Book-Keeping.
2. State the objectives of Book-Keeping.
3. What do you mean by Double-Entry Book-Keeping? How is it different from Single Entry system of Accounting?
4. How are Accounts classified? Give three examples for each class of Accounts.
5. What is a Journal? Set forth the rules for journalising.

Exercises

1. **Journalise the following transactions:**

1993

January
1 Started business with cash Rs. 10,000
2 Opened a bank account with Rs. 9,750
5 Bought furniture by cheque Rs. 525
6 Purchase from Badsha Rs. 2.500
8 Sales to Ravikumar Rs. 1.785
11 Purchase by cheque Rs. 275
14 Bought goods from Basu Rs. 450
17 Cheque paid into bank Rs. 850
22 Sales to Roshan Rs. 775
24 Goods returned to Basu Rs.50
26 Goods returned to Roshan Rs. 75
28 Wages paid by cheque Rs. 20
29 Salaries paid by cheque Rs. 125
30 Sundry Expenses paid in cash Rs. 5. Received Rs. 950 by cheque from Ravikumar and allowed him discount Rs. 50
31 Paid Basu Rs.275 by cheque and was allowed discount Rs. 25

2. **Show how the following transactions would be journalised in the books of the trader:**
1994 May 1 Balances on date: Cash in hand Rs.175; Bank Rs.4,825; Stock in trade Rs.1.100; Furniture and fittings Rs.250; Debtors for goods: All Rs.650; Apte Rs.2,100; Creditors for goods: Baig Rs. 1,500; Balu Rs. 2,100; Capital Rs. 5,500.

1993

May
4 Purchases from Baig Rs. 1,500 and Apte Rs. 600
7 Sales to Ali Rs. 1,150 and Apte Rs. 600
10 Returns to Baig Rs. 500
12 Returns from Apte Rs. 100
15 Cash purchases Rs. 700 and sales Rs. 1,400
16 Wages paid by cash Rs.25

18 Cash paid into Bank Rs. 500
21 Drawings by cheque Rs. 100
24 Gave cheque to Balu Rs. 300 in settlement of Rs. 2,100
26 Received from Apte cheque for Rs. 2,400 and the same paid into Bank and discount allowed Rs.200
30 Bought land and building for Rs. 3,500 and paid from Bank 31 Salaries paid by cash Rs. 200

3. **Journalise the following transactions:**

1993

January 1 Rajaram commenced business with Rs.7,500
2 He opened a Current Account with Rs.7,000 with State Bank of India
3 Bought by cheque goods worth Rs. 1,500 and furniture and fixtures Rs. 250
5 Purchases from David Rs. 500 and Daniel Rs. 1,700
7 Sales to Salim Rs. 550 and Samuel Rs. 1,775
9 Returns to Daniel Rs. 200
10 Wages paid in cash Rs. 25
12 Insurance premium paid by cheque Rs. 25
14 Samuel returned goods worth Rs. 275
15 Rent paid by cheque Rs. 100
18 Sales by cheque Rs. 250. The cheque was banked at once
20 David sold him goods worth Rs. 575
21 Sold damaged furniture by cheque Rs. 35
27 Carriage expenses paid by cash Rs. 30
28 Drew cheque for his personal use Rs. 170
29 Withdrew capital by cheque Rs. 1,000
30 Received cash towards commission Rs. 25 and also cheque Rs. 525 from Salim and was allowed discount Rs. 25
31 Remitted to Daniel by money order for Rs. 75, and a cheque for Rs. 1,925 in settlement of Rs. 2,075

LESSON 2.2 LEDGER ACCOUNTS

LEDGER

Introduction: This is a book of final or ultimate entry, and is very important as it contains the essential details of pecuniary transactions. The word 'Ledger' comes from the word 'Leggen'. The quintessence of the final financial position of a business is derived from this book. The first or prime entry though made in the book called Journal, is ultimately recorded in the Ledger. The method of entering the transactions from the Journal to the Ledger is known as posting. Postings are made not only from the Journal but also from the book of subsidiary Journals.

As stated above, Ledgers contain the various accounts and show the final and actual effect of transactions. The Ledgers are broadly classified into Personal Ledgers which contain the accounts of all persons with whom trade transactions have been effected, i.e., with whom purchases or sales have been made, and Impersonal Ledger which contain all other accounts. Sometimes, the Impersonal Ledger is subdivided into Nominal Ledger in which all the Fictitious and Nominal Accounts are maintained. A type of General Ledger is also in vogue which houses all the other accounts like Property or Real Accounts. It is also customary to subdivide the Ledger as Personal Ledger, General Ledger and Nominal Ledger.

First of all, opening entry should be posted as it indicates the balances with which assets and liabilities start the new period. The way to post the opening entry is to write on the debit side of various assets (which have to be debited according to the opening entry) ‘To balance brought down' or just ‘To balance b/d' and then enter the amount against this. In the case of liabilities and capital accounts, the entry is ‘By balance brought down' or just ‘By balance b/d' and then the amount is written against it.

The Ledger rulings are as follows:

Dr. Cr.

Date	Particulars	JF	Amount	Date	Particulars	JF	Amount

The Ledger is a very valuable record of great importance and significance. The entries made in it cannot be surreptitiously altered or erased. This is a questionable practice. If any correction has to be effected it is to be passed through a separate Journal entry.

LEDGER POSTING

The term "Posting" means transferring the debit and credit items from the Journal to their respective accounts in the Ledger. It should be noted that the exact names of accounts used in the Journal should be carried to the Ledger. For example, if in the Journal, Expenses Account has been debited, it would not be correct to debit the Office Expenses Account in the Ledger, though, in the Journal, it might have been indicated clearly in the narration that it is an item of office expenses. The correct course would have been to record the amount to the Office Expenses Account in the Journal as well as in the Ledger.

Posting may be done at any time. However, it should be completed before the financial statements are prepared. It is advisable to keep the more active accounts posted to date. The examples of such accounts are the cash account, personal accounts of various parties, etc.,

The Posting may be done by the book-keeper from the Journal to the Ledger by any of the following methods:

(i) He may take a particular side first. For example, he may take the debits first and make the complete postings of all debits from the Journal to the Ledger.

(ii) He may take a particular account and post all debits and credits relating to that account appearing on one particular page of the Journal. He may then take some other account and follow the same procedure.

(iii) He may complete postings of each journal entry before proceeding to the next entry.

It is advisable to follow the last method. One should post each debit and credit item as it appears in the Journal.

The Ledger Folio (L.F.) column in the Journal is used at the time when debits and credits are posted to the Ledger. The page number of the Ledger on which the posting has been done is mentioned in the L.F. column of the Journal. Similarly a Journal folio column in the Ledger can also be kept where the page from which posting has been made from the Journal may be mentioned. Thus, there are cross references in both the Journal and the Ledger.

A proper index should be maintained in the Ledger giving the names of the accounts and the page numbers.

RULES REGARDING POSTING

The following rules should be observed while postings transactions in the Ledger from the Journal:

(i) Separate accounts should be opened in the Ledger for posting transactions relating to different accounts recorded in the Journal. For example, separate accounts may be opened for sales, purchases, sales returns, purchases returns, salaries, rent, cash, etc.

(ii) The relevant account which has been debited in the Journal should also be debited in the Ledger. However, a reference should be made of the other account which has been credited in the Journal. For example, for salaries paid, the salaries account should be debited in the Ledger, but reference should be given of the Cash Account which has been credited in the Journal.

(iii) The relevant account, which has been credited in the Journal should also be credited in the Ledger, but reference should be given of the account which has been debited in the Journal. It will be credited in the Ledger also, but reference will be given of the Salaries Account in the Ledger.

Thus, it may be concluded that while making postings in the Ledger, the relevant account which has been debited or credited in the Journal should also be debited or credited in the Ledger, but reference has to be given of the other account which has been credited or debited in the Journal, as the case may be. This will be clear with the following example:

Suppose salaries of Rs.10,000 have been paid in cash, the following entry will be passed in the Journal:

Salaries Account	Dr.	(i)	10,000	
To Cash Account		(ii)		10,000

In the Ledger two accounts will be opened (i) Salaries Account, and (ii) Cash Account. Since Salaries Account has been debited in the Journal, it will also be debited in the Ledger. Similarly Cash Account has been credited in the Journal and, therefore, it will also be credited in the Ledger, but reference will be given of the other account invrtived Thus, the account will appear as follows in the Ledger:

Dr.	**Salaries Account**	**Cr.**

To Cash Account(i)	Rs. 10,000		
Dr.	**Cash Account**		**Cr.**
		By Salaries A/c. (ii)	10,000

Use of the words "To" and "By": It is customary to use words To' and 'By' while making postings in the Ledger. The word “To” is used with the accounts which appear on the debit side of a Ledger Account. For example in the Salaries Account, instead of writing only “Cash" the words "To Cash" will appear on the debit side on the account. Similarly, the word "By" is used with account which appear on the credit side of a Ledger Account. For example in the above case, the word "By Salaries A/c" will appear on the credit side of the Cash Account instead of only "Salaries A/c". The words ‘To' and 'By' do not have any Specific meanings. Modern accountants are, therefore, ignoring the use of these words.

At this juncture you must note the important point that for every debit posting in a ledger account there is a corresponding credit posting in some other ledger account for an equivalent amount. Thus, the double entry effect of the transactions is preserved in ledger also. To put it in another way, after completion of the postings of Journal entries, the total of the debit side of all accounts should be equal to the total of the credit side of all the accounts in the ledger.

RELATIONSHIP BETWEEN JOURNAL AND LEDGER

Both Journal and Ledger are the most important books used under Double Entry system of book-keeping. Their relationship can be expressed as follows:

(i) The transactions are recorded first of all in the Journal and then they are posted to the Ledger. Thus, the Journal is the book of first or original entry, while the Ledger is the book of second entry.

(ii) Journal records transactions in a chronological order, while the Ledger records transactions in an analytical order.

(iii) Journal is more reliable as compared to the Ledger since it is the book in which the entry is passed first of all.

(iv) The process of recording transactions is termed as "Journalising" while the process of recording transactions in the Ledger is called as "Posting".

Balancing of Ledger Account: We have noted that the purpose of a ledger account is to show the cumulative effect of all the transactions with reference to that particular account. To ascertain the net results, the ledger accounts have to be balanced. Balancing is nothing but ascertaining whether the debit or the credit side is more in an account. The excess of debit over credit or the excess of credit over debit represents the balance. Ledger accounts are balanced at periodical intervals such as at the end of every month, quarter, or half year, etc. All the accounts have to be balanced at the end of the accounting year to prepare the annual accounts.

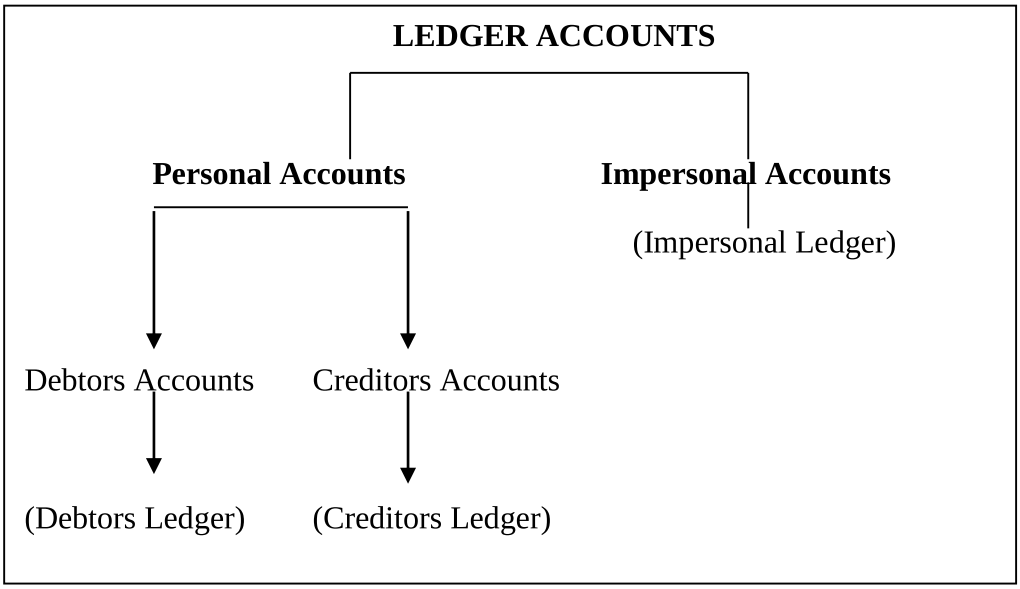
The following procedure is to be adopted for balancing a ledger account. As you know every ledger account has two sides' viz., the debit side and credit side. The side which is heavier in amount should be totaled up first. The same total should be extended in the amount column in the opposite side. Now the deficit is ascertained and the amount is filled up as balance. For the purpose of continuing the same account in the next period the balance is carried down and shown again in the opposite side immediately after the total column.

CLASSIFICATION OF LEDGER ACCOUNTS

With the help of ledger accounts we can arrive at the net result of the transaction concerning a particular account. For example, in the case of personal accounts after balancing the account we would know whether that person is our debtor or creditor. That is to say whether balance on his account indicates a debit or credit balance. If it is a credit balance we have to pay money to him and he becomes our creditor. If it is a debit balance we have to collect money from him and he is our debtor. Similarly from impersonal accounts we can get such information as what is our total purchases? How much sales are made? What is total salaries paid? How much expenses are incurred in stationery? etc.

The job of locating a ledger account and knowing the result will be easy if the accounts are kept in a form facilitating reference. If about 65 accounts are kept in a ledger one has to search through all the pages to pick out a particular account about which results are wanted. One way to reduce the difficulty is to keep the ledger accounts in alphabetical order and maintain an index in the first page.

If the accounts to be kept are numerous, say more than 100, it would be necessary to keep more than one ledger. In such a case, it is beneficial to classify the ledger accounts into different categories and keep one separate ledger for each category. It is convenient to keep all debtors accounts in one Ledger and all the creditors' accounts in another ledger. A third ledger may be maintained for all other accounts which are impersonal in nature. The classification of ledger accounts is shown under the following chart.



To facilitate easy reference three separate ledgers are maintained. They are 1) The Debtors Ledger 2) Creditors Ledger and 3) The Impersonal Ledger. As the debtors account arises out of credit sales, it is also known by the name "Sales Ledger"; similarly creditors ledger is also known as "Bought ledger". The other name for the Impersonal Ledger is "General Ledger".

Now let us take up a month's transactions of a trader and see how these transactions are entered in the Journal and from there posted to the ledger accounts.

Illustration 1

From the following transactions of Mr. Sharma, you are required to write up his Journal, post the entries in the Ledger accounts and balance the accounts at the end of the month and prepare a Trial Balance.

1978 Jan –
1 Sharma commenced business with Furniture Rs. 1,000 Stock Rs. 6,000 and cash Rs. 3,000.
2 Purchased from Sriram Rs. 6,000.
4 Sold goods for cash Rs. 3,000
5 Returned goods to Sriram Rs. 700
7 Purchased goods for cash Rs.3,000
8 Sold goods to Raju Rs. 4,000

11 Raju returned goods Rs. 600
13 Paid cash to Sriram Rs. 2,060 and he allowed us discount Rs. 40
15 Sold goods to Balaram Rs. 2,600
17 Received cash from Raju Rs. 1,080 and allowed him discount Rs. 20
18 Purchased stationery Rs. 300
19 Received cash from Balaram Rs. 1,600
21 Sold old furniture for cash Rs. 100
23 Paid commission Rs. 100
25 Sharma withdrew cash Rs. 1,000
27 Paid salary Rs.900 and office rent Rs. 300
30 Postage stamps purchased Rs. 50
31 Received cash from Balaram Rs. 1,000

Solution **Journal**

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
Jan. 1	Furniture A/c Dr. Stock A/c Dr. Cash A/c Dr. To Capital A/c (Being the assets brought in as capital)		1,000 6,000 3,000	 10,000
2	Purchases A/c Dr. To Sriram's A/c (Being the goods purchased on credit)		6,000	 6,000
4	Cash A/c Dr. To Sales A/c (Being the goods sold for cash)		3,000	 3,000
5	Sriram's A/c Dr. To Purchase Returns A/c (Being the goods returned to Sriram)		700	 700
7	Purchases A/c Dr. To Cash A/c (Being the goods purchased for cash)		3,000	 3,000
9	Raju's A/c Dr. To Cash A/c (Being the goods sold on credit to Raju)		4,000	 4,000
11	Sales Returns A/c Dr. To Raju's A/c (Being the goods returned by Raju)		600	 600
13	Sriram's A/c Dr. To Cash A/c To Discount received A/c (Being the cash paid to Sriram and discount allowed to us)		2,100	 2,060 40
15	Balaram's A/c Dr. To Sales A/c (Being the goods sold on credit to Balaram)		2,600	 2,600
17	Cash A/c Dr. Discount allowed A/c Dr.		1,080 20	

	To Raju's A/c (Being the entry for cash received from Raju and discount allowed to him)			1,100
18	Stationery A/c Dr. To Cash A/c (Being the stationery purchased)		300	 300
19	Cash A/c Dr. To Balaram's A/c (Being the cash received from Balaram)		1,600	 1,600
21	Cash A/c Dr. To Furniture A/c (Being the sale of furniture)		100	 100
23	Commission A/c Dr. To Cash A/c (Being the commission paid)		100	 100
25	Drawings A/c Dr. To Cash A/c (Being the drawings made by the proprietor)		1,000	 1,000
27	Salary A/c Dr. Rent A/c Dr. To Cash A/c (Being the salary and rent paid)		900 300	 1,200
30	Postage A/c Dr. To Cash A/c (Being the purchase of postage stamps)		50	 50
31	Cash A/c Dr. To Balaram's A/c (Being the cash received from Balaram)		1,000	 1,000

Though the number of accounts covered by the above transactions is limited, for the purpose of understanding ledger postings, they are given under the three ledgers viz., Debtors Ledger, Creditors Ledger and General Ledger.

LEDGER

DEBTORS LEDGER

Dr. ***Raju's Account***
Cr.

Date	**Particulars**	**JF**	**Amount Rs.**	**Date**	**Particulars**	**JF**	**Amount Rs.**
1978 Jan 9	 To Sales A/c		 4,000 4,000 ----------	1978 Jan 11 Jan 17 Jan 31	 By Sales Returns A/c By Cash A/c By Discount allowed A/c By Balance c/d		 600 1.080 20 2,300 4,000
1979	To Balance b/d		2,300				

Feb 1				

Dr. ***Balaram's Account*** ***Cr.***

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1978				1978			
Jan 15	To Sales A/c		2,600	Jan 1	By Cash A/c		1,600
				Jan 31	By Cash A/c		1,000
			2,600				2,600
			----------				----------

CREDITORS LEDGER

Dr. ***Sriram's Account*** Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1978				1978			
Jan 5	To Purchases Returns A/c		700	Jan 2	By Purchase A/c		6,000
Jan 13	To Cash A/c		2,060				
	To Discount received A/c		40				
	Balance c/d		3.200				
			6,000				6,000
				Feb 1	By Balance b/d		3,200

GENERAL LEDGER

Dr. ***Furniture Account*** ***Cr.***

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1978				1978			
Jan 1	To Capital A/c		1,000	Jan 21	By Cash A/c		100
				Jan 31	By Balance b/d		900
			1,000				1,000
			----------				---------
Feb 1	To Balance b/d		900				

Dr. ***Stock Account*** ***Cr.***

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1978	To Capital A/c		6,000	1978	By Balance c/d		6,000
Jan 1			6,000	Jan 31			6,000
			--------				--------
Feb 1	To Balance b/d		6,000				

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

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1978				1978			
Jan 1	To Capital A/c		3,000	Jan 7	By Purchases A/c		3,000
4	To SalesA/c		3,000	18	By Sriram's A/c		2,060
17	To Raju's A/c		1,080	23	By Stationery A/c		300
19	To Balaram's A/c		1,600	25	By Commission A/c		100
21	To FurnitureA/c		100	25	By Drawings A/c		1,000
31	To Balaram's A/c		1,000	27	By Salary A/c		900
				30	By Rent A/c		300
				31	By Postage A/c		50
				31	By Balance c/d		2,070
			9,780				9,780
Feb 1	To Balance b/d		2,070				

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

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1978				1978			
Jan 31	To Balance c/d		10,000	Jan 1	By Furniture A/c		1,000
					By Stock A/c		6,000
					By Cash A/c		3,000
			10,000				10,000

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

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1978	To Sriram's A/c		6,000	1978			
Jan 2	To Cash A/c		3,000	Jan 7	By Balance c/d		9,000
			9,000				9,000
			----------				--------
Feb 1	To Balance b/d		9,000				

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

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1978				1978			
Jan 31	To Balance c/d		9,600	Jan 4	By Cash A/c		3,000
				" 9	By Raju's A/c		4,000
				" 15	By Balaram's A/c		2,600
			9,600				9,600
			-------				-------
				Feb 1	By Balance b/d		9,600

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

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1978 Jan 1	To Balance c/d		700	1978 Jan 1	By Sriram's A/c		700
			700				700
				Feb 1	By Balance b/d		700

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

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1978 Jan 11	To Raju's A/c		600	1978 Jan 31	By Balance c/d		600
			600				600
Feb 1	To Balance b/d		600				

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

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1978 Jan 17	To Raju's A/c		20	1978 Jan 31	By Balance c/d		20
			20				20
Feb 1			20				

Dr. ***Discount Received Account*** *Cr.*

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1978 Jan 31	To Balance c/d		40	1978 Jan 13	By Sriram's A/c		40
			40				40
				Feb 1	By Balance b/d		40

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

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1978 Jan 18	To Cash A/c		300	1978 Jan 31	By Balance c/d		300
			--------				-------
			300				300
			--------				-------
Feb 1	To Balance b/d		300				

Dr. ***Commission Account***
Cr.

Date	Particulars	JF	Amount	Date	Particulars	JF	Amount

			Rs.				Rs.
1978 Jan 23	To Cash A/c		100	1978 Jan 31	By Balance c/d		100
			100				100
Feb 1	To Balance b/d		100				

Dr. ***Drawings Account*** ***Cr.***

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1978 Jan 25	To Cash A/c		1,000	1978 Jan 31	By Balance c/d		1,000
			1,000				1,000
Feb 1	To Balance b/d		1,000				

Dr. ***Salary Account*** ***Cr.***

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1978 Jan 25	To Cash A/c		900	1978 Jan 31	By Balance c/d		900
			900				900
Feb 1	To Balance b/d		900				

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

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1978 Jan 27	To Cash A/c		300	1978 Jan 31	By Balance c/d		300
			300				300
Feb 1	To Balance b/d		300				

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

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1978 Jan 30	To Cash A/c		50	1978 Jan 31	By Balance c/d		50
			50				50
Feb 1	To Balance b/d		50				

QUESTIONS

1. Explain the meaning of 'posting'.

2. How are Ledgers classified?

3. Give four examples of Accounts that are found in each of the types of Ledgers.

4. Outline the procedure for posting Journal entries. Explain with suitable examples.

5. What is an opening Journal entry? How is it posted in the Ledgers?

6. Indicate how the Double Entry principle is observed in the course of Ledger postings.

EXERCISES

1. From the following information write up the Journal and make the postings there from into the Ledgers:

1994 July

1. Balances Assets: Cash in hand Rs. 500; Cash at Bank Rs. 5,750; Stock Rs.3,400; Fixtures and fittings Rs. 250; Debtors: Mohan Rs. 1,000; Mankekar Rs. 750; Masani Rs. 1,250. Liabilities: Loan from Roy Rs. 2,000: Creditors: David Rs. 1,400; Martin Rs. 1,750; Shroff Rs. 1,220; Capital Rs.6,650

3. Purchases from David Rs. 500
5. Sales to Mohan Rs. 450
7. Carriage paid Rs. 15
10 Cash sales by cheque Rs. 250
12 Above cheque paid into Bank
14 Returns from Mohan Rs. 150
15 Sundry expenses by cash Rs. 10
17 Purchases from Masani Rs. 175
19 Purchases from Masani Rs. 150
20 Electricity charges paid by cheque Rs. 22
22 Returns to Masani Rs. 150
24 Drawings by cheque Rs. 55
26 Cheque received from Mohan and paid into Bank Rs. 1,250 discount allowed Rs. 50
28 Gave cheque to David Rs. 1,825 in full settlement of his balance
29 Wages and salaries paid by cheque Rs. 125
31 Additional capital brought into business and banked Rs. 1,500

2. Journalise the following and post into the appropriate Ledgers:
1995
May 1. Debit balances: Cash at Bank Rs. 4,600; Stock in trade Rs. 1,250; Plant and machinery Rs. 12,000; Buildings Rs. 22,500; B. Babu Rs. 1,220; C. Charles Rs. 250; D. Darling Rs. 780; Cash in hand Rs. 900; Credit balances: Mortgage on buildings Rs. 7,500; R. Rao Rs. 2,000; M. Mardi Rs. 1,000
4. Sales to Babu Rs. 780
6. Purchases from Mardi Rs. 500
8. Freight paid in cash Rs. 5

10. Purchases from Mardi Rs. 250
12. Sales by cheque and paid into bank Rs. 225
14. Sales to Darling Rs. 220
16. Purchases from R. Rao Rs. 750; cash Rs. 57
18. Printing and stationery expenses paid cheque Rs. 45
20. Returns outwards Rao Rs. 150; M. Mardi Rs. 175
22. Returns inwards Babu Rs. 125; Darling Rs. 80
24. Insurance premium paid by cheque Rs. 124; advertising expenses paid by cash Rs. 50
26. Received from B.Babu Rs.1,650 and wrote off the balance as discount
29. Rent received from tenant Rs.180
30. Gave R. Rao cheque forRs. 2,550 in settlement of his balance of Rs. 2,600 alsopaid Mardi by cheque in full settlement of Rs. 1,825
31. Drawing by cheque Rs. 125; sundry expenses paid by cash Rs. 25

3. From the following particulars write up the Journal and Ledgers:

1994

June

1 Basu commenced business with cash Rs. 5,000
2 Opened a current account with the Bank of India Rs. 4,750 and bought furniture by cheque Rs. 100
3 Purchases from Kumar and Roy Rs. 1,250 and Rs. 875 respectively
5 Sales to Mohan and Charles Rs. 750 and Rs. 840 respectively
7 Sale by cheque Rs.125
9 Returns outwards Kumar Rs. 250; Roy Rs. 75
11 Returns inwards; Mohan Rs. 59 and Charles Rs. 40
13 Cheque banked Rs. 125
15 Wages paid in cash Rs. 75; rent by cheque Rs. 125
17 Cheque for private use Rs. 50
19 Purchases by cheque Rs. 175
22 Purchases from Roy Rs. 425
24 Sales to Mohan Rs. 750
26 Cheque paid to Roy Rs. 1,000 discount Rs. 225
27 Withdrew capital by cheque Rs. 1,000
28 Received from Mohan cheque for Rs. 1,400 in full settlement and paid the same into bank; sent Kumar cheque for Rs.478; Discount received Rs. 22
29 Cheque drawn for office use Rs. 225; received Charles' cheque for Rs. 490 and allowed Rs. 10 discount; the cheque was paid into bank on the same day
30 Purchases from Das Rs. 775 and by cheque Rs. 130; sales to

Black Rs. 270 and cash sales Rs. 130; carriage expenses paid by cash Rs. 30; remitted Income Tax Rs. 100 by MO; MO commission Rs. 2.

LESSON 2.3 TRIAL BALANCE

Introduction

The Journal Entries and the posting of the entries in the Ledger Accounts fulfill the fundamental needs for keeping accounts in a business. But a businessman should know the progress of his business at least once in a year. The profit or loss made during the previous year should be known before he commences his business operations for the next year. So also he should know whether he has enough assets to meet the liabilities incurred by him in his business.

From out of the ledger accounts, it is possible to build up the necessary accounts to show the profit or loss in a business and a statement showing the assets and liabilities of a business. Information regarding purchases, sales, expenses and gains of a business are readily available from ledger accounts. But before proceeding to ascertain the financial results of a business it is necessary to check whether the accounts are arithmetically accurate. The preparation of a Trial Balance serves this important purpose. It guarantees at the outset that the accounts are fairly accurate.

A Trial Balance is prepared from out of the ledger accounts. We have already noted that the double entry effect of the transitions is preserved in ledger also. That is to say, that for every debit posting there should be a corresponding credit posting. Therefore, the debit totals of all the ledger accounts put together should be equal to the credit totals of all the ledger accounts. The debit total should balance itself with the credit total, if there is no error in the postings and the totals are correctly made.

If, however, it does not do so, the existence of errors, is implied and efforts must be directed towards the detection of errors, and thereby setting right the Trial Balance. In certain cases, the time factor is likely to weigh heavily against the detection of errors and the agreement of the Trial Balance. In all such cases, the Trial Balance must be tallied for the time being, by including in the Ledgers and the Trial Balance, an account called the Suspense Account or Difference in the Books Account, having a balance equal to the deficit in the Trial Balance. As and when the errors are subsequently detected, this Suspense Account will be automatically written off.

A perusal of the Trail Balance will also show that some accounts always have debit balances, some credit balances, and yet some others debit or credit balances. Thus accounts involving properties like cash, furniture, machinery, land and building will always have only debit balances. Likewise, debtors and all items constituting losses and expenses will be debits. Thus, trade debtors, wages, salaries, rates and taxes, etc., will have debit balances. Similarly, items like discounts received and other incomes, profits and gains will have credit balances. Lastly, there are accounts which may have debit or credit balances. They are rent, discount, bank and interest. As far as nominal accounts are concerned, in the absence of any specific indication, they may be taken as debit balances, e.g., rent, interest, etc. Likewise, loan (without any clue) should be taken as liability and a credit balance, while the term bank implies always cash at bank, i.e., debit balance.

OBJECTIVES OF PREPARING A TRIAL BALANCE

I. Checking of the arithmetical accuracy of the accounting entries: As indicated above, Trial Balance helps in knowing the arithmetical accuracy of the accounting entries. This is because according to the dual aspect concept, for every debit, there must be an equivalent credit. Trial Balance represents a summary of all ledger balances, and therefore, if the two sides of the Trial Balance tally, it is an indication of the fact that the books of accounts are arithmetically accurate. Of course, there may be certain errors in the books of accounts in spite of an agreed Trial Balance. For example, if a transaction has been completely omitted, from the books of accounts, the two sides of the Trial Balance will tally, in spite of the books of accounts being wrong.

2. Basis for Financial Statements: Trial Balance forms the basis for preparing financial statements such as the Income Statement and the Balance Sheet. The Trial Balance represents all transactions relating to different accounts in a summarised form for a particular period. In case, the Trial Balance is not prepared, it will be almost impossible to prepare the financial statements as stated above to know the profit or loss made by the business during a particular period or its financial position on a particular date.

3. Summarised Ledger: It has already been stated that a Trial Balance contains the ledger balances on a particular date. Thus, the entire ledger is summarised in the form of a Trial Balance. The position of a particular account can be judged simply by looking at the Trial Balance. The Ledger may be seen only when details regarding the accounts are required.

ERRORS NOT DISCLOSED BY A TRIAL BALANCE

Before concluding the discussion on the Trial Balance, it is necessary to indicate as to what extent the Trial Balance is an index of the correctness of the accounts. The fact remains that the Trial Balance merely ensures the arithmetical accuracy of the books, subject to certain conditions. In short, it discloses only certain errors, but not all of them. This is mainly due to the fact that the Trial Balance is a device based on the Double Entry principle and that for every debit there should be a corresponding credit. Errors not disclosed by the Trial Balances are:

1. Errors of total omission from the Subsidiary Books.
2. Errors in regard to the Subsidiary Book itself or the amount involved. In short, any error in a subsidiary book, other than the one involving wrong carry-forwards and totaling, will not affect the agreement of the Trial Balance.
3. Postings to the right side of wrong accounts.
4. Compensating errors which exist together without affecting the agreement of the Trial Balance.

Errors disclosed by the Trial Balance are:

- Errors by way of wrong postings, i.e., to wrong side or of wrong amounts.
- Duplication of postings.
- Omission to post.
- Mistakes in totaling and carry-forwards.
- Omission of an account in the Trial Balance.

Illustration

Prepare the Ledger Accounts and the Trial Balance on the basis of transactions given in Illustration 2 in the Lesson 2.1

Solution

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

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
1994				1994			
Jan 1	To Balance b/d		8,000	Jan 1	By Purchases A/c		3,800
5	To Vijay		1,980	8	By Plant A/c		300
15	To Rahim		300	20	By Salary A/c		2,000
18	To Sales A/c		1,000	21	By Anand A/c		4,800
26	To Interest		200	28	By Interest on loan		500
31	Received A/c		500	31	A/c		580
	To Sales A/c				By Balance c/d		11,980
Feb 1			11,980				
	To Balance b/d		580				

Dr. Interest Received Account Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 31	To Balance c/d		200	Jan 26	By Cash A/c		200
			200				200
				Feb 1	By Balance b/d		200

Dr. Bank Account Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 1	To Balance b/d		25,000	Jan 31	By Balance c/d		25,000
			25,000				25,000
Feb 1	To Balance b/d		25,000				

Dr. Stock Account Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 1	To Balance b/d		20,000	Jan 31	By Balance c/d		20,000
			20,000				20,000
Feb 1	To Balance b/d		20,000				

Dr. Furniture Account Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 1	To Balance b/d		2,000	Jan 31	By Balance c/d		2,000
			2,000				2,000
Feb 1	To Balance b/d		2,000				

Dr. Building Account Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 1	To Balance b/d		10,000	Jan 31	By Balance c/d		10,000
			10,000				10,000
Feb 1	To Balance b/d		10,000				

Dr. Vijay Account Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 1	To Balance b/d		2,000	Jan 31	By Cash A/c		1,980
					By Discount A/c		20
			2,000				2,000

Dr. Anil Account Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 1	To Balance b/d		1,000	Jan 31	By Balance c/d		1,000
			1,000				1,000
Feb 1	To Balance b/d		1,000				

Dr. **Madhu Account** **Cr.**

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 1	To Balance b/d		2,000	Jan 31	By Balance c/d		2,000
			2,000				2,000
Feb 1	To Balance b/d		2,000				

Dr. **Anand Account** **Cr.**

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 1	To Cash A/c To Discount Received A/c		4,800 200	Jan 31	By Balance b/d		5,000
			5,000				5,000

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

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 31	To Balance c/d		55,000	Jan 1	By Balance b/d		55,000
			55,000				55,000
				Feb 1	By Balance b/d		55,000

Dr. **Bablu's Loan Account** Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 31	To Balance c/d		10,000	Jan 1	By Balance b/d		10,000
			10,000				10,000
				Feb 1	By Balance b/d		10,000

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

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 1 Jan 1 Jan 6	To Cash A/c To Discount received A/c To Bharat A/c		3,800 200 5,000	Jan 31 Jan 31	By Drawings A/c By Balance c/d		200 8,800
			9,000				9,000
Feb 1	To Balance b/d		8,800				

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

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 4	To Vijay		20	Jan 31			20
			20				20
Feb 1	To Balance b/d		20				

Dr. **Discount Received Account** **Cr.**

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 31	To Balance c/d		400	Jan 1 Jan 21	By Purchases A/c By Anand		200 200
			400				400
				Feb 1	By Balance b/d		400

Dr. Bharat Account Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 31	To Balance c/d		5,000	Jan 6	By Purchases A/c		5,000
			5,000				5,000
				Feb 1	By Balance b/d		5,000

Dr. Plant Account Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 8	To Mukesh		5,000	Jan 31	By Balance c/d		5,300
Jan 8	To Cash A/c		300				
			5,300				5,300
Feb 1	To Balance b/d		5,300				

Dr. Interest on Loan Account Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 8	To Cash A/c		500	Jan 31	By Balance c/d		500
			500				500
Feb 1	To Balance b/d		500				

Dr. Mukesh Account Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 31	To Balance c/d		5,000	Jan 8	By Plant A/c		5,000
			5,000				5,000
				Feb 1	By Balance b/d		5,000

Dr. Sales Account Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 31	To Balance c/d		2,100	Jan 12	By Rahim		600
				18	By Cash A/c		1,000
				28	By Cash A/c		500
			2,100				2,100
				Feb 1	By Balance b/d		2,100

Dr. Rahim Account Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 12	To Sales A/c		600	Jan 15	By Cash A/c		300
					By Bad Debts A/c		300
			600				600

Dr. **Bad Debts Account** Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 15	To Rahim A/c		300	Jan 31	By Balance c/d		300
			300				300
Feb 1	To Balance b/d		300				

Dr. **Salary Account** Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 20	To Cash A/c		2,000	Jan 31	By Balance c/d		2,000
			2,000				2,000
Feb 1	To Balance b/d		2,000				

Dr. **Drawings Account** Cr.

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
Jan 31	To Purchases A/c		200	Jan 31	By Balance c/d		200
			200				200
Feb 1	To Balance b/d		200				

TRIAL BALANCE
(as on 31st January, 1994)

Particulars	Debit Amount	Credit Amount
	Rs.	Rs.
Cash Account	580	
Interest Received Account		200
Bank Account	25,000	
Stock Account	20,000	
Furniture Account	2,000	
Building Account	10,000	
Anil	1,000	
Madhu	2,000	
Capital Account		55,000
Babu's Loan Account		10,000
Purchases Account	8,800	
Discount Allowed Account	20	
Discount Received Account		400
Bharat		5,000
Plant Account	5,300	
Interest on Loan Account	500	
Mukesh Account.		5,000
Sales Account		2,100

Bad Debts Account	300	
Salary Account	2,000	
Drawings Account	200	
Total	**77,700**	**77,700**

QUESTIONS

1. What is a Trial Balance and what purpose does it serve?
2. Explain the term 'Suspense Account'. What are the circumstances under which a Suspense Account is opened?
3. To what extent is the Trial Balance useful for detecting errors?
4. Set forth the errors that are not disclosed by the Trial Balance.

EXERCISES

1. From the following particulars pertaining to the Ledger Balances as on 31 December 1993, prepare a Trial Balance:

	(Rs.)
Capital account	25,000
Freight	5,000
Rent paid	4,500
Motor lorry	7,000
Petty expenses	520
Drawings	24,000
Wages and salaries	8,500
Trade debtors	9,500
Mortgage	1,320
Advertising	1,000
Carriage outwards	1,300
Purchases	1,05,000
Office expenses	400
Trade expenses	100
Goodwill	10,000
Cash on hand	250
Stock (1-1-63)	10,000
Sales	1,60,000
Discounts received	5,750
Building	10,000
Rates paid	2400
Commission received	4130
Bills payable	6,970

(Ans: Trial Balance Totals Rs.1,99,470)

2. A Novice has prepared the Trial Balance which does not agree. Scrutinize and rectify the errors:

	Rs.	Rs.
Salaries		2,414
Sales	18,205	
Wages	6,116	196
Commission		
Purchase returns	295	
Furniture and fittings		720
Publicity expense		200
Discounts allowed		446
Carriage on sale		163
Sundry expenses		86
Capital	7,200	
Machinery and plant		1,460
Rates	175	
Cash at bank		1,200
Samples		100
Bills payable	300	
Repairs		328
Sundry creditors	664	
Sundry debtors		3,445
Stock at commencement		1,572
Petty cash		13
Cash at hand	390	
Drawings		900
Postal expense	37	
Insurance		87
Loans	500	
Rent received	200	
Purchases		7,336
Total	34,092	20,666

(Ans: Trial Balance Totals after correction Rs. 27,374)

3. From the following Ledger Balances prepare a Trial Balance: Bills receivable Rs. 1,500; Bad debts Rs. 140; Discounts earned Rs. 395; Rates, taxes and insurance Rs.370;General expenses Rs. 210; Sundry receipts Rs. 30; Coal Rs. 150; Manufacturing expenses Rs. 700; Sales Rs. 16, 500; Bills payable Rs. 400; Cash on deposit Rs. 300; Cash on Current Account Rs. 700; Sundry creditors Rs. 6,000; Patents Rs. 1,000; Office furniture Rs. 800; Plant and machinery Rs. 2,500; Drawings Rs. 1,500: Interest on deposit Rs. 100: Rents earned Rs.50; Travelling expenses Rs. 300; Discounts allowed Rs. 280; Office salaries Rs. 1,200; Gas and water Rs. 180; Renewals and replacements Rs. 250; Purchases Rs. 9,600; Mortgage loan Rs. 800; Loan to Antonio Rs. 2,000; Cash on hand Rs. 95: Sundry debtors Rs. 7,500; Patterns and models Rs. 1,200; Stock in trade Rs. 4,500; Freehold property Rs. 2,000; Capital Rs. 15,000. (Ans: Trial Balance Totals Rs. 39,275)

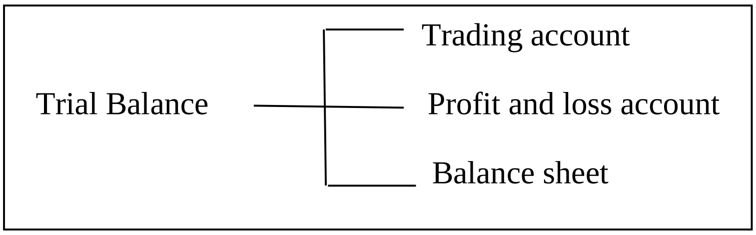
LESSON 2.4 FINAL ACCOUNTS

INTRODUCTION

In the previous chapter we discussed up to book keeping i.e., Trial balance. Now we shall discuss the final accounts. As the title says, it is the final stage of accounting. The previous stages, journal or ledger or trial balance, are not disclosing anything about profit or loss and financial position. So, to know the profit or loss made during a particular period and financial position on a particular point of time, the final accounts are prepared.

Final accounts of a trading concern contain three parts namely: Trading Account, Profit and Loss Account and Balance Sheet.

First two statements are connected with profit or loss and the last one is connected with financial position. One important point to be noted at this juncture is that for all these statements, trial balance is the base and also like previous cases the information will move in a 'chain form'. The following chart will make it clear.



Capital and Revenue Items: A Trial Balance, as you know, contains a list of ledger balances. Some of them are revenue in nature and others are capital. If an item is recurring in nature and does not add permanently to the value of the business, it is known as revenue. Example of revenue items are: Salary, Rent, Commission, Discount, Purchases, Sales, Purchases Returns, etc. On the other hand, items of permanent value, the benefits of which are not lost in one year, are capital item. They are: Land and Buildings, Furniture, Machinery, Proprietor's Capital, Sundry Debtors, Sundry Creditors etc. Capital items are for permanent use and they reappear in the next year accounts. The revenue items contribute for the profit or loss in a business and the accounts are closed at the end of the accounting period.

TRADING ACCOUNT

Trading Account gives the overall result of trading, i.e., purchasing and selling of goods. In other words, it explains whether purchasing of goods and selling them has proved to be profitable for the business or not. It takes into account on the one hand the cost of goods sold and on the other, the value for which they have been sold away. In case the sales value is higher than the cost of goods sold, there will be a profit, while in a reverse case, there will be a loss. The profit disclosed by the Trading Account is termed as Gross Profit. Similarly, the loss disclosed by the Trading Account is termed as Gross Loss.

IMPORTANT POINTS REGARDING TRADING ACCOUNT

1. Stock: The term 'Stock' includes goods lying unsold on a particular date.

The Stock may be two types:

(i) Opening Stock
(ii) Closing Stock

The term 'Opening Stock' means goods lying unsold with the businessman in the beginning of the accounting year. This is shown on the debit side of the Trading Account.

The term Closing Stock' includes goods lying unsold with the businessman at the end of the accounting year. It should be noted that stock at the end of the accounting year is taken after the books of accounts have been closed. The following journal entry is passed in the Journal Proper to record the amount of closing stock:

Closing Stock Account Dr.
To Trading Account

The amount of closing stock is shown on the credit side of the Trading Account and as an asset in the Balance Sheet. This will be explained later. The Closing Stock at the end of the accounting period will become the Opening Stock in the next year. The Opening Stock, is therefore, shown on the debit side of the Trial Balance.

2. Purchases: The term 'Purchases' includes both cash and credit purchases of goods. The term 'goods' (as already explained in an earlier chapter) means, items purchased for resale. Assets purchased for permanent use in the business such as purchase of plant, furniture, etc., are not included in the purchase of goods. Similarly, purchase of articles such as stationery meant for using in the business will also not be included in the item of purchases. The amount of purchases will be the net purchases made by the proprietor. The term 'net purchases' means total purchases of goods made by the businessman less the goods that he has returned back to the suppliers. In other words, purchases returns are deducted from the gross purchases made during the accounting period.

3. Sales: The term 'Sales' include both cash and credit sales. Gross sales will be shown in the inner column of the Trading Account out of which "sales returns" will be deducted. The net sales will then be shown in the outer column of the trading Account. Sales of assets like plant and machinery, land and buildings or such other assets which were purchased for using in the business, and not for sale, should not be included in the figure of 'sales' to be taken to the Trading Account.

4. Wages: The amount of wages is taken as a direct expense and, therefore, is debited to the Trading Account. Difficulty arises in those cases when the Trial Balance includes a single amount for "wages and salaries". In such a case, the amount is taken to the Trading Account. However, if the Trial Balance shows "Salaries and wages" the amount is taken to the Profit and Loss Account. Wages paid for the purchase of an asset for long-term use in the business e.g., wages paid for plant and machinery or wages paid for construction of a building should not be charged to the Wages Account. They should be charged (debited) to the concerned Asset Account.

5. Customs and import duty: In case the goods have been imported from outside the country, customs and import duty may have to be paid. The amount of such duty should be charged (debited) to the Trading Account.

6. Freight, carriage and cartage: Freight, Carriage and Cartage are taken as direct expenses incurred on purchasing the goods. They are, therefore, taken to the debit side of the Trading Account. The terms "Freight In", "Cartage In" and "Carriage In" have also the same meaning. However, "Cartage Out" "Freight Out" and "Carriage Out" are the expenses incurred on selling the goods. They are, therefore, charged (debited) to the Profit and Loss Account.

7. Royalty: Royalty is the amount paid to the owner for using his rights. For example, the royalty is paid by a "Lessee" of a coal mine to its owner for taking out the coal from the coal mine. Similarly, royalty is paid to the owner of a patent for using his right. It is generally taken as a direct expense and, therefore, is charged (debited) to the Trading Account. However, where royalty is based on sales, for example in the case of book publishing trade, it may be charged (debited) to the Profit and Loss Account.

8. Gas, electricity, water, fuel, etc.: All these expenses are direct expenses and, therefore, they are charged (debited) to the Trading Account.

9. Packing materials: Packing Materials used for packing the goods purchased for bringing them to the shop or to convert them into a saleable state are direct expenses and, therefore, they are charged (debited) to the Trading Account. However, packing expenses incurred for making the product look attractive or packing expenses incurred after the product has been sold away are charged (debited) to the Profit and Loss Account.

FORMAT OF A TRADING ACCOUNT

Now let us consider the preparation of Trading Account from out of the Trial Balance and the value of the closing stock. A model Trading Account is given below:

TRADING ACCOUNT
for the year ended --------------

Dr. Cr.

	Rs.	Rs.		Rs.	Rs.
To Opening stock			By Sales Less Sales Returns		
To Purchases			By Closing Stock		
Less Purchases Returns					
To Carriage on Purchases					
To Freight and Insurance					
To Duty and Clearing charges					
To Wages					
To Fuel, Coal, Gas, etc.					
To Factory Lighting					
To Factory Rent					
To Manufacturing Expenses					
To Gross Profit Transferred to P & L A/c					

Illustration 1: From the following particulars, prepare a Trading Account for the year ended 31st December 1979.

Particulars	Debit Rs.	Credit Rs.
Opening Stock (Stock on 1-1-79)	15,000	
Sales		42,000
Purchases	27,000	
Sales-Returns	2,000	
Purchases Returns		3,000
Wages	6,000	
Carriage Inwards	1,600	
Freight and Insurance	400	

The closing stock (stock on 31-12-79) has been ascertained to be Rs. 18,000.

The Trading Account will appear as follows.

TRADING ACCOUNT
for the year ended 31st December 1979

Dr. Cr.

	Rs.	Rs.		Rs.	Rs.
To Opening Stock		15,000	By Sales	42,000	
To Purchases	27,000		Less Sales Returns	2,000	40,000
Less Purchases Returns	3,000	24,000	By Closing Stock		18,000
To Wages		6,000			
To Carriage Inwards		1,600			
To Freight and Insurance		400			
Gross Profit transferred to Profit and Loss A/c		11,000			
		58,000			58,000

MANUFACTURING ACCOUNT

A productive unit or a manufacturing concern may like to know its cost of production. An ordinary Trading Account is not sufficient to pin-point costs. To ascertain cost, we have to work out a working account or a manufacturing account or a production account. For detailed knowledge of the manufacturing account, it must be pointed out that we have to debit all the factory or production expenses, otherwise known as direct expenses, incurred in the production of goods.

IMPORTANT POINTS REGARDING MANUFACTURING ACCOUNT

1. Stocks: In case of manufacturer, there can be stocks of three types:

(i) Stock of raw materials: It includes stock of raw materials or finished components which might have been purchased by the manufacturer for using them in the products manufactured by him but still lying unsold.

(ii) Stock of work-in-process: This is also termed as stock of work-in-progress. It includes goods in semi-finished form.

(iii) Stock of finished goods. It includes stock of those goods which have been completely processed and are lying unsold at the end of an accounting period with the manufacturer. It also includes stock of those finished goods which might have been purchased by a manufacturer-cum-trader from outside parties, but still lying unsold with him at the end of the accounting period.

2. **Raw materials consumed:** It is customary to show in the Manufacturing Account, the value of raw materials consumed for manufacturing goods during a particular period. This is computed as follows:

Opening Stock of Raw Materials	----
Add Purchase of Raw Materials	----
Less Closing Stock of Raw Materials	----

For example, if the opening stock of raw materials is Rs.5,000, purchases of raw materials is Rs. 20,000 and closing stock of raw materials is Rs. 8,000, the value of raw materials consumed will be calculated as follows:

	Rs.
Opening Stock of Raw Materials	5,000
Add Purchase of Raw Materials	20,000
	25,000
Less Closing Stock of Raw Materials	8,000
Raw Materials Consumed	17,000

3. **Carriage inwards, etc.:** The expenses incurred for bringing the raw materials to the factory or the octroi or customs duty paid by the manufacturer on the raw materials purchased or imported by him will also be charged (debited) to Manufacturing Account.

4. Factory overheads: The term "Overheads" includes indirect material, indirect labour and indirect expenses. The term "Factory Overheads", therefore, stands for all factory indirect materials, indirect labour, and indirect expenses. For example, in the case of manufacturer of chairs, the cost of timber purchased will be taken as raw materials. However, the polishing material used by him will be taken as indirect material and will be taken as an item of factory overheads. Similarly, the wages paid to the carpenters who have been employed for making chairs will come as cost of direct labour since they are actively engaged in manufacturing the chairs. However, the salaries of the supervisor or the wages of the gate-keeper will be taken as indirect labour cost and come in the definition of factory overheads. Similarly, the carriage charges paid for bringing the raw materials to the factory are considered to be direct charges since they can directly be charged to the raw materials purchased. However, the rent for the factory, depreciation of the factory machines, insurance of the factory are all taken as indirect factory expenses and, therefore, covered under the category of factory overheads.

5. Cost of production: The Manufacturing Account gives the cost of manufacturing the goods during a particular period. This is computed by deducting from the total of the debit side of the Manufacturing Account, the total of the various items appearing on the credit side of the Manufacturing Account as shown in the proforma of the Manufacturing Account given earlier in the Chapter.

6. Sale of scrap: In manufacturing operations, certain scrap is unavoidable. It may or may not have any sales value. In order to calculate the true cost of manufacturing the goods, it is necessary that the money realised on account of sale of scrap (or realisable value of the scrap in case it has not been sold) should be considered. The amount of scrap, is therefore, credited to the Manufacturing Account.

PROFIT AND LOSS ACCOUNT

Since, in any business, it is the net profit or net loss that ultimately matters, the preparation of the Profit and Loss Account as an adjunct to the Trading Account is an absolute necessity. In fact, that is the main reason why the Trading and Profit and Loss Accounts are prepared together, and the gross profit or loss is transferred to the Profit and Loss Account.

It has been explained before that the Profit and Loss Account is prepared with a view to ascertain the net profit or net loss, which is the net difference between total expenses, and total income of the business for the period under review. Or, to state it differently, it is what remains of the gross profit or loss after charging all expenses and making necessary provisions normally and properly attributable to the business. Hence, the procedure for preparing the Profit and Loss Account will be as follows:

1. The Gross Profit or Loss will be brought down from the Trading Account to the credit or debit side respectively of the Profit and Loss Account.
2. Debit the Profit and Loss Account and credit the various Nominal accounts for bringing the various expenses of the business proper into the Profit and Loss Account.
3. Credit the Profit and Loss Account and debit the various Nominal Accounts for bringing the various business incomes into account.
4. The difference between the two sides of the Profit and Loss Account will represent Net Profit or Net Loss. Since losses and gains have to be borne by the proprietor, the Profit and Loss Account will be closed by means of a credit to the latter in case of net profit and a debit in case of net loss. It is to be remembered that all business expenses other than those transferred to the Trading Account will have

to be transferred to the Profit and Loss Account. Likewise, all business incomes will have to be brought into Profit and Loss Account after making adjustments and provisions, if any.

FORMAT OF A PROFIT AND LOSS ACCOUNT

Profit and Loss Account for the year ended 31st December, . .

Dr. Cr.

	Rs.		**Rs.**
To Salaries		By G.P. transferred from Trading A/c	
To Rent, Rates &Taxes			
To Printing and Stationery		By Discount (Cr.)	
To Postage and Telegram		By Interest (Cr.)	
To Insurance		By Commission (Cr.)	
To Repairs and Renewals			
To Interest			
To Trade Expenses			
To Stable Expenses			
To Travelling Expenses			
To Commission			
To Discount			
To Advertisement			
To Packing Expenses			
To Bad debts			
To Carriage Outwards			
To Net Profit transferred to Capital A/c			

Illustration 2 From the following balances extracted from the books of M/s Rajendra Kumar Gupta & Co., pass the necessary closing entries, and prepare a Trading and Profit and Loss Account.

	Rs.		Rs.
Opening Stock	1,250	Plant and Machinery	6,230
Sales	11,800	Returns Outwards	1,380
Depreciation	667	Cash in hand	895
Commission (Cr.)	211	Salaries	750
Insurance	380	Debtors	1,905
Carriage Inwards	300	Discount (Dr.)	328
Furniture	670	Bills Receivable	2,730
Printing Charges	481	Wages	1,589
Carriage Outwards	200	Returns Inwards	1,659
Capital	9,228	Bank Overdraft	4,000
Creditors	1,780	Purchases	8,679

Bills Payable	541	Petty cash in hand	47
		Bad Debts	180

The value of stock on 31st December,1992 was Rs.3,700.

Trading and Profit & Loss Account for the year ended 31st Dec. 1992.

Dr. **Cr.**

Particulars	Amount		Particulars	Amount	
	Rs.	Rs.		Rs.	Rs.
To Opening Stock		1,250	By Sales	11,800	
To Purchases	8,679		Less: Returns Inwards	1,659	10,141
Less: Returns Outward	1,380	7,299	By Closing Stock		3,700
To Wages		1,589			
To Carriage Inward		300			
To Gross Profit c/d		3,403			---------
		13,841			13,841
To Depreciation		667	By Gross Profit b/d		3,403
To Insurance		380	By Commission		211
To Printing Charges		481			
To Carriage Outwards		200			
To Salaries		750			
To Discount		328			
To Bad Debts		180			
To Net Profit		628			
		3614			3614

Illustration 3

From the following Trial Balance prepare the Manufacturing Account, the Trading and Profit and Loss Account for the year ending 31st March, 1993.

Particulars	Debit Rs.	Credit Rs.
Shri. Ranjit's Capital Account		41,000
Shri. Ranjit's Drawing Account	6,100	
Mrs. Ranjit's Loan Account		4,000
Sundry Creditors		45,000
Cash in hand	250	
Cash at Bank	4,000	
Sundry Debtors	40,500	
Patents	2,000	
Plant and Machinery	20,000	
Land and Buildings	26,000	
Purchases of raw materials	35,000	
Raw material - 1-4-1992	3,500	
Work-in-process - 1-4.1992	2,000	
Finished Stock - 1-4-1992	18,000	

Carriage Inwards	1,100	
Wages	27,000	
Salary of Works Manager	5,600	
Factory Expenses	3,400	
Factory Rent and Taxes	2,500	
Royalties (paid on sales)	1,200	
Sales (less returns)		1,23,400
Advertising	3,000	
Office Rent and Insurance	4,800	
Printing and Stationery	1,000	
Office Expenses	5,800	
Carriage Outwards	600	
Discounts	1,400	2,100
Bad Debts	750	
	2,15,500	2,15,500

Rs. 4,000 Raw Materials, Rs. 4,500 Work-in-progress and Rs. 28,000 Finished Goods.

Solution

Manufacturing Account for the year ending March, 31, 1993

Dr. **Cr.**

Particulars	**Rs.**	**Rs.**	**Particulars**	Rs.
To Opening Work-in-process		2,000	By Transfer to Trading Account (cost of finished goods produced)	71,600
To Raw Materials used: Opening Stock Add Purchases	3,500 35,000			
 Less: Closing Stock	38,500 4,000	34,500	By Closing Work-in-process	4,500
To Carriage Inwards		1,100		
To Wages		27,000		
To Salary of Works Manager		5,600		
To Factory Expenses		3,400		
To Factory Rent and Taxes		2,500		
		76,100		76,100

Trading and Profit & Lou Account for the year ending March 31, 1993

Particulars	**Rs.**	**Particulars**	**Rs.**
To Opening Stock of Finished goods	18,000	By Sales	1,23,400
To Manufacturing A/c (Cost of goods produced)	71,600	By Closing Stock of finished goods	28,000
To Gross Profit transferred to Profit & Loss account	61,800 **1,51,400**		 **1,51,400**
To Royalties	1,200	By Gross Profit transferred from Trading A/c	61,800
To Advertising	3,000		
To Office Rent and Insurance	4,800	By Discount received	2,100
To Printing and Stationery	1,000		
To Office Expenses	5,800		
To Carriage Outwards	600		

To Bad Debt	750		
To Discount Allowed	1,400		
To Net profit carried to Capital Account	45,350		
	63,900		63,900

BALANCE SHEET

Previously, it was pointed out that the term 'Final Account' covers, apart from the Trading Account and Profit and Loss Accounts, the Balance Sheet as well. Thus no final accounts would be complete from the practical and utilitarian point of view without the Balance Sheet. What is a Balance sheet? THE BALANCE SHEET IS A STATEMENT OF THE POSITION OF THE BUSINESS AFTER PREPARATION OF TRADING AND PROFIT AND LOSS ACCOUNTS FOR THE PERIOD UNDER REVIEW. It is the final picture of the state of affairs of the business and, therefore, is primarily an attachment of the various ledger balances after the revenue accounts have been prepared; however, the statement is put forward in a technical and analytical form so that it can be as informative and complete as possible.

How is a Balance Sheet Prepared?

A Balance Sheet is prepared from the Trial Balance. We have noted already that the revenue items in the Trail Balance are closed and transferred to either Trading Account or Profit and Loss Account. For this purpose Journal entries have to be passed. These entries are known as closing entries.

Now this procedure will leave only the capital items to remain as balance in the ledger. These balances should not be closed but carried forward to the next year. The balances, however, have to be shown in a statement known as Balance Sheet. Therefore the Balance sheet is a statement showing the position of a trader as on a particular date regarding the liabilities incurred by him in his business and the assets held against such liabilities including his capital. The usual liabilities are Sundry Creditors, Bills Payable, Bank Loan, Bank Overdraft and his own capital. The usual assets are Land and Buildings, Plant and Machinery, Furniture and Fixtures, Closing Stock, Sundry Debtors, Bills Receivable, Cash in Hand and Cash at Bank. The Balance sheet completes the preparation of final accounts. The Net Profit is transferred from the Profit and Loss Account and added to the Capital Account to be shown in the Balance sheet. If it is net loss it is deducted from capital.

Format of a Balance Sheet:

The Balance Sheet, though not an account, has two sides. In the left hand side the capital and liabilities are shown and in the right hand side the assets are shown. It is important to note that if a capital item is a credit balance it is shown as a liability and if a capital item is a debit balance it is shown as an asset. As the Balance sheet is not an account the items should not be shown with either To' or 'By' in the assets or liabilities side. A model Balance Sheet is given below.

BALANCE SHEET OF Mr…………………… as on 31st December…………………..

Capital and Liabilities		**Rs.**	**Assets**	**Rs.**
Capital Account	----	----	Good will	----
ADD Net profit	-----	----	Land and Building	----
Loan Account		----	Plant and Machinery	----
Sundry Creditors		----	Fixtures	----
Bank Over draft		----	Patent Rights	----
Bills Payable		----	Closing Stock	----
			Sundry Debtors	----
			Bills Receivable	----
			Cash at Bank	----
			Cash in Hand	----

Note that the Balance Sheet is titled 'as on' the closing date of the accounting period, whereas the Trading and Profit and Loss Account are titled 'for the year ended'. The drawings should be deducted from capital.

Illustration 4

Write up a Balance Sheet with the information supplied. Capital Account Rs.36,000; Drawings Rs.9,000; Cash Rs.1,350; Debtors Rs. 40,100, B/R 7,500 B/P Rs.6,000; Fixtures and furniture Rs.6,750; Bank Rs.18,750; Loan from Shylock Rs.9,000; S. Creditors Rs.64,500; Land & Building Rs. 21,000; Closing Stock Rs. 18,200; Net Profit Rs. 7,150.

Balance Sheet of Mohan as on 31 December 1973

Liabilities	Rs.	Rs.	Assets	Rs.
Bills Payable		6,000	Cash	1,350
Loan from Shylock		9,000	Bills Receivable	7,500
Sundry Creditors		64,500	Bank	18,750
Mohan's Capital	36,000		Sundry Debtors	40,100
Add: Net Profit	7,150		Stock	18,200
	43,150		Fixtures and Furniture	6,750
Less: Drawing	9,000	34,150	Land and Building	21,000

		1,13,650		1,13,650

ADJUSTMENT ENTRIES

At the beginning of this chapter we observed that the Trial balance is the base for Trading account, Profit and Loss account and Balance sheet i.e., final accounts.

How is a trial balance prepared?

Whenever some transactions take place physically it is entered immediately into the Day book. Then it goes to Journal book, Ledger and Trial balance. This is like a pipe line which has only two ends and no opening in between. Thus, once something is entered in the Day book, automatically it will come to Trial balance and go to final account.

The following chart will make it very clear.

Journal Book

Ledger

Trial Balance

Trading Account | Profit And Loss account | Balance Sheet

Now, let us look at the concept called accounting period concept. Under this concept two important points are to be observed while preparing books of accounts.

They are:

(a) Each and every transaction of the particular accounting period should be considered while preparing the final accounts i.e., none should be missed out, and

(b) No transaction of previous period or future period should be included in the Final accounts of the particular accounting period.

By keeping the above concept in mind, let us proceed further and let us take a situation mentioned below:

(a) Accounting period: 1-4-1990 to 31-3-1991

(b) Rent of Rs.1000 of every month is paid on 5th of next month. So, rent for the month of February 1991 was paid on 5th march 1991, and rent for March 1991 was paid on 5th April, 1991.

(c) Here 5th April, 1991 falls on the next accounting period.

(d) Only if something was paid or received between the period 1-4-90 to 31-3-91, it would find a place in the Day book of the above accounting period. But here even though service was received during March, 1991 the payment was done on 5th April 1991, which is next accounting period. Hence this will not find a place in any book of the above accounting period.

(e) Once it is not entered in the Day book of the accounting period 1-4-90 to 31-3-91, naturally, it cannot find a place in the Trial balance and subsequently in the Final account of that particular accounting period.

But our accounting period concept says otherwise i.e., none of the transactions of accounting year should be missed out.

How to solve this problem?

Here comes adjustments for help:

At this stage i.e., after preparing Trial balance, if any such transaction is found, it is not possible to go back to the Journal, Ledger, etc. and alter them and prepare a new Trial balance. It is highly laborious and cumbersome job.

So, something must be done at the final account stage and the principles of double entry book-keeping, i.e., every debit is having corresponding credit and vice versa, also should be observed. If it is not observed, the balance sheet will not tally.

So left out items and items belonging to other accounting period are adjusted by passing direct entries in the final accounts. As we have discussed in the previous paragraph, every transaction is given the debit and credit effect. This effect is given in two stages. Thus (i) One fold will go to Trading account and the other will go to Balance sheet or (ii) One fold will go to the Profit and Loss account and the other will go to Balance sheet and very rarely (iii) one will go to Trading account and the other will go to the Profit and Loss account.

Transactions Requiring Adjustments:

Generally the following transactions require adjustment treatment while preparing final accounts:

1. Closing Stock
2. Expenses and Incomes
3. Depreciation
4. Bad Debts &Provision for Bad Debts
5. Provision for Discount on Debtors
6. Reserve for Discount on Creditors

7. Interest on Capital
8. Interest on Drawings
9. Transfer to Reserves
10. Stock destroyed by Fire
11. Writing off Goodwill/Preliminary Expenses, etc.
12. Goods Drawn for Personal use by the Proprietor
13. Goods included in stock but not recorded in Books
14. Goods under Sale or Return
15. Commission Payable on Net Profits

In the following pages, the treatments (in two places) to be made in case of each of the above transactions have been explained briefly for the benefit of the students.

S. No	Transaction	Accounting Treatment
1	Closing Stock	1. Trading Account - Credit side 2. Balance Sheet - Asset side
2	Outstanding Expenses	1. Add with the concerned expenses 2. Show it as a liability
3	Prepaid Expenses	1. Deduct from concerned expenses 2. Show it as an Asset
4	Outstanding Income	1. Add with the concerned income 2. Show it as an Asset
5	Income Received in Advance	1. Deduct from the concerned income 2. Show it as a liability
6	Depreciation	1. Debit P & L A/c 2. Deduct from the concerned Asset
7	Provision for Bad debts	1. Debit P & L A/c [after deducting old Reserve, if any] 2. Deduct from Sundry Debtors.
8	Reserve for Discount on Debtors	1. Debit P & L A/c 2. Deduct from Sundry Debtors
9	Reserve for Discount on Creditors	1. Credit P & L A/c 2. Deduct from Sundry Creditors
10	Interest on Capital	1. Debit P & L A/c 2. Add with the Capital
11	Interest on Drawings	1. Credit P & L A/c 2. Deduct from capital
12	Transfer to Reserves	1. Debit P & L A/c 2. Show it as a liability
13	Stock Destroyed by Fire	1. Debit Trading Account with the whole value of loss caused by fire 2. Debit P & L A/c with the value of stock not compensated by Insurance Company. 3. Show as asset the amount of compensation given by the Insurance Company.
14	Write off Goodwill/Preliminary Expenses	1. Debit P & L A/c 2. Deduct from Goodwill/ Preliminary Expenses
15	Goods Drawn for personal use by the proprietor	1. Deduct from Purchases 2. Add with the Drawings

16	Goods Included in stock but not recorded in Books	1. Add with purchases 2. Add with Creditors
17	Goods under Sale or Return	1. Deduct from Sales (at selling price) Deduct from Debtors (at selling price) 2. Add with closing stock (at cost price)
18	Commission Payable on Net Profits	1. Debit P & L A/c 2. Show it as a liability (Appropriate calculation should be made to find out the commission payable depending on whether it is before charging commission or after charging commission)

Illustration 5

From the following Trial Balance of Mr. Shyam as at 31st December 1993, you are required to prepare a Trading and Profit and Loss Account for the year ended 31st December 1993 and a Balance Sheet as at the date, after making necessary adjustments. Also give journal entries for adjustments.

TRIAL BALANCE

Name of the Account	Debit Rs.	Credit Rs.
Mr. Shyam's Capital Account		80,000
Mr. Shyam's Drawings Account	6,000	
Plant and Machinery (balance on 1st Jan. 1993)	20,000	
Plant and Machinery (additions on 1st July 1993)	5,000	
Stock on 1st January 1993	15,000	
Purchases	82,000	
Returns Inwards	2,000	
Sundry Debtors	20,600	
Furniture and Fixtures	5,000	
Freight and Duty	2,000	
Carriage outwards	500	
Rent, Rates and Taxes	4,600	
Printing and Stationery	800	
Trade Expenses	400	
Sundry Creditors		10,000
Sales		1,20,000
Returns outwards		1,000
Postage and Telegrams	800	
Provision for Doubtful Debts		400
Discounts		800
Rent of premises sub-let for year to 30th June 1994		1,200
Insurance Charges	700	
Salaries and Wages	21,300	
Cash in Hand	6,200	
Cash at Bank	20,500	
	2,13,400	**2,13,400**

ADJUSTMENTS

1) Stock on 31st December 1993 was valued at Rs.14,600.

2) Write off Rs.600 as bad debts.

3) The provision for Doubtful Debts is to be maintained at 5 % on Sundry Debtors.

4) Create a Provision for Discounts on Debtors and on Creditors at 2 %.

5) Provide for depreciation on Furniture and Fixture at 5 % p.a and on Plant and Machinery at 20 % p.a.

6) Insurance Prepaid was Rs.100.

7) A fire occurred on 25th December,1993 in the godown and stock of the value of Rs.5,000 was destroyed. It was fully insured and the Insurance Company admitted the claim in full.

JOURNAL ENTRIES

1993			Rs.	**Rs.**
Dec 31	Bad Debts a/c Dr. To Sundry Debtors (The amount written off as bad debts)		600	 600
Dec 31	Provision for doubtful Debts a/c Dr. To Bad Debts a/c (The transfer of bad debts to the provision for doubtful Debts)		600	 600
Dec 31	Profit and Loss A/c Dr. To provision for doubtful Debts A/c (The amount required to make up the provision up to Rs.1,000 @ 5% on 20,000 as under:) Provision required 1,000 Add: Bad Debts 600 1,600 Less: Existing Provision 400 1,200		1,200	 1,200
Dec 31	Profit and Loss a/c Dr. To Provision for Discount on Debtors a/c (The amount required as provision for discount on debtors at 2% on 19,000)		380	 380
Dec 31	Reserve for Discount on Creditors a/c Dr. To Profit and Loss a/c (The amount expected to be earned as discount on creditors 2% on 10,000)		200	 200
Dec 31	Depreciation a/c Dr. To Plant & Machinery a/c To Furniture and fixtures a/c (The amount written off as depreciation is as follows:) Machinery:20% on 20.000 4,000 20% on 5,000 for 6 months 500 4,500 Furniture.: 5 % on Rs. 5,000 Rs. 250		4,750	 4,500 250

Dec 31	Insurance Prepaid a/c Dr. To Insurance a/c (The Insurance Premium paid in advance)		100	 100
Dec 31	Insurance Co. a/c Dr. To Trading a/c (Being the value of stock destroyed by fire will be recovered from the Insurance co.,)		5,000	 5,000
Dec 31	Rent Received a/c Dr. To Rent Received in Advance Account (The rent for premises sublet from 1st Jan. 1974 to 30th June 1974 already received in Advance)		600	 600

Books of Mr. SHYAM

Trading and Profit and Loss Account for the year ended 31st December 1993

Dr. Cr.

	Rs.	Rs.		Rs.	Rs.
To Stock		15,000	By Sales	1,20,000	
To Purchases	82,000		Less: Returns	2,000	1,18,000
Less: Returns	1,000	81,000	By Closing Stock		14,600
To Freight & Duty		2,000	By Insurance Co.		
To Gross Profit Transferred			(Good destroyed)		5,000
to P & L A/c		39,600			
		1,37,600			**1,37,600**
To Salaries & Wages		21,300	By G. P Transferred		
To Rent , Rates & Taxes		4,600	From Trading A/c		39,600
To Printing & Stationery		800	By Discounts		800
To Trade Expenses		400	By Reserve for		
To Postage & Telegrams		800	discounts on creditors		200
To Carriage outwards		500	By Rent received	1,200	
To Insurance Charges	700		Less : Received in		
Less: Prepaid Insurance	100	600	advance	600	600
To Depreciation:					
Plant &Machinery	4,500				
Furniture & Fixtures	250	4,750			
To Provision for Doubtful debts Required	1,000				
Add : Bad debts	600				
	1,600				
Less : Existing Provisions	400	1,200			
To Provision for Discount on Debtors		380			
To Net Profit		5,870			
		41,200			**41,200**

BALANCE SHEET OF Mr. SHYAM as on 31st December 1993

LIABILITIES	Rs.	Rs.	**ASSETS**	Rs.	Rs.

Sundry creditors	10,000		Current Assets:		
Less: Reserve for			Cash in hand		6,200
discounts	200	9,800	Cash at Bank		20,500
Rent Received in			Sundry Debtors	20,000	
Advance		600	Less: Provision for Doubtful Debts	1,000	
Capital on 1st Jan. 1993	80,000			19,000	
Add: Profit	5,870		Less: Provision of Discounts	380	18,620
	85,870		Stock		14,600
Less : Drawings	6,000	79,870	Insurance Period		100
			Insurance Company's A/c		5,000
			Fixed Assets :		
			Plant & Machinery 1st Jan. 1993	20,000	
			Add: Additions	5.000	
				25,000	
			Less: Depreciation	4,500	20,500
			Furniture & Fixture	5000	
			Less: Depredation	250	4,750
Total		**90,270**	**Total**		**90,270**

Following illustrations will explain the procedure of making the above adjustments.

Illustration 2

From the following balance extracted from the books of M/s. Jaya & Co. and the subjoined information you are required to prepare the Trading and Profit and Loss Account for the year ended on 31st December,1994 and also the Balance Sheet as on that date:-

Particulars	Debit Rs.	Credit Rs.
Stock on January 1, 1994	60,500	
Purchases and Sales	90,300	1,37,200
Returns	2,200	1,300
Capital Account		30,000
Drawing Account	4,500	
Land and Buildings	30,000	
Furniture and Fittings	8,000	
Sundry Debtors and Creditors	25,000	45,000
Cash in hand	3,500	
Investments	10,000	
Interest		500
Commission		3,000
Total Direct Expenditure	7,500	
Postage, Stationery and Phones	2,500	
Fire Insurance Premium	2,000	
Salaries	11,000	
Bank Overdraft		40,000
Total	**2,57,000**	**2,57,000**

(a) Closing Stock on 31st December,1994 was valued at Rs.65,000. Goods worth Rs.500 are reported to have been taken away by the proprietor for his personal use at home during 1994. (b) Interest on investments Rs.500 is yet to be received while Rs.1,000 of the commission received is yet to be earned in 1995. (c) Rs.500 of the fire insurance premium paid is in respect of the quarter ending 31st March, 1995. (d) Salaries Rs.1,000 for December 1994 and Bank Overdraft interest estimated at Rs.2,000 have to be recorded as outstanding charges. (e) Depreciation is to be provided on Land and Buildings @ 5% and on Furniture and Fittings @ 10%. (f) Provision for doubtful debts @ 5% on Sundry Debtors.

Solution

TRADING & PROFIT & LOSS ACCOUNT OF M/S. JAYA & CO
for the year ending 31st December, 1994

Dr. Cr.

	Rs.	Rs.		Rs.	Rs.
To Opening Stock		60,500	By Sales	1,37,000	
To Purchases	90,300		Less: Returns	2,200	1,35,000
Less: Purchases Returns 1300			By Closing Stock		65,000
Less: Goods for personal use 500	1,800	89,500			
To Direct Expenses		7,500			
To Gross Profit c/d		43,500			
		2,00,000			**2,00,000**
To Salaries Add : Outstanding	11,000 1,000	12,000	By Gross Profit b/d		43,500
To Fire Insurance Premium Less : Prepaid	2,000 500	1,500	By Commission Less: Received in Advance	3,000 1,000	2,000
To Postage, Stationery & Phones		2,500	By Interest Add : Accrued	500 500	1,000
To Interest outstanding (For Bank overdraft)		2,000			
To Reserve for doubtful Debts on Debtors @ 5%		1,250			
To Depreciation on Land & Buildings Furniture & Fittings	1,500 800	2,300			
To Net Profit transferred to Capital Account		24,950			
		46,500			**46,500**

BALANCE SHEET OF M/s. JAYA & CO
as on 31st December, 1994

Dr. Cr.

Liabilities	**Rs.**	**Rs.**	**Assets**	**Rs.**	**Rs.**

Creditors		45,000	Cash in Hand		3,500
Outstanding Salaries	1,000		Sundry Debtors	25,000	
Outstanding Interest on overdraft	2,000	3,000	Less: Provisions for doubtful debts	1,250	23,750
Bank Overdraft		40,000	Investments	10,000	
Commission received in advance		1,000	Add : Interest Accrued on Investments	500	10,500
Capital Account	30,000		Stock		65,000
Add : Net Profit	24,950		Insurance (prepaid)		500
Less : Drawings 4,500	54,950		Land & Buildings	30,000	
Less: Goods for Personal use 500	<u>5,000</u>	49,950	Less: depreciation	1,500	28,500
			Furniture & Fittings	8,000	
			Less: Depreciation	800	7,200
		1,38,950			**1,38,950**

Illustration 3

The following Trial Balance was extracted from the books of M/S Tip Top & Co. as on 31st December, 1993:

Debit Balances:	Rs.		Rs.
Plant and Machinery	20,000	Motor car	12,000
Manufacturing wages	34,500	Purchases	1,02,000
Salaries	15,850	Sales Returns	3,100
Furniture	10,000	Bad Debts	1,400
Freight on Purchases	1,860	Interest and Bank charges	400
Freight on Sales	2,140	Cash at Bank	4,200
Buildings	24,000	Cash in Hand	1,120
Manufacturing Expenses	9,500	Credit Balances:	
Insurance and Tax	4,250	Capital Account	80,000
Goodwill	25,000	Sundry Creditors	44,560
General Expenses	8,200	Bank Loan	15,000
Factory Fuel and Power	1,280	Purchases Returns	1,740
Sundry Debtors	78,200	Sales	2,50,850
Factory Lighting	950	Reserve for bad debts	2,000
Opening Stock	34,200		

Prepare the Trading and Profit and Loss Account for the year ended 31st December 1993 and the Balance Sheet as on that date taking into consideration the following information:

(a) Stock in hand on 31st December 1993 was valued at Rs. 30,500. (b) Depreciate Plant and Machinery by 10%, Furniture by 5% and Motor Car by Rs.1,000. (c) Bring Provision for Bad Debts to 5% on Sundry Debtors. (d) A commission of 1% on the gross profit is to be provided for Works Manager. (e) A commission of 2% on net profit (after charging the Works Manager's commission) is to be credited to the General Manager.

Solution

TRADING & PROFIT & LOSS A/c of M/s TIP TOP & Co
for the year ending 31st Dec. 1993

	Rs.	Rs.		Rs.	Rs.
To Opening Stock		34,200	By Sales Less: Returns	2,50,850 3,100	2,47,750
To Purchases Less: Returns	1,02,000 1,740	1,00,260	By Closing Stock		30,500
To Freight on Purchases		1,860			
To Manufacturing wages		34,500			
To Factory Fuel & Power		1,280			
To Factory Lighting		950			
To Manufacturing Expenses		9,500			
To Gross Profit c/d		95,700			
		2,78,250			**2,78,250**
To Salary		15,850	By Gross Profit b/d		95,750
To Freight on Sales		2,140			
To Insurance & Tax		4,250			
To General Expenses		8,200			
To Bad Debts Add: Provision Less: Provision	1,400 3,910 5,310 2,000	3,310			
To Interest and Bank charges		400			
Depreciation: Plant &Machinery		2,000			
Furniture		500			
Motor Car		1,000			
To Works Manger's commission		957			
		38,607			
To General Manager's commission 2% on Rs. 57,100 (i.e. 95,700 - 38,607)		1,142			
To Net Profit transferred to Capital Account		55,951			
		95,700			**95,700**

BALANCE SHEET M/s TIP TOP & Co
as on 31st Dec. 1993

Dr.

Liabilities	**Rs.**	**Rs.**	**Assets**	**Rs.**	**Rs.**

Sundry Creditors		44,560	Cash in hand		1,120
Bank Loan		15,000	Cash at Bank		4,200
Outstanding commisison:			Sundry Debtors Less: Provision	78,200 3,910	
Works Manager		957			74,290
General Manager		1,142			
Capital	80,000		Closing Stock		30,500
Add: Net Profit	55,951	1,35,951	Furniture		9,500
			Motor Car		11,000
			Plant & Machinery		18,000
			Building		24,000
			Goodwill		25,000
		1,97,610			**1,97,610**

Illustration 4

The following are the balances abstracted from the books of Mr. Nirmal: Balances as on 31st December, 1992.

Nirmal's Capital	30,000
Nirmal's Drawings	5,000
Furniture and Fittings	2,600
Bank Overdraft	4,200
Creditors	13,300
Business Premises	20,000
Stock on 1st January, 1992	22,000
Debtors	18,600
Rent from Tenants	1,000
Purchases	1,10,000
Sales	1,50,000
Sales Returns	2,000
Discounts - Debit	1,600
Discounts - Credit	2,000
Taxes and Insurance	2,000
General Expenses	4,000
Salaries	9,000
Commission-Debit	2,200
Carnage on Purchases	1,800
Provision for Bad & Doubtful Debts	600
Bad Debts written off	800

Stock on hand on 31st December,1992 was estimated at Rs.20,000. Rent Rs.300, is still due from the tenant. Salaries, Rs.750, are as yet unpaid. Write off Bad Debts Rs.600 and depreciate Business Premises by Rs.300 and Furniture and Fittings by Rs.266. Make a provision of 5 per cent on Debtors for Bad and Doubtful Debts and provision of 2% for Discounts. Allow interest on Capital at 5 percent and carry forwardRs.700 for unexpired insurance. The manager is entitled to a commission of 10% on profits remaining after charging his commission. Prepare Trading Account, Profit and Loss Account and Balance Sheet as on 31st December, 1992.

Solution

In questions where a regular Trial Balance is not given, it is better to first prepare it in order to locate any difference that there may be. Hence:-

TRIAL BALANCE OF NIRMAL
as at December 31, 1992

Debit Balances	Rs.	Credit Balances	Rs.
Nirmal's Drawings	5,000	Nirmal's Capital	30,000
Furniture & Fittings	2,600	Bank Overdraft	4,200
Business Premises	20,000	Creditors	13,300
Stock, 1st Jan, 1992	22,000	Rent from Tenants	1,000
Debtors	18,000	Sales	1,50,000
Purchases	1,10,600	Discounts	2,000
Sales Returns	2,000	Provision for Doubtful Debts	600
Discounts	1,600		2,01,100
Taxes and Insurance	2,000	Suspense (Difference in Trial balance)	500
General Expenses	4,000		
Salaries	9,000		
Commission	2,200		
Carriage	1,800		
Bad Debts	800		
	2,01,600		2,01,600

The total of the credit side is Rs.2,01,100, while it is Rs.2,01,600 for the debit side. Hence Rs.500 has been credited to the Suspense Account.

TRADING AND PROFIT AND LOSS ACCOUNT OF NIRMAL
for the year ended 31st December, 1992

Dr. **Cr.**

	Rs.	**Rs.**		**Rs.**	**Rs.**
To Opening Stock		22,000	By Sales:	1.50,000	
To Purchases		1,10,000	Less: Returns	2,000	1,48,000
To Carriage		1,800	By Closing Stock		20,000
To Gross Profit c/d		34,200			
		1,68.000			**1,68,000**
To Salaries Paid	9,000		By Gross Profit b/d		34,200
Add: Due	750	9,750	By Discount Received		2,000
To General Expenses		4,000	By Rent Received	1,000	
To Commission		2,200	Add Due	300	1,300

To Taxes Insurance: Paid Less Prepaid	2,000 700	 1,300			
To Discounts To Depreciation: Business premises Furniture & Fittings	 300 266	1,600 566			
To Provision for Bad & Doubtful Debts Required Add Bad Debts	900 1,400*				
Less Existing Provision	2,300 600	1,700			
To Provision for Discounts• To Interest on Capital To Commission payable to Manager** To Net Profit to Capital A/c		342 1,500 1,322 13,220			
		37,500			**37,500**

*Rs.600 has to be written off as bad debts. This increases total bad debts to Rs.1,400. It reduces sundry debtors to Rs.18,000. 5% of this is Rs.900. Deducting this amount from sundry debtors, Rs.17,100 is left. The Provision for Discount will be 2% of this figure.

** Before providing for the commission, the profit is Rs.14,542 (deduct all expenses from the incomes). The manager's commission will be 10/110 of this, because if net profit of the commission is 100, commission will be 10, making a total of 110.

Balance Sheet of Nirmal as at December 31, 1992

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital Account:			Fixed Assets:		
Balance on 1st Jan. 1992 Add Interest Add net Profit	30,000 1,500 13,220		Business Premises: Cost Less Depredation	 20,000 300	 19.700
 Less: Drawings	44,720 5,000	39,720	Furniture and Fittings Less Depreciation	2,600 266	 2,334
			Current Assets:		
Bank Overdraft		4,200	Sundry Debtors	18,000	
Creditors		13,300	Less Provision for Bad and Doubtful Debts	900	
Liability for:				17,100	

Salaries Commission	750 1,322	2,072	Less: Provision for Discounts	342	16,758
			Stock		20,000
Suspense Account		500	Amount Due from Tenant		300
			Prepaid Insurance		700
		59,792			59,792

Illustration 5

Below is the Trial Balance of Mr. Mohan as at December 31, 1994.

Debit Balances	Rs.	Credit Balances	Rs.
Mohan's Current Account	1,500	Capital Account	50,000
Adjusted Purchases	6,99,200	Loan from Ravi @ 9% (taken on 1st Jan. 1993)	20,000
Salaries	4,200	Sales	7,20,000
Carriage on Purchases	400	Discount	500
on Sales	500	Sundry Creditors	20,000
Lighting	300		
Rates and Insurance	400		
Buildings	27,000		
Furniture	6,000		
Sundry Debtors	8,000		
Cash on hand	250		
Cash at Bank	1,500		
Stock (31st December, 1994)	61,250		
	8,10,500		8,10,500

Rates have been prepaid to the extent of Rs.175. Bad debts totaling Rs.500 have to be written off. A provision for doubtful debts @ 5% on debtors is necessary. Buildings have to be depreciated at 2% and Furniture @ 10%. The manager is entitled to a commission of 5% of net profits before charging such commission.

Solution

Note: (1) The Trial Balance gives "Adjusted purchases". It means that the opening stock has already been transferred to the Purchases Account and has thus been closed. Further entry for closing stock has already been passed by debiting the Closing Stock Account and Crediting Purchases Account. That is why closing stock appears inside the

Trial Balance: It will now be shown in the Balance Sheet and not in the Trading Account since purchases already stand reduced.

(2) There is a loan of Ravi @ 9% taken in 1993. The trial balance makes no mention of any interest being paid to him. Hence, interest 9% must be provided for the whole year.

TRADING AND PROFIT AND LOSS ACCOUNT OF MOHAN
for the year ended December 31, 1994

Dr. **Cr.**

	Rs.		**Rs.**
To Adjusted Purchases	6,99,200	By Sales	7,20,000
To Carriage on Purchases	400		
To Gross profit c/d	20,400		
	7,20,000		**7,20,000**
To Salaries	4,200	By Gross Profit b/d	20,400
To Carriage on Sales	500	By Discount	500
To Lighting	300		
To Rates & Insurance : Paid 400 Less Prepaid 175	225		
To Bad debts	500		
To Provision for Doubtful Debts (5% of Rs.7,500)	375		
To Depreciation Building (2%) 540 Furniture 600	1,140		
To Interest on Ravi's Loan	1,800		
To Commission payable to Manager (5% of Rs.11,860*)	593		
To Net Profit to Mohan's Current A/c	11,267		
	20,900		**20,900**

*Rs. 20,900 less Rs. 9,040 (the total of all expenses so far). Manager is entitled to 5% of this figure.

Balance Sheet of Mohan as at December 31, 1994

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Loan from Ravi: Add Interest Due	20,000 1,800	21,800	Fixed Assets:		
			Building: Less Depreciation	27,000 540	26,460
Sundry Creditors		20,000			
Commission Payable		593	Furniture: Less Depreciation	6,000 600	5,400
Capital Account		50,000			
Current Account Net Profit: Less: Debit Balance	 11,267 1,500	9,767	Current Assets:		
			Cash on hand		250
			Cash at Bank		1,500
			Sundry Debtors Less:Doubtful Debts	7,500 375	7,125
			Stock		61,250
			Prepaid Rates		175
		1,02,160			**1,02,160**

Illustration 6

Dilip's Trial Balance as on 30th June, 1995 was as under.

Debit Balance	Rs.	Credit Balance	Rs.
Land and Buildings	20,000	Capital	80,000
Machinery	50,000	Sundry Creditors	8,000
Furniture and Fixtures	4,000	Discount Received	400
Opening Stock	16,300	Outstanding Expenses	1,550
Purchases	80,000	Sales	1,50,500
Salaries	6,000	Repairs and Renewals Provision	6,000
Carriage on Sales	1,500		
Freight on Purchases	2,000		
Customs duty on Purchases	8,000		
Advertising	5,400		
Wages	15,000		
Rent	3,000		
Postage and Stationery	1,500		
General Expenses	3,200		
Repairs to Machinery	2,000		
Loan to Kumar @ 9% (given on 1st January, 1995)	5,000		
Prepaid Insurance	200		
Sundry Debtors	20,000		
Cash in hand	250		
Cash at Bank	3,100		
	2,46,450		2,46,450

The following further information is given:

(a) Stock on 30th June, 1995 was Rs. 14,900.

(b) Machinery was purchased on 1st January, 1995 for Rs. 10,000 and was installed by own workmen. The wages for this purpose amounted to Rs.500. This amount is included in Wages Account.

(c) Depreciation is to be written off @ 3% on Land and Buildings: 10% on Machinery; and 5% on Furniture and Fixtures.

(d) Provision for Repairs and Renewals is credited with Rs. 1,500 every year. (e) A reserve of 2% is to be made on creditors for discount. From the information given above, prepare Trading Account Profit and Loss Account and Balance Sheet as at that date.

Solution

[Note: The attention of the student is drawn to Prepaid Insurance and Outstanding Expenses which appear in the Trial balance. This means that double entry in respect of these items has been completed. Hence, these items will now be shown only in the Balance Sheet].

Trading and Profit and Loss Account of Dilip
for the year ended June 30,1995

	Rs.	Rs.		Rs.	Rs.
To Opening Stock		16,300	By Sales		1,50,500
To Purchases		80,000	By Closing Stock		14,900
To Freight on Purchases		2,000			
To Customs Duty		8,000			
To Wages:	15,000				
Less Charged to Machinery	500	14,500			
To Gross Profit c/d		44,600			
		1,65,400			**1,65,400**
To Salaries To Carriage on Sales To Advertising To Rent To Postage and Telegrams To General Expenses		6,000 1,500 5,400 3,000 1,500 3,200	By Gross Profit b/d By Discount Received By Reserve for discount on Creditors (2% on Rs. 8,000) By Interest due on Loan to Kumar for 6 months		44,600 400 160 225
To Depreciation: Machinery Land & Buildings Furniture & Fixtures	4,525 600 200	5,325			
To Provision for Repairs		1,500			
To Net Profit transferred to Capital A/c		17,960			
		45,385			45,385

Balance Sheet of Dilip as at June 30, 1995

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Sundry Creditors:	8,000		Fixed Assets:		
Less: Reserve for Discounts	160	7,840	Land & Buildings	20,000	
Outstanding Expenses		1,550	Less: Depreciation	600	19,400
Provision for Repairs & Renewals:**	6,000		Machinery Less: Depreciation	50,500* 4,525	45,975
Add Addition	1,500		Furniture & Fixtures	4,000	
	7,500		Less: Depreciation	200	3,800
Less Actual Repairs	2,000	5,500	Current Assets: Cash		250
Capital Account:	80,000		Cash at Bank		3,100
Add Profit	17,960	97,960	Sundry Debtors		20,000
			Stock		14,900
			Loan to Kumar	5,000	
			Add interest due	225	5,225
			Prepaid Insurance		200
		1,12,850			1,12,850

* Machinery stand @ Rs.50,000. Out of this Rs.10,000 was added on 1st January,1995. Hence on 1st July,1994 the machinery account must have stood at Rs.40,000. On 1st Jan.1995 another Rs.500 have to be transferred to the debit of Machinery A/c by crediting Wages A/c. Total Machinery Account will stand at a debit of Rs.50,500. Depreciation has to be charged

	Rs.
On Rs. 40,000 © 10% for full year	4,000
On Rs. 10,000 @ 10% for six months	525
Total	4,525

There is a provision for Repairs and Renewals, Actual repairs will therefore, be debited to this account and not to the Profit and Loss Account. The Provision for Repairs and Renewals Account will be credited by Rs. 1,500 by debiting Profit and Loss Account.

QUESTIONS

1. What do you mean by "Final Accounts"? Discuss its uses.
2. Explain the need for making adjustment entries while preparing final accounts. Give example.
3. State the objectives for preparing Final Accounts.
4. What is Trading Account? What are its uses?
5. Explain the need of trading account.
6. What are direct and indirect expenses?
7. Bring out the differences between trial balance and balance sheet.
8. What do you mean by Assets? Classify the assets with suitable examples.
9. Explain the term liabilities.

Exercises

1. Below is given the Trial Balance of Vijay as at 31st March, 1991. You are required to prepare the Trading and Profit and Loss Account for the year ended 31st March, 1995 and a Balance Sheet as at this date:

TRIAL BALANCE

Particulars	Debit Rs.	Credit Rs.
Capital Account		75,000

Stock	45,000	
Purchases	2,25,000	
Plant and Machinery	75,000	
Trade Charges	10,000	
Sales		4,20,750
Carriage In	2,500	
Carriage Out	1,500	
Factory Rent	1,500	
Discount	350	
Insurance	700	
Sundry Debtors	60,000	
Sundry Creditors		15,000
Office Rent	3,000	
Bad Debts Provision		200
Printing and Stationery	600	
General Expenses	2,800	
Advertising	15,000	
Bills Receivable	3,000	
Drawings	6,000	
Bills Payable		2,000
Salaries	18,000	
Manufacturing Wages	20,000	
Furniture & Fixtures	7,500	
Coal, Gas & Water	1,000	
Cash in Hand	2,000	
Cash in Bank	12,500	
	5,12,950	5,12,950

The following adjustments are required:

(a) The closing stock amounted to Rs. 35,000

(b) Plant & Machinery and Furniture & Fixture are to be depreciated at 10% and 5% respectively.

(c) Bad Debts Reserve to be raised to 2 1/2% on Debtors

(d) Provide for Outstanding Liabilities:- Factory Rent Rs.300: Office Rent Rs.600

(e) Insurance includes Rs.100 in respect of 1994-95

(Gross Profit: Rs. 1,60,450; Net Profit: Rs. 98,825,

Balance Sheet Totals: Rs. 1,85,725)

2. Prepare Trading and Profit and Loss Account and Balance Sheet as on 31st March, 1992 from the following balances:

Balan's Capital Account	1,19,400
Balan's Drawings Account	10,550
Sundry Creditors	59,630
6% Loan Account (Credit)	20,000
Cash in hand	3,030
Cash at Bank	18,970

Sundry Debtors	62,000
BillsReceivable	9,500
Provision for Doubtful Debts	2,500
Fixtures and Fittings	8,970
Plant & Machinery	28,800
Stock, 1st Apri1,1992	89,780
Purchases	2,56,590
Manufacturing Wages	40,970
Sales	3,56,530
Returns Inwards	2,780
Salaries	11,000
Rent and Taxes	5,620
Interest and Discount (Debit).	5,870
Travelling Expenses	1,880
Repairs and Renewals	3,370
Bad Debts	3,620
Commission Received	5,640
Insurance (including Premium @ Rs.300 per annum paid upto 30th Sept. 1992)	400

Stock on hand on 31st March, 1992 was Rs. 1,28,960. Create a provision of 5% on Sundry Debtors. Charge 5% Interest on Capital. Manufacturing Wages include Rs.1,200 for erection of new machinery purchased last year. Depreciate Plant and Machinery by 5% and Fixtures and Fittings by 10% per annum. Commission earned but not received amounts to Rs.600. Interest on loan for the last 2 months is not paid.

(Gross Profit: Rs. 96,570; Net Profit: Rs. 62,033; Totals of Balance Sheet: Rs.2,56,683)

3. From the under mentioned Trial Balance of M/s Johnson & Co prepare a Trading and Profit and Loss Account for the year ended 31st December,1993 and Balance Sheet as on that date:

Particulars	Debit Rs.	Credit Rs.
Capital Account		1,00,000
Stock	30,000	
Purchases	1,00,000	
Sales		2,00,000
Returns In and Out	2,500	1,500
Bad Debts provision		750
Bills Receivable and Payable	45,000	
Carriage	7,500	
Plant and Machinery	65,000	
Office Furniture	3,500	
Sundry Debtors	60,000	
Sundry Creditors		28,000

Coal, Gas and Water	1,200	
Wages	10,000	
Duty and Clearing Charges	1,500	
Office Rent	2,500	
Printing and Stationery	500	
Insurance	350	
Carriage Out	4,200	
Salaries	18,000	
Factory Rent	1,900	
Electricity and Telephone	800	
Loan @ 9% (taken on May 1, 1993)		25,000
Bank charges	25	
Drawings	5,000	
Cash in hand	1,250	
Cash at bank	4,525	
	3,65,250	3,65,250

The following adjustments are to be taken into consideration: Closing Stock, Rs. 40,000. Outstanding Liabilities to be provided for: Salary Rs.2,400 Factory Rent 1,500 and Office Rent 550. Bad Debts Provision to be adjusted to 2 1/2% of Sundry Debtors after elimination of bad Debts amounting to Rs,2,000. Goods withdrawn Rs,2,525 for private use. Depreciation on Plant 10%.Interest on Capital at 5% per annum.

The manager is allowed a commission of 5% of net profit before charging the commission.

(Gross Profit: Rs. 87,925; Net Profit: Rs. 40,755; Totals of Balance Sheet: Rs. 2,09,325)

4. The following Trial Balance has been taken from the books of Prasana as on 31st December,1994. You are required to prepare the Trading and the Profit and Loss Account for the year ended 31st December,1994 and the Balance Sheet as at that date.

Particulars	Debit Amount	Credit Amount
Rs. Rs.		
Capital A/c		80,000
Drawings	4,800	
Stock 31st Dec. 1994	40,000	
Office Furniture	13,000	
Printing and Stationery	1,200	
Coal, Gas and Water	600	
Freight and Clearing charges	3,500	
Purchases Adjusted	65,000	
Sundry Creditors		15,000
Bank Loan (at 16% taken on 1st Jan. 1994)		20,000

Discount	950	
Repairs to Plant	1,000	
Sales		2,05,350
Factory Rent	2,500	
Salaries	2,800	
Manufacturing Wages	24,000	
Advertising	19,000	
Plant and Machinery	70,000	
Office Rent	3,600	
Miscellaneous Expenses	1,000	
Bad Debts Provision		600
Bills Receivable	22,000	
Bills Payable		1,500
Carriage Out	1,500	
Insurance	600	
Interest on Bank Loan	1,000	
Cash at Bank	7,500	
Cash in Hand	3,500	
Sundry Debtors	33,800	
	3,22,850	3,22,850

The following adjustments are required:

(a) Depreciate: Plant and Machinery @ 10% ; Office Furniture @ 7 1/2%

(b) Provision for Bad Debts to be raised to 5% and Reserve for discount on Creditors to 1%

(c) Insurance Premium was paid for six months up to 31st March,1995.

(d) Sales include Rs. 350 worth of goods which were taken by the proprietor.

(e) Half of the Advertising A/c is to be carried to a Suspense A/c and to be written off in the subsequent 2 years. (f) Rs.100 were paid in advance for Factory Rent; and

(f) An outstanding bill for Repairs amounting to Rs.250 remains to be paid.

(Gross Profit: Rs. 1,09,850; Net Profit: Rs. 76,035; Totals of Balance Sheet: Rs. 1,90,035)

5. The following are the balances taken on 31st December, 1995, from the books of M/s Bright Ltd.

Capital	8,794
Opening stock (1st January,1995)	8,560
Discount (Cr.)	35
Wages	3,000
Advertising	470
Plant and Machinery	2,000
Sales	36,000

Electric energy and water	70
Returns outwards	190
Office rent	150
Purchases	26,270
Bills receivable	200
Cash at Bank	666
Furniture and Fittings	250
Cash in hand	5
Sundry Creditors	845
Rates and taxes	30
Printing and Stationery	50
Sundry Debtors	1,800
Drawings	1,250
General Expenses	123
Insurance	42
Stock as on 31st December,1995 was Rs. 3,980.	

You are asked to prepare Manufacturing and Profit and Loss account for the year ending 31st December 1995, and the Balance Sheet as on that date after taking into consideration the following:-

(a) Rs.15 owing for premises sublet, were not taken into account.

(b) Bad debts provision required is Rs. 250

(c) Depreciation is to be written off at 10 per cent on Plant and Machinery and Furniture and Fittings.

(d) Insurance was prepaid to the extent of Rs.13.

(e) Bills receivable Rs.100 not yet due, were discounted on 31st December 1995.

(f) The manager is entitled to a commission of 25 per cent on the net profit after charging such commission. Prepare the Final Accounts and Balance sheet relating to 1995.

(Gross Profit: Rs. 2,270; Net Profit: Rs. 794; Totals of Balance Sheet: Rs. 9,382)

Unit Structure:

Lesson 3.1: Receipts and Payments Account

Lesson 3.2: Income and Expenditure Account

LESSON 3.1 RECEIPTS AND PAYMENTS ACCOUNT

Introduction:

The basic objective of any trading institution dealing in sale of goods or services is to earn profits. Therefore, such trading institutions prepare their accounting records in such a way as to reveal not only true profit or losses but also the precise financial position for each accounting period. However, there are certain institutions which do not deal in purchasing or selling of goods but deal in services with or without profit motive. These are non-trading entities. Charitable institutions like hospitals, educational institutions, clubs, etc., are non-trading institutions which do not carry on any trading and do not have making of profit as one of their objectives. They do not prepare a trading and profit and loss Account. However, they maintain a Cash Book and, on the basis of entries made in it, prepare a summary of the cash transactions. When presented in an account form, this summary is called Receipts and Payments Account.

Receipts and Payments Account is prepared at the end of the accounting period from the cash book. The cash book contains a record of cash receipts and cash payments in a chronological order while Receipts and payments Account is a summary of total cash receipts and total cash Payments received and made under different heads during a particular period.

Features of Receipts and Payments Account: The main features of the Receipts and Payments Account can be summarized as follows:

(i) It is a Real Account

(ii) It commences with the balance of cash and bank in the beginning of the accounting period.

(iii) All cash receipts and payments irrespective of the fact whether they are of capital or revenue nature or whether they relate to the current year or not are entered in it.

(iv) Only actual receipts and payments are entered.

(v) The balance in the account will show the closing balance of cash in hand and at bank. However, if the credit side exceeds the debit side, it represents the net bank overdraft.

Now, an illustration is given as to how to prepare a Receipts and Payments Account.

Illustration 1

Prepare a Receipts and Payments Account of the Pondicherry Recreation Club from the following particulars taken out from the Cash Book of the Club:

Opening Balance:	Rs.
Cash in hand	500
Cash at bank	4500
Receipts: Subscriptions: 1994 - 700 1995 - 7000 1996 - 2000	9700
Admission fee	1200
Donations	5000
Sale of old sports materials	900
Investments realized	4000
Payments:	
Investments purchased	5000
Rent paid	1200
Sports materials purchased	3000
General expenses	800
Postage and stationery	100
Salaries	2200
Closing cash balance	400

Solution:

Receipts and Payments Account for the year ended…………………

Dr. Cr.

Receipts	Amount	Payments	Amount
To opening balance: Cash in hand 500 Cash at bank 4500	5,000	By Investments " Rent " Sports Materials	5,000 1,200 3,000
" Subscriptions: 1994- 700 1995 - 7000 1996 - 2000	9,700	" General Expenses " Postage & Stationery " Salaries " Closing Balance:	800 100 2,200
" Admission fee	1,200	Cash in hand 400	
" Donations	5,000	Cash at bank 13,100	13,500
" Sale of old sports Materials	900	(Balancing figure)	
"Investments Realized	4,000		
	25,800		25,800

From the above illustration, students are advised to note the following points:

i) The items of Investment (Rs.5000) and Sports materials (Rs.3000) recorded in the credit side relate to Capital Expenditure which are assets;

ii) The depreciation of Sports materials and other assets, if any is unaccounted; and

iii) The accruals and prepayments of income and expense items like subscriptions, rent, etc., are not dealt with in the account.

This is because the Receipts and Payments Account deals, like the Cash Book, exclusively with the actual collections and disbursements (of cash and bank). Therefore, to know the exact result of the year's working, it is essential to prepare an Income and Expenditure Account on the double entry principle which also paves the way for a Balance sheet to appraise one's financial position as at the accounting date.

LESSON 3.2 INCOME AND EXPENDITURE ACCOUNT

Introduction

Receipts and Payments Account by itself does not indicate the financial position of any non-trading institution since a large cash balance can result from the sale of an asset; the balance will quickly disappear if current expenses exceed the current income. For the purpose of knowing the exact financial position of the institution, it is necessary to compare current expenses with current incomes and to compile assets and liabilities. For this, we have to prepare an Income and Expenditure Account and a Balance Sheet.

An Income and Expenditure Account is a revenue account of a non-trading institution and may be considered as equivalent to the Profit and Loss Account of a trading concern. It performs the same functions and is compiled and constructed on precisely the same principles. Its salient features are summarized as follows:

i) It is a nominal account.

ii) Items of revenue nature alone are dealt with in the account, but they are not confined merely to the actual cash transacted during the period covered by it.

iii) All incomes and gains, whether received or accrued, are credited and expense and losses, whether paid or incurred, are debited to it.

iv) Any advance receipt of income or payment of expense is duly adjusted.

v) The final balance of the account, after due adjustments of accruals, pre-payments, provisions, depreciation, etc., represents an excess of income over expenditure or excess of expenditure over income for the relevant period.

The *Balance sheet* of a non-trading concern is prepared in the usual way and contains particulars of all assets and liabilities of the institution on the date on which it is prepared. The excess of assets over the liabilities is termed as Capital Fund or General Fund. The Capital Fund is made o up of excess of income over expenditure and other incomes or surpluses which might have been capitalized by the institution from time to time. Sometimes two Balance Sheets may have to be prepared,

i) Balance Sheet in the beginning of the accounting year to ascertain the amount of capital in the beginning of the accounting year, and

ii) Balance Sheet at the end of the accounting year to show the financial position of the Institution as on that date.

The following points should be remembered while preparing Income and Expenditure account. They are:

1. Entrance Fee.
2. Subscriptions.
3. Life Membership.
4. Donations.

1. **Entrance Fee:** Entrance Fee is generally considered as an item of income. As such, it is credited to the Income and Expenditure Account. However, some people argue that entrance fee is of a non-recurring nature and therefore they favour capitalizing the entrance fee, in which case it is added to the Capital Fund directly and not credited to the Income and Expenditure Account. But in the absence of any specific instructions in the question, students are advised to treat it as an item of income.

2. **Subscriptions:** Subscription is a source of income to a non-trading concern. While the Receipts and Payments Account records the actual subscriptions received, the Income and Expenditure Account records only the subscriptions which relate to the Accounting period, whether received or not. Therefore necessary adjustments should be made to find out the actual amount of income from subscription to be recorded to the accounting period.

3. Life Membership: In case of life membership, members have to pay fee only once in their life time. It is a receipt of non-recurring nature and should be added to the capital fund and not credited to the Income and Expenditure Account.

4. Donations: The amount of donation received by a non-trading institution may be treated either as an income or may be capitalized and taken to Balance Sheet depending upon whether it is a specific donation or a general donation.

When any donation is received for any specific purpose, it is considered as a specific donation; (eg) donation for instituting a prize, donation for construction of a building. The amount of such donation cannot, therefore, be used for any other purpose. It should be taken to the Balance Sheet on the liabilities side and be used only for purpose for which it is meant, irrespective of the amount.

A donation not received for a specific purpose is termed as a general donation. Its treatment depends upon the amount received. If the donation is of a substantial amount, it should be taken to the Balance Sheet on the liabilities side. However, if the amount of donation is small, it can be safely taken to the Income and Expenditure Account.

Illustration 1

From the following information, prepare an Income and Expenditure Account for the period ending 30th June 1993:

Particulars	Rs.
Capital fund (1.7.1992)	1,60,000
Drawings	8,260
Sundry investments	1,55,000
Profits on sale of investments	15,500
Loss on sale of investments	23,000
Reserve for fluctuations on investments (1.7.93)	24,000
Dividends and interest received	7,600
Reserve for Taxation	1,020
Depreciation	230
Rent received	1,600
Rent receivable	450
Sundry creditors	500
Deposit interest received	220
Cash at bank	9,500
Properties	1,400

Market value of investments at 30th June 1993 was Rs.1,24,000 and the reserve is to be increased to cover full fall in price. Prepare an Income and Expenditure Account and a Balance Sheet.

Solution:

INCOME AND EXPENDITURE ACCOUNT
For the Year ending June 30, 1993

Expenditure	Rs.	Income	Rs.
To Loss on sale of investments	23,000	By Dividends &interest	7,600
To Investment fluctuation reserve	7,000	By Rent received	1,600
To Depreciation	230	By Deposit interest	220
		By Profit on sale of investments	15,500
		By Excess of expenditure over income	5,130
	30,230		30,230

BALANCE SHEET as at June 30, 1993

Liabilities	Rs.	Assets	Rs.
Capital fund	1,60,000	Cash at bank	9,500
Less: Drawings	8,260	Sundry investments	1,55,000
	1,51,740	Rent receivable	450
Less: Excess of expenditure over income	5,130	Properties	14,000
	1,46,430		

Investment Fluctuation Reserve 24, 000 Add: Addl. reserve 7,000	31,000		
Reserve for taxation	1,020		
Sundry creditors	500		
	1,78,950		**1,78,950**

Notes:

1) Balances given in the question will be taken to one place only i.e., either to income and expenditure account or to the Balance sheet. As per this rule,

i) Rent receivable has been taken to the Balance sheet

ii) Depreciation has been taken to Income & Exp. A/C.

2) Since the fall in value of investments is to the extent of Rs. 31,000, a further reserve of Rs.7,000 has been made to bring up the existing reserve of Rs.24,000 to the required amount of Rs. 31,000.

Difference between Receipts & Payments Account and Income & Expenditure Account:

Receipts and Payments Account		Income & Expenditure Account	
1	It is a summary of cash book and hence receipts are shown on the debit side and payments on the credit side.	1	It is similar to profit & loss account of trading concern and incomes appear on the credit side and expenses on the debit side.
2	It commences with opening cash balance.	2	Without any opening balance.
3	It includes both capital and revenue receipts and payments	3	Excludes all the capital receipts and payments.
4	It ignores accrued incomes and expenses as it deals only with the actual receipts and payments.	4	Deals with all income earned and the expenses incurred for the year actually received and paid or merely accrued.
5	It includes the items pertaining to preceding, current and succeeding years.	5	Confines to the items of current year only and hence the accrued items of the preceding year and prepayments for the succeeding year are excluded.
6	It is usually based on cash system which suggests the absence of double entry and balance sheet	6	Adopts mercantile system which suggests the presence of double entry and balance sheet.
7	Difference between the two sides represents cash at the close, unless a Bank overdraft, and is carried forward to the next year.	7	Difference denotes a surplus or deficit, depending upon the excess of income over expenditure or vice-versa and is merged with the capital fund.

Preparation of Income and Expenditure Account from Receipts and Payments Account:

The following steps should be followed if an Income and Expenditure Account is to be prepared from Receipts and Payments Account:

i) Ignore the opening and closing balances of cash and Bank.

ii) Exclude all the capital receipts and payments without any regard to the preceding, current or succeeding year to which they relate to.

iii) Delete those items of incomes and expenses which although are received and paid in the current year but are meant for either previous year or the following year.

iv) Account for all the accrued (due or not) incomes and expenses of the current year with the help of given data. Also include the revenue sums advanced in the previous year, unless stated otherwise.

v) Provide for current year's taxation, depreciation, bad and doubtful debts, etc., with reference to the notes for adjustments so as to arrive at the year's true net result. The account thus prepared embodies only the revenue items and the excess of income over expenditure or vice-versa represents the surplus or deficit of the given period.

Illustration 2

The Baroda Sports Club presents to you its Receipts and Payments Account for the year ending on 31st December 1994. You are required to prepare the Income and Expenditure Account and the Balance sheet relating to the year.

Receipts and Payments Account for the year ended 31st Dec. 1994

Dr. Cr.

Receipts	**Rs.**	**Payments**	**Rs.**
To Opening balance: Cash at hand Cash at bank	 550 20,250	By Establishment (includes Rs. 500 for 1995) By Donations	6,150 5,000
To Members' admission fees	1,250	By Telephone charges	500
To Interest on securities	1,000	By Electricity charges	300
To subscriptions (Including Rs. 750 for 1995)	21,250	By Stamp and stationary By Travelling expenses	400 400
To Donations	10,000	By Meeting expenses	300
To Telephone receipts	200	By Rent	5,200
		By Library books	3,000
		By Closing balance: Cash in hand Cash at bank	 460 32,790

	54,500		**54,500**

The Association gives the following information:

i) The association holds 6% Govt. Securities amounting to Rs.40,000 on 1.1.94.

ii) The library account stood at Rs. 20,000 on 1.1.1994.

iii) Half of the donations received is to be transferred to the Capital Fund.

iv) Rent Rs. 300 is still payable.

Solution:

Income & Expenditure Account of the Baroda Sports Club for the Year ended 31st Dec. 1994

Expenditure	Rs.	Income	Rs.
To Establishment 6150 Less: For 1995 500	5,650	By Subscription 21,250 Less for 1995 750	20,500
" Telephone charges	500	" Members admission fee	1,250
" Electricity charges	300	" Interest on securities 1,000 Add accrued interest 1,400	2,400
" Stamp & stationery	400	" Donation 11/2 of 10000]	5,000
" Travelling expenses	400	" Telephone receipts	200
" Meeting expenses	300		
To Rent 5,200 Add: Outstanding rent 300	5,500		
To Donations	5,000		
" Excess of income over Expenditure	11,300		
	29,350		29,350

BALANCE SHEET as on 31st Dec. 1995

Liabilities	Rs.	Assets	Rs.
Capital fund on1.1.94 (1) 80,800 Add Excess of income over expenditure 11,300 Add Donations 5,000	97,100	Cash in hand Cash at bank 6% Govt. securities 40,000 Add: Accrued int. 1,400	460 32,790 41,400
Outstanding rent	300	Library account (20,000+3,000)	23,000
Subscription received in advance	750	Prepaid expenses	500
	98,150		**98,150**

Working Notes: 1) Calculation of Capital Fund at the Beginning:

BALANCE SHEET as at 1st Jan. 1994

Liabilities	Rs.	Assets	Rs.
Capital fund		Cash in hand	550
(Balancing figure)	80,800	Cash at bank	20,250
		6% Govt. securities	40,000
		Library account	20,000
	80,800		**80,800**

Preparation of Receipts and Payments Account from Income and Expenditure Account:

This requires finding out of cash receipts and cash payments received or made during the accounting year. Any cash received and paid against the previous and current year's income and expenses is found from the adjustments shown in the inner columns of Income and Expenditure Account and/or supplementary notes.

Illustration 3

The East Coast Hospital Ltd. prepared the following Income and Expenditure Account for the year 1992.

Expenditure	Rs.	Income	Rs.
To Salaries	23,500	By Subscriptions	25,000
" Surgery and dispensary	3,000	" Interest	9,000
" Rent and rates	500	" Donations	4,000
" Insurance	200	" Miscellaneous receipts	300
" Office expenses	800		
" Depreciation			
Building 3,750			
Furniture 120			
Instruments 100	3,970		
" Excess of income over expenditure	6,330		
	38,300		**38,300**

Other information is as follows:

	31.12.1991 Rs.	**31.12.1992 Rs.**
Cash in hand and at bank	?	18,700
Govt. securities (face value Rs.2,00,000)	1,80,000	1,80,000
Subscriptions outstanding	7,000	10,000
Subscriptions received in advance	500	600
Salaries unpaid	1,000	1,500
Furniture	2,000	1,980
Land and buildings	2,00,000	1,96,250
Instruments	3,500	3,900
Surgery expenses due	200	300
Stock of medicines	300	100

You are required to prepare the Receipts and Payments Account for 1992 and also the Balance Sheet as on 31.12.1992

Solution:

Receipts and Payments Account of East Coast Hospital Ltd
for the Year Ended 31st Dec. 1992

Receipts	Rs.	Payments	Rs.
To Balance b/d:		By Salaries (2)	23,000
(Balancing figure)	11,100	" Surgery & disp (3)	2,700
" Subscriptions (1)	22,100	" Rent and rates	500
" Interest	9,000	" Insurance	200
" Donations	4,000	" Office expenses	800
" Misc. receipts	300	" Furniture (4)	100
		" Instruments (5)	500
		" Balance c/d	18,700
	46,500		**46,500**

BALANCE SHEET as at 31st Dec. 1992

Liabilities		Rs.	Assets	Rs.
Capital fund (6)			Cash in hand and at bank	18,700
on 1.1.91	4,02,000		Govt. securities	1,80,000
Add surplus	6,330	4,08,530	Subscriptions outstanding	10,000
Salaries unpaid		1,500	Furniture	1,980
Surgery expenses unpaid		300	Instruments	3,900
Subscriptions received in advance		600	Land and Buildings	1,96,250
			Stock of medicines	100
		4,10,930		**4,10,930**

.

Working Notes:

(1) Subscriptions		**Rs.**
Subscriptions actually received		25,000
Add: Outstanding for 1991		7,000
Add: Subscriptions received in advance for 1992		600
		32,600
Less: Outstanding for 1992	10,000	10,500
Subscription received in Advance for 1991	500	
		22,100
(2) Salaries :		
Salaries Paid		23,500
Add: Outstanding for 1991		1,000
		24,500
Less: Outstanding for 1992		1,500
		23,000
(3) Surgery and dispensary :		

Surgery and Dispensary paid	3,000
Add: Outstanding for 1991	200
Add: Stock of medicines on 31.12.92	100
	3,300
Less: Outstanding for 1992 300 Stock of medicines on 31.12.1991 300	600
	2,700

(4) **Furniture Account**

Dr. Cr.

	Rs.		Rs.
To Balance c/d	2,000	By Depreciation	120
" Cash (purchases)	100	" Balance c/d	1,980
	2,100		**2,100**

(5) Instruments Account

Dr. Cr.

	Rs.		Rs.
To Balance b/d	3,500	By Depreciation	100
" Cash (purchases)	500	" Balance c/d	3,900
	4,000		4,000

(6) Calculation of Capital Fund

Balance Sheet as at 1.1.92

Liabilities	**Rs.**	**Assets**	Rs.
Subscriptions received in advance	500	Cash in hand Govt. securities	11,100 1,80,000
Salaries unpaid	1,000	Subscription outstanding	7,000
Surgery expenses due	200	Furniture	2,000
Capital fund on 1.1.92 (Balancing figure)	4,02,200	Land and Buildings Instruments	2,00,000 3,500
		Stock of medicines	300
	4,03,900		**4,03,900**

Receipts and Expenditure Account for Professional People:

So far, we have explained about the preparation of Receipts and Payments Account and Income & Expenditure Account by non-trading institutions. This is the usual system of accounting adopted by them. However, some of the professionals like Doctors, Lawyers, Engineers, Accountants, etc., prepare a Receipts and Expenditure Account to determine the income earned by them during a particular period. While preparing Receipts and Expenditure

Account these persons follow cash system for recording income but mercantile system for recording their expenditure. This means that they do take into account outstanding expenses but not such incomes which have not been received. This is because of the reason that they generally do not file a suit for the recovery of their dues.

While preparing the Receipts and Expenditure Account, credit is taken for the outstanding income but at the same time a provision is created for an amount equivalent to the outstanding income by debiting the Receipts and Expenditure Account. Thus the effect of giving credit to the Receipts and Expenditure Account by the amount of income outstanding is nullified. This will be clear from the following illustration:

Illustration 4

From the following Receipts and Payments Account of Dr. David, an Eye Specialist, who commenced his practice on 1st January 1994 with a capital of Rs.30,000 (Rs.20,000 invested in the necessary apparatus and Rs.10,000 on Furniture & Fixtures), prepare his Receipts and Expenditure Account and Balance sheet as on 31st December 1994.

Receipts and Payments Account for the year ending 31st Dec. 1994

Receipts	Rs.	Payments	Rs.
To Dispensing fees	30,000	By salaries to assistants	7,500
" Visiting fees	8,000	" Rent	6,000
" Miscellaneous income	2,000	" Conveyance	3,000
" Apparatus (cost Rs.5000; sold on 1.10.94)	3,000	" Lighting	2,400
		By Subs. for journals	300
		" Books	2,000
		" Stationery and postage	500
		" Drawings	8,000
		" Apparatus purchased on 1.7.94	6,000
		" Balance:	
		Cash in office	1,300
		Cash at bank	6,000
	43,000		**43,000**

Additional Information:

Depreciate Furniture & Fixtures at 10%, apparatus at 20% p.a., and Books by Rs.800. Unpaid salaries stand at Rs.1200 and an undischarged bill for Apparatus (1.1.94) is Rs. 6600. 30% of conveyance is for domestic affairs and outstanding fees for Dispensing and visiting respectively are Rs.3000 and Rs.2000.p.a.

SOLUTION:

Receipts and Expenditure Account of Dr. David
For the year ended 31st. Dec. 1994.

Expenditure	Rs.	Receipts	Rs.
To salaries to Asst. 7,500 Add: Unpaid 1,200	8,700	By Dispensing fees 30,000 Add Outstanding 3,000	33,000
" Rent	6,000	" Visiting fees 8,000 " Add outstanding 2,000	10,000
To Conveyance 3,000 Less: 30% for domestic affairs 900	2,100	" Miscellaneous income	2,000
" Lighting	2,400		
" Subs. for Journals	300		
" Stationery & Postage	500		
" Depreciation:			
Apparatus at 20% p.a. on			
Rs.5000 for 9 months 750			
Rs.1500 for 1 year 3000			
Rs.6000 for 1/2 year 600			
Rs.6600 for 1 month 110	4,460		
Books	800		
To Furniture & fixtures	1,000		
To Loss on sale of apparatus Cost 5000 Less sale 3000 2,000 Less Depreciation 750	1,250		
To Provision for outstanding (3000+2000)	5,000		
To Profit (Transfer to capital account)	12,490		
	45,000		**45,000**

Balance Sheet of Dr. David as at 31st Dec. 1994

Liabilities		Rs.	Assets		Rs.
Capital	30,000		Furniture & Fixture	10,000	
Less Drawing	8,000		Less Depreciation	1,000	9,000
	22,000		Books	2,000	
Less: Conveyance for domestic use	900		Less Depreciation	800	1,200
	21,100		Apparatus	20,000	
Add: Profit	12,490	33,590	Add: additions (6000+6600)	12,600	
Outstanding Liabilities:				32,600	
For Apparatus		6,600	Less: Sold during the year	5,000	
For Salaries		1,200		27,000	
			Less depreciation other than on	5,000	
			(cost) sold away	3,170	23,890
			Cash:		

		in office 1,300	
		at Bank 6,000	7,300
		Outstanding fees 5,000	
		Less Provision 5,000	Nil
	41,390		**41,390**

Questions

1. Explain the nature of Receipts and Expenditure Account.
2. State the difference between a Receipts and Payments Account and Income and Expenditure Account.
3. Write a note on income and expenditure account.
4. Enumerate the steps involved in preparing income and expenditure account from the receipts and payments account.

Problems:

1. From the following details of the City Club for the year ended 31st December 1990, prepare the Receipts and payments account for the same:

Cash (Jan. 1, 1990) in hand 200 at bank 3000	3,200
Subscriptions and donations received	1,500
Purchase of government securities	2,300
Sale of tickets for annual dinner	350
Expenses of annual dinner and entertainment	250
Interest on bank deposits	80
Dividends received	200
Contributions for flood & famine victims	50
Furniture purchased	200
Rent and hire charges paid	220
Postage, printing and stationery	40
Periodicals and newspaper	260
Secretary's honorarium and sundries	110
Cash in hand (31st Dec. 1990)	200

(Ans: Closing cash at Bank Rs. 1,700)

2. The Happy Club gives you its Receipts and Payments Account for 1992. Prepare its Income and Expenditure account for the year.

Receipts and Payments Account

	Rs.		Rs.
To Balance b/d	1,200	By Sports equipment	3,500
To Subscriptions	15,300	By Rent	1,000
To Sale of old newspapers	300	By Cost of entertainments	10,100
To Donations of Buildings	10,100	By Misc. expenses	800

To Sale of furniture	600	By Investments	10,000
		By Balance c/d	2,100
	27,500		**27,500**

Investments consisted of 4% government loan and were purchased on 1st July 1992. Subscriptions included Rs.700 for 1991 and Rs.200 for 1993. Subscriptions for 1992 still receivable were Rs.1500 out of these Rs.200 were considered doubtful.

(Excess of Income over Expenditure Rs.4300]

3. From the following particulars relating to Hindu Mission Charitable Hospital, prepare Income and Expenditure Account for the year ended 31st December, 1994 and Balance sheet on that date.

Receipts and Payments Account

For the year ended 31st December 1994

Receipts	Rs.	Payments	Rs.
To Cash in hand on		By Medicines	30,590
1st Jan. 1994	7,130	" Doctor's honorarium	9,000
" Subscriptions	47,996	" Salaries	27,500
" Donations	14,500	" Petty expenses	461
" Interest on investment		" Equipment	15,000
@ 7% for full year	7,000	" Expenses on Charity	750
" Proceeds from Charity Show	10,450	" Cash in hand on 31st December 1984	3,775
	87,076		87,076

Additional information	1.1.94 Rs.	31.12.94 Rs.
i) Subscription due	240	280
ii) Subscription received in advance	64	100
iii) Stock of medicines	8,810	9,740
iv) Estimated value of equipment	21,200	31,600
v) Building (cost less depreciation)	40,000	38,000
vi) Creditors for medicines	10,000	8,000

[Ans: Excess of Income over expenditure Rs.7,979; Balance sheet as at 31.12.94

Total-183395; capital fund as on 1.1.94 Rs.167316]

4. The following Income and Expenditure Account of Merry Club is given for the year ended on 31st December 1990:-

Dr. Cr.

	Rs.		Rs.
To Opening stock of provisions	10,000	By Subscriptions	26,000
" Purchase of provisions	30,000	" Donations	30,000
" Salaries	10,000	" Entrance fees	8,000
" Printing & stationary	5,000	" Sale of provisions	28,000
" General expenses	3,000	" Closing stock of provisions	5,000

" Depreciation on Equipment	1,000		
" Excess of income over expenditure	38,000		
	97,000		**97,000**

The following further information is given:-

Balance Sheet of the Club as on 31st December 1989

	Rs.		Rs.
Creditors for provisions	8,000	Equipment at written down value	10,000
General fund	37,000	Stock of provisions	10,000
		Cash in hand and at bank	20,000
		Subscriptions receivable	5,000
	45,000		**45,000**

Balance Sheet of the Club as on 31st December 1990

	Rs.		Rs.
Creditors for provisions	10,000	Equipment at written down value	15,000
General fund	75,000	Stock of provisions	5,000
		Cash in hand and at bank	45,000
		Subscriptions receivable	20,000
	85,000		**85,000**

Prepare a Receipts and Payments Account of the club for the year ended on 31st December 1990 from the above information.

5. The following particulars relate to a Sports Club:

Receipts and Payments Account
for the year ending December 31, 1990

Receipts	Rs.	Payments	Rs.
To Balance b/d	7,600	By Salaries	4,800
" Entrance fees	5,200	" Insurance	1,000
" Subscriptions (including for 1989 Rs. 1500)	17,000	" Rates and taxes	1,400
" Proceeds of sale of old newspapers	120	" Addition to library on Dec. 30	2,500
" Rent of library (including for 1989 Rs.700)	2,080	" Payment of creditors of last year	1,300
" Proceeds from sale of lecture hall furniture	300	" Postage	100
		" Repairs	500
		" Printing & Stationery	800
		" Electric installation expenses	9,000
		" Sundry expenses	4,300
		" Balance c/d	12,600
	38,300		**38,300**

Income and Expenditure Account
for the year ending December 31, 1990

Expenditure	Rs.	Income	Rs.

To Salaries	4,800	By Entrance fees	5,200
" Rates and Taxes	1,400	" Subscription	17,700
" Insurance	650	" Income from the use of library hall	2,130
" Repairs	500	" Sale of old newspapers	120
" Printing and stationery	800	" Proceeds from lectures and entertainment	6,000
" Postage	100		
" Sundry expenses	1,900		
" Depreciation: Building @2 ½%	700		
" Investments @ 5%	500		
" Old furniture	50		
" Excess of income over expenditure	**16,380**		

You are required to prepare opening and closing balance sheets.
[Ans: Capital fund in the beginning Rs.80550; Balance sheet total as on 31.12.89 Rs.81850; Balance sheet total as on 31.12.90 Rs.96930].

6. Dr. S.K. Sharma commenced practice as a dentist, investing Rs.50,000 in equipment, on 1st January 1993. The Receipts and Payments account for the year was as follows:

	Rs.		Rs.
To Fees	1,00,000	By Rent	6,000
" Miscellaneous receipts	200	" Salaries to assistants	15,000
" Equipment sold	4,000	" Journals	2,000
		" Library books	6,000
		" Equipment purchased	8,000
		" Drawings	24,000
		" Balance: at Bank at hand	 43,000 200
	1,04,200		**1,04,200**

Rs. 3000 of the fees were still outstanding. Equipment sold and purchased was on 1st October 1993, the cost of Equipment sold being Rs.6000. Depreciation on equipment is 20% and on library books 5%. Salary to assistants still payable is Rs.2000. Prepare the Receipts and Expenditure account and Balance Sheet relating to 1993. [Ans: Surplus - Rs. 63,709 Balance sheet total Rs. 91,700]

UNIT – IV

Unit Structure:

Lesson No. 4.1: Depreciation Accounting

Lesson No. 4.2: Methods of Providing Depreciation

LESSON 4.1 DEPRECIATION ACCOUNTING

Introduction:

The concept of depreciation is closely linked to the concept of business income. In the revenue generating process, the use of long term assets tends to consume their economic potential. At some point of time these assets become useless and are disposed of and possibly replaced. The economic potential so consumed represents the expired cost of these assets and must be recovered from the revenue of the business in order to determine the income earned by the business. Depreciation may, therefore, be defined as that portion of the cost of the assets that is deducted from revenue for assets services' used in the operation of a business.

Definition: In order to have a clear understanding about the concept of depreciation, it will be useful to quote definitions given by some prominent writers.

According to Pickles, "Depreciation is the permanent and continuing diminution in the quality, quantity or value of an asset".

The Institute of Chartered Accountants of England and Wales defines depreciation as "that part of the cost of a fixed asset to its owner which is not recoverable when the asset is finally put out of use by him. Provision against this loss of capital is an integral cost of conducting the business during the effective commercial life of the asset and is not dependent upon the amount of profit earned."

According to Spicer and Pegler, "depreciation may be defined as the measure of the exhaustion of the effective life of an asset from any cause during a given period."

From the above definitions, it can be concluded that depreciation is a gradual decrease in the value of an asset from any cause.

CAUSES OF DEPRECIATION

The causes of depreciation are as follows:

1. Wear and tear: Assets get worn or torn out on account of constant use as is the case with plant and machinery, furniture, and fixtures used in a factory.

2. Exhaustion: An asset may get exhausted through working. This is the case with mineral mines, oil wells, etc. On account of continuous extraction of minerals or oil, a stage comes when the mine or well gets completely exhausted and nothing is left.

3. Obsolescence: Some assets are discarded before they are worn out because of changed conditions. For example, an old machine which is still workable may have to be replaced by a new machine because of the latter being more efficient and economical. Such a loss on account of new inventions or changed fashions is termed as loss on account of obsolescence.

4. Efflux of time: Certain assets get decreased in their value with the passage of time. This is true in the case of assets like leasehold properties, patents or copy rights.

5. Accidents: An asset may meet with an accident and, therefore, it may get depreciation in its value.

On the basis of the above causes, it can be said that depreciation, is the decrease or depletion in the value of an asset due to wear and tear, lapse of time, obsolescence, exhaustion and accidents,

Basic features of depreciation

1. The term depreciation is used only in respect of fixed assets. Of course, the current assets may also lose their value. Loss on account of fall in their value is taken care of by valuing them for Balance Sheet purpose at cost or market price whichever is less.

2. Depreciation is a charge against profits. This means that true profit of the business cannot be ascertained without charging depreciation.

3. Depreciation is different from maintenance. Maintenance expenses are incurred for keeping the machine in a state of efficiency. However, any degree of maintenance cannot assure that the asset will never reach a state of scrap. Of course, good maintenance delays this stage but it cannot absolutely prevent it.

4. All fixed assets, with certain possible exceptions e.g. land, and antiques, etc., suffer depreciation although the process may be invisible or gradual.

DEPRECIATION ACCOUNTING

Depreciation Accounting is mainly concerned with a rational and systematic distribution of cost over the estimated useful life of the asset. According to the American Institute of Certified Public Accountants, Depreciation Accounting is "a system of accounting which aims to distribute the cost or other basic values of tangible capital assets less salvage (if any) over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is the process of allocation and not of valuation."

The objective of Depreciation Accounting is to absorb the cost of using the assets in different accounting periods in a way so as to give the true figures of profit or loss made by the business.

Objectives of providing Depreciation

The following are the objectives of providing depreciation:

1. **Ascertainment of true profits:** When an asset is purchased, it is nothing more than a payment in advance for an expense. For example, if a building is purchased for Rs.10,000 for business purposes, the effect of such a purchase will be saving in the cost of rent in the future. But, after a certain number of years, the building will become useless. The cost of the building is, therefore, nothing except paying rent in advance for a period of years. If the rent had been paid, it would have been charged as an expense for determination of the true profits, made by the business during a particular period. The amount paid for the purchase of building should, therefore, be charged over a period of time for which the asset would be serviceable.
2. **Presentation of true financial position:** The assets get depreciated in their value over a period of time on account of various factors as explained before. In order to present a true state of affairs of the business, the assets should be shown in the Balance Sheet, at their proper values.
3. **Replacement of assets:** Assets used in the business need replacement after the expiry of their service life. By providing depreciation a part of the profits of the business is kept in the business which can be used for purchase of new assets on the old fixed assets becoming useless.

Factors Affecting the Account of Depreciation

Following are the three important factors which should be considered for determining the amount of depreciation to be charged to the Profit and Loss Account in respect of a particular asset.

1. Cost of the asset: The cost of the asset includes the invoice price of the asset less any trade discount plus all costs essential to bring the asset to a usable condition. It should be noted that financial charges, such as interest on money borrowed for the purchase of the asset, should not be included in the cost of the asset.

2. Estimated scrap value: The term scrap value means the residual or the salvage value which is estimated to be realised on account of the sale of the asset at the end of its useful life. In determining the scrap value, the cost to be incurred in the disposal or removing of the asset should be deducted out of the total realisable value.

3. Estimated useful life: This is also termed as economic life of the asset. This may be calculated in terms of years, months, hours, units of output or other operating measures such as kilometers in case of a taxi or a truck.

METHODS OF PROVIDING DEPRECIATION:

The following are the various methods of providing depreciation:

- i) Fixed installment or Straight Line Method
- ii) Diminishing Balance or Written Down Value Method
- iii) Sum of the years [or Digits] Method
- iv) Annuity Method
- v) Sinking Fund or Depreciation Fund Method
- vi) Insurance Policy Method
- vii) Revaluation Method
- viii) Depletion Method
- ix) Machine Hour Rate Method

We will now discuss in detail each of the above Methods.

1. Fixed Installment or Straight Line Method:

In this method, a suitable percentage of original cost is written off the asset every year throughout the effective life of the asset. Thus if an asset costs Rs. 50,000 and 10 percent depreciation is thought proper (over its useful life of 10 years), Rs. 5000 would be written off every year. In this method, the amount of depreciation is arrived at as under:

$$\boxed{\text{Depreciation} = \frac{\text{Cost – Scrap Value}}{\text{Estimated Life in Years}}}$$

Merits:

i) This method is very simple to understand and easy to apply.

ii) The value of the asset can be reduced to zero or to its scrap value under this method.

iii) This method is very suitable particularly in case of those assets which get depreciated more on account of expiry of period e.g., Lease-hold properties, patent Rights, etc.

Demerits:

i) This method does not take into account the effective utilization of the asset. The amount of depreciation charged in this method is same every year irrespective of the use of the asset.

ii) This method tends to report an increasing rate of return on investment in the asset on account of the fact that net balance of the asset account is taken. This is not justifiable.

Illustration 1

ABC Ltd. purchases a machinery for a sum of Rs.48,000 on 1st January 1990. Installation charges are Rs.3,000. The machinery is estimated to have a scrap value of Rs. 1,000 at the end of its useful life of five years. You are required to prepare the Machinery account for five years charging depreciation according to Straight Line Method.

Solution

Annual Depreciation to be charged = $\frac{C - S}{N} = \frac{51,000 - 1,000}{5}$

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

Date	Particulars	Rs.	Date	Particulars	Rs.
1990 Jan 1	To Bank To Bank (installation charges)	48,000 3,000	1990 Dec. 31	By Depreciation " Balance c/d	10,000 41,000
		51,000			**51,000**
1991 Jan 1	To Balance b/d	41,000	1991 Dec. 31	By Depreciation " Balance c/d	10,000 31,000
		41,000			**41,000**
1992 Jan. 1	To Balance b/d	31,000	1991 Dec. 31	By Depreciation " Balance c/d	10,000 21,000
		31,000			31,000
1993 Jan. 1	To Balance b/d	21,000	1993 Dec. 31	By Depreciation " Balance c/d	10,000 11,000
		21,000			21,000
1994 Jan. 1	To Balance b/d	11,000	1994 Dec. 31	By Depreciation " Balance c/d (Scrap value)	10,000 1,000
		11,000			11,000

2. Diminishing Balance or Written Down Value Method

In this method, the rate or percentage of depreciation is fixed and depreciation is charged on the book value of the asset standing at the beginning of each year. Thus, the amount of depreciation goes on decreasing every year. For example, if the cost of an asset is Rs. 10,000 and the rate of depreciation is 10%, then the amount of depreciation to be charged in the first year will be Rs.1000 [10% on Rs.10,000]. In the second year, depreciation will be charged at 10% on the book value of the asset i.e., on Rs.9000 [i.e., 10000-1000] and so on.

Merits:

(i) This method is simple to understand and easy to follow.

(ii) This method puts an equal burden for the use of the asset on each subsequent year. The amount of depreciation goes on decreasing for each subsequent year while the charge for repairs goes on increasing for each subsequent year. Thus, the increase in the cost of repairs for each subsequent year is compensated by decrease in the amount of depreciation for each subsequent year.

Demerits:

(i) The value of the asset cannot be brought down to zero under this method.

(ii) The determination of a suitable rate of depreciation is also difficult under this method as compared to the Fixed Installment Method.

Illustration 2

Cosmos Enterprises Ltd. acquired a machine on 1st January 1992 at a cost of Rs. 18,000 and spent Rs.2,000 on its installation. The firm writes off depreciation at 10% of the original cost every year. Show the Machinery Account for three years.

Solution

Dr. Machinery Account Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
1992 Jan 1	To Bank To Bank (installation charges)	18,000 2,000	1992 Dec. 31	By Depreciation (10% on Rs.20,000) " Balance c/d	2,000 18,000
		20,000			**20,000**
1993 Jan 1	To Balance b/d	18,000	1993 Dec. 31	By Depreciation (10% on Rs.18,000) " Balance c/d	1,800 16,200
		18,000			**18,000**
1994 Jan.1	To Balance b/d	16,200	1991 Dec. 31	By Depreciation (10% on Rs.16,200) " Balance c/d	1,620 14,580
		16,200			**16,200**
1995	To Balance b/d	14,580			

3. Sum of the Years (or Digits) Method:

This method is on the pattern of Diminishing Balance method. Under this method, the amount of depreciation to be charged to Profit and Loss Account goes on decreasing every year. The depreciation is calculated according to the following formula:

$$\frac{\text{Remaining Life of the Asset (including the current year) x Original cost}}{\text{Sum of all the digits of the life of the asset in years}}$$

For example, if the cost of an asset is Rs.10000 and it has an effective life of 5 years, the amount of depreciation to be written off each year will be computed as follows:

1st Year - 5 /(1 +2+3+4+5)x 1000

= 5/15 x 10000 = Rs. 3333

2nd Year = 4/15 x 10000 = Rs. 2666

3rd Year = 3/15 x 10000 = Rs. 2000

4th Year = 2/15 x 10000 = Rs. 1333

5th Year = 1/15 x 10000 = Rs. 667

4. Annuity Method:

The three methods discussed above ignore interest factor. The Annuity Method takes care of this factor. Under this method, the depreciation is charged on the basis that besides losing the original cost of the asset, the business also loses interest on the amount used for buying the asset. The 'interest' here means the interest which the business could have earned otherwise if the money used in purchasing the asset would have been invested in some other form of investment. Thus, according to this method, such an amount is charged by way of depreciation which takes into account not only the cost of the asset but also interest thereon at an accepted rate. The amount of interest is calculated on the book value of the asset in the beginning of the year. The amount of depreciation is uniform and is determined on the basis of the Annuity Table. An extract of the Annuity Table is shown in the Appendix. The following journal entries are passed in case depreciation is charged according to this method.

i)	On purchase of an asset :	Asset A/C To Bank	Dr.
ii)	For Charging interest	Asset A/C To Interest A/C	Dr.
iii)	For charging Depreciation:	Depreciation A/C To Asset A/C	Dr.

Illustration 3

A lease is purchased on 1st January 1990 for four years at a cost of Rs. 20,000. It is proposed to depreciate the lease by the annuity method charging 5% interest. Show the Lease Account for four years and also the relevant entries in the P & L A/C.

Solution:

Annuity Table shows that to depreciate Re.1 by annuity method over 4 years, charging 5% interest, one must write off a sum of Re.0.282012. To write off Rs.20,000 one requires to write off every year Rs.5.640.24 [i.e.. 0.282012 x 20,000].

Dr. **Lease Account** **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
1990 Jan. 1 Dec.31	To Bank "Interest (5% on 20,000)	20,000 1,000	1990 Dec.31	By Depreciation "Balance c/d	5,640.24 15,359.76
		21,000			**21,000**
1991 Jan. 1 Dec.31	To Balance b/d "Interest (5% on 15359.76)	15,359.76 767.99	1991 Dec.31	By Depreciation "Balance c/d	5,640.24 10,487.51
		16,127.75			**16,127.75**
1992 Jan. 1 Dec. 31	To Balance b/d "Interest (5% on 10487.51)	10,487.51 524.38	1992 Dec.31	By Depreciation "Balance c/d	5,640.24 5,371.65
		11,011.89			**11,011.89**
1993 Jan. 1 Dec. 31	To Balance b/d "Interest (5% on 5371.65)	5,371.65 268.59	1993 Dec.31	By Depreciation	5,640.24
		5,640.24			**5,640.24**

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

Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
1990 Dec.31	To Depreciation a/c	5640.24	1990 Dec.31	By Interest a/c	1,000.00
1991 Dec.31	To Depreciation a/c	5640.24	1991 Dec.31	By Interest a/c	769.99
1992 Dec.31	To Depreciation a/c	5640.24	1992 Dec.31	By Interest a/c	524.00
1993 Dec.31	To Depreciation a/c	5640.24	1993 Dec.31	By Interest a/c	268.59

LESSON 4.2 METHODS OF PROVIDING DEPRECIATION

Sinking Fund or Depreciation Fund Method:

One of the objectives of providing for depreciation is to provide for replacement of the asset at the end of its useful life. In case of the four methods discussed earlier, the amount of depreciation charged from the Profit and loss Account continues to remain in the business. However, this amount may get invested in all sorts of assets in course of running the business thus making it difficult to buy a new asset in place of the old one. Depreciation Fund method takes care of such a contingency. According to this method, the amount charged by way of depreciation is invested in readily saleable securities carrying a certain rate of interest. The amount received on account of interest from these securities is also invested from time to time together with the annual amount charged, by way of depreciation. At the end of the useful life of the asset, when replacement is required, the securities are sold away and the money realized on account of the sale of the securities is used for purchase of a new asset. How much amount is to be invested every year so that a given sum is available at the end of a given period depends on the rate of interest. The Sinking Fund table shows how much is to be invested every year together with the interest earned so that at the end of the period one gets Re. 1.

Merits

(i) Periodic depreciation together with realized interest is invested outside the business in liquid securities which readily provides ready money for replacing the old asset.

(ii) Overall as also periodic depreciation is smaller than the asset's actual depreciable cost due to deduction of interest.

Demerits

(i) Sinking fund method assumes a constant rate of return on every periodic investment in identical securities. This is hardly true in this dynamic world where rates do vary now and then. This upsets the earlier periodic allocation for depreciation.

(ii) This method puts an increasing burden on the profit and loss of each year on Account of a fixed charge for depreciation but increasing charging for repairs. The journal entries are as follows:

A] At the end of First Year:

i) On setting aside the amount of depreciation:
Depreciation A/c (or P&L a/c) Dr. (With the periodic depreciation)
To Depreciation Fund A/c (Calculated from the SF Table)

ii) For investing the money charged by way of Depreciation:
Depreciation Fund Investment A/c Dr.
To Bank A/c

B] At the end of each subsequent accounting year:

iii) For receipt of interest:
Bank A/c Dr. (With the interest received)
To Depreciation Fund A/c (transferred to the credit of Depreciation Fund A/c)

iv) For setting aside the amount of depreciation:
Depreciation (or P&L A/c) A/c Dr. With the annual installment of depreciation
To Depreciation Fund A/c

v) For investing the money:
Depreciation Fund Investment A/c Dr. With the annual installment plus interest earned
A/c To Bank A/c

C] At the end of the last year:

vi) For receipt of interest:
Bank A/c Dr. With the amount of interest received
To Depreciation Fund A/c transferred to D.F. A/c

vii) For setting aside the amount of depreciation:
Depreciation A/c (or P&L A/c) Dr. With the annual installment of Depreciation
To Depreciation Fund A/c

No investment will be made in the last year, since the asset is due for replacement.

viii) For sale of investment:
Bank A/c Dr. With the net sale proceeds of Dep. Fund Investments
To Depreciation Fund Investment A/c

ix) The profit or Loss on sale of Depreciation Fund Investments will be transferred to the depreciation Fund Account:

a) In case of Profit:
Depreciation Fund Investments A/c Dr. with the amount of profit on sale of investments
To Depreciation Fund A/c

b) In case of Loss:
Depreciation Fund A/c Dr. with amount of loss on sale of investments
To Depreciation Fund Investment A/c

x) For sale of old Asset:
Bank A/c Dr. with the sale proceeds of old asset
To old Asset A/c

xi) The balance in the Depreciation Fund Account represents accumulated depreciation and it will be transferred to old asset account. The entry will be:

Depreciation Fund A/c	Dr.	with the amount of accumulated
To old Asset A/c		depreciation

xii) The balance in old Asset Account represents profit or loss which will be transferred to P&L A/C.

xiii) When new asset is bought:

New Asset A/c	Dr.	with the sale proceeds of investments
To Bank A/c		and old asset

Illustration 4

A firm purchased a machinery or 1st January 1990 for Rs.20,000 whose estimated life is four years. It is decided to provide for the replacement of the asset at the end of four years by setting up a Depreciation Fund. It is expected that investments will yield interest at 4% p.a. Sinking Fund Table shows that to provide the requisite sum at 4% at the end of four years, an investment of Rs.4 709.80 [i.e., 0.235490 X 20,000] is required. Investments are made to the nearest rupee.

On 31st December 1993, the investments were sold for Rs.15,000. On 1st January 1994, new machinery was purchased for Rs.24000.

Pass journal entries and prepare the necessary ledger accounts.

Journal

1990 Jan 1	Machinery A/c Dr. To Bank A/c (Purchase of Machinery for 4 years)	20,000	20,000
Dec. 31	Depreciation A/c Dr. To Depreciation Fund A/c (Annual Depreciation to be provided)	4,709.80	4,709.80
	Depreciation Fund Investments A/c Dr. To Bank A/c (Annual installment invested)	4,710.00	4,710.00
1991 Dec. 31	Bank A/c Dr. To Depreciation Fund A/c (Interest on investments transferred to fund)	188.40	188.40
	Depreciation A/c Dr. To Depreciation Fund A/c (Annual Depreciation set aside)	4,709.80	4,709.80
	Depreciation Fund Investment A/c Dr. To Bank A/c (Annual installment with interest invested)	4,989.00	4,898.00
1992 Dec. 31	Bank A/c Dr. To Depreciation Fund A/c (Interest on Investments transferred to Fund)	384.32	384.32
	Depreciation A/c Dr.	4,709.80	

	To Depreciation Fund A/c (Annual depreciation set aside)		4,709.80
	Depreciation Fund Investment A/c Dr. To Bank A/c (Annual installment with interest invested)	5,094.00	5,094.00
1993 Dec. 31	Bank A/c Dr. To Depreciation Fund A/c (Interest on investments transferred to Fund)	588.08	588.08
	Depreciation A/c Dr. To Depreciation Fund A/c (Annual Depreciation set aside) Bank A/c Dr. To Depreciation Fund Investment A/c (Sale of DF investment for Rs.15,000)	4,709.80 15,000.00	4,709.80 15,000.00
	Depreciation Fund Investment A/c Dr. To Depreciation Fund A/c (Profit on DF Investments transferred)	298.00	298.00
	Depreciation Fund A/c Dr. To Machinery A/c (Transfer of Machinery A/c to DF A/c upon its expiry)	20,000	20,000
	Depreciation Fund A/c Dr. To P & L A/c (Balance left in the DF A/c transferred to P&L A/c)	298.00	298.00
1994 Jan. 1	New Machinery A/c Dr. To Bank (New machinery purchased)	24,000.00	24,000.00

Dr. **Depreciation Fund Account** Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
1990 Dec. 31	To Balance c/d	4,709.00	1990 Dec.31	By Depreciation A/c	4,709.00
		4,709.00			**4,709.00**
1991 Dec.31	To Balance c/d	9,608.00	1991 Jan.1 Dec.31	By Balance b/d " Interest on DF Investments A/c " Depreciation A/c	4,709.80 188.40 4,709.80
		9,608.00			**9,608.00**
1992 Dec.31	To Balance c/d	14,702.12	1992 Jan.1	By Balance b/d " Interest on DF Investments A/c " Depreciation A/c	9,608.00 384.32 4,709.12
		14,702.12			**14,702.12**
1993 Dec.31 Dec.31	To Machinery A/c (transfer) To P & L A/c (Balance transferred)	20,000.00 298.00	1993 Jan.1	By Balance b/d " Interest on DF Investments A/c " Depreciation A/c " DF Investments A/c (profit)	14,702.12 588.08 4.709.80 298.00
		20,298.00			**20,298.00**

Dr.		Machinery Account			Cr.
Date	Particulars	Rs.	Date	Particulars	Rs.
1990 Jan.1	To Bank A/c	20,000	1991Dec.31	By Balance c/d	20,000
1991 Jan.1	To Balance b/d	20,000	1991 Dec.31	By Balance c/d	20,000
1992 Jan.1	To Balance b/d	20,000	1992 Dec.31	By Balance c/d	20,000
1993 Jan.1	To Balance b/d	20,000	1993 Dec.31	By Depreciation Fund A/c transfer	20,000

Dr.		Depreciation Fund Investment Account			Cr.
Date	Particulars	Rs.	Date	Particulars	Rs.
1990 Dec.31	To Bank a/c	4,710.00	1990 Dec.31	By Balance c/d	4,710.00
		4,710.00			**4,710.00**
1991 Jan.1	To Balance b/d To Bank A/c (Rs 4710+188.40)	4,710.00 4,898.00	1991 Dec.31	By Balance c/d	9,6,08.00
		9,608.00			**9,608.00**
1992 Jan. 1	By Balance b/d To Bank A/ c	9,608.00 5,094.00	1992 Dec. 31	By Balance c/d	14,702.00
		14,702.00			**14,702.00**
1993 Jan 1 Dec.31	To Balance b/d To Dep. fund A/c (profit transferred)	 14,702.00 298.00	1993 Dec. 31	By Bank	15,000.00
		15,000.00			**15,000.00**

Dr.		Interest on Depreciation Fund Investment A/c			Cr.
Date	Particulars	Rs.	Date	Particulars	Rs.
1991 Dec.31	To Depreciation Fund A/c transfer	188.40	1991 Dec.31	By Bank A/c	188.40
1992 Dec.31	To Depreciation Fund A/c transfer	384.32	1992 Dec.31	By Bank A/c	384.40
1993 Dec.31	To Depreciation Fund A/c transfer	588.08	1993 Dec.31	By Bank A/c	588.08

Dr.		New Machinery Account			Cr.
Date	Particulars	Rs.	Date	Particulars	Rs.
1994 Jan.1	To Bank	24.000			

5. Insurance Policy Method

This method is similar to the Depreciation Fund method. Instead of making investment, arrangements are made with the insurance company which will receive premium annually and pay at the end of the fixed period, the required amount with which the old asset can be replaced premium have to be paid at the beginning of each year. The annual premium is treated as the annual depreciation.

The following entries are passed:

A. First and subsequent years:

On payment of insurance premium at the beginning of each year

(i) Depreciation Insurance Policy A/C Dr.
  To Bank

At the end of the year for providing depreciation:

(ii) Profit and Loss A/C Dr.
  To Depreciation Fund A/C

B. **At the end of the last year:**

On realization of money from the Insurance Co.,

(iii) Bank A/C Dr.
  To Depreciation Insurance Policy A/C

(iv) For transfer of profit on insurance policy

Depreciation Insurance Policy A/C Dr.
  To Depreciation Fund A/C

(v) For transfer of accumulated depreciation to the Asset A/C

Depreciation Fund A/C Dr.
  To Asset A/C

Illustration 5

Alfa Co. Ltd., purchased a machine on 1st January 1992 for Rs.11.000. It decided to provide for its replacement by Insurance policy method. The company took an insurance policy for 3 years for Rs.10,000 in consideration of the yearly premium of Rs.3150.

Show the Insurance Policy A/c, Depreciation Fund A/C and the Machinery A/c assuming that the retired machine realizes Rs.900 as scrap.

Solution

Dr. **Insurance Policy Account** Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
1992 Jan. 1	To Bank (Premium)	3,150	1992 Dec. 31	By Balance c/d	3,150
		3,150			**3,150**
1993 Jan 1	To Balance b/d To Bank (Premium)	3,150 3,150	1993 Dec. 31	By Balance c/d	6,300
		6,300			**6,300**
1994 Jan 1	To Balance b/d To Bank (Premium) To Depreciation A/c (Profit Transferred)	6,300 3,150 550	1994 Dec. 31	By Bank	10,000
		10,000			**10,000**

Dr. Depreciation Fund Account Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
1992 Dec. 31	To Balance c/d	3,150	1992 Dec. 31	By P & L A/c	3,150
		3,150			**3,150**
1993 Jan 1	To Balance c/d To Bank (Premium)	6,300 3,150	1993 Jan 1	By Balance b/d By P & L A/c	3,150 3,150
		6,300			**6,300**
1994 Dec. 31	To Machinery A/c Transfer	10,000	1994 Dec. 31	By Balance b/d By P & L A/c By Insurance Policy A/c	6,300 3,150 550
		10,000			**10,000**

Dr. Machinery Account Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
1992 Jan. 1	To Bank	11,000	1992 Dec. 31	By Balance c/d	11,000
1993 Jan 1	To Balance b/d	11,000	1993 Dec. 31	By Balance c/d	11,000
1994 Dec. 31	To Balance b/d	11,000	1994 Dec. 31	By Depreciation Fund A/c By Bank By P & L A/c Loss (transferred)	10,000 900 100
		11,000			**11,000**

7. Revaluation Method:

This method is used in case of loose tools, livestock, etc. At the end of every year, the loose tools in hand are valued properly and enough depreciation is written off to bring the value of the assets to its proper figure. Suppose, a firm had in the beginning of the year loose tools worth Rs. 5000. During the year it purchased new tools costing Rs.2000 thus making a total of Rs. 7000. At the end of the year the loose tools are found to be worth Rs. 5500. Then the depreciation to be written off is Rs. 1500 (ie Rs. 7000 - 5500).

8. Depletion Method: This method is most suitable for mines quarries, etc. from which a certain quantity of output is expected to be extracted. The value of mines depends only on the quantity of minerals that can be extracted. When the whole quantity is taken out, the mine loses its value. Hence one can say that the mine depreciates according to the quantity mined. The rate of depreciation is worked out as so much per tonne. It is obtained by simply dividing the cost of the mine by the total quantity of mineral expected to be extracted. Thus, if a mine is acquired at a cost of Rs. 10,00,000 and if it is expected that a total of 8,00,000 tonnes of minerals will be extracted, then the depreciation rate will be Rs. 1.25 per ton, (i.e), Rs. 10,00,000 / 8,00,000. The total depreciation to be written off will depend upon the quantity mined. If, in the above example, in the first year 30,000 tonnes are taken out, the depreciation will be 30,000 x Rs.1.25 or Rs 37,500. If, in the next year, the output is 40,000 tonnes, the depreciation will be 40,000 x Rs.1.25 or Rs. 50,000 and so on.

9. Machine Hour Rate Method:

This method is useful in case of machines. The life of the machine is fixed in terms of hours. Hourly rate of depreciation is worked out by the total number of hours for which the machine is expected to be used. Suppose, a machine costing Rs. 62,000 and having an estimated scrap value of Rs. 2,000 is expected to be used for 30,000 hours in all. The hourly rate of depreciation is then Rs. 60,000 / 30,000 or Rs 2.00. Depreciation to be written off in a year will be ascertained by multiplying the hourly rate of depreciation by the number of hours that the machine actually works in the year. To continue the example, suppose the machine works for 1,000 hours in the first year and 1,500 hours in the next. The depreciation for the first year will be Rs. 2,000 (ie Rs.2.00 X 1,000) and Rs. 3,000 in the next. The students can observe that this method is similar to the first method - fixed installment method.

Depreciation on an asset purchased in the course of a year:

There are two alternatives available regarding charging of depreciation on an asset which has been purchased during the course of an accounting year.

(a) Depreciation may be charged for the full year irrespective of the date of purchase at the given rate. This is also accepted by the Income Tax authorities.

(b) Depreciation may be charged only for the part of the year for which the asset could have been made available for use on account of it’s being purchased, during the course of the year. For example, if the asset has been purchased on 1st July, 1980 and the accounting year ends on 31st December, depreciation may be charged only for a period of six months.

Note: The students are advised to give the assumption made by them in the absence of any instructions in the question. However, if the rate of depreciation has been given as a certain percentage per annum and the date of the purchase of the asset has been given, it would be advisable to charge depreciation only for the part of the accounting year for which the asset has been made available for use.

Sale of an asset during the year: In case an asset is sold during the course of the year, the amount realized should be credited to the Asset Account. Depreciation for the period for which the asset has been used (i.e., up to the date of sale) should be written off in the usual manner. Any balance in the Asset Account representing profit or loss on sale of the asset should be transferred to the Profit and Loss Account.

Change in the Method of Depreciation: Sometimes a change in the method of depreciation may be required. For example, a firm may change the method of depreciation from Fixed installment Method to Reducing Balance Method or vice versa. In such a case, there can be two different situations:

(1) Change in the method of depreciation may be desired from the current year onwards. In such a case, depreciation will be charged according to the new method from the current year.

(2) Change in the method of depreciation may be desired from a back date (with retrospective effect). In such a case, adjustments will have to be made in the current year for any additional or shortage of depreciation charged in earlier years. In such a case, the best course would be to compute the amount of depreciation which has already been charged according to the old method and the amount of depreciation that is to be charged according to the new method separately. The difference, if any, should be credited (or debited) to the Asset Account in the current year and should be shown as a separate charge (or income) in the Profit and Loss Account of the current year of the firm.

DEPRECIATION OF DIFFERENT ASSETS

The following observations can be made regarding charging of depreciation on different assets:

1. Goodwill: Depreciation does not arise in the value of the goodwill of the business unless the profits of the firm are declining. Since, goodwill is an intangible asset; it will be advisable to **write off** the value of the goodwill over a reasonable period. The amount written off should be shown separately in the Profit and Loss Account.

2. Free-hold land: No depreciation need be charged in case of such properties.

3. Free-hold buildings, plants, ship, etc: Fixed Installment Method or Diminishing Balance Method may be used for charging depreciation on these assets. The endeavour should be to write off the asset during its effective life. In case of **Plant and Machinery, the Machine Hour Rate method** can also be profitably used.

4. Lease-hold land and buildings: The Fixed Installment Method should generally be used for writing off depreciation in respect of such assets.

However, **Depreciation Fund Method or Insurance Policy Method can also be used** profitably for assets coming in the 3rd and 4th category discussed above.

5. Loose tools, jigs, livestock, etc: Revaluation Method is the most appropriate method for charging depreciation on these assets.

6. Patents, trademarks, etc: These assets have a maximum legal life. However, their commercial life may be much shorter. Such assets should, therefore, be depreciated according to the **Fixed Installment Method** in a way so that they are written off within their legal or commercial life, whichever is shorter.

7. Mines, oil wells, quarries, etc: Depreciation should be charged according to the **Depletion Method** in case of these assets.

It should be noted that the method of charging depreciation in respect of assets should be consistent year after year. In case, the method of depreciation is changed, such fact together with the effect on profit, on account of the change in the method of depreciation has to be disclosed by way of a note in the final accounts of the business. Similarly, if it has not been possible to charge depreciation on assets on account of inadequacy of profits in any year, such fact should also be disclosed in the Final Accounts of the business for that particular year.

DEPRECIATION POLICY: The management has to adopt a suitable depreciation policy keeping in view the following objectives: (i) Recovery of the original investment i.e. the acquisition cost of the asset before the expiry of the economic life of the asset. (ii) Ensuring a uniform rate of return on investments. (iii) Generating sufficient funds for the replacement of the assets after the expiry of its economic life. (iv) Deriving maximum tax benefit. (v) Ascertainment of correct profit or loss. The above objectives can be considerably achieved if the management takes care of the following aspects in framing its depreciation policy.

(i) Selection of an appropriate method: The management should select an appropriate method keeping in view the nature of the asset and the prime objective of the management.

(ii) Periodic review of provision: The choice of the method determines the amount of the depreciation and the mode of its recording. However, the management must review periodically whether the provision for depreciation which is being made is proper or not. Any under or over provision in the context of changed circumstances should properly be adjusted in the books of accounts.

(iii) Evaluation and disclosure of depreciation policy: The depreciation policy being followed by the business should be evaluated in the context of tax incidence, price level changes, Government regulation, etc. The effect of any change in the depreciation policy in an accounting period should be quantified and disclosed in the financial statements of the business.

I A S 4 (INTERNATIONAL ACCOUNTING STANDARD)

Depreciation Accounting

The standard was issued in October,1976. The main recommendations are as summarized below:

(1) The depreciable amount of a depreciable asset should be allocated on a systematic basis to each accounting period during the useful life of the asset;

(2) The depreciation method selected should be applied consistently from period to period unless altered circumstances justify a change. In an accounting period in which the method is changed, the effect should be quantified and disclosed and the reason for the change should be stated.

(3) The useful life of a depreciable asset should be estimated after considering the following factors:

(a) expected physical wear and tear taking into consideration the number of shifts for which the asset is to be used and repairs and maintenance;

(b) Obsolescence;

(c) Legal or other limits on the use of the asset, expiry dates of related leases.

(4) The useful life of major depreciable assets or classes of depreciable assets should be reviewed periodically and depreciation rates adjusted for the current and future periods if expectations are significantly different from the previous estimates. The effect of change should be disclosed in the accounting period in which the change takes place.

(5) The valuation bases used for determining the amount at which depreciable assets are stated should be included with the disclosure of other accounting policies as described in IAS I (Disclosure of Accounting policies).

(6) The following should be disclosed for each major class of depreciable assets:

(a) The depreciation methods used.

(b) The useful life or the depreciation rates used.

(c) Total depreciation allocated for the period.

(d)The gross amount of depreciable assets and the related accumulated depreciation.

These provisions will be applicable to financial statements covering periods beginning on or after 1st January, 1977.

Depreciation is to be charged in each accounting period even though the value of an asset has increased and irrespective of the level of profitability of the enterprise and of taxation considerations. Land should not usually be regarded as depreciable asset, except when it has a limited useful life. Land and buildings are to be considered separately, not in aggregate.

PROVISIONS AND RESERVES

The terms provisions and reserves have been used quite loosely in the past on account of lack of authentic definitions of these two terms. However, the meanings of these two terms have been considerably clarified by the Companies Act, 1956.

Provision

The term Provision has been defined in Part (iii) of Schedule VI to the Companies Act, 1956 as follows:

Provision usually means any amount written off or retained by way or providing depreciation, renewals or diminution in the value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy.

The provisions are usually created by debiting the Profit & Loss Account. They are either deducted on the asset side of the Balance Sheet (as in the case of Depreciation and Bad & Doubtful Debts) or shown on the liability side under appropriate sub-heading.

Reserve

The term reserve has not been defined in Part (iii) of Schedule VI to the companies Act except negatively in the sense that profits retained in the business not having any of the attributes of the provision should be treated as reserve. Moreover, the provision in excess of the amount considered necessary for the purpose it was originally made, is also considered as a reserve.

It is evident from the above that a provision is a charge against profits while reserve is an appropriation of profits. Thus, creation of reserves increases proprietor's funds while creation of provisions decreases his funds in the business.

Reserve Fund

The term reserve fund means such reserve against which, clearly earmarked investment, etc., outside the business, exist. Thus, if the amount of reserve is being utilized by the business itself, it cannot be called reserve fund.

Kinds of reserves: Reserves can be classified into the following categories:

(i)**Revenue reserves:** These are reserves created out of revenue profits of the business. They can be categorized as follows:

(a) Specific reserves: These reserves are created out of revenue profits for a specific purpose. Examples of such reserves are: Dividend Equalization Reserve i.e., a reserve created for maintaining equilibrium in dividend, debentures Redemption Reserve i.e. a reserve created for redemption of debentures etc.

(b) General reserves: These are reserves created only to strengthen the financial position of the business and to keep the funds available for any future contingency or expenditure that may be required. Such reserves are also termed as free reserves, since they represent profits which are freely available for distribution. The contingency reserve or undistributed balance of the P & L A/c (after taking debit balance if any) also comes within this category.

(ii) Capital reserves: These reserves are created out of the capital profits. The following are some of the examples of capital profits, out of which such reserves are created:

(a) Profit on sale of fixed assets. It should be noted that capital profit is only excess of sale price over the cost of fixed asset and not the entire surplus over the book value of the asset.

(b) Profits prior to incorporation.

(c) Premium on issue of shares or debentures.

(d) Profits on redemption of debentures, profit on forfeiture of shares.

(e) Surplus on revaluation of fixed assets or fixed liabilities.

(f) Amount transferred out of profits to Capital Redemption Reserve on redemption of redeemable preference shares.

Capital profits are generally not available for distribution by way of dividend among the shareholders of a company. However, some of the capital profits are available for dividend if certain conditions are satisfied.

(i) The articles of the company do not prohibit such distribution.

(ii) The profits have been actually realized in cash.

(iii) The profits remain after revaluation of all the assets and liabilities of the company.

Capital profits which arise because of revaluation of fixed assets cannot be distributed as dividend among the shareholders

(iii) Secret reserves: The reserves explained in the preceding pages are shown on the face of the Balance Sheet. Secret reserves are reserves, the existence of which does not appear on the face of the Balance Sheet. In such a situation, net assets position of the business is stronger than that disclosed by the Balance Sheet.

Secret reserves are created by:

(a) excessive depreciation of an asset, or excessive over-valuation of a liability;

(b) complete elimination of an asset, or under valuation of an asset;

(c) charging' capital expenditure to revenue, or crediting revenue receipts to an asset (e.g., dividends received and earned credited to investment account);

(d) permanent appreciation in a fixed asset or permanent diminution or extinction of liability not recorded in the books of account;

(e) showing a contingent liability as an actual liability or as a provision therefor;

(f) grouping of "free" reserves with creditors; and

(g) deliberately withholding sales till the succeeding period; or taking delivery of goods on forward contract in a falling market.

Undisclosed Reserves

Sometimes a reserve is created but its identity is merged with some other account or group of accounts so that the existence of the reserve is not known. Such a reserve is called an undisclosed reserve. This often happens in the Balance Sheet of banks where provisions for taxation (incl. excess provision which amounts to reserve) is shown under the heading of "Current and Contingency accounts" which includes not only a provision for taxation but also the balances in the current account of the customers. Thus, the exact amount of provision for taxation made by the banks cannot be ascertained from the published accounts of the bank.

Prior to coming into force of the Companies Act, 1956, there were no restrictions on the creation of secret reserves except that whenever secret reserves were brought back into accounts, it was necessary to disclose the amount adjusted out of such reserves. At present such reserves cannot be created by a company because the auditor has to give the report that the Balance Sheet of the company reveals a true and fair view of the state of affairs of the company.

In case secret reserves have been created, the auditor cannot give such a report without disclosing the extent of such reserves.

Problem 1. A company whose accounting year is the calendar year, purchased on 1st April, 1982 Machinery costing Rs.30,000.

It purchased further Machinery on 1st October, 1982 costing Rs.20,000 and on 1st July, 1983 costing Rs.10,000.

On 1st January, 1984, one-third of the Machinery installed on 1st April,1982 became obsolete and was sold for Rs.3,000.

Show how Machinery Account would appear in the books of the company, it being given that Machinery was depreciated by Fixed Installment Method at 10 % per annum.

Solution

Dr **MACHINERY ACCOUNT** Cr.

Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
1982 Apr. l Oct. 1	 To Bank A/c To Bank A/c	 30,000 20,000	1982 Dec.31	By Depreciation A/c (on Rs.30,000 for nine months and on Rs.20,000 for 3 months)	2,750
		50,000			**50,000**
1983 Jan.1 Jul. 1	 To Balance b/d To Bank A/c	 47,250 10,000	1983 Dec.31	By Depreciation A/c (on Rs.50,000 for one year and on Rs. for 10,000 for 6 months) By Balance c/d	5,500 51,750
		57,250			**57,250**
1984 Jan. 1	To Balance b/d	51,750	1984 Jan 1 Dec. 31 Dec. 31	By Bank A/c By P&L a/c (Loss on sale) By Dep. (on Rs.50,000 for one year) By Balance c/d	3,000 5,250 5,000 38,500
		51,750			**51,750**

Working Notes:

Calculation of Loss on Sale of 1/3 of the Machinery

	Rs.
Cost of Machinery on 1st April, 1982 Less Depreciation for 1982 (for 9 months)	10,000 750
 Less: Depreciation for 1983	9,250 1,000
Written down Value of Machinery on 1.1.1984	8,250
Less: Sale price on 1.1.1984	3,000
Loss on sale transferred to P&L A/c	5,250

Problem 2. On 1st January, 1982, a limited company purchased machinery for Rs.12,000 and on 30th June, 1983 it acquired additional machinery at a cost of Rs.2,000. On 31st March, 1984 one of the original machines which had cost of Rs.500 was found to have become obsolete and was sold as scrap for Rs.50. It was replaced on that date by a new machine costing Rs.800.

Depreciation to be provided at the rate of 15 per cent per annum on the written down value. Show ledger accounts for the first three years.

Solution

MACHINERY ACCOUNT

Date	Particulars	Rs.	Date	Particulars	Rs.
1982	To Cash	12,000	Dec.3I	By Dep. (15% on Rs.12,000) " Balance c/d	1,800 10,200
		12,000			**12,000**
1983 Jan.1 Jun.30	 To Balance b/d " Cash	 10,200 2,000	1983 Dec.31	By Dep. (15% on Rs.10,200 for 1 year and on Rs.2,000 for 1/2 year) " Balance c/d	1,680 10,520
		12,200			**12,200**
1984 Jan.1 Mar.31	To Balance b/d " Cash	10,520 800	1984 Mar.31	By Cash " P & L A/c (Loss on sale)* " Dep. (15% on Rs.10,159 for 1 year and on Rs.800 for a 3/4 year) " Balance c/d	50 297 1,628 9,345
		11,320			11,320

* The loss on the sale of the machine on 31st March, 1984 is calculated as follows:

	Rs.

Cost of Machinery on 1.1.1982 Less: Depreciation for 1982	500 75
Written down value on 1.1.83 Less: Depreciation for 1983	425 64
Written down value on 1.1.84 Less: Depreciation for 3 months	361 14
Book value on the date of sale Less: Proceeds of Sale	347 50
Loss on Sale of Machinery	297

Problem 3. A company has acquired a lease of a cinema theatre for a term of 5 years by payment of Rs.4,00,000. It is proposed to depreciate the lease by the Annuity Method, charging 5 percent per annum. Show the Ledger Account of asset during the period of the lease. Reference to the Annuity Table shows that the amount for Re.1 for 5 years at 5 percent is Re.0.230975. Calculations are to be made to the nearest rupee.

Solution

Annual depreciation is calculated as follows:

0.230975 x 4,00,000 = Rs. 92,390

LEASE ACCOUNT

Date	Particulars	Rs.	Date	Particulars	Rs.
Year 1 Jan 1 Dec. 31	 To Bank A/c To Interest A/c	 4,00,000 20,000	Year 1 Dec. 31 Dec. 31	 By Depreciation A/c Balance c/d	 92,390 3,27,610
		4,20,000			**4,20,000**
Year II Jan 1 Dec. 31	 To Balance b/d To Interest A/c	 3,27,610 16,386	Year II Dec. 31 Dec. 31	 By Depreciation A/c By Balance c/d	 92,390 2,51,606
		3,43,996			**3,43,996**
Year III Jan 1 Dec. 31	 To Balance b/d To Interest A/c	 2,51,606 12,580	Year III Dec. 31 Dec. 31	 By Depreciation A/c By Balance c/d	 92,390 1,71,196
		2,64,186			**2,64,186**
Year IV Jan 1 Dec. 31	 To Balance b/d To Interest A/c	 1,71,796 8,590	Year IV Dec. 31 Dec. 31	 By Depreciation A/c By Balance c/d	 92,390 87,996
		1,80,386			**1,80,386**
Year V Jan 1 Dec. 31	 To Balance b/d To Interest (Balancing figure)	 87,996 4,394	Year V Dec. 31	 By Depreciation	 92,390
		92,390			**92,390**

Problem 4. C Company Ltd. purchased a four year's lease on January 1, 1981, for Rs.50,000. It is decided to provide for the renewal of the lease at the end of four years by setting up a Depreciation Fund. It is expected that investments will fetch interest at 4% p.a. Sinking Fund tables show that Re.0.235490 invested each year will produce Re.1 at the end of four years at 4% p.a. Investments are made in multiples of Rs. 5.

On 31st December, 1984, the Depreciation Fund Investments are sold for Rs.36,455. On 1st January,1985, the same lease was renewed for a further period of four years by payment of Rs.55,000.

Prepare necessary ledger accounts.

Solution

DEPRECIATION FUND ACCOUNT

Date	Particulars	Rs.	Date	Particulars	Rs.
1981 Dec.31	To Balance c/d	11,774.50	1981 Dec.31	By Depreciation a/c	11,774.50
		11,774.50			**11,774.50**
1982 Dec.31	To Balance c/d	24,020.00	1982 Jan.1 Dec. 31	By Balance b/d By Bank (Interest) By Depreciation A/c	11,774.50 471.00 11,774.50
		24,020.00			**24,020.00**
1983 Dec.31	To Balance c/d	36,755.30	1983 Jan.1 Dec. 31	By Balance b/d By Bank (Interest) By Depreciation A/c	24,020.00 960.80 11,774.50
		36,755.30			**36,755.30**
1984 Dec.31 Dec.31	To Depreciation Fund Investment A/c To Lease A/c	 300.00 50,000.00	1984 Jan.1 Dec. 31	By Balance b/d By Bank (Interest) By Depreciation A/c By P & L A/c (Loss transfer)	36,755.30 1,470.20 11,774.50 300.00
		50,300.00			**50,300.00**

DEPRECIATION FUND INVESTMENT ACCOUNT

Date	Particulars	Rs.	Date	Particulars	Rs.
1981 Dec.31	To Bank	11,775	1981 Dec.31	By Balance c/d	11,775
		11,775			**11,775**
1982 Jan 1 Dec.31	To Balance c/d To Bank	11,775 12,245	1982 Dec. 31	By Balance c/d	24,020
		24,020			**24,020**
1983 Jan 1 Dec.31	To Balance c/d To Bank A/c	24,020 12,735	1983 Dec. 31	By Balance c/d	36,755
		36,755			**36,755**
1984 Dec. 31	To Balance c/d	36,755	1984 Dec. 31 Dec.31	By Bank By Depreciation	36,455 300
		36,755			**24,020**

DEPRECIATION ACCOUNT

Date	Particulars	Rs.	Date	Particulars	Rs.
1981 Dec.31	To Depreciation Fund a/c	11,744.50	1981 Dec. 31	By P & L A/c	11,744.50
1982 Dec.31	To Depreciation Fund a/c	11,744.50	1981 Dec. 31	By P & L A/c	11,744.50
1983 Dec.31	To Depreciation Fund a/c	11,744.50	1983 Dec. 31	By P & L A/c	11,744.50
1984 Dec.31	To Depreciation Fund a/c	11,744.50	1984 Dec.31	By P & L A/c	11,744.50

OLD LEASE ACCOUNT

Date	Particulars	Rs.	Date	Particulars	Rs.
1981 Dec.31	To Bank	50,000	1984 Dec. 31	By Depreciation Fund a/c	50,000

LEASE ACCOUNT

Date	Particulars	Rs.	Date	Particulars	Rs.
1985 Jan.1	To Bank	55,000			

Problem 5. X purchases a 5 years' lease for Rs.10,000 and arranges for its renewal by means of insurance policy, the annual premium being Rs.1,850. The value of the policy increases each year by 4%. Show the necessary accounts for 5 years, presuming that the renewal of the lease costs Rs.9,500.

Solution **DEPRECIATION RESERVE ACCOUNT**

Date	Particulars	Rs.	Date	Particulars	Rs.
Year I Dec. 31	To Balance c/d	1,924	Year I Dec.31	By P & L A/c By Depreciation Insurance Policy A/c	1,850 74
		1,924			**1,924**
Year II Dec. 31	To Balance c/d	3,925	Year II Jan 1 Dec.31 Dec.31	By Balance b/d By P & L A/c By Depreciation Insurance Policy A/c	1,924 1,850 151
		3,925			**3,925**
Year III Dec. 31	To Balance c/d	6,006	Year III Jan 1 Dec.31 Dec.31	By Balance b/d By P & L A/c By Depreciation Insurance Policy A/c	3,925 1,850 231
		6,006			**6,006**
Year IV Dec. 31	To Balance c/d	8,170	Year IV Jan 31 Dec. 31 Dec. 31	By Balance b/d By P & L A/c By Depreciation Insurance Policy A/c	6,006 1,850 314
		8,170			**8,170**
Year V Dec. 31	To Lease A/c To P & L A/c	10,000 421	Year V Jan 1 Dec. 31 Dec. 31	By Balance b/d By P & L A/c By Depreciation Insurance Policy A/c	8,170 1,850 410
		10,421			**10,421**

OLD LEASE ACCOUNT

Date	Particulars	Rs.	Date	Particulars	Rs.
Year I Jan. 1	To Bank	10,000	Year V Dec.31	By Depreciation Reserve A/c	10,000

DEPRECIATION INSURANCE POLICY ACCOUNT

Date	Particulars	Rs.	Date	Particulars	Rs.
Year I Jan. 31 Dec 31	To Bank To Depreciation Reserve A/c	1,850 74	Year I Dec.31	By Balance c/d	1,924

Year II Jan 1 Dec.31	 To Balance b/d To Bank To Depreciation Reserve A/c	 1,924 1,850 151	Year II Dec. 31	 By Balance c/d	 3,925
Year III Jan 1 Dec.31 Dec.31	 To Balance b/d To Bank To Depreciation Reserve A/c	 3,925 1,850 231	Year III Dec. 31	 By Balance c/d	 6,006
IV Jan 1 Dec.31 Dec.31	 To Balance b/d To Bank To Depreciation Reserve A/c	 6,006 1,850 314	Year IV Dec. 31	 By Balance c/d	 8,170
Year V Jan 1 Dec.31 Dec.31	 To Balance b/d To Bank To Depreciation Reserve A/c	 8,170 1,850 410	Year V Dec. 31	 By Balance b/d	 10,421

NEW LEASE ACCOUNT

Date	Particulars	Rs.	Date	Particulars	Rs.
Year VI Jan. 1	 To Bank	 9,500			

Problem 6. A second-hand machinery was purchased on 1st January, 1981 for Rs.30,000 and Rs.6,000 and Rs.4,000 were spent on its repairs and erection immediately. On 1st July,1982 another machinery was purchased for Rs.26.000 and on 1st July, 1983 the first machinery having become obsolete was auctioned for Rs.30,000. On the same date another machinery was purchased for Rs,25,000. On first July,1984 the second machinery was also sold off and it fetched Rs.23,000

Depreciation was provided on machinery at the rate of 10 percent on the original cost annually on 31st December. In 1983 the method of providing depreciation was changed to the written down (diminishing) value method; the rate of depreciation being 15 percent.

You are required to prepare Machinery account for the calendar years mentioned hereto for.

Solution

MACHINERY ACCOUNT

Date	Particulars	Rs.	Date	Particulars	Rs.
1981			1981		
Jan. 1	To Cash	30,000	Dec.31	By Depreciation	4,000
	To Cash (repairs)	6,000	Dec.31	By Balance c/d	36,000
	To Cash (erection)	4,000			
		40,000			**40,000**
1982			1982		
Jan 1	To Balance b/d	36,000	Dec.31	By Depreciation	
July 1	To Bank	26,000	Dec.31	On 1^{st} Machine	4,000
				On 2^{nd} Machine	1,300
				By Balance c/d	56,700
		62,000			**62,000**
1983			1983		
Jan 1	To Balance b/d	56,700	July 1	By Depreciation	2,000
July 1	To Bank	25,000		(on 1^{st} Machine for 6 months)	
			July 1	By Cash (1^{st} Machine sold)	30,000
			Dec.31	By Depreciation	
				On 2^{nd} Machine 3705	
				On 3^{rd} Machine 1875	5,580
			Dec. 31	By Balance c/d	44,120
		81,700			**81700**
1984			1984		
Jan.1	To Balance b/d	44,120	July1	By Depreciation	
July l	To P & L A/c	3,580		(on 2^{nd} Machine for 6 months)	1,575
			July 1	By Cash (2^{nd} Machine sold)	23,000
			Dec.31	By Depreciation	3,469
			Dec.31	By Balance c/d	19,656
		47,700			**47,700**

Working Notes: Rs.

1. Depreciation written off in 1983
   Book Value of second machine on 1.1.83
   Rs. 24,700 Depreciation @ 15% — 3,705
   Depreciation on third machine @ 15% on
   Rs. 25,000 for 6 months — 1,875
   5,580

2. Depreciation written off in 1983 and profit on sales
   Second Machine: Book Value on 1.1.83 — 24,700
   Dep. for 1983 — 3,705
   Book value on 1.1.84 — 20,995
   Dep. for 1984 for 6 months — 1,575
   19,420
   Sale proceeds — 23,000
   Profit — 3,580
   Third Machine: Book value on 1.1.83 — 25,000

Dep. in 1983	1,875
	23,125
Dep. in 1984	3,469

Problem 7. Sanjay Industries Limited, which depreciates its Machinery at 10% according to diminishing balance method, had on 1st January, 1984 Rs. 9,72,000 balance on Machinery Account.

During the year 1984 part of the Machinery purchased on 1st January, 1982 for Rs.80,000 was sold for Rs.45,000 on 1st July, 1984 and a new machinery at a cost of Rs.1,50,000 was purchased and installed on the same date, installation charges being Rs.8,000.

The company wanted to change its method of depreciation from diminishing balance method to straight line method with effect from 1st January, 1982 and adjust the difference before 31st December, 1984. The rate of depreciation remains the same as before.

Show the Machinery Account and ascertain the amount chargeable to Profit and Loss Account as depreciation and on sale of machinery in the year 1984.

Solution

MACHINERY ACCOUNT

Dr.

Cr.

1984 Jan.1 July1	To Balance b/d To Bank A/c (cost) To Bank A/c (installation charges)	9,72,000 1,50,000 8.000	1984 July l Dec.31	By Bank A/c By P & L A/c (Loss on sale (1)) By Extra Dep. (2) By Dep. for 1984 (3) By Balance c/d	45,000 16,560 11,200 1,23,140 9,34,100
		11,30,000			11,30,000

Working Notes:

1. Loss on sale of machinery

	Rs.
Cost of Machinery sold as on 1.1.82	80,000
Less Depreciation for 1982 @ 10% on diminishing balance	8,000
Written down value on 1.1.83	72,000
Less Depreciation for 1983 @ 10% on diminishing balance	7,200
Written down value on 1.1.1984	64,800
Less Depreciation for 1/2 year at 10% diminishing balance	3,240
	61,560
Less Realized value of Machinery	45,000
Loss on Sale of Machinery	16,560

2. Calculation of Extra Depreciation:

Cost of Machinery on January 1, 1982

@ Rs. 9,72,000 x 100/90 x 100/90 - 12,00,000		
Depreciation on Rs .11,20,000 (Rs.12,00,000 Rs.80,000) at 10% at cost for 2 years		
Less Depreciation written off on diminishing balance		
in 1982	1,12,000	
in 1983	1,00,800	2,12,800
Extra depreciation to be written off in 1984		11,200

3. Calculation of Depreciation for 1984

On Machinery sold (as calculated above)	3,240
On Rs.11,20,000 at 10% for 1 year	1,12,000
On Rs.1,58,000 at 10% p.a. for 1/2 year	7,900
	1,23,140

QUESTIONS

1. Define depreciation. Explain the need and significance of depreciation.
2. Enumerate the various causes of depreciation and spell out the objectives of providing for depreciation.
3. Discuss the various factors which are to be considered for calculating depreciation.
4. Discuss in detail various methods of providing depreciation. Bring out the pros and cons of each method.
5. Distinguish between straight line method and diminishing balance method of providing depreciation.
6. A newly established concern has acquired the following assets:

   (i) Lease-hold property (ii) Loose Tools (iii) Coal mine

   (iv) Power Plant (v) Motor Truck

You are required to suggest the suitable method of depreciation for each of the assets, giving reasons in support of your suggestion.

7. Write short notes on:

   (i) Provisions and Reserves

   (ii) Secret Reserves

   (iii) Depreciation policy.

PROBLEMS

1. M/s. Sekar & Co purchased a Machinery on 1.1.2002 for Rs.10,00,000. The firm writes off depreciation at 10 % on the original cost every year. The Books are closed on 31st March every year. Pass the necessary Journal entries, prepare Machinery Account and Depreciation Account for the first three years.

   (Answer: Balance at the end of the third year Rs. 7,00,000)
2. A & Co. purchased a Plant for Rs.80,000 on 1.4.2001. it is depreciated at 10 % p.a on reducing balancing method for three years. Accounts are closed on 31st March every

year. Pass the necessary Journal entries, prepare Machinery Account and Depreciation Account for the first three years.

(Answer: Balance at the end of the third year Rs. 58,320)

3. A company purchased a Plant for Rs. 4,00,000 on 1st April 2000, an additional machinery was purchased for Rs.40,000 on 1st April 2001. Prepare the Plant account for three years. Depreciation is provided at 10% p.a using Straight line method. The firm closes its books on 31st March of every year.

   (Answer: Balance at the end of the third year Rs. 3,12,000)

4. A Plant is purchased for Rs.90,000. It is depreciated at 10 p.a on reducing balance for three years. When it becomes obsolete due to new method of production and is scrapped. The scrap produces Rs. 66,000 at the end of the third year. Prepare plant and depreciation account for three years.

   (Answer: Profit on sale of plant is Rs. 390)

5. Depreciation in a factory is provided by the "straight line" method at the rate of 10 per cent per annum.

   The balance standing on the Plant and Machinery December 1991 after writing off depreciation for the year was Rs.19,515 (Total cost price of the plant was (Total cost price of the plant was Rs.35,800 including plant purchased in 1981 for Rs.8,900)

   During January 1992 new plant was purchased at a cost of Rs.2,950 and one machine which had cost of Rs.550 in 1978 was sold as scarp for Rs.35.

   During January 1993, there were additions costing Rs.1,800 and a machine which had cost Rs.700 in 1989 was sold for Rs.350.

   You are required to write up Machinery Account for 1992 and 1993. All calculations are to be shown.

   (Ans: Machinery Account Balance 1992 Rs.19,480 and 1993 Rs.17,765)

   (Hints: (i) Do not provide depreciation in 1992 on Rs.8,900 because it must have been completely written off by 1992

   (ii) Profit on sale of plant during 1992 Rs.35; (iii) Loss on sale of plant during 1993 (Rs.420-Rs.350) = Rs.70).

6. The book value of Plant and Machinery on 1st January 1988 was Rs.2,00,000. New Machinery for Rs.10,000 was purchased on 1st October 1988 and for Rs.2,00,000 on 1st July, 1989. On 1st Apri1,1990 a machinery whose book value had been Rs.30,000 on 1st January,1988 was sold for Rs.16,000 and the entire amount was credited to plant and machinery Account. Depreciation had been charged at 10% per annum on the book

value on 1st January,1968 on straight line method. It was decided on 31st December,1990 that depreciation at the rate of 20 percent per annum on diminishing balance method should be charged with retrospective effect since 1st January,1988. Show the Plant and Machinery Account from 1st January 1988 to 31st December, 1990. (Ans: Depreciation in 1988,1989 and 1990 Rs. 40,500, 35,900 and 27,840 (including Rs.960 on sold Machine). Book value of sold machine on 1st April 1990 Rs. 18,240 ; Loss on sold machine Rs.2,240; Balance in Machinery A/c Rs.1,07,520)

7. Kiwi Enterprises Ltd., which depreciates its machinery at 10% on diminishing balance method held on 1st January,1991 Rs.9,72,000 to the debit of machinery account.

   During the year 1991, part of the machinery purchased on 1st January 1989 for Rs.80,000 was sold for Rs.45,000 on 1st July 1991 and a new machinery at a cost of Rs.1,50,000 was purchased and installed on the same date, installation charges being Rs.8,000.

   The company wanted to change its method of depreciation from diminishing balance method to straight line method with effect from 1st January 1989 and adjust the difference in the account of 1991.

   The rate of depreciation remains the same as before.

   Show the machinery Account and ascertain the amount chargeable to profit & loss A/c for depreciation including obsolescence loss in the year 1991.

   (Ans; Rs.1,50,900 chargeable to P & L A/c for depreciation (including Rs.15,000 for obsolescence in 1991; Balance in machinery A/c Rs.9,34,100.)

8. On 1st April, 1988 a new plant was purchased for Rs.40,000 and a further sum of Rs.2,000 was spent on its installation.

   On 1st October,1990 another plant was the acquired for Rs.25,000. Due to an accident on 3rd January 1991 the first plant was totally destroyed and the remnants were sold for Rs.1,000 only.

   On 1st January 1992 a second hand plant was purchased for Rs.30,000 and a further sum of Rs.5,000 was spent for bringing the same to use on and from 15th March 1992. Depreciation has been provided at 10 percent on straight line basis. It was the practice to provide depreciation for full year on all acquisitions made at any time during any year and to ignore depreciation on any item sold or disposed of during any year. None of the assets were insured. The accounts are closed annually to 31st March.

It is now decided to follow the rate of 15 percent on diminishing balance method with retrospective effect in respect of the existing items of plant and to make the necessary adjustment entry on 1st April 1992.

Show the journal entries to be passed for the purpose and the Plant Account and the Accumulated Depreciation Account for all the years.

(Ans: Balance in Plant A/c Rs.60,000 and Accumulated Depreciation A/c Rs.12,187 including additional depreciation of Rs.3687)

9. A company purchased 3 years lease on January 1st 1992 for Rs.25,000. It is decided to provide for the replacement of the lease at the end of 3 years by setting up a depreciation fund. It is expected that investments will fetch interest at 5%. Sinking fund tables show that to provide the requisite sum at 5% at the end of 3 years, an investment of Rs. 7,930.22 is required every year. Investments are made to the nearest rupee.

   On 31st December 1994 the investments are sold for Rs.15,250.

   Show the journal entries and give the Lease account, Depreciation Fund account and Depreciation Fund Investment account.

   (Ans: Interest at the end of 1993 and 1994 Rs.397 and Rs.813 respectively; Loss on sale of investments Rs.1007; debit to P & L A/c for 1994 Rs.8937.)

10. The Machinery Account of a factory showed a balance of Rs.3,80,000 on January, 1991. Its accounts were made up on 31st December each year and depreciation written off at 10 percent on written down value. On 1st June 1991 new machinery was acquired at a cost of Rs.57,783 and on the same date a machine, which had cost Rs.12,000 on 1st January 1987 was scrapped without realising anything.

    Write up the Plant and Machinery Account for the year 1991 allowing the same rate of depreciation as in the past, and showing clearly- how you arrive at the amounts of obsolescence and depreciation to be charged to the profit and loss account.

    (Ans: Balance of Machinery Rs.3,89,326).

Unit – V

Unit Structure:

Lesson 5.1 Consignment Accounts

Lesson 5.2 Joint Venture

LESSON 5.1 CONSIGNMENT ACCOUNTS

Introduction:

The increasing size of the market is making it more and more difficult for the manufacturer or wholesaler to come in direct contact with customers living at far off distances. This has made imperative for him to enter into an agreement with a reliable local trader who can sell goods on his behalf and at his (Principal) risk for an agreed amount of commission. Such a dispatch of goods from one person to another person at a different place for the purpose of warehousing and ultimate sale is termed as consignment. Goods so sent are termed as 'Goods sent on Consignment'; the sender is called 'Consignor' and the recipient `Consignee.'

For example, if A of Pondicherry sends 100 Television sets to B of Madras to sell on his (A's) behalf and at his (A's) risk, the transaction between A and B is a consignment transaction. A is the consignor and B is the consignee.

The main features of a consignment transaction can now therefore be put follows:

(i) Consignment of goods is not a sale. It is a mere transfer of possession of goods.

(ii) The consignee sells goods at the risk of the consignor. He is not responsible for any loss or destruction of goods.

(iii) The sale proceeds belong to the consignor and the consignee merely gets commission and expenses that he might have incurred.

(iv) The relationship between consignor and consignee is that of a Principal and an Agent.

Since the consignee deals on behalf of the consignor (as against his own account), the principal must properly reward the agent for the services rendered in selling the consignment. This reward is called 'commission' which is usually allowed as a certain percentage on sales. Sometimes, the consignee also undertakes the risk of bad debt arising from the credit sale of consigned goods, in return of additional reward called 'del credere commission'. This is a sort of insurance premium and computed on total (as against credit) sales, unless agreed, otherwise.

Not infrequently, an additional incentive in the form of 'over-riding commission' is granted to induce the agent in pushing a new line of trade. This is also allowed on total sales.

Along with the consignment, the consignor also sends a detailed information as to the nature of goods, number of items, their weight, measurement, price, marking, etc. This is called 'proforma invoice'. However, unlike a regular invoice, it is not a debit note since goods sent on consignment is not a sale. This proforma invoice is of the nature of memorandum and serves as a guide to the consignee, unless it is tantamount to factual instruction to sell at the price specified therein. Periodically, the consignee renders to his principal a detailed statement as to the sale proceeds, expenses incurred, commission charged, remittance sent, balance due and stock still in hand. This is called 'account sales'. Based on this statement, the consignor incorporates the various entries and arrives at the result (profit or loss) of the consignment transactions.

ACCOUNTING RECORDS

Consignor's Books

To incorporate the transactions pertaining to the consignment, the special accounts included in the consignor's books are (a) Consignment Account, (b) Goods sent on Consignment Account, (c) Consignee's Personal Account, (d) Consignment Stock Account, and (e) Consignment Stock Reserve Account, if any.

Consignment Account is a Nominal Account. It is in fact a special Trading and Profit & Loss Account and, therefore, its balance shows the profit or loss made on a particular consignment.

Consignee's Account is a Personal Account and, therefore, in case the Consignee has not remitted the balance due by him in full, he will be a debtor, whereas if he has remitted more than the balance due by him, he will be a creditor.

Goods sent on Consignment Account is a Real Account. It is closed by transferring its balance to Purchases Account (sometimes it is also transferred on the credit side of Trading Account).

The above accounts are maintained in respect of each of the consignments. For example, if goods have been sent on consignment to Bombay, Calcutta and Madras, Consignment Account, Consignee's Account and Goods sent on Consignment Account will be maintained in respect of each of these consignments.

Pricing of Goods Sent on Consignment: Goods can be consigned to the consignee either (i) at cost or (ii) at invoice price.

At cost: In case of this method the goods are charged to the consignment at cost price to the consignor. The proforma invoice is also prepared at this price. For example if the goods costing Rs.10,000 are purchased by A and 80 percent of such goods are sent by him on consignment to Bombay, proforma invoice will show the value of goods as Rs.8,000 and the Consignment to Bombay account will also be charged with this price. The consignee may be given the direction regarding the price at which he should sell the goods (see illustration 1.2.) At invoice Price: In case of this method the goods are charged to consignment at a price higher than cost. The proforma invoice also shows the value of goods at such higher price. The excess of invoice price over the actual cost, represents the profit which the consignor intends to make on the goods consigned. For example, if in the above case the goods are consigned at a profit of 25 percent on cost (or 20 percent on invoice price), the consignment account will be charged with Rs.10,000 (i.e. Rs.8,000 + Rs.2,000) for the value of goods sent on consignment. However, in order to find out the profit, at the end of the accounting period, the consignment account will be given credit with the excess price so charged. In this case, the credit to the consignment account will be of Rs.2,000. Thus, in fact, consignment account has been charged only with the cost (i.e. Rs. 10,000 -Rs. 2,000) of the goods sent on consignment as has been done in the first case. Suitable adjustment for profit element included in the stock with the consignee has also to be made.

The following are the advantages of invoicing goods to consignee at a price higher than the cost:

(i) The consignor can keep secret from the consignee the profit that he is making on the goods sold, thus reducing the possibility of bringing more competition in the field.

(ii) The consignee can be directed to sell the goods at the invoice price only. Thus, he is prevented from charging different prices from different customers.

(iii) Control over stock with the consignee becomes slightly easier. The value of stock with the consignee at any time will be the difference between the value of goods sent on consignment and the sales made by him.

The accounting entries to be recorded in the books of the consignor are summed as follows:

(i) On despatch of the goods-

Debit Consignment Account

Credit Goods sent on Consignment Account

If this entry is recorded at invoice price, then with the excess of invoice over the cost

Debit Goods sent on Consignment Account

Credit Consignment Account

This adjustment is usually made at the accounting date. Opposite treatment is accorded for the goods returned by the consignee.

(ii) On the incurrence of expenses by the Consignor

Debit Consignment Account

Credit Cash/Creditor (as the case may be)

(iii) On receipt of advance, if any, from the consignee

Debit Cash/Bank/Bills Receivable (as may be the case)

Credit Consignee's Personal Account

(iv) On discounting the Bill

Debit Cash

Credit Bills Receivable

(v) For expenses incurred by the consignee

Debit Consignment Account Credit

Consignee's Personal Account

(vi) With gross proceeds of sales made by consignee

Debit Consignee's Personal Account

Credit Consignment Account

(vii) For commission charged by consignee

Debit Consignment Account

Credit Consignee's Personal Account

(viii) With the worth of unsold stock

Debit Consignment Stock Account

Credit Consignment Account

If this is based on invoice value, then with the excess of invoice over cost

Debit Consignment Account

Credit Consignment Stock Reserve

(ix) For abnormal loss of Consigned Goods (discussed later)

Debit Insurance Company (with recoverable loss, if any)

Debit Profit & Loss Account (with non-recoverable loss)

Credit Consignment Account

(x) To close off the Consignment Account at accounting date,

(a) if profit:

Debit Consignment Account

Credit Profit & Loss Account

(b) if loss:

Debit Profit & Loss Account

Credit Consignment Account

(x) To close 'Goods sent on Consignment Account'

Debit Goods sent on Consignment Account

Credit Purchases Account (or Trading Account)

Consignment Stock and Consignment Stock Reserve, if any, will appear in the Balance sheet; the latter is shown as a deduction from the former on the assets side. If any balance is left in the Consignee's Personal Account, the same will be carried forward. In case of debit balance, he will be debtor and shown on the Assets side; conversely, shown on the Liabilities side as a creditor.

Valuation of Unsold Stock: Where all the goods have not been sold, it becomes necessary to value the unsold goods. Such goods are similar to closing stock in case of a Trade Account. This stock should be valued at a price which will include:

(i) Proportionate cost price and

(ii) Proportionate direct expenses, i.e. proportionate expenses incurred both by the consignor and the consignee till the goods reach the godown of the consignee.

It should be noted that direct expenses will include all expenses incurred by the consignor while only such expenses of the consignee which are incurred by him till goods reach his godown. Examples of such expenses are: carriage, cartage, freight, octroi, import duty etc. paid by the consignee, should be excluded.

Moreover, the fundamental principle of accounting regarding valuation of stock should also be taken into consideration i.e. stock should be valued at cost or market price whichever is less. Cost price stands for cost + proportionate direct expenses.

Tutorial Note

In case in an examination question, the details regarding expenses incurred by the consignee have not been given (e.g. the question states "expenses incurred by the consignee are Rs.2,000" or "the consignee paid Rs.2,000 as cartage, godown rent, insurance etc.", the students are advised to consider only proportionate expenses incurred by the Consignor, while valuing the unsold stock).

Illustration 1: S. Kumar consigns 100 Bicycles to T. Suresh. Each Bicycle costs Rs.800.00. S. Kumar pays the following expenses:

	Rs.
Freight	1,000
Insurance	400
Carriage	500
T. Suresh pays the following expenses:	
Customs duty	2,000
Dock dues	500
Godown rent	500
Salary to salesman	300

Goods reach the godown of the consignee.

At the end of the year 25 Bicycles remained with T. Suresh. The market value of each Bicycle is Rs-.850. You are required to calculate the value of stock lying with T. Suresh.

Solution

Statement showing Value of Stock

Cost of 25 Bicycles @ Rs.800 per Bicycle		
1/4 of Direct Expenses (i.e. 25 / 100)		20,000.00
Freight	250.00	
Insurance	100.00	
Carriage	125.00	
Customs duty	500.00	
Dock dues	125.00	1,100.00
		21,100.00

Market value of stock is Rs.2‘5 x 850 = Rs.21,250

Cost being less 25 Bicycles should be valued at Rs.21,100,00.

Accounting Treatment for Loss of Stock: In the course of consignment transactions some loss of stock may occur. It may be in the course of transit before or after taking delivery of the goods by the consignee or it may occur at the godown of the consignee. Such loss of stock may be normal or abnormal. Normal Loss is due to inherent characteristics of goods, e.g., loss due to evaporation, sublimation, drying up of goods etc. If loss occurs on account of reasons which are only accidental or which rarely happen the loss is termed as Abnormal. The example of such losses are-theft of goods or destruction of goods by fire.

Normal loss: It is not shown in the consignment account. This is included in the value of goods sold and closing stock by inflating the rate per unit. The value of closing stock will, therefore, be that proportion of total value of goods sent which number of units in hand bear t to total number of units as diminished by loss (i.e., the units actually received by the consignee). In short, cost of goods sent becomes, cost of goods received.

This can be put in the form of the following formula:

Value of Closing Stock = Total value of goods sent x Units of closing stock/Units actually recd. by the consignee

Illustration 2:

A consigned 2,000 tonnes of coal @ Rs.50 per tonne B of Delhi. He paid Rs.20,000 as freight. Due to normal wastage only 1.950 tonnes were received by B. He also paid Rs.5,000 as unloading and cartage charges. The goods unsold amount to 650 tonnes. You are required to calculate the value of closing stock.

Solution

	Rs.
Cost price of 2,000 tonnes of coal @ Rs.50 per tonne	1,00,000.00
Freight paid by the consignor	20,000.00
Unloading and cartage charges paid by consignee	5,000.00
Cost of 1,950 tonnes	1,25,000.00
Cost of 650 tonnes – (650 x 1,25,000)/1,950 = Rs.41,667	

Abnormal loss: This loss should be debited to Abnormal Loss Account and credited to Consignment Account. Abnormal Loss Account may be closed by transferring to P & L Account.

The credit to the consignment account with the value of. Abnormal Loss is given, because it will make possible for the management to judge properly the profitability or otherwise of the consignment.

The valuation of stock destroyed on account of abnormal reasons will be done on the same basis as valuation of Stock on Consignment i.e., proportionate cost price plus proportionate direct expenses incurred upto the date of loss.

While valuing abnormal loss, care should be taken of the stage where abnormal loss took place, since only such expenses have be included in the valuation of such abnorn(ial loss which have been incurred upto that stage. This will be clear with the help of the following illustration.

Illustration 3:

A consigned to B 100 cases of tea costing Rs.100 per case. He paid Rs.1,000 as freight and cartage. B could take delivery of only 90 cases since 10 cases were lost in transit. He paid Rs.2.000 as unloading and carriage charges. At the end of the year, he reported that he had sold away 80 cases at Rs.150 per case. You are required to calculate (i) the value of abnormal loss and (ii) the value of closing stock.

Solution

Value of Abnormal Loss

	Rs.
Cost of 100 cases @ Rs. 100 per case	10,000
Direct Expenses incurred by the Consignor	1,000
Total cost of 100 cases	11,000

$$\text{Value of Abnormal Loss} = \frac{\text{(Total Cost x Units of Abnormal Loss)}}{\text{Total Units to be recd. by the consignee}}$$

$$\frac{\text{Rs. } 11{,}000}{100} \times 10 = \text{Rs. } 1{,}100$$

Value of Closing Stock:	Rs.
Total cost of 100 cases calculated as above: Rs.11,000	1,100

Cost of 10 cases (i.e., units of closing stock)	
Add: Proportionate expenses incurred by the consignee (Rs. 2,000 x 10) /90	222
	1,322

Books of Consignee

The consignee does not purchase the goods. He obtains delivery of goods only for the purpose of selling them on behalf of and at the risk of the consignor for an agreed commission. Thus, only such entries will be made which directly affect him.

Entries to be made in the books of the Consignee

1) When he gives security
   Consignor's a/c Dr. –
   To Bank or Bills Payable
   (with the amount of security given)
2) When goods are received by him, no entry will be passed except that a record of this fact will be made in his Stock Register.
3) When he incurs expenses for goods received on consignment
   Consignor's a/c Dr.
   To Bank or Creditor's a/c
   (With the amount of expenses incurred)
4) For Sales made
   Bank or Debtors' a/c Dr. –
   To Consignor's a/c
   (With the amount of sales)
5) For commission earned by him
   Consignor's a/c Dr.
   To commission a/c
   (With the amount of commission)
   In case 'del credere commission' is payable to him this will be credited to a special account i.e. del credere commission account. Any bad debts incurred will be debited to this account. The balance will be transferred to Consignee's P. & L. a/c.
6) For stock in hand with the consignee
   No entry will be passed.

Note: It will not make any difference for the consignee whether the goods are sent to him at cost price or at invoice price (i.e., a price higher than cost price.)

Illustration 4

A & Co. of Calcutta sent on consignment account goods to B & Co. of Bombay at an invoice price of Rs.29,675 and paid for freight. Rs.762, cartage Rs.232, and insurance Rs.700. Half of the goods were sold by the agents for Rs.17,500 subject to the agents' commission of Rs.875, storage expenses of Rs.200 and other selling expenses of Rs,350. One-fourth of the consignment was lost by fire and a claim of Rs.5000 was recorded. Draw up the necessary accounts in the books of A & Co. and ascertain the profit or loss made on consignment. The consignor received a two months bill of exchange from the agents in satisfaction of the dues.

Solution

Journal

Particulars	Debit	Credit
A & Co., Calcutta Dr. To Bank a/c (Expenses incurred on receipt of consignment)	550	550
Bank a/c Dr. To A& Co. (A & Co., credited for sales proceeds)	17,500	17,500
A & Co., Calcutta a/c To Commission a/c Dr. (For commission earned)	875	
A & Co., Calcutta a/c Dr. To Bills payable a/c (Bills payable accepted in settlement of account)	16,075	16,075
Bills payable a/c Dr. To Bank a/c (Payment made on maturity)	16,075	16,075

Dr. **A & Co., Calcutta** Cr.

	Rs.		
To Bank (expenses)	550	By Bank	17,500
To Commission	875		
To Bills payable a/c	16,075		
	17,500		17,500

Bills Payable Account

To Bank	16,075	By A & Co., Calcutta	16,075

Commission Account

To P & L a/c	875.00	By A & Co., Calcutta	875.00

Bank Account

To A & Co., Calcutta	17,500	By A & Co., Calcutta a/c By Bills payable By Balance c/d	550 16,075 875
	17,500		17,500

Illustration 5:

Mr. Achut of Bombay consigned 100 units of a commodity to Mr. Rao of Delhi. The goods were invoiced at Rs.150 sc.) as to yield a profit of 50 percent on cost. Mr. Achut incurred Rs.1,000 on freight and insurance. Mr. Rao incurred Rs.500 on freight and Rs.800 on Rent. He sold 50 units for cash at Rs.160 per unit and 20 units. at Rs.175 on credit. He retained his commission of 6 percent (including del credere) and remitted the balance. Mr. Rao noticed that 10 units were damaged on account of bad packing and were saleable only for Rs.80 per unit. A Debtor for Rs.1,000 to whom the goods were sold by Mr. Rao became insolvent and only 50 passe in a rupee was recovered.

Make necessary ledger entries in the books of Mr. Achut and Mr. Rao

Solution

Achut's Ledger
Consignment to Delhi Account

To Goods sent on consignment	Rs. 15,000	By Rao (sales)	11,500
To Bank (freight and insurance)	1,000	By Goods sent on consignment a/c (loading)	5,000
To Rao: Freight 500 Rent 800	1,300	By Consignment stock (1): Good 3,300 Damaged 752	4,052
To Rao: Commission (6% (including del credere)	690	By P & L a/c (abnormal loss (2))	398
To Stock reserve 4 Rs.50 on 20 units	1,000		
To P & L a/c (Profit on consignment)	1,960		
	20,950		20,950

Goods sent on Consignment Account

Rao's Account

To Consignment to Delhi a/c (Sales)	11,500	To Consignment to Delhi a/c Expenses 1,300 Commission 690	1,990 9,510
	11,500		11,500

Working Notes:

(1) Stock: 20 units (good): Invoice value 3,000
Freight 1500 x 20/100 300
10 units (damaged) saleable value 800
Less commission @ 6% 48 752
4,052

(2) Abnormal Loss: Cost of the damaged 10 units (cost plus freight) 1,150
Less value as stated above 752
398

Rao's Ledger
Achut's Account

	Rs.		Rs.
To Bank (Exp.)	1,300	By Bank	8,000
To Commission	690	By Sundry Debtors (re. consignment)	3,500
To Bank	9,510		
	11,500		11,500

Sundry Debtors (re. consignment)

	Rs.		Rs.
To Achut	3,500	By Bank	3,000

	3,500	By Commission (Bad debts)	500 3,500

Commission Account

To Sundry Debtors (bad debts) To P & L a/c transfer	500 190	By Achut	690
	690		690

QUESTIONS

Problem 1: On 1st July, 1994, Madras Paper Mart of Pondicherry consigned 1000 Note Books to Banerjee Bros. of Calcutta. The cost of each Note Book was Rs.45 but the proforma invoice price was Rs.60. Madras Paper Mart sent Rs.3000 for freight and insurance. On 7th July 1994, Banerjee Bros. accepted at 3 months' bill drawn upon them by Madras Paper mart for Rs.30,000. Banerjee Bros. paid Rs.1,200 as rent and Rs.750 for advertisement and upto 31st December 1994 (on which date Madras paper Mart close their books) they sold 850 Note Books at Rs.61.50 each. Banerjee Bros. were entitled to a commission of 5 percent on sales. Give the ledger accounts in the books of Madras Paper Mart.

Problem 2: Kumar consigned 40 machines to Ram on 1st January 1993 on the following terms :

(a) All machines were to be sold 20% above the cost of Rs.10,000. Any deficit in selling price is to be borne by Ram while Ram is to retain 50% of any surplus price realised.

(b) Ram is to be paid 3% commission and 2% Del Credere Commission on all sales. Bhola incurred freight charges of Rs.40,000 in consigning the machines. Ram sent

10 machines sold for Rs.12,000 each.

5 machines sold for Rs.10,000 each.

15 machines sold for Rs.14,000 each.

Ram had incurred unloading charges of Rs.4,000 and selling expenses of Rs.6,000. He had collected the entire sale proceeds except Rs.2,000, which had become a bad debt. Ram sent a bank draft for the net amount due to Bhola.

On 30th June 1994, Ram sent a further Account Sale disclosing:

10 machines sold at Rs. 12,000 each. Selling expenses were Rs. 1, 500.

He also sent a draft for the net amount due.

Kumar closes his books on 31st December each year.

Write up the ledger accounts in the books of Kumar recording the above transactions.

Problem 3: On 1st April 1994, A sent to B, on consignment, goods costing Rs.60,000 and incurred expenses totaling Rs.3,000. Account sales revealed that 3/4th of the goods were sold at profit at 20% on sales and B's expenses amounted to Rs.3,500 including Rs.1,500 being the cost of Typewriter purchased for A's personal use. B is entitled to a commission of 4% on sales. Towards the end of the year, B requested A to allow him to purchase, for his own private use, goods costing Rs. 2,000 at a concessional price of Rs.2,375, to which A consented. A fire occurred in the godown on 31st March 1995, destroying goods whose original cost.

A paid Rs. 5,000 and a claim for Rs.3,000 was settled with the Insurance Company. The terms of agreement, between A and B, provided that any loss, caused by fire at the consignee's end, shall be borne by them in equal proportions. The rest of the goods remained unsold. B had earlier sent an advance of Rs.10,000 to A.

You are required to show in A's books:

(a) The Consignment Account adjusted to reveal the profit or loss on consignment deal only (i.e., ignoring the abnormal fire loss and the concessional - price sale to B).

(b) B's Account.

LESSON - 5.2 JOINT VENTURE ACCOUNTS

Introduction

The term joint venture means an association of two or more persons for a short while to exploit a particular business opportunity. Suppose A and B jointly undertake the construction of a building. They share the cost in agreed proportions, say, equally and also agree that any profit that may arise or any loss that may occur will also be borne equally. As soon as the construction of the building is over, the business association of A and B will come to an end. This is a case of joint venture. Legally, joint venture is not distinct from partnership. We shall, of course, consider partnership accounts in a later chapter; but it is better from the accountancy point of view to deal with joint ventures separately from partnerships, simply because joint ventures are of short duration. One should note that profits and losses are shared according to the agreement between the parties but, in the absence of any such agreement, all parties will share profits and losses from joint ventures equally.

Joint ventures must be distinguished from joint ownership. If two brothers purchase a building jointly, without any idea of earning an income from it, it will be a case of joint ownership. In the case of joint ventures, the earning of profit is an essential point; the profit or loss will be shared by the co-venturers.

Distinction between Consignments and Joint ventures differ

In the case of consignments, the relationship is that of principal and agent, the consignee is the agent and he has to work according to the instructions of the consignor (the principal). The parties to a joint venture (may be even more than two) are of equal status; decisions are made jointly. (Strictly speaking, each co-venturer is principal as well as agent).

(i) All the risks and the profit or loss, in the case of a consignment, are those of the consignor. The consignee gets a commission for his work; he is not concerned with the profit or loss made by the consignor. The profit or loss, in the case of a joint venture, belongs to all the co-venturers and will be shared equally, unless otherwise agreed upon.

(ii) A joint venture is usually of a small duration; in any case it is over when the particular venture is over. The relationship between the consignor and the consignee may subsist for many years- consignment after consignment may be sent to the consignee.

(iii) The consignee supplies information to the consignor in the form of Account Sales. But co-venturers may merely exchange copies of the relevant account in their respective books or one party may prepare a Memorandum Joint Venture Account and circulate it among the co-venturers.

(iv) Consignments concern only movable goods but joint ventures may concern other things also such as procuring subscriptions for shares or debentures of a company, construction of a building, making a film etc.

Accounting Record

Maintenance of account books usually rests with the magnitude of the operations. If it is on a large scale, a separate set of books is opened, otherwise each party records the accounts in his existing books.

1. **Separate Books**

These books are totally distinct from those already kept by each coventurer, if any. The important accounts incorporated under it are (a) Joint Bank A/c, (b) Personal Account of each Coventurer, and (c) Joint Venture A/c.

(1) Cash contributed by each venturer is pooled together and placed in a *'Joint Bank A/c'* with a banker. The entry is:

Debit Joint Bank A/c
Credit Venturer's Personal A/c

(2) On making purchases for joint venture operations:

Debit Joint Venture A/c
Credit Joint Bank A/c (on cash purchase)
Credit Creditors' A/c (on credit purchase)
Credit Venturer's Personal A/c (on supplies from any venturer)

(3) On incurring expenses for the operations

Debit Joint Venture A/c
Credit Joint Bank A/c (for cash)
Credit Expense Creditors (for outstanding amounts)
Credit Venturer's Personal A/c (if due to or paid by any venturer)

(4) On Sale of the goods or completion of the job

Debit Joint Bank A/c (if realized in Cash)
Debit Customers' A/c (if on credit)
Debit Venturer's Personal A/c (if proceeds realized by any venturer)
Credit Joint Venture

(5) On allocation of the Venture result (say a profit):

Debit Joint Venturer A/c
Credit Venturer's Personal A/c (in agreed ratio)

Reverse this entry on loss to close off the Joint Venture Account.

On realization from the debtors or payment to the creditors, the usual entries are passed by debiting or crediting the Joint Bank A/c. The Joint Bank balance should be now just sufficient to balance off the Venturers' Personal Accounts. With the settlement of these accounts the separate books will automatically be closed off.

2. In the individual books of each venturer, a Joint Venture Investment Account is opened which is debited with the contribution made (cash, materials or expertise) and the share of profit earned. For realizations and losses incurred the Account stands credited. Just before the final settlement, the balance standing in the Joint Venture Investment Account in each venturer's books should tally (though on opposite side) with that of his personal account in the separate (common) Books. Accordingly, with the receipt (or payment) of the final amount, the Joint Venture Investment Accounts in the individual books of the Venturers close down along with the various accounts in the separate books.

Illustration 1: [Separate Joint Venture Books]

X and Y enter into a joint venture to construct a tube-well for Z and Co. The contract price is Rs. 2,00,000. The venturers open a joint bank account and deposit Rs. 65,000 each. The contractee company pays an earnest money of Rs. 25,000 of which Rs.15,000 is deposited in the bank and the balance kept by X for the distribution of wages. The expenses incurred in constructing the well are:

	Rs.
Iron bars and cement etc.	80,000
Other sundry materials	10,000
Wages to labourers and masons	55,000
Remuneration to supervisors and other construction expenses	7,000

All the expenses are met out of the 'Joint bank A/c' except Rs. 12,000 and Rs.3,000 paid personally by X and Y respectively in the distribution of wages. On completion of the tube-well, the residual items of Rs.2,000 are disposed off and realized by Y.

Finding the Z and Co. unsatisfied with the constructed tube-well, the contractors agree to a reduction of 10% in the contract price. Accordingly, the company pays off the balance due.

The co-venturers close the joint venture books after equally dividing the result of the venture.

Show the Ledger Accounts in the

(1) Separate Joint Venture Books, and

(2) Joint Venture Investment Accounts in the books of X and Y.

Solution

Separate Joint Venture Books

Joint Bank Account

To Coventurers:			By Joint Venture A/c		
X	65,000		Iron and Cement	80,000	
Y	65,000	1.30,000	Sundry materials	10,000	
To Contractee (advance)		15,000	Wages (55,000-15,000)	40,000	
To Contractee (residue)		1,55,000	Supervisory charges etc.	7,000	1,37,000
			By Coventurers:		
			X	82,000	
			Y	81,000	1,63,000
		3,00,000			3,00,000

Joint Venture Account

To Joint Bank :			By Contractee (Z & Co.,) (Rs. 2 lakhs less 10%)	1,80,000
Iron and Cement	80,000		By Conventurer : Y Realization of residual materials	2,000
Sundry materials	10,000			
Wages	40,000			
Supervisory charges etc.	7,000	1,37,000		
To Coventurers:				
X	12,000			
Y	3,000	15,000		
To Profit to Coventureres :				
X	15,000			
Y	15,000	30,000		
		1,82,000		1,82,000

Coventurers' Account

	X	Y	Total		X	Y	Total
To Contractee (Adv)	10000	-	10000	By Joint Bank	65000	65000	130000
To Joint Venture (residue realized)	-	2000	2000	By Joint Venture (wages)	12000	3000	15000
To Joint Bank (final settlement)	82000	81000	163000	By Joint Venture : Profit	15000	15000	30000
	92000	83000	175000		92000	83000	175000

Coventurer X's Books

Joint Venture Investment Account (with Y)

To Cash (Initial contribution	65,000	By Cash (advance for wage)	10,000
To Cash (payment of wages)	12,000	By Cash (final settlement)	82,000
To P & L a/c (profit)	15,000		
	92,000		92,000

Coventurer Y's Books
Joint Venture Investment Account (with X)

To Cash (Initial contribution	65,000	By Cash (advance for wage)	2,000
To Cash (payment of wages)	3,000	By Cash (final settlement)	81,000
To P & L a/c (profit venture)	15,000		
	83,000		83,000

Examinees may note that reference of Joint Bank is a sufficient indication of the existence of Separate (Joint Venture) Books even if the examination problem is silent thereto.

We shall first consider the record to be made in the books of the various parties. Each party opens a joint venture account and the accounts of other parties. Suppose P and Q enter into a joint venture. Then P will open a joint venture account and also an account of Q. Similarly, Q will open, in his books, a joint venture account and the account of P. The following entries are made:

1. When an expenditure is incurred on account of joint venture:
   Joint Venture Account Dr.
   To Cash Account or
   To Goods Account (if goods are used from stock)
2. When an expenditure is incurred by the other party:
   Joint Venture Account Dr.
   To the other party's account
3. If any advance is received from the other party, say, in the form of bill of exchange:
   Bill Receivable Account Dr.
   To the other party's account
4. If any advance is given to the other party, say, in the form of a promissory note:
   The other party's account Dr.
   To Bills Payable Account

5. (a) If the bill receivable is discounted, the usual entry will be passed, viz.,
   Cash Account Dr.
   Discount Account Dr.
   To Bills Receivable Account

   (b.)The discount account should be transferred to the Joint Venture Account. The entry is:
   Joint Venture Account Dr.
   To Discount Account

   (c) If a bill payable was issued in favour o1 the other party and that party has got it discounted, the discount will have to be debited to the Joint Venture Account; the credit will be in the other party's account.

6. (a) When money is received on account of joint venture:
   Bank Account Dr.
   To Joint Venture Account

(b) If money is received by the other party on account of joint venture:

The other party's account Dr.

To Joint Venture Account

7. (a) If any special commission is receivable on account of joint venture:

Joint Venture Account Dr.

To Commission Account

(b) If any commission is payable to the other party:

Joint Venture Account Dr.

To the other party's account

(Commission may have to be paid for making sales or even for making purchases).

8. (a) Sometimes some goods are left unsold and one of the parties takes them. The entry is:

Purchases Account Dr.

To Joint Venture Account

(b) If the other party has taken the goods, the entry will be:

The other party's account Dr.

To Joint Venture Account

9. Now the Joint Venture Account will show a profit or loss. The profit will be divided in the agreed proportions. The entry is:

Joint Venture Account Dr.

To the other party's account

To Profit and Loss Account

In case of loss this entry will be reversed.

Illustration 2: Arun and Ashok enter into a joint venture sharing profits 3/5ths and 2/5ths. Arun is to purchase timber in Madhya Pradesh and forward it to Ashok in Delhi. Arun purchased timber worth Rs.10,000 and paid Rs.1,000 as expenses. Ashok received the consignment ands immediately accepted Arun's draft for Rs.8.000. Arun got it discounted for Rs.7,850. Ashok disposed off the timber for Rs.16,000. He had to spend Rs.350 for fire insurance and Rs.300 for rent. Under the agreement he is entitled to a commission of 5 percent on sales.

Give journal entries and ledger accounts in the books of both the parties.

Solution **Arun's Journal**

Joint Venture Account Dr.	10,000	
To Bank Account (Amount spent on timber forwarded to Ashok)		10,000
Joint Venture Account Dr.	1,000	
To Bank Account (Expenses incurred on timber sent to Ashok)		1,000
Bills Receivable Account Dr. To Ashok (Acceptance received from Ashok as an advance)	8,000	8,000

Bank Account Dr. Discount Account To Bills Receivable A/c (Ashok's acceptance discounted for Rs.7,850)	7,850 150	 8,000
Joint Venture Account Dr. To Discount Account (Discount on Ashok's acceptance transferred to Joint Venture Account)	150	150
Ashok Account Dr. To Joint Venture Account (Sales effected by Ashok)	16,000	16,000
Joint Venture Account Dr. To Ashok Account (Expenses incurred by Ashok on Joint Venture)	650	650
Joint Venture Account Dr. To Ashok Account (Commission due to Ashok on sales)	800	800
Joint Venture Account Dr. To Profit and Loss Account To Ashok (Profit on Joint Venture. Rs.3,400; 3/5ths to self and 2/5ths to Ashok)	3,400	2,040 1,360

Arun's Ledger: Joint Venture Account

To Bank a/c Timber Purchased	 10,000	By Ashok-Sale proceeds	16,000
To Bank a/c Expenses	1,000		
To Discount a/c	150		
To Ashok-expenses	650		
To Ashok-commission	800		
To Profit to: Ashok (2/5) 1,360 P&L a/c (3/5) 2,040	 3,400		
	16,000		16,000

Bills Receivable Account

To Ashok a/c	8,000	By Bank a/c	7,850
		By Discount a/c	150
	8,000		8,000

Discount Account

To Bills receivable a/c	150	By Joint venture a/c transfer	150
	150		150

Bank Account

To Balance b/d	3,150	By Joint Venture a/c Timber	10,000
To Bills receivable a/c	7,850	By Joint Venture a/c Expenses	1,000
	11,000		11,000

Ashok Account

To Joint Venture a/c (Sale)	16,000	By Bills Receivable a/c	8,000

		By Joint Venture a/c	
		Expenses	650
		Commission	800
		Profit (2/5)	1,360
		By Balance c/d	5,190
	16,000		16,000
To Balance b/d	5,190		

Profit & Loss Account

		By Joint venture a/c	2,040

Journal Books of Ashok

Joint Venture Account Dr.	11,000	
To Arun a/c		11,000
(Arun spent Rs. 10,000 on timber & Rs.1,000 as expenses)		
Arun Account Dr.	8,000	
To Bills Payable a/c		8,000
(Acceptance sent to Arun as advance)		
Joint Venture account Dr.	150	
To Arun a/c		150
(Discount Rs. 150 paid by Arun		
Joint Venture Account Dr	650	
To Bank Account		650
(Rent Rs.300 and insurance Rs.350 paid)		
Bank Account Dr.	16,000	
To Joint Venture Account		16,000
(Sales effected on account of Joint Venture)		
Joint Venture Account Dr.	800	
To Commission Account		800
(5% commission on Rs. 16,000)		
Joint Venture Account Dr.	3,400	
To Profit and Loss Account		1,360
To Arun a/c		2,040
(Profit on joint venture, Rs.3,400 divided as 2/5ths to self and 3/5ths to Arun)		
Bills Payable Account Dr.	8,000	
To Bank Account		8,000
(Acceptance of Arun met)		

Ledger - Joint Venture Account

Dr. Cr.

To Arun-Timber and expenses	11,000	By Bank a/c sale	
To Bank a/c expenses	650	proceeds	16,000
To Commission a/c	800		
To Arun-Discount	150		
To Profit to: Arun (3/5)	2,040		
P & L a/c (2/5)	1,360		
	16,000		16,000

Arun Account

To Bills Payable a/c	8,000	By Joint venture a/c	11,000
To Balance c/d	5,190	By Joint venture a/c -	
		Discount	150
		Profit	2,040
	13,190		13,190
		By Balance b/d	5,190

Illustration 3:

Varma and Sanon entered into a joint venture to carry out the interior decoration of a pavilion at the 1981 Trade Fair at New Delhi. Varma provided the necessary capital of Rs.30,000 which he handed over to Sanon and for which he was to be allowed interest at 20% p.a. Sanon was to personally supervise the work and make the necessary arrangements for which he was allowed remuneration at Rs.3,000 per month; he would be liable for any penalty for delay to the extent of 50%. The contract provided for a payment of Rs.1,00,000 with a clause stating that for every week's or part of week's delay Rs.10,000 would be deducted. According to the terms agreed upon, the work was to be completed by 31st October 1981. The work commenced on 1st Sept. and was completed on the 7th November actually. The following payments were made:

	Rs.
Expenses in connection with obtaining the contract	5,000
Workmen	6,000
Art work	20,000
Entertainment	2,000

The contractee paid the amount due to Sanon and the two co-venturers settled the accounts between themselves on the 7th November, 1981.

Prepare the Memorandum Joint Venture Account and the account that each party would have in respect of the joint venture.

Solution

Memorandum Joint Venture Account

To Expenses-obtaining the contract	5,000	By Amount paid by the Contractee	90,000
- Workmen's wages	6,000		
- Art work	20,000		
- Entertainment	2,000		
To Remuneration for Sanon for 2 months and 7 days 6,700			
Less pena1ty(1/2) 5,000	1,700		

To Interest to Varma for 68 days on Rs.30,000 at 20%	1,118		
To Profit-Varma	27,091		
Sanon	27,091		
	90,000		90,000

Books of Varma: Sanon in Joint Venture Account

	Rs.		Rs.
To Cash-amount remitted	30,000	By Cash - received from Sanon	58,209
To interest due	1,118		
To P & L share of profit	27,091		
	58,209		58,209

Books of Sanon Varma in Joint Venture Account

	Rs.		Rs.
To Cash-expenses on		By Cash-received from	
obtaining the contract	5,000	Varma	30,000
- Wages	6,000	By Cash-received from	
- Art-work	20,000	the contractee	90,000
- Entertainment	2,000		
To P & L a/c net remuneration	1,700		
To P & L a/c Share of profit	27,091		
To Cash-remitted to Varma	58,209		
	1,20,000		**1,20,000**

QUESTIONS

1. What is Consignment?
2. What is Proforma invoice?
3. What do you mean by Account Sales
4. Define Joint Venture.
5. How do you differentiate consignment from sales?
6. How does consignment differ from joint venture?

Exercises

Problem 1. A and B enter into a Joint speculation and purchase an old house with extensive grounds for .Rs.8,000, each .contributing Rs.4,000. For an agreed fee of Rs.500 A is to manage the disposal of the property. Sale of internal fittings, windows etc. amounted to Rs.1,700. A pays Rs.300 for demolishing the house, materials of which realises Rs.200. Sundry expenses paid by A were Rs.100 and the whole of the land is eventually sold for Rs.9,000. A and B share the net profits equally, A paying B his share by cheque.

Record these transactions in A's Journal and show Joint Venture A/c and B's A/c in his ledger.

Problem 2: A and B were participants in a joint venture, sharing profits and losses in the proportion of 10:9 respectively. Each party maintains a complete record in his own books. A supplies goods to the value of-Rs.25,000 and incurs an expenditure of Rs.500 on them: and B supplies goods to the extent of Rs.21,000 and his expenses thereon amounted to Rs.1,000. A sells all the goods for Rs.70,000 for which he is entitled to receive a commission at 5 per cent. Accounts are settled by bank draft. Give journal entries and prepare necessary accounts in the books of both the parties.

Problem 3: X and Y entered into a joint venture of underwriting the subscription at par of the entire share capital of Copper Mines Limited consisting of 10,000 shares of Rs.10 each and to pay all expenses upto allotment. They were to share profits in the ratio of 3:2 respectively. The consideration in return for the guarantee was 1,200 other shares of Rs.10 each fully paid to be issued to them.

X provides the funds for Registration Fee Rs.1,200, Advertising Rs.1,100 and Printing and Stationery Rs.950. Y contributed towards payment of Office Rent Rs.300, Legal Charges Rs. 1,550 and Staff Salaries Rs.900.

The prospectus was issued and the applications fell short of the full issue by 1,500 shares. X took these over on joint account and paid for the same in full. They received 1,200 fully paid shares as underwriting commission. They sold their entire holding at Rs.12 per share. The proceeds were received by X for 1,500 shares and by Y for 1,200 shares.

Write up the necessary accounts in the books of both the parties showing the final adjustment.

Problem 4: Ramesh and Suresh entered into a joint venture to purchase and sell hosiery goods. Profit and losses were to be shared equally. Ramesh financed the venture and Suresh undertook the sales on a commission of 5% on the sale proceeds. Ramesh purchased goods to the value of Rs.50,000 less 5% trade discount, paid freight Rs.1,500 and advanced Rs.1,200 to Suresh to meet expenses. Suresh expended for carriage Rs.300, rent Rs.450, advertisement Rs.200 and sundries Rs.150. Sales made by Suresh amounted to Rs.67,500. It was agreed that Ramesh would receive Rs.2,500 as interest.

Remaining unsold goods costing Rs.2,500 were retained by Suresh and those were charged to him at a price to show the same rate of gross profit (without charging any expenditure) as that made on the total sales (excluding those goods taken).

Give journal entries in the books of Ramesh and Suresh and also prepare the necessary ledger accounts in their books.

Problem 5: X and Y entered into a joint venture for purchase and sale of some household items. They agreed to share profits and losses in the ratio of their respective contributions. X contributed Rs.10,000 in cash and Y Rs.13,000. The whole amount was placed in a Joint Bank Account. Goods were purchased by X for Rs.10,000 and expenses paid by Y amounted to Rs.2,000. They also purchased goods for Rs.15,000 through the Joint Bank Account. The expenses on purchase and sale of the articles amounted to Rs.6,000. (including those met by Y). Goods costing Rs.20,000 were sold for Rs.45,000 and the balance was lost due to fire. Prepare Joint Venture Account, Joint Bank Account and the Venturers' Accounts closing the venture.

UNIT – VI

Unit Structure:

Lesson No. 6.1: Branch Accounts

Lesson No. 6.2: Departmental Accounts

LESSON 6.1 BRANCH ACCOUNTS

INTRODUCTION

Local demand for the products or services of a concern is easily met from its single office. But as the area of its operation extends, it becomes increasingly difficult and costly to pursue from the same office. Sooner or later, a section of the business is segregated from the existing centre of operation and established elsewhere. Every such segregated establishment is called 'branch', as distinguished from the parent establishment, termed 'head office'.

Branch merchandising or servicing activities: Section 2(9) of the Companies Act, 1956, inter alia defines a branch office as "any establishment carrying on either the same or substantially the same activity as that carried on by the head office....or any establishment engaged in any production, processing or manufacture." Large concerns engaged in merchandising, manufacturing, banking, insurance and various other operations have numerous branches scattered at different places inside and outside the country of their origin. Accordingly, this chapter elaborates the fundamental accounting procedures applied to the operations of various branches.

DEPARTMENTS Vs. BRANCHES

Although departments (see Lesson 6.2) and branches are the intrinsic divisions of their respective concern, yet they widely differ as to the following:

(1) Departments operate along with their head office in the same premises but branches are distantly segregated from each other as also their head office. This is why L.C. Cropper calls branches as 'departments conducted at a distance.' Thus, place or physical segregation is a distinguishing feature of branches.

(2) Because of (1), the head office is in constant touch with its departments. It closely supervises and effectively controls their affairs. But in case of far off branches, it is well nigh impossible for the head office to remain in constant touch. It may exercise considerable control over closely located branches but only a nominal control on overseas branches.

(3) Functional division is a must for the existence of departments. No two departments can pursue the same line of trade. This is not so with branches. Usually they function on the line of multiple shops. Numerous offices of a commercial bank and retail shops of Bata Shoe Company are the common examples of branch establishments. In some cases, they also function diversely. For instance, branches of the Delhi Cloth and General Mills Ltd. are variously engaged in the manufactures of cotton textiles, sugar, chemicals, vegetable oils, engineering products, business machines, etc.

TYPES OF BRANCHES

Branches vary according to the nature and magnitude of operations pursued as also the degree of autonomy enjoyed. Obviously, no single system of branch accounting would suit each of the varied types of branches. Accordingly, numerous systems of branch accounting have been developed and the use of any one thereof largely rests with the given type of branch. Study of the branch accounting is thus interlinked with the types of branches.

Branches may be variously classified. According to location, they are grouped into home and foreign branches. Based on practical consideration (such as autonomy, varied currencies, etc.), they are divided into dependent, independent and foreign branches.

As regards the work that is done by branches, there is no hard and fast rule. There are branches, like the Bata Shops, that only do retailing. Others carry on wholesale business. A branch may also be a full-fledged manufacturing unit. For example, the Delhi Cloth and General Mills Ltd. has 'branches' at various places which manufacture sugar, cotton textiles, hydrogenated oils, fertilizers and chemicals, etc. These "branches", however, are so big that they are better termed as divisions; they enjoy a very large degree of autonomy and trade in their own name. The same company also maintains a large number of retail shops. The parent organisation-the Head Office-may itself be engaged in manufacturing and/or selling or it may be only a controlling and co-ordinating agency. The accounting work that may be done at the branches will depend on the decision made by the head office in this behalf; but generally, more the work entrusted to a branch, the more will be the accounting work that will be done by the branch. Branches are usually divided into five classes:

(a) A branch that receives goods only from the head office, sells only for cash and remits
all the cash collected to head office, the expenses of the branch being met by remittances from the head office.

(b) A branch that receives goods only from the head office, sells both for cash and credit

and remits all the cash collected to head office, the expenses of the branch being met by remittances from the head office.

(c) Same as above, but with the difference that goods are invoiced by the head office to

the branch at selling price.

In the above three cases, the branches will not do any accounting work except preparing statements of stocks as regards receipt, sale and balance and cash statements. Branches that are allowed to make credit sales will also maintain accounts of customers.

(d) "Independent" branches, i.e., those branches that are allowed to make purchases themselves, make sales both for cash and credit and carry on their work in an autonomous manner. Such branches usually maintain their own books of account. The results of the branch and the head office are integrated at the end of the financial period.

(e) Foreign branches: Such branches are also "independent" and have their own books of account.

ACCOUNTS OF VARIOUS TYPES OF BRANCHES

(A) Branch selling only for cash: As has been stated above, the branch that is allowed to sell only for cash is generally not required to maintain account books. The branch will maintain a petty cash book a copy of which will be forwarded to the head office. It will also forward to the head office, each week or each month, a stock statement. This statement will show, for each item, the opening stock, the stocks received during the period, sales during the period, breakage or losses during the month (for which head office sanction will be required) and the closing stock. The stock statement will serve the purpose of controlling the stock at the branch and the purpose of guiding the head office as to which stocks should be replenished. Needless to say, the statement must be submitted by a fixed day.

The column for total sale proceeds will enable the head office to check whether the total cash realised has been remitted to the head office or not. In the remarks column, details of breakages, losses or leakages (entered in the column for Other Issues) together with head office sanction to write off the breakages, etc., should be entered. The statement should be signed by the branch manager and also by the person in-charge of the stocks. It would be better to prepare this statement every week.

The head office finds out the profit or loss made at the branch by the simple method of putting on one side what is sent to the branch (goods and cash for expenses) and putting on the other side the total cash received. Supposing there are no opening or closing stocks, if goods worth Rs. 10,000 are sent to the branch and a sum of Rs.3,000 is incurred as expenses at the branch and if the branch remits a sum of Rs.15,000, there is a net profit of Rs.2,000 at the Branch. The entries to be made at the head office will be as follows:-

1. When goods are sent:
   Debit the Branch Account
   Credit Goods Sent to Branch Account
2. When Cash is sent to branch (for expenses):
   Debit the Branch Account
   Credit Cash
3. When Cash is received from the branch:
   Debit Cash (or Bank)
   Credit Branch Account.

If the branch has no stock left and no balance of cash, the Branch Account will reveal profit or loss made at the Branch. But usually, there is a closing stock and a closing balance of cash. The entry to record these at the end of the year is:

Debit Stock at Branch Account;
Debit Cash at Branch Account; and
Credit Branch Account.

Profit or loss should be ascertained after making this entry. The profit or loss should be transferred to the General Profit and Loss Account. "Goods Sent to Branch Account" should be transferred either to the credit of the Trading Account in case of manufacturing concerns or to the credit of the Purchases Account in case of trading concerns. "Stock at Branch" and "Cash at Branch" are assets and will appear in the balance sheet. Next year, in the beginning, both these accounts will be transferred to the debit of the Branch Account.

To summarize, the Branch Account should be debited with (1) the opening balances of stock or cash; (2) the value of goods sent to the branch, and (3) the cash sent for expenses. It should be credited with cash received from the branch and the value of closing stock and cash in hand. The difference in the two sides will be profit or loss.

Illustration 1: Branch selling for cash only and invoiced at cost:

Pondicherry Papers Ltd. invoices goods to its Mahe Branch at cost. All the expenses are paid direct from the head office, except petty cash expenses which are paid by branch manager. Branch is advised to sell for cash only, and deposit the day's sale proceeds in the Head Office Account with a local bank. From the following details, ascertain the profit of the Mahe Branch through Debtors System.

	Rs.		Rs.
Stock (Jan. 1)	2,100	Salaries and Wages	1,860
Petty Cash (Jan. 1)	50	Advertisement	240
Furniture (Jan. 1)	250	Rent and Rates	360
Goods supplied from H.O.	7,800	Stock (Dec. 31)	1,950
Goods returned back to H.O	300	Petty Cash (Dec. 31)	30
Cash Sales	15,250	Furniture (Dec. 31)	230

Solution

Books of Pondicherry Papers Ltd. (H.0.)
Mahe Branch Account

		Rs.	Rs.			Rs.	Rs.
Jan 1	To Branch Assets:			Dec. 31	By Return of Goods to H.O.		300
	Stock	2,100			Bank (Sale proceeds)		15,250
	Petty Cash	50			By Branch Assets:		
	Furniture	250	2,400		Stock	1,950	
Dec. 31	Goods supplied to Branch		7,800		Furniture (1)	230	
	Cash:				Petty Cash (2)	30	2,210
	Salaries & Wages	1,860					
	Rent and Rates	360					
	Advertisement	240	2,460				
	Profit transferred to Profit & Loss A/c		5,100				
			17,760				17,760

(B) Branch selling both for cash and credit: In this case also, the main accounting work is done at the head office. The branch will keep a petty cash book and prepare, periodically, the stock statement to be sent to the head office. It will also have to keep accounts of credit customers so that the customers can be reminded about the balances due from them. The head office will keep accounts of the branch much in the same way in which in the accounts of the first type of branch are kept. The only exception is that the following additional entries will be made:

1. To transfer the branch debtors in the beginning of the year:

    Branch Account . . . Dr.

        To Branch Debtors

2. To record the branch debtors at the end of the year

    Branch Debtors . . . Dr.

        To Branch Account

The Branch profit or loss will be ascertained only after the above entries are made. The "Branch Debtors," like "Branch Stock," are assets and will be shown in the Balance Sheet.

Note: No entry is made for credit sales at branch in the head office books. Cash received from the debtors will be remitted to the head office along with cash received for cash sales. The head office will make entry only for cash received by it. It will debit cash and credit the branch. By the same token, the head office makes no entry for discounts allowed, bad debts written off or returns by the branch debtors. If the branch has received a bill of exchange, it will be sent to the head office. The entry then will be to debit Bills Receivable Account and credit Branch Account.

Illustration 2: Messrs VST & Sons are having their Head Office at Pondicherry and Branch at Madras. The following are the transactions of the Head Office with Branch for the year ended 31st August. ,1995.

Stock at Branch as on 1.9.94	30,800	
Debtors at the Branch as on 1.9.94	16,500	
Petty Cash as on 1.9.94	500	
Goods supplied to the Branch	1,51,200	
Remittances from Branch:		
Cash Sales	10,500	
Realization of Debtors	1,57,740	1,68,240
Amount sent to Branch:		
Salary	7,440	
Rent	2,400	
Petty Cash	3,000	12,840
Stock at Branch as on 31.8.95		23,150
Sundry Debtors at the Branch as on 31.8.95		50,460
Petty Cash as on 31.8.95		750

Show the Branch Account in the books of the Head Office.

Solution

VST & SONS Madras Branch Account

		Rs.	Rs.			Rs.	Rs.
1994	To Balance b/d:			1994	By Bank/Cash :		
Sep. 1	Stock at Branch	30,800		Sep. 1	Cash Sales	10,500	
	Branch Debtors	16,500		1995	Debtors	1,57,740	1,68,240
	Cash	500	1,51,200	Aug.	By Balance c/d :		
	To Goods sent to			31	Stock at Branch	23,150	
	Branch A/c				Branch Debtors	50,460	
	To Bank				Cash at Branch	750	74,360
	(Remittances)						
	Salary	7,440					
	Rent	2,440					
	Petty Cash	3,000	12,840				
	To P & L A/c		30,760				
			2,42,600				2,42,600

Illustration 3:

From the following particulars relating to Madurai branch for the year ending December 31, 1991 prepare Branch Account in the books of Head Office:

Stock at branch on January 1, 1991		10,000
Branch debtors on January 1, 1991		4,000
Branch Debtors on Dec. 31, 1991		4,900
Petty Cash at branch on January 1, 1991		500
Furniture at branch on January 1, 1991		2,000
Pre-paid fire insurance on January 1, 1991		150
Salaries outstanding at branch on January 1, 1991		100
Goods sent to Branch during the year		80,000
Cash sales during the year		1,30,000
Credit Sales during the year		40,000
Cash received from debtors		35,000
Cash paid by the branch debtors direct to Head Office		2,000
Discount allowed to debtors		100
Cash sent to branch for expenses:		
Rent	2,000	
Salaries	2,400	
Petty Cash	1,000	
Insurance upto March 31, 1992	600	6,000
Goods returned by the branch		1,000
Goods returned by the debtors		2,000
Stock on December 31		5,000
Petty expenses by the branch		850

Provide depreciation on furniture 10% p.a

Goods costing Rs.1,200 were destroyed on account of fire and a sum of Rs.1,000 was received from the Insurance Company.

Solution

Madurai Branch Account

	Rs.	Rs.		Rs.	Rs.
To Opening Balances:			By Opening Balances:		

Stock		10,000	Salaries Outstanding 100		
Debtors		4,000	By Remittances:		
Petty Cash		500	Cash sales	1,30,000	
Furniture		2,000	Cash received from debtors	35,000	
Prepaid Insurance		150	By Cash paid by debtors direct to H.O.	2,000	
To Goods sent to branch		80,000	By Received from Insurance Company	1,000	1,68,000
To Bank (expenses):			By Goods sent to branch		
Rent	2,000		(return of goods by the		
Salaries	2,400		branch to H.O.)		1,000
Petty Cash	1,000		By Closing Balances:		
Insurance	600	6,000	Stock		5,000
To Net Profit		78,950	Petty Cash		650
			Debtors		4,900
			Furniture		1,800
			Prepaid Insurance (1/4 • Rs. 600)		150
		1,81,600			**1,81,600**

- Alternatively the amount of liabilities could have been deducted from assets.

Working Note:

Calculation of petty cash balance at the end:

Opening balance	Rs.	500
Add: Cash recd. from the Head Office		1,000
Total Cash with branch		1,500
Less: Spent by the branch		850
Closing Balance	Rs.	650

(C) Goods invoiced at selling price or inflated price: Some firms choose to "invoice" goods to its branches at selling price. This presupposes that there will be a fixed selling price. The purpose of making out the invoice at selling price is to control stocks at the branch easily. We shall see how this is done later. But at the moment we must remember that to ascertain profit we must compare the sale proceeds only with the cost. If the Branch Account is debited with more than the cost, the difference must be credited to the Branch. Stock at the end will also be valued according to the "invoiced" value. This will be more than the cost. The difference between the cost of the stock and its "invoiced" or loaded price must be put right. The Branch Account is debited and Stock Reserve Account is credited with the difference. Both Branch Stock Account and Stock Reserve Account are carried forward to the next year and then transferred to the Branch Account.

To recapitulate, the entries to be made are:

(a) When goods are sent to the branch
Debit Branch Account (at the invoiced figure)
Credit Goods sent to Branch Account

(b) When cash is sent to the branch for expenses
Debit Branch Account and
Credit Cash Account.

(c) When cash is received from the branch-
Debit Cash Account and
Credit Branch Account.

(d) for amount of debtors at the end at the branch-
Debit Branch Debtors Account and
Credit Branch Account.

(e) for value of stock at the branch-
Debit Branch Stock Account (according to the invoiced price)
Credit Branch Account

(f) to remove the loading (or inflation) from gonds sent to the branch-
Debit Goods Sent to Branch Account (with the amount added to the cost)
Credit Branch Account

(g) to "correct" the amount of the stock-
Debit Branch Account and
Credit Stock Reserve Account.

The Branch Account will now reveal profit and loss which is transferred to the Profit and Loss Account. The balance in the Goods sent to Branch Account is transferred to the Trading Account or Purchases Account.

Illustration 4: Dinesh & Co. Ltd. opened in 1993 a branch at Goa. It invoiced goods to the Branch at cost plus 25%. Information about 1993 and 1994 is given below:

	1993 Rs.	1994 Rs.
Goods sent to the Branch (invoice price)	50,000	80,000
Cash sent to the Branch for expenses	8,000	10,000
Sales-		
Cash	22,000	33,000
Credit	23,000	48,000
Cash received from debtors	20,000	47,000
Bad Debts written off	600	400
Stock on 31st December (invoice price)	4,800	4,000

Journalise the entries to be made in the Head Office for 1993 and give ledger accounts for both the years.

Solution

Journal

1993	Goa Branch Account	Dr.	50,000	

	To Goods sent to Branch A/c [Goods sent to the Goa Branch (invoice value)]		50,000
	Goa Branch Account Dr. To Cash Account (Cash remitted to the Branch for expenses)	50,000	50,000
	Cash Account. Dr. To Goa Branch Account (Cash received from the Branch Cash Sales 22,000 from Debtors 20,000)	42,000	42,000
Dec.31	Branch Debtors Account Dr. To Goa Branch Account [The balances due from Branch Debtors Rs. 23,000 - (Rs. 20,000 plus Rs. 600)]	2,400	2,400
	Branch Stock Account Dr. To Goa Branch Account (Invoice value of the stock lying at the Branch)	4,800	4,800
	Goods sent to Branch Account Dr. To Goa Branch Account (Loading in the goods sent to Branch credited to Goa Branch A/c 50,000*25/ 125 = 10,000)	10,000	10,000

1993 Dec. 31	Goa Branch Account Dr. To Stock Reserve Account (Reserve against stock created equal to the loading in the Closing Stock)	960	960
	Goods sent to Branch Account Dr. To Trading Account (The balance in the former account transferred to the Trading Account)	40,000	40,000
	Goa Branch Account Dr. To Profit and Loss Account (Profit at Goa Branch transferred to the Profit and Loss Account)	240	240

Goa Branch Account

Dr.

Cr.

1993		Rs.	1993		Rs.

Dec.31	To Goods Sent to Branch A/c To Cash – Expenses To Stock Reserve A/c loading To Profit & Loss	50,000 8,000 960 240	Dec.31	By Cash A/c By Branch Debtors A/c By Branch Stock A/c By Goods sent to Branch A/c - loading	42,000 2,400 4,800 10,000
		59,200			**59,200**

Goods Sent to Branch Account

1993		Rs.	1993		Rs.
Dec. 31	To Goa Branch A/c loading	10,000	Dec.31	By Goa Branch A/c	50,000
	To Trading A/c -transfer	40,000			
		50,000			**50,000**

Goa Branch Debtors Account

1993		Rs.	1993		Rs.
Dec. 31	To Goa Branch A/c	2,400	Dec.31	By Balance c/d	2,400
1994			1994		
Jan. 1	To Balance b/d	2,400	Jan. 1	By Goa Branch A/c Transfer	2,400

Goa Stock Account

1993		Rs.	1993		Rs.
Dec. 31	To Goa Branch A/c	4,800	Dec.31	By Balance c/d	4,800
1994			1994		
Jan. 1	To Balance b/d	4,800	Jan. 1	By Goa Branch A/c - Transfer	4,800

Stock Reserve Account

1993 Dec. 31		Rs.	1993 Dec.31		Rs.
	To Balance c/d	960		By Goa Branch A/c	960
				Transfer	
1994			1994		
Jan. 1	To Goa Branch A/c	960	Jan. 1		
	Transfer			By Balance b/d	960

Goa Branch Account

1993		Rs.	1993		Rs.
Dec.31	To Opening Balances:		Dec.31	By Cash A/c	80,000
	Stock	4,800		By Branch Debtors A/c	3,000
	Debtors	2,400		By Branch Stock A/c	4,000
	To Goods sent to Branch A/c	80,000		By Stock Reserve A/c (on opening stock)	960

Dec.31	To Cash-expenses	10,000		By Goods sent to Branch A/c (loading)	16,000
	To Stock – Reserves A/c (on closing stock)	800			
	To Profit & Loss A/c Profit transferred *	5,960			
		1,03,960			1,03,960

*The student should note that if there is opening stock at inflated price, there will be a stock reserve A/c showing a credit balance equal to the loading.

Goods Sent to Branch Account

Dr. Cr.

1993		Rs	1993		Rs.
Dec. 31	To Goa Branch A/c loading	16,000	Dec.31	By Goa Branch A/c	80.000
	To Trading A/c transfer	64,000			
		80,000			80,000

Branch Debtors Account

		Rs.			Rs.
1993 Dec. 31	To Goa Branch A/c	3,000	1993 Dec.31	By Balance c/d	3,000
1995 Jan. 1	To Balance b/d	3,000			

Branch Stock Account

		Rs.			Rs.
1993 Dec. 31	To Goa Branch A/c	4,000	1993 Dec.31	By Balance c/d	4,000
1995 Jan. 1	To Balance b/d	4,000			

Stock Reserve Account

		Rs.			Rs.
1994 Dec. 31	To Balance c/d	800	1993 Dec.31	By Goa Branch A/c	800
				By Balance c/d	800

Illustration 5: X & Co. of Delhi has a branch at Madras. 'Goods are sent by the Head Office at invoice price which is at the profit of 25% on cost price. All expenses of the branch are paid by the Head Office. From the following particulars, prepare branch account in the Head Office books: (a) when goods are shown at cost price, and (b) when goods are shown at invoice price.

	Rs.
Opening Balance:	
Stock at invoice price	11,000
Debtors	1,700
Petty Cash	100
Goods sent to branch at invoice price	20,000
Expenses made by head office:	
Rent	600
Wages	200
Salary, etc.	900

Remittances made to Head Office:	
Cash sales	2,650
Cash collected from Debtors	21,000
Goods Returned by Branch at invoice price	400
Balance at the end:	
Stock at invoice price	13,000
Debtors at the end	2,000
Petty Cash	25

Solution

(a) When goods are shown at cost price

Madras Branch Account

To Opening Balance		By Cash:	
Stock		Cash Sales 2,650	
(Rs. 11,000-2.200)	8,800	Cash collected from	
Debtors	1,700	Debtors 21,000	23,650
Petty Cash	100	By Goods sent to Branch A/c (at cost)	320
To Goods sent to Branch A/c (at cost)	16,000		
To Bank Expenses		By Closing Balances:	
Rent 600		Stock (at cost)	10,400
Wages 200		Debtors	2,000
Salaries 900	1,700	Petty Cash	25
To Net Profit transferred to General Profit & Loss A/c	8,905		
	36,395		36,395

(b) When goods are shown at invoice price

Madras Branch Account.

To Opening Balance		By Cash:	2,650
Stock	11,000	Cash Sales	21,000
Debtors	1,700	Cash collected from Debtors	400
Petty Cash	100	By Goods sent to Branch A/c (returned)	
To Goods sent to Branch A/c	20,000	By Goods sent to Branch A/c (loading on	3,920
To Bank		net goods sent)	2,200
Rent 600		By Stock Reserve (loading in Op.stock)	
Wages 200		By Closing Balances:	
Salaries 900	1,700	Stock (at cost) 13,000	
To Stock Reserve (Loading on	2,600	Debtors 2,000	
closing stock)		Petty Cash 25	15,025
To Net Profit transferred to			
General Profit & Loss A/c	8,905		
	45,195		45,195

Ascertainment of Branch Stock and Branch Debtors

In case in an examination question, the balance (opening or closing) of the Branch Stock or Branch Debtors Account is not given, the students should prepare a Memorandum Branch Stock Account or a Memorandum Branch Debtors Account. The accounts will be prepared as follows:

Memorandum Branch Stock Account

To Balance b/d	By Sales:
To Goods received from H.O.	Cash Sales
	Credit Sales
To Goods returned by Branch Debtors	By Goods returned to Head Office
To Surplus of Stock	By Shortage of Stock
	By Balance c/d

It should be noted that the Branch Stock Account should be prepared either at cost or at invoice price. In case some of the items have been given at invoice price and the others at cost price, they should be suitably decreased or increased to bring all items at a uniform price. In case goods have been sent to the branch at invoice price, it will be better to prepare the Branch Stock Account at invoice price.

Memorandum Branch Debtors Account

To Balance b/d	By Cash received
To Credit Sales	By Bills receivable received
To Bills receivable dishonoured	By Bad debts
	By Discount
	By Sales returns
	By Balance c/d

The Memorandum Branch Debtors Account as shown above is prepared on the same pattern on which a Total Debtors Account is prepared under Single Entry System.

Illustration 6: Vasan of Madras has a branch at Calcutta. Goods are invoiced from the Head Office at cost plus 33.5%. Branch is allowed to make sales at invoice price only. Expenses of the Branch except petty expenses are paid directly by the Head Office.

From the following particulars, you are required to prepare the necessary accounts to ascertain the net profit at the branch according to the Debtors System.

Debtors on 1.1.1981		10,000
Petty Cash on 1.1.1981 with the Branch		1,000
Stock on 1.1.1981 (at invoice price)		8,000
Goods invoiced by the Head Office		88,000
Furniture on 1.1,1981		2,000
Cash sent by Head Office for petty expenses at the Branch		2,000
Sales: Cash	50,000	
Credit	36,000	
		86,000
Sales Returns by Branch Debtors		800

Goods damaged at invoice price	1,000
(amount recovered from the insurance company Rs. 500)	
Goods returned by Branch to Head Office	2,000
Cash remitted by Branch to Head Office	70,500
Branch Expenses:	
Freight and cartage	500
Rent	1,000
Salary	3,900
Bad debts	50
Depreciation on furniture	80
Advertisement for the branch	200
Petty expenses	1,500

Solution

Branch Account

To Opening Balances	Rs.		
Petty Cash	1,000	By Remittances:	
Debtors	10,000	Cash Sales 50,000	
Stock	8,000	Recovery from Insurance Co. 500	
Furniture	2,000	Collections from Debtors 20,000	70,500
To Goods sent to Branch	88,000	By Goods sent to Branch (returns)	2,000
To Bank (expenses)	5,600	By Stock Reserve (loading)	2,000
To Bank (for petty expenses)	2,000	By Goods sent to Branch (loading)	21,500
To Stock Reserve (Loading)	1,950	By Closing Balances:	
To Net Profit	13,820	Stock	7,800
		Debtors	25,150
		Petty Cash	1,500
		Furniture	1,920
	1,32,370		1,32,370

Goods sent to Branch Account

To. Branch Account (Returns)	2,000	By Branch A/c	88,000
To Branch Account (Loading on Rs.86,000)	21,500		
To Trading Account (Cost of goods sent to branch)	64,500		
	88,000		88,000

Working Notes:

(i) Memorandum Branch Petty Cash Account

To Balance b/d	1,000	By Petty Expenses	1,500
To Cash from Head Office	2,000	By Balance	1,500
	3,000		3,000

(ii) Memorandum Branch Stock Account

To Balance b/d	8,000	By Sales	
To Goods sent to Branch	88,000	Cash 50,000	
To Sales Returns	800	Credit 36,000	86,000

		By Goods returned by Branch	2,000
		By Goods damaged	1,000
		By Balance c/d	7,800
	96,800		96,800

(iii) Memorandum Branch Debtors Account

To Balance b/d	10,000	By Sales Returns	800
To Credit Sales	36,000	By Cash	20,000
		By Bad Debts	50
		By Balance c/d	25,150
	46,000		46,000

Stock and Debtors system

In case of this system, the Head Office maintains a number of accounts for keeping a record of Branch transactions in place of one branch account. A brief description of each of these accounts is given below:

(i) Branch Stock Account : This account is on the pattern of a goods account. The account helps the Head Office in maintaining an effective control over the Branch Stock. It tells about shortage or surplus of stock and the closing stock at the Branch.

(ii) Branch Debtors Account : The account is maintained to keep a record of all transactions relating to Branch and ascertainment of the balance of the debtors at the end of the accounting period.

(iii) Branch Fixed Assets Account : A separate account for each of the Branch Fixed assets is maintained to record all transactions relating to each of these fixed assets.

(iv) Branch Cash Account : The account is maintained to record all cash transactions of the Branch. This is particularly helpful in those cases where the Branch is not required to send immediately all collections of cash made by it but to remit money at regular intervals. The account helps the Head Office in having a control over Branch Cash.

(v) Branch Expenses Account: The account is prepared to give to the Head Office a summary picture of different expenses, bad debts and discounts etc. incurred at the Branch.

(vi) Branch Adjustment Account : The account is maintained for ascertaining the gross profit made at the Branch. All loadings in the goods sent to the branch, opening and closing stocks at the branch and shortage and surplus of stock etc., are recorded in this account.

(vii) Branch Profit and Loss Account : The account is prepared to ascertain profit or loss made at the Branch. The gross profit or loss from the Branch Adjustment Account is transferred to this account. It is debited with all other expenses and losses and credited with all gains and profits. The balance of the account represents the net profit or loss.

(viii) Goods sent to the Branch Account : The account is prepared to ascertain the net value of goods sent to the Branch. Goods sent to the Branch and goods returned by the Branch and loading included in them are recorded in this account.

Journal Entries

The following Journal entries are passed in the books of the Head Office in case the transactions are recorded according to the Stock and Debtors System:

(i) For goods sent to the Branch (at invoice price)
Branch Stock Account Dr.
To Goods sent to the Branch Account

(ii) For goods returned by the Branch to the Head Office (at invoice price)
Goods sent to the Branch Account Dr.
To Branch Stock Account

(iii) For Credit Sales at the Branch (at invoice price)
Branch Debtors Account Dr.
To Branch Stock Account

(iv) For Cash Sales at the Branch (at invoice price)
Cash Account Dr.
To Branch Stock Account

(v) For goods returned by Branch Debtors to the Branch (at invoice price)
Branch Stock Account Dr.
To Branch Debtors Account

(vi) For goods' returned by Branch' Debtors directly to the Head Office (at invoice price)
Goods sent to the Branch Account Dr.
To Branch Debtors Account

(vii) For Goods sent by one Branch to Another.

It will be recorded as if the Branch .has first returned the .goods to the Head Office, and then the Head Office has sent goods to another Branch. For example, if. Branch X sends goods to Branch.- the following entries will be passed:

(a) Goods sent to X Branch Account Dr.
To X Branch Stock Account

(b) Y Branch Stock Account Dr.
To Goods sent to Y. Branch Account

(viii) For Bad Debts, Discount etc.
Branch Expenses Account Dr.
To Branch Debtors Account

(ix) For Expenses at Branch
Branch Expenses Account Dr.
To Bank Account

(x) For Abnormal Shortage (or pilferage or loss) of Stock

Branch Adjustment Account Dr.
(with the amount of loading)
Branch Profit & Loss Account Dr.
(with shortage at cost)
To Branch Stock Account
(with the shortage at invoice price)

For surplus at Branch, a reverse entry will be passed.

No entry is required for normal loss of stock. The Branch Stock balance will be shown at the net amount as found by physical verification.

Any amount received from the Insurance Company for abnormal loss of stock (if insured), will be debited to Branch Cash Account and Credited to Profit & Loss Account.

(xi) For transfer of Branch Expenses
Branch Profit & Loss Account Dr.
To Branch Expensed Account

(xii) For adjustment of loading in the Opening Stock
Stock Reserve Account Dr.
To Branch Adjustment Account

(xiii) For adjustment of loading in Closing Stock
Branch Adjustment Account Dr.
To Stock Reserve Account

(xiv) For adjustment of loading in Net Goods sent to the Branch Account (i.e., goods sent less goods returned by branch)
Goods sent to the Branch Account Dr.
To Branch Adjustment Account

(xv) For transfer of the balance in goods sent to the Branch Account
Goods sent to Branch Account Dr.
To Purchases/Trading Account

(xvi) For transfer of Gross Profit shown by the Branch Adjustment Account
Branch Adjustment Account Dr.
To Branch Profit & Loss Account
In case of gross loss, the entry will be reversed.

(xvii) For transfer of Net Profit at the Branch
Branch Profit & Loss Account Dr.
To General Profit & Loss Account

In case of net loss, the entry will be reversed.

Illustration 7: Kalyani Bros. have two retail sales branches selling goods supplied to them by the firm's central warehouse. All such supplies of goods are charged at the fixed selling price of cost plus 50 per cent.

Sales are mainly for cash but in approved cases limited credit sales are authorised. The whole book-keeping work is centralised at the Head Office.

From the following particulars in respect of the transactions of the branch at Lowhill, Delhi, for the period of 3 months ending on 31st March, 1982, you are required to record them in the Journal and Ledger accounts in the Head Office Books showing clearly how any balances thereon are dealt with (i.e., prepare Branch Stock Account, Branch Debtors Account, Branch Adjustment Account, Branch Profit and Loss Account and Goods sent to Branch Account).

	Rs.
Stock (at selling price) January 1, 1982	26,700
Debtors, January 1, 1982	1,400
Cash sales	72,940
Cash remitted to Head Office by customers	2,800
Goods Returned: by Branch to Head Office	1,170
by credit customers to Branch	570
by credit customers to Head Office	120
Goods transferred by the Branch to Low Hill Branch	4,500
Goods issued to Branch by Head Office (at selling price)	78,300
Bad debts written off	150
Cash remitted to Head Office by the Branch	72,000

The amount due by credit customers on March 31, 1982 was Rs.960. Head Office to Goods (at a sales value of Rs.660) lost in transit from the Branch, the actual stock on that date was in agreement with the figures. A claim was made on the insurance company in respect of the lost stock and a sum of Rs.500 was accepted in full settlement.

Solution **Journal Entries**

Particulars	Dr. Rs.	Cr. Rs.
Branch Cash A/c Dr. To Branch Stock A/c (Cash Sales at Branch)	72,940	72,940
Cash A/c Dr. To Branch Debtors A/c (Cash remitted by Branch Debtors)	2,800	2,800
Goods sent to Branch Account Dr. To Branch Stock Account (Goods returned by Branch)	1,170	1,170
Branch Stock Account Dr. To Branch Debtors Account (Goods returned by Branch Debtors to Branch)	570	570
Goods sent to Branch Account Dr. To Branch Debtors Account (Goods returned by Branch Debtors to Head Office)	120	120
Goods sent to Branch Account Dr. To Branch Stock Account (Goods transferred to Low Hill)	4,500	4,500
Branch Stock Account Dr. To Goods sent to Branch Account (Goods sent to Branch)	78,300	78,300
Branch Profit & Loss Account Dr.	150	

To Branch Debtors Account (Bad debts at Branch)		150
Branch Adjustment Account Dr. Branch Profit & Loss Account Dr. To Branch Stock Account Loss at stock)	220 440	 660
Branch Cash Account Dr. To Branch Profit & Loss Account (for recovery of money from Insurance (Company)	500	 500
Branch Debtors Account Dr. To Branch Stock Account (For Credit Sales)	3,200	3,200
Goods sent to Branch Account Dr. To Branch adjustment account (Loading in goods sent to Branch net)	24,170	24,170
Goods sent to Branch Account Dr. To Purchases Account (For transfer of cost of goods sent to Branch)	48,340	48,340
Branch Adjustment Account Dr. To Stock Reserve (For loading in closing stock)	7,700	7,700
Stock Reserve Account Dr. To Branch Adjustment Account (For loading in opening stock)	8,900	8,900
Branch Adjustment Account Dr. To Branch Profit & Loss Account (For transfer of Gross Profit)	25,150	25,150
Branch Profit & Loss Account Dr. To General Profit & Loss Account (Transfer of Branch Profit)	25,060	25,060
Cash Account Dr. To Branch Cash Account (Remittance received from the Branch)	72,000	72,000

Notes:

1. Alternatively, the amount may be debited to Branch .Expenses Account which may later on be transferred to Profit & Loss Account
2. Alternatively, the amount may be transferred to Head Office Trading Account.

LEDGER ACCOUNTS

Branch Stock Account

	Rs.		**Rs.**
To Balance b/d	26,700	By Cash (Sales)	72,940
To Goods sent to Branch A/c	78,300	By Branch Debtors (credit sales)	3.200
To Branch Debtors	570	By Goods sent to Branch A/c (returns)	1,170
		By Goods sent to Branch A/c (transferred to Low Hill branch)	4,500
		By Branch Adj. A/c	220
		By Branch P & L A/c (Loss in transit)	440
		By Balance (Balancing figure)	23,100
	1,05,570		1,05,570

Branch Debtors Account

	Rs.		**Rs.**
To Balance b/d	1,400	By Cash received	2,800
To Branch Stock A/c (credit sales) (Bal. fig.)	3,200	By Branch Stock A/c (returns) 570	570
		By Goods sent to Branch A/c (direct returns to H.0.)	120
		By Branch P & L (bad debts) 150	150
		By Balance c/d 960	960
	4,600		4,600

Goods Sent to Branch Account

	Rs.		**Rs.**
To Branch Stock A/c (returns)	1,170	By Branch Stock A/c	78,300
To Branch Stock A/c	4,500		
To Branch Debtors A/c	120		
To Branch Adj. A/c (loading 1/3 of Rs.72,510)	24,170		
To Purchase A/c (transfer)	48,340		
	78,300		78,300

Branch Adjustment Account

	Rs.		**Rs.**
To Stock Reserve (Closing Stock)	7,700	By Stock Reserve (opening stock)	8,900
To Branch Stock A/c (loading in loss in transit)	220	Goods sent to Branch A/c (1/3 of 72,510)	24,170

To Gross Profit taken to Branch P & L A/c	25,150		
	33,070		33,070

Branch P & L Account

	Rs.		Rs.
To Branch Debtors A/c (bad debts)	150	By Gross Profit	25,150
To Branch Stock A/c (loss in transit)	440	By Cash (Insurance claim)	500
To Net Profit taken to General P & L A/c	25,060		
	25,650		25,650

Branch Cash Account

	Rs.		Rs.
To Branch Stock Account	72,940	By Cash Account	72,000
To Branch Profit & Loss A/c	550	By Balance c/d	1,490
	73,490		73,490

Cash Account (Head Office)

	Rs.		Rs.
To Branch Debtors Account	2,800	By Balance c/d	74,800
To Branch Cash Account	72,000		
	74,800		74,800

Illustration 8: Shri X has a retail branch at Allahabad. Goods are sent by the H.O. to the Branch marked at selling price which is cost plus 25%. All the expenses of the Branch are paid by the H.O. All cash collected by the Branch (from customers and from cash sales) is deposited to the credit of H.O.

From the following particulars of the Branch, prepare Branch Stock Account, Branch Debtors Account, Branch Expenses Account and Branch Adjustment Account in the books of the Head Office.

	Rs.
Debtors on 1.1.1980	12,000
Debtors on 31.12.1980	14,000
Inventory with the Branch at invoice	
Price on 1.1.1980	16,000
On 31.12.1980	17,000
Cash Sales during the year	60,000
Total amount deposited in the H.O	
Account during the year	1,27,000
Return of goods to H.O. at invoice price	5,000
Salaries paid	6,000

Rent paid	4,000
Discount allowed to customers	2,000
Bad Debts written off	1,000
Spoilage	2,000

Solution

BOOKS OF SHRI X

Branch Stock Account

	Rs.		Rs.
To Balance b/d	16,000	By Cash A/c (cash sales)	60,000
To Goods sent to Branch A/c(balancing fig.)	1,40,000	By Goods sent to Branch A/c(returns)	5,000
		By Branch Adjustment A/c (loading on spoilage)	400
		By Branch P & L A/c (actual spoilage)	1,600
		By Branch Debtors (credit sales)*	72,000
		By Balance c/d	17,000
	1,56,000		1,56,000

Branch Debtors Account

	Rs.		Rs.
To Balance b/d	12,000	By Cash (received from Debtors)	67,000**
To Branch Stock A/c (Credit sales)	72,000	By Branch Exp. A/c (discount)	2,000
(balancing figure)		By Branch Expenses (bad debts)	1,000
		By Balance c/d	14,000
	84,000		84,000

Branch Expenses Account

	Rs.		Rs.
To Cash A/c Salaries paid 6,000 Rent paid 4,000	10,000	By Branch Adjustment A/c balancing figure)	13,000
To Branch Debtors A/c (discount)	2,000		
To Branch Debtors A/c (bad debts)	1,000		
	13,000		13,000

Goods Sent to Branch A/c

	Rs.		Rs.
To Branch Stock (returns to H.O)	5,000	By Branch Stock A/c	1,40,000
To Branch Adjustment A/c (1/5 x 1,35,000)	27,000		
To Balance tr. to Trading A/c	1,08,000		
	1,40,000		1,40,000

Branch Adjustment Account

	Rs.		Rs.
To Branch Stock A/c(1/5 x 2.000) (loading spoilage)	400	By Goods sent to Branch A/c (loading)	27,000
To Stock Reserve (adjustment of	3,400	By Stock Reserve (adjustment of	3,200

closing stock (1/5 x 17,000)		stock 1/5 x 16.000)	
To Gross Profit c/d	26,400		
	30,200		30,200

Branch P & L Account

	Rs.		Rs.
To Branch Stock A/c		By Gross Profit b/d	26,400
(spoilage at cost)	1,600		
To Branch Expenses A/c	13,000		
To Net Profit	11,800		
	26,400		26,400

**** Working Note:**

Amount (collected) recovered from Drs. = Total amount deposited in H.O A/c during the year - Cash Sales

1,27,000 - 60,000 = 67,000

Independent branch or branch keeping own accounts: We have so far considered branches that do not maintain accounts themselves. The accounting is done at the head office. Now we shall consider the branch that keeps its own books of account.

The method of accounting is really simple; in essence it means treating the branch as a sort of special customer. The branch keeps its accounts like anyone else. The head office will have a "Branch Account" in its books. All goods sent to the branch or cash sent to it will be debited to this account and cash received from the branch will be credited to it. Entries are made in the usual manner. The balance in this account will show the amount invested by the head office at the branch.

Similarly, the branch will open "Head Office Account" in its books. The balance shown by this account will usually be credit. The balance shown by the Branch Account (in head office books) will be debit. The amounts in both cases should be the same. But due to certain reasons there may be a difference. If there is a difference, the cause of it must be located and suitable entries passed at the end of the financial year.

Cash or goods in transit: One of the reasons for difference in the balance of the two accounts may be cash sent by branch but received by the head office after the close of the year. Similarly, the goods sent by the head office may reach the branch after the close of the financial year. Entries are passed immediately by the branch when cash is sent by the branch but the head office will not pass entry for receipt until cash is actually received. So also for goods in transit. A record must be made for cash or goods in transit. The entry is usually made by the party which sent the cash or goods. If cash sent by the branch has not yet reached head office, the branch will pass the entry:

Cash in Transit A/c Dr.

To Head Office Account.

If goods sent by the head office are in transit, the head office will record it as under :

Goods in Transit A/c Dr.

To Branch Account

But there is no hard and fast rule about it. In fact it is enough it either party makes a record of the items in transit.

Both the cash in Transit and Goods in Transit are assets and shown in the Balance Sheet.

Note: In examination' problems. cash or goods in transit may have to be inferred. This is done by comparing the balance of the Branch Account (in head office books) and of the Head Office Account (in branch books). Suppose the Branch Account shows a debit balance of Rs.16,000 in the Head Office Account, it can be taken to be either Cash in Transit or Goods in transit.

Accounts of branch's fixed assets kept in 11.0. books: Often the accounts of branch's fixed assets are kept in head office books and not in branch's books. Even if the branch pays for them the amount is debited to Head Office Account. The Head Office will debit the asset account and credit Branch Account. At the end of the year, the question of depreciation will arise. The entries to be passed are:

In Head Office Books

Branch Account Dr.

To Branch Asset A/c

In Branch Books-

Depreciation Account Dr.

To Head Office A/c

Head Office expenses: The head office will always do some work for the branch. At the end of the year, the head office may charge the branch with an amount representing the value of the time devoted to the branch. The entries required are:

In Head Office Books-

Branch Account Dr.

To Salaries Account.

In Branch Books

Head Office Expenses A/c Dr.

To Head Office A/c

Illustration 9: Preliminary accounts made by the Kanpur Branch on 31st December, 1968 showed a profit of Rs.9,500. It was found that the following items were not yet taken into account:

Cash remitted to H.O. not yet received there	5,000
Goods sent by the H.O. not yet received at Kanpur	4,000
Depreciation on Branch assets (accounts kept in H.O. books)	1,200
H.O. expenses charged to the branch	2,500

Journalise the above in the books of both the Head Office and the Branch. Also show how much is the real profit at Kanpur.

Solution

H.O. Journal

1978		Dr.	Cr.
Dec. 3	Goods in Transit A/c Dr. To Kanpur Branch A/c (Goods sent to Kanpur, not yet received there)	4,000	4,000
Dec. 31	Kanpur Branch A/c Dr. to Kanpur Branch Assets A/c (Depreciation on Kanpur Branch assets charged to the Branch account of assets being kept in own books)	1,200	1,200
Dec. 31	Kanpur Branch A/c Dr. To Salaries Account (Amount of expenses charged to the Branch for work done on its behalf)	2,500	2,500

Branch Journal

1978		Rs.	Rs.
Dec. 31	Cash in Transit A/c Dr. To Head Office Account	5,000	5,000

	(The amount of the cash sent to the H.O. not yet received there)		
Dec. 31	Depreciation Account Dr. To Head Office Account (Depreciation of Branch assets whose accounts are in Head Office Books)	1,200	1,200
Dec. 31	Head Office Expenses A/c Dr. To Head Office A/c (Amount charged to the branch in respect of work done at the H.O.)	2,500	2,500

The profit at the Branch is reduced by Rs.1,200 and Rs.2,500, It now stands at Rs.5,800.

Incorporation of Branch accounts in H.O. books: The branch sends its trial balance to the Head Office which will then incorporate branch figures to prepare consolidated Profit and Loss Account and Balance Sheet. The entries to be passed in the Head Office Books are:

(a) Debit Branch Trading Account (with the items debited to Trading A/c
Credit Branch Account such as opening stock, purchases, wages, etc., at the branch.)

(b) Debit Branch Account (with the sale and closing stock at the
Credit Branch Trading Account branch.)

(c) Debit Branch Trading Account (transfer of gross profits.)
Credit Branch profit and Loss A/c

(d) Debit Branch Profit and Loss A/c (with the total of expenses at the
Credit Branch Profit and Loss Account branch.)

(e) Debit Branch Account (with items of gain at the branch.)
Credit Branch Profit and Loss Account

(f) Debit Branch Profit and Loss Account with the net profit at the branch, as disclosed by the
Credit (General) Profit and Loss A/c Branch Profit and Loss A/c

(This entry will be reversed in case of loss.)

With these six entries given above, the Branch Account will show a balance equal to net assets at the branch, i.e., assets less liabilities. If it is desired to close the Branch Account two further entries will be required:

(f) Debit Branch Assets (individually)
Credit Branch Account; and

(g) Debit Branch Account
Credit Branch Liabilities (individually).

Illustration 10: A head office receives the following Trial Balance from its branch:

Debit	Rs.	Credits	Rs.
Opening Stock	21,800	Head Office A/c	21,000
Purchases	42,000	Sundry Creditors	5,600
Wages	10,200	Discount received	300
Salaries	6,300	Sales	81,000
General Expenses	8,300		
Sundry Debtors	18,200		
Cash at Bank	800		
	1,07,900		1,07,900

The closing stock at the branch was Rs.19,700. The Branch Account (in Head Office books) stood at a debit of Rs.26,500. Goods sent by the Head Office, Rs.1,000, had not yet reached the Branch. Head Office expenses chargeable to the Branch were Rs.3,100. Depreciation of Branch assets whose accounts are kept in Head Office books was Rs.3,600. Record the above noted items and the incorporation of Branch figures in Head Office books by means of journal entries and show Branch Account.

Solution

Head Office Journal

1978			
Dec. 3	Goods in Transit A/c Dr. To Branch Account (Adjustment for goods still in transit)	1,000	1,000
Dec. 31	Branch Account Dr. To Salaries Account (Amount charged to the Branch in respect of work done on its behalf)	3,100	3,100
Dec. 31	Branch Account Dr. To Branch Assets Account .(Depreciation on Branch assets whose accounts are kept in H.O. Books)	3,600	3,600
	Branch Trading Account Dr. To Branch Account (Total of items debited to the Branch Trading Account, viz., opening stock, purchases and wages)	74,300	74,300

* The student is advised to first prepare Branch Trading and Profit and Loss Account and then to note the journal entries.

Branch and Departmental Accounts

		Dr. Rs.	Cr. Rs.

	Branch Account Dr. To Branch Trading A/c (Total of credit items credited to Branch Trading Account)	1,00,700	1,00,700
	Branch Trading Account Dr. To Branch Profit and Loss Account (Transfer of gross profit)	26,400	26,400
	Branch Profit and Loss A/c Dr. To Branch Account (Total expenses debited to Branch P & L a/c Salaries 6,300 General Expenses 8,300 H.O. Expenses 3,100 Depreciation 3,600	21,300	21,300
	Branch Account Dr. To Branch Profit and Loss A/c (Discount received credited to Branch P&LA/c)	300	300
	Branch Profit and Loss A/c Dr. To General Profit and Loss Account (Net Profit transferred to General Profit and Loss A/c)	5,400	5,400
	Branch Sundry Debtors A/c Dr. Branch Bank A/c Dr. Branch Stock A/c Dr. Cash in Transit A/c* Dr. To Branch Account (Branch assets transferred to H.O. Books)	18,200 800 19,700 4,500	43,200
	Branch A/c Dr. To Branch Sundry Creditors (Branch Liabilities transferred to H.O. Books)	5,600	5,600

Note: If the last two entries are not passed, the Branch Account will show a balance, showing the H.O. investment at the Branch at the end of the year. If the two entries are passed, the Branch Account will balance and account for various assets and liabilities will be opened in the H.O. Books.

* The difference between the Branch A/c balance and H.O. A/c balance is Rs.5,500 (Rs.26,500 - 21,000). Of this Rs.1,000 is explained by goods in transit. The balance of difference is due to cash in transit.

Branch Account

Debits	Rs.	Credits	Rs.
To Balance b/d	26,500	By Goods in Transit A/c	1,000
To Branch A/c H.O. Expenses	3,100	By Branch Trading Account	74,300
To Branch A/c (Depreciation)	3,600	By Branch Profit and Loss A/c	21,300
To Branch Trading Account	1,00,700	By Sundry Assets	

To Branch P & L A/c	300	Debtors 18,200	
To Branch sundry Creditors	5,600	Bank 800	
		Cash in Transit 4,500	
		Stock 19,700	43,200
	1,39,800		1,39,800

Alternatively, only one entry in respect of revenue items may be passed. This is passed after preparing the Branch Profit and Loss Account on memorandum basis. If there is net profit, the Branch is debited and the (General) Profit and Loss Account is credited. In case of loss, this entry is reversed. If we do the above illustration in this manner, only the following entry (for net profit) will be necessary:

		Rs.	Rs.
Branch Account	Dr.	5,400	
To (General) Profit and Loss A/c			5,400
(Being the net profit at the Branch during the year)			

(Note: The first three entries in respect of goods in transit, head office expenses and depreciation of Branch assets will still be necessary).

The Branch Account will appear as under:

Branch Account

Dr. Cr.

To Balance b/d	26,500	By Goods in Transit A/c	1,000
To Salaries A/c H.O. Expenses	3,100	By Balance c/d	37,600
To Branch Expenses A/c	3,600		
To Profit and Loss A/c	5,400		
	38,600		**38,600**
To Balance b/d	37,600		

The balance in the Branch Account represents what the branch owes to the Head Office; what any firm owes to its proprietor is the difference between assets and liabilities. Capital is always assets - liabilities. Therefore, the accuracy of the branch balance can be checked by ascertaining net assets. In Illustration 10, the balance at Branch is as shown below: -

Stock	19,700
Debtors	18,200
Bank	800
Cash in Transit	4,500
	43,200
Less Creditors	5,600
Net Assets	37,600

If the Branch Account is to be closed, two entries are necessary:

Branch Stock A/c	Dr.	19,700	
Branch Debtors A/c	Dr.	18,200	
Branch Bank A/c	Dr.	800	
Cash in Transit	Dr.	4,500	
To Branch Account			43,200
Branch Account	Dr.	5,600	
To Branch Creditors A/c			5,600

Foreign Branch

A foreign branch keeps its own books of account. It will send a Trial balance to the head office but in foreign currency and the one additional problem is to convert the foreign currency into own currency. Once the trial balance is converted, the treatment is exactly like the one for "independent branch" already discussed above. The rules for conversion of the trial balance are as follows :

(a) Fixed assets (and fixed liabilities, if any) should be converted at the rate prevailing on the date of acquisition. The same rate will be used always in future. (In examination problems, in absence of information, fixed assets should be converted at the rate prevailing on the first day of the year).

(b) Current assets and current liabilities should be converted at the rate prevailing on the last day of the year.

(c) Revenue items, that is, items appearing in the trading and profit and loss account, should be converted at the average rate. (But opening stock should be converted at the opening rate and closing stock should be at the closing rate).

Also, if goods have been received from the Head Office, the Goods Received from H.O. Account should be converted at the same figure as is shown by the Goods sent to Branch Account (in H.O. books).

Further, if during .the year there has been a devaluation, revenue items should be converted at the rate prevailing at the end of the year and not at the average rate.

(d) Head Office Account and connected accounts (like Remittances to H.O. A/c etc.)are not converted by calculation. The relevant accounts in the Head Office Books should be seen and their balances should be used to convert Head Office and similar accounts. Suppose Branch Trial Balance shows a credit balance the Head Office Account as £3,000 and the Branch Account (in H.O. books) stands at Rs.54,200. The Head Office Account will be converted at Rs.54,200.

(e) The trial balance will now disagree. The difference should be put on the shorter side as "Difference in Exchange Account". If the amount is small, it should be transferred to the Profit and Loss Account. If the amount is big and credit, it may be carried forward to the next year. A debit balance by the Difference in Exchange Account should be transferred to the P & L. A/c.

Illustration 11: Delhi Textiles Ltd. have a branch in Singapore. On 31st December, 1978 the Trial Balance of the Branch was as given below:-

	Dr. £	Dr. £
Head Office Account	…	18,000
Sales	…	1,20,000
Goods from Head Office Account	90,000	
Stock, 1st January 1968	15,000	
Furniture and Fixtures	20,000	
Cash in Hand	100	
Cash at Bank	1,900	
Owing for expenses 2,000	….	2,000
Salaries 6,000	6,000	
Taxes, Insurance, etc	500	
Rent	2,000	
Sundry Debtors	4,500	
	1,40,000	1,40,000

The Branch Account in the Head Office showed a debit balance of Rs. 2,25,000 and "Goods Sent to Branch Account" a credit balance of Rs.16,15,000.

Furniture and Fixtures were acquired in 1965 when £1 = Rs.13.50.

The exchange rates were:

January 1, 1978	£1 = Rs. 17.50
December 31, 1978	£l = Rs. 18.50
Average	£1 = Rs. 18.00

The stock at branch on 31st December 1968 was valued at £9,000. Convert the Branch Trial Balance into rupees and prepare the Branch Trading and Profit and Loss Account for 1978 and the Branch Account in Head Office Books. Depreciation is to be written off the furniture and fixtures @ 10%.

Solution

Singapore Branch Trial Balance as at December 31, 1978.

Item	Rate Rs.	Dr. £	Cr. £	Dr. Rs.	Cr. Rs.
H.O. Account	…		18,000		2,25,000
Sales	18.50		1,20,000		21,60,000
Goods from H.O. A/c	….	90,000		16,15,000	
Stock 1st Jan	17.50	15,000		2,62,500	
Furniture & Fixtures	13.50	20,000		2,70,000	
Cash in hand	18.50	100		1,850	
Cash at Bank	18.50	1,900		35,150	
Owing for expenses	18.50		2,000		37,000
Salaries	18.00	6,000		1,08,000	
Taxes, Insurance etc	18.00	500		9,000	
Rent	18.00	2,000		36,000	
Sundry Debtors	18.50	4,500		83,250	
		1,40,000	1,40,000	24,20,750	24,22,000
Difference in Exchange				1,250	
				24,22,000	24,22,000
Closing Stock	18.50	9,000		1,65,500	

Singapore Branch Trading and Profit & Loss Account
for the year ended December 31, 1978

To Stock opening	2,62,500	By Sales	21,60,000
To Goods from H.O.	16,15,000	By Closing Stock	1,65,000
To Gross profit c/d	4,49,000		
	23,26,500		23,26,500
To Salaries	1,08,000	By Gross Profit b/d	4,49,000
To Taxes, Insurance etc	9,000		
To Rent	36,000		
To Difference in Exchange	1,250		
To Depreciation	27,000		
To Net Profit	2,67,750		
	4,49,000		**4,49,000**

Singapore Branch Account

1978 Dec. 31	To Balance b/d	2,25,000	1978 Dec.31		
	To Branch Trading A/c Sales 21,60,000 Stock 1,65,500	23,26,500		By Branch Trading A/c Opening Stock Goods from H.O 16,15,000	18,77,500
				By Branch P & L A/c (expenses)	1,81,250
				By Balance c/d	4,92,750

		25,51,500			25,51,500
1979 Jan.1	To Balance b/d	4,92,750			

Alternatively:

Singapore Branch Account

1978	To Balance b/d	2,25,000	1978	By Balance c/d	4,92,750
Dec.31			Dec. 31		
	To Profit & Loss A/c.				
	Net Profit	2,67,750			
		4,92,750			4,92,750
1979					
Jan. 1	To Balance b/d	4,92,750			

The alternative treatment of the Branch Account assumes that the Branch Trading and Profit and Loss Account was prepared on a memorandum basis.

The accuracy of the balance shown by the Singapore Branch Account is proved below:

Assets at the Branch:

	Rs.
Stock	1,66,500
Sundry Debtors	83,250
Cash at Bank	35,150
Cash in hand	1,850
Furniture (Rs.2,70,000 less Depreciation Rs.27,000)	2,43,000
Total of assets	5,29,750
Less: Liabilities, expenses unpaid	37,000
Net assets	4,92,750

QUESTIONS

Problem 1. A head office at Pondicherry has a branch at Kochi to which goods are invoiced by the head office at cost plus 25%. All cash received by the branch is daily remitted to the head office. All expenses are paid from Pondicherry. From the following particulars show how the branch account will appear in the head office books:

Stock on January 1, 1994 (invoice price)	12,000
Cash in hand on January 1, 1994	200
Debtors on January 1, 1994	30,000

Goods invoiced from Pondicherry	80,000
Cash sales	35,000
Credit sales	52,000
Goods returned by debtors	3,000
Discount allowed to debtors	300
Cheques received from Pondicherry	
Wages and salaries 11,000	
Rent 4,000	
Office furniture 1,500	16,500
Balance of stock on December 31, 1994 (invoice price)	20,000
Balance of debtors on December 31, 1994	27,000

Notes:

1. In the absence of any information about cash expenses met by the branch manager, it has been assumed that cash in hand at the end of the year was the same as it was in the beginning, i.e., Rs.200.
2. Furniture purchased by the head office for the branch will appear as an asset at the end.
3. Debtors account will reveal cash received from the customers, which when added to the cash sales figures, will give the figure of remittances.

Problem 2. Head office of a company invoices goods to its Madras branch at cost plus 20%. The Madras branch also purchases independently from local parties goods for which payments are made by the head office. All the cash collected by the branch is banked on the same day to the credit of the head office and all expenses are directly paid by the head office except for a petty cash account maintained by the branch for which periodical transfers are made from the head office.

From the following particulars, show branch account as maintained in the head office books, reflecting the branch profit for the year ended December 31, 1995.

Imprest cash:	
3-1-1995	2,000
31-12-1995	1,850
Sundry debtors on 1-1-1995	25,000
Stock on 1-1-1995:	
Transferred from head office at invoice price	24,000
Directly purchased by branch	16,000

Cash sales	45,000
Credit sales	1,30,000
Direct purchases	45,000
Returns from customer	3,000
Goods sent to branch from head office at invoice price	60,000
Transfer from head office for petty cash expenses	2,500
Bad debts	1,000
Discount to customers	2,000
Cash received from customers	1,25,000
Branch expenses	30,000
Stock on 31-12-1995:	
Directly purchased by branch	12,000
Transferred from head office (at invoice price)	18,000

Problem 3. Mohan Brothers had a small branch at Pondicherry. You are required to prepare Pondicherry Branch account in the books of Mohan Brothers for calculating profit made at Pondicherry branch. Transactions during the year ending on March 31, 1995 were as follows :

Stock at cost on 1-4-1994	4,000
Furniture on 1-4-1994	2,000
Goods sent to branch at cost	60,000
Cash sales made by the branch	90,000
Furniture purchased by the branch on permission from head office	1,200
Stock at the end with branch	3,500
Expenses paid by head office	5,300

It was required to write off furniture at 10% p.a. No depreciation is provided on additions made during the year. Hint: Remittances will be reduced by the amount spent on purchases of furniture.

Problem 4.Nirmal Brothers operate a retail branch at Mahe. All purchases as made by the head office at Madargate, goods being charged out to the branch at cost price. All cash received by the branch is remitted to Madargate. Branch petty expenses are paid out of an imprest which is reimbursed by the head office from time to time. From the following particulars relating to

Mahe branch, you are required to prepare branch account (for calculating profit) in the books of head office:

January 1, 1993:	Rs.
Stock at cost	7,000
Petty cash	700
Plant	8,000
December 31, 1993:	
Stock at cost	6,300
Goods sent to branch	40,800
Expenses paid by the head office	4,200
Petty expenses paid by the branch out of imprest	630
Cash sales during the year	60,700
Sale of plant on July 1, 1993 (book value of plant on the date of sale Rs. 950)	900
It is required to write off plant at 10% p.a.	

Hints: Petty expenses will appear on the debit side of branch account and petty cash balance will remain at Rs.700 because of imprest system.

Problem 5. The KotahDoria Ltd. with its head office at Kotah opened a branch at Ajmer on 1st January, 1992. Goods are invoiced to the branch at cost plus 25%. From the following particulars calculate gross profit and net profit or loss at Ajmer Branch (by Stock and Debtors System) and open all necessary accounts.

	Rs.
Goods sent to Ajmer branch at invoice price	45,000
Expenses paid by head office	7,200
Discount allowed to debtors	50
Bad debts written off	80
Sale: Cash 21,000 Credit 12,000	33,000
Stock on December 31 (Invoice price)	11,800

Goods returned by the branch (Invoice price)	600
Goods returned by debtors	500
Cash remitted to head office	30,800
Cash in hand on December 31	300

(Gross profit Rs.6,500; Net loss Rs.910; Debtors at the end Rs.1,570)

Problem 6.Swamy Bros. of Guntur have a branch at Vijayawada. Goods are sent to the branch at cost price plus 1/2 of cost price. From the following particulars prepare necessary accounts on Stock and Debtors system and calculate gross profit and net profit for the branch.

	Rs.
Stock in the beginning (at invoice price)	3,900
Goods sent to branch	30,000
Goods returned by the branch	3,000
Credit sales by the branch	15,000
Cash remitted by the branch	31,000
Debtors balance in the beginning	4,000
Cash received by the branch from the debtors	16,000
Cash received by the head office direct from the branch debtors	2,000
Bad debts	100
Cash discount on cash payment	20
Shortage at the branch	120
Recurring expenses paid by the head office	1,600
Non-recurring expenses paid by the head office	200

Gross profit Rs.9,800; Net profit Rs.8,000)

Note:

1. Difference between cash remitted and cash received will be treated as cash sales.
2. Non-recurring expense is a term used for direct expense. Hence, non-recurring expenses have been taken to adjustment account for calculating gross profit.
3. Recurring expenses, being indirect expenses, have been taken to branch profit and loss account.

4. Shortage has been divided into two parts. The adjustment portion of shortage is considered for calculating gross profit and rest of the portion for the net profits.

Problem 7. Preetham and Jeethu are two partners who respectively manage Pondy and Madras branches of MessrsPreejee& Co., and have calendar year as accounting year and share profits 2/3rds and 1/3rd respectively.

On 31-12-1994 the balances stood as under:

	Pondy Rs.	Madras Rs.
Opening Stock	54,000	39,000
Madras branch (Dr.)	22,500	
Pondy Branch (Cr.)	…..	18,000
Preetham capital	1,02,000	
Jeethu capital	…..	24,000
Purchases	96,000	51,000
Sales	1,56,000	72,000
Books debts	22,500	15,000
Creditors	21,000	6,000
Wages	18,000	12,000
Freight (Inward)	2,700	1,200
Machinery (Pondy)	36,000	
Machinery (Madras)	24,000	
Cash in hand	3,300	1,800
Closing Stock	50,400	42,600

Madras office debited Pondy office with remittance made on 31-12-1994 for Rs. 4,500 which was received by Pondy on 2-1-1995.

Partners are to be allowed interest at 5% by the respective offices. Each of these offices has to charge depreciation at 5%.

Prepare journal entries with narration in the books of each of the offices and also the columnar trading and profit and loss account and balance sheet of the firm.

[Pondy branch-Gross profit Rs.35,700; Net profit Rs,28,800; Madras branch-Gross profit Rs.11,400; Net profit Rs.9,000; Balance sheet total-Madras Rs.63,900; PondyRs. 1,53,300 ; Balance- Pondy Office Rs. 20,100 (Cr.); Madras Office Rs. 20,100 (Dr.)].

LESSON 6.2 DEPARTMENTAL ACCOUNTS

Introduction

A business may have a number of Departments each dealing in a different type of goods. For example, one department may be dealing in medicines, the other may be dealing in textiles, still another may be dealing in provisions etc. In order to ascertain the profit or loss made by each Department, it will be advisable to prepare separately Trading and Profit & Loss Account of each Department at the end of the accounting year. Preparation of such Departmental Accounts is helpful to the business in the following respects:

(i) It enables the business to compare the performance of one Department with that of another.

(ii) It helps the business in formulating proper policies relating to the expansion of the business. New profitable lines of production of trading can be taken up while the existing lines of production or trading which are running at a loss can be closed down.

(iii) It helps in appropriate rewarding or penalising the Departmental employees on the basis of the results shown by them.

MAINTENANCE OF COLUMNAR SUBSIDIARY BOOKS

The principle of Departmental Trading and Profit & Loss Account requires maintenance of proper subsidiary books having appropriate columns for different departments. For example, if a business has three departments A, B & C, the subsidiary books such as Purchases Book, Purchases Returns Book, Sales Book, Sales Returns Books etc., should have separate columns for each of the departments. Cash Book may also have columns for recording cash sales of each of the departments separately in case the volume of cash sales is quite large. The specimen of a Purchases Book having columns for different Departments is given below:

Purchases Book

Date	Particulars	L.F.	Dept. A	Dept. B	Dept. C	Dept. D

The same pattern of rulings may be followed in case of other subsidiary books also.

DEPARTMENTALISATION OF EXPENSES

In order to ascertain the profit or loss made by each department, it is necessary that each department is charged with a proper share of the various business expenses. The following basis may be adopted for departmentalisation of such expenses:

(i) Expenses incurred specifically for a particular department should be directly charged to that department. For example, salaries payable to each of the departmental managers will be charged to the respective departments. Similarly if there are separate electricity metres for each of the departments, the electricity should be charged to each of the departments on the basis of the electricity bills received for each one of them.

(ii) Expenses which have been incurred for the business as a whole but capable of being apportioned over different departments on a suitable basis should be charged to the different departments, on such basis. Of course, there are no hard and fast rules as regards the basis to be applied for apportionment of such expenses. However, the following basis for apportionment may be adopted:

(a) **Departmental wages:** Expenses which directly vary with the departmental wages can be apportioned on this basis. For example, premium for work-men's compensation, insurance, E.S.I. may be apportioned on this basis.

(b) **Capital value of the assets:** Expenses such as depreciation of buildings, plant and machinery, fire insurance premiums in respect of these assets etc. may be apportioned on this basis.

(c) **Floor area:** Expenses such as lighting (unless metered separately), rent and rates, wages of night watchman etc. may be apportioned on this basis.

(d) **Number of workers employed:** Expenses of workers' canteen, welfare, personnel and time keeping departments etc. may be apportioned on this basis.

(e) **Production hours of direct labour:** Works manager's remuneration, general over-time expenses, cost of inter-departmental transport should be charged to the various departments in the ratio which the Departmental Direct Labour Hours bears to the Total Factory Direct Labour Hours.

(f) **Technical estimate:** Advice of the technical personnel may also be useful for the apportionment of certain expenses e.g., the cost of steam consumed by a particular department, may be estimated on the basis of the engineer's estimate.

(iii) Expenses which cannot be allocated or apportioned over different departments in a reasonable manner, should be charged to the total profit of all the departments taken together. For this purpose, the profit shown by the different departments should be brought down in one account which will be termed as the

General Profit & Loss Account and all such expenses should be charged there. General Manager's salary, Director's fees, Auditor's remuneration, Interest on Debentures etc. are some of the expenses which fall in this category.

Departmentalisation of Expenses

Illustration 1. M/s Raju Auto Garage have three departments, viz. (i) Cars and Trucks, (ii) Two-wheelers, and (iii) Servicing. The former two sell spare parts and occupy a godown-cum-show-room. The servicing department uses a garage and adjoining site.
The following particulars are extracted from the books of the business for the year ended 31st March, 1979, from which you are required to prepare:

(a) A Departmental Trading and Profit and Loss A/c,
(b) A General Profit and Loss A/c, and
(c) A Balance Sheet.

	Rs.
Stock 1-4-78	
Cars and Trucks	1,00,000
Two-wheelers	27,500
Purchases:	
Cars and Trucks	3,50,000
Two-wheelers	1,10,000
Sales:	
Cars and Trucks	6,00,000
Two-wheelers	3,00,000
Servicing	1,00,000
Wages of Counter-salesmen:	
Cars and Trucks	30,000
Two-wheelers	12,000
Wages of garage labour	10,800
Office salaries and wages	12,000
Godown and showroom rent	24,000
Land and Garage Building	2,72,000
Office Expenses	36,000
Garage Equipment	1,00,000
Showroom Furniture and Fittings	70,000
Office van	24,000
Sundry Debtors	12,000
Sundry Creditors	60,000
Bank Overdraft	17,200
Power and lighting	36,000
Bank Interest	1,000
Cash in hand	900
Drawings A/c	12,000
Proprietor's Capital Account	1,63,000

Following further Information is available:
(i) Included in " Land and Garage Buidling" is cost of suite used by the servicing department
Rs.2,00,000.

(ii) Closing stock on 31.03.1979 at the departments :

Cars and Trucks Rs.90,000

Two – wheelers Rs. 32,500

(iii) 50% of power and lighting is to be charged to Servicing Department, the balance equally to the other departments.

(iv) Rates for depreciation are :

Building 5%, Garage Equipment 15%, Showroom furniture etc. 10% and Office Van 20%.

(v) Outstanding expenses were

Interest Rs.150

Office expenses Rs.2,000

(vi) Interest and all expenses relating to the office are to be considered common and charged to the General Profit and Loss A/c.

(vi) The departments using the showroom share the space and furniture and fittings equally.

Solution:

MESSRS RAJU AUTO GARAGE

Departmental Trading & Profit and Loss Account for the year ending March 31, 1979

Particulars	**Cars & Trucks Rs.**	**Two Wheelers Rs.**	**Servi-cing Rs.**	**Particulars**	**Cars & Trucks Rs.**	**Two Wheelers Rs.**	**Servi-cing Rs.**
To Opening Stock	100,000	27,500	---	By Sales	600,000	300,000	100,000
To Purchases	350,000	110,000	---	By Closing Stock	90,000	32,000	--
To Wages	30,000	12,000	10,800				
To Gross Profit c/d	210,000	183,000	89,200				
	690,000	**332,500**	**100,000**		**690,000**	**332,500**	**100,000**
To Godown & Showroom	12,000	12,000	--	By Gross Profit b/d	210,000	183,000	89,200
To Power & Lighting	9,000	9,000	18,000				
To Depreciation:							
Building			3,600				
Garage Equipment			15,000				
Furniture	3,500	3,500	--				
To Net Profit c/d	185,500	158,500	52,600				
	210,000	**183,000**	**89,200**		**210,000**	**183,000**	**89,200**

General Profit & Loss Account for the year ending 31st March, 1979

Particulars	Rs.	Particulars	Rs.
To Office salaries & wages	12,000	By Profit b/d:	
To Office Expenses 36,000		Cars & Trucks Dept.	1,85,500

Outstanding 2,000	38,000	Two Wheelers Dept.	1,58,500
To Depreciation on Van	4,800	Servicing Dept.	52,600
To Bank Interest 1,000			
Outstanding 150	1,150		
To Net Profit	3,40,650		
	3,96,600		3,96,600

Balance Sheet as at 31st March, 1979

Liabilities	Rs.	Assets	Rs.
Bank overdraft	17,200	Current Assets:	
Outstanding expenses		Cash-in-Hand	900
Interest 150		Sundry Debtors 12,000	
Office Expenses 2,000	2,150	Stock in trade	
Sundry Creditors	60,000	Cars & Trucks 90,000	
		Two Wheelers 32,500	1,22,500
Capital 1,63,000		Fixed Assets:	
Net Profit 3,40,650		Land	2,00,000
5,03,650		Garage Building 72,000	
Less: Drawings 12,000	4,91,650	Less: Depreciation 3,600	68,400
		Garage Equip. 1,00,000	
		Less: Depreciation 15,000	85,000
		Show Room Furniture & Fittings 70,000 Less: Depr. 7,000	63,000
		Office Van 24,000	
		Less: Depr. 4,800	19,200
	5,71,000		**5,71,000**

Computation of Departmental Costs

Illustration 2. The following purchases were made by a business house having three departments:

Department A 1,000 units
Department B 2,000 units at a total cost of Rs 1,00,000
Department C 2,400 units
Stock on 1st January were:
Department A 120 units, Department B 80 units and Department C 152 units.

The sales were. The sales were :

Department A 1,020 units @ Rs.20 each.
Department B 1,929 units @ Rs. 22.50 each.
Department C 2,496 units @ Rs. 25 each.

The rate of gross profit is the same in each case. Prepare Departmental Trading Account.

Solution

In order to determine the rate of Gross Profit, it is assumed that all units purchased have been sold away.

Sales: Dept. A 1,000 units @ Rs. 20 each	20,000
Dept.B 2,000 units @ Rs. 22.50 each	45,000
Dept. C 2,400 units @ Rs. 25 each	60,000

Total Sales	1,25,000
Less: Cost of Purchases	1,00,000
Gross Profit	25,000

Gross Profit as a percentage = 25,000/ 1,25,000 x 100 = 20%

Cost Price of units purchased for each Department can now be ascertained as follows:

	Selling Price	Gross Profit	Cost
Dept. A	Rs. 20	Rs. 4	16
Dept. B	Rs. 22.50	Rs. 4.50	18
Dept. C	Rs. 25	Rs. 5	20

Units of Closing Stock	Opening Stock	+	Purchase -	Sales
Dept. A	120	+	1,000 -	1,020 = 100
Dept. B	80	+	2,000 -	1,920 = 160
Dept. C	152	+	2,400 -	2,496 = 56

Departmental Trading Account can now be prepared as follows:

Departmental Trading Account

	Dept. A	Dept. B	Dept. C		Dept. A	Dept. B	Dept. C
To Opening Stock	1,920	1,440	3,040	To Sales	20,400	43,200	62,400
To Purchases	16,000	36,000	48,000	To Closing Stock	1,600	2,880	1,120
To Gross Profit	4,080	8,640	12,480				
	22,000	**46,080**	**63,520**		**22,000**	**46,080**	**63,520**

INTER-DEPARTMENTAL TRANSFERS

Transfers of goods or services may take place from one department to another while preparing the Departmental Trading and Profit & Loss Account. The department receiving the goods or services should be debited with the value of the goods or services so supplied and the department providing such goods or services should be credited with the same amount.

The transfer of goods from one department to another is usually at cost. However, if such transfer is at a profit, the pi Da or low of each department should be ascertained on the basis of the transfer price itself. However, if the goods transferred by one department to another at a profit, still remain unsold with the transferee department, an appropriate reserve for unrealised profit will have to be created by means of the following journal entry.

General Profit & Loss Account Dr. -

To Stock Reserve

In case the transferree Department has also some stock in the beginning of the accounting year, including some unrealised profit, against which stock reserve was created last year, such reserve will also be transferred to the General Profit & Loss Account by means of the following journal entry.

Stock Reserve Account	Dr.	-
To General Profit & Loss Account		-

Alternatively, a single journal entry may be passed for the unrealised profit on the basis of the difference between unrealised profit included in the opening and closing stocks. This will be clear with the help of the following illustration.

Illustration 3. From the following Trial Balance, prepare Departmental Trading and Profit and Loss Account for the year ending 31st March, 1974 and the Balance Sheet as at that date:

		(Rs. in '000)
Stock, 1st April, 1973	A Department	1,700
	B Department	1,450
Purchases	A Department	3,540
	B Department	3,020
Sales	A Department	6,080
	B Department	5,125
Wages	A Department	820
	B Department	270
Rent, Rates, Taxes and Insurance		939
Sundry Expenses		360
Salaries		300
Lighting and Heating		210
Discount allowed		222
Discount received		65
Advertising		368
Carriage Inward		234
Furniture and Fittings		300
Machinery		2,100
Sundry Debtors		606
Sundry Creditors		1,860
Capital Account		4,766
Drawings		450
Cash at Bank		1,007

The following further information is available:

1. Internal transfer of goods from A to B Department Rs.42,000.
2. The items Rent, Rates and Taxes and Insurance, Sundry Expenses, Lighting and heading Salaries and Carriage are to be apportioned 2/3rd to A Department and

1/3rd to B Department.

3. Advertising is to be apportioned equally.
4. Discounts allowed and received are to be apportioned on the basis of Departmental Sales and Purchases (excluding Transfers).

5.Depreciation at 10 per cent per annum on Furniture and Fittings and on Machinery is to be charged 3/4ths to A Department and 1/4th to B Department.

6. Services rendered by B Department to A Department are included in wages Rs.50,000

7. Stock on 31st March 1974 in A Department was worth Rs.16,74,000 and in B Department it was worth Rs.12,05,000.

Solution

Departmental Trading & Profit & Loss Account
for the year ending 31st March, 1974

(in thousand Rupees)

Particulars	**Dept. A**	**Dept. B**	**Particulars**	**Dept. A**	**Dept. B**
To Opening Stock	1,700	1,450	By Sales	6080	5,125
To Purchases	3,540	3,020	By Transfer	42	50
To Wages	820	270	By Closing Stock	1,674	1,205
To Transfer	50	42			
To Carriage Inward	156	78			
To Gross Profit	1,530	1,520			
	7,796	6,380		7,796	6,380
To Salaries	200	100	By Gross Profit	1,530	1,520
To Rent, Rates, Taxes & Insurances	625	313	By Discount	35	30
To Sundry Expenses	240	120	By Net Loss	126	----
To Lighting Heating	140	70			
To Advertising	184	184			
To Depreciation on Machinery	158	52			
To Furniture	22	8			
To Discount	121	101			
To Net Profit	---	602			
	1,691	**1,550**		**1,691**	**1,550**

Balance Sheet as on 31 st March, 1974 (in thousand Rupees)

Liabilities			Assets		
Capital	4,766		Machinery	2,100	
Add : Profit	476		Less : Depreciation	210	1,890

	5,242		Furniture & Fittings	300	
Less : Drawings	450	4,792	Less : Depreciation	30	270
Sundry Creditors		1,800	Stock in trade		2,879
			Sundry Debtors		606
			Cash at Bank		1,007
		6,652			**6,652**

QUESTIONS

Problem 1. From the following Thal Balance, prepare Departmental Trading and Profit and Loss A/c for the year ended 31st March, 1985 and Balance Sheet as at that date.

TRIAL BALANCE

		Dr. Rs.	Cr. Rs.
Stock 1.4.84	Department A	17,000	
	Department B	14,500	
Purchases	Department A	35,400	
	Department B	30,200	
Sales	Department A	---	60,800
	Department B	---	51,250
Wages	Department A	8,200	
	Department B	2,700	
Rent, rates, taxes and Insurance		9,390	
Sundry expenses		3,600	
Salaries		3,000	
Light and heating		2,100	
Discount allowed		2,220	
Discount received		---	
Advertising		3,680	
Carriage inwards		2,340	
Furniture and Fittings		3,000	
Plant and Machinery		21,000	
Sundry debtors		6,060	
Sundry creditors		---	18,600
A's Capital Account			47,660
A's Drawing		4,500	
Cash in hand		170	
Cash at Bank		9,900	
		1,78,960	1,78,960

The following information is also provided:

(a) Internal transfer of goods from Deptt. A to Deptt. B Rs.420.

(b) The items rent, taxes and insurance, sundry expenses, lighting and heating, salaries and carriage inwards to be apportioned at 2/3rd to Dept. A and 1/3rd to Dept. B.

(c) Advertising to be apportioned equally.

(d) Discount allowed and received are apportioned on the basis of departmental sales and purchases (excluding transfers) corrected to nearest Rs.10.

(e) Depreciations at 10% per annum on furniture and fittings and on plant and machinery. This is to be charged 3/4 to Dept. A and 1/4 to Dept. B.

(f) Services rendered by B Dept. included in wages Rs.500.

(g) Stock as at 31.3.85 A Dept. Rs.16,740 and B Dept. Rs.12,050.

(h) Fixed assets remain unchanged during the year.

Problem 2. The following balances were extracted from the books of Vijay Shanker. You are required to prepare departmental Trading Account and Profit and Loss Account for the year ended 31st December 1984, after adjusting the unrealised departmental profit, if any.

	Departments	**Departments**
	A Rs.	B Rs.
Opening Stock	50,000	40,000
Purchases	6,50,000	9,10,000
Sales	10,00,000	15,00,000

General expenses incurred for both the departments were Rs.1,25,000 and you are also supplied with the following informations:

(a) Closing Stock of Department A Rs.1,00,000 including goods from Department B for Rs.20,000, at cost to Department A.

(b) Closing Stock of Department B Rs.2,00.000 including goods from Department A for Rs.30,000, at cost to Department B.

(c) Opening Stock of Department A and Department B includes goods of the value of Rs.10,000 and Rs.15,000 taken from Department B and Department A respectively at cost to transferred Departments.

(d) The gross profit is uniform from year to year.

Problem 3. The following is the trial balance of Automatic Motors and Garage on 31st March, 1985:

	Rs.	Rs.
Capital Account		76,250
Drawings	8,500	

Opening Stock:		
Petrol and Oil	1,675	
Spare parts and tyres	5,500	
Tools	2,200	
Hire Cars	72,000	
Tools	4,000	
Spare parts and tyres	32,000	
Petrol and Oil	41,250	
Advertising Expenses	4,500	
Rent, Rates and Taxes	12,000	
Insurance Permium:		
On hire cars	4,000	
Fire, theft and burglary cases	425	
Wages:		
Drivers	12,000	
Repairs Department	16,500	
Office	7,500	
Garage	1,000	
Sales:		
Petrol and Oil		23,000
Spare parts and tyres		37,000
Garage receipts		4,000
Repairs Department		14,000
Hire Receipts		70,000
Licence fees and permit fees for hire cars	3,000	
Office Expenses	4,000	
Sundry Debtors	400	
Sundry Creditors		1,200
Commission received on cars sold		5,000
Loan		4,000
Cash in hand and at Bank	2,000	
	2,34,450	2,34,450

The following additional information is also given to you:

(a) The loan was taken on 1st January, 1985 on which interest at 12% is to be paid:

(b) Stocks in hand on 31st March, 1985 were as under:

(i) Tools	5,000
(ii) Petrol and Oil	4,300
(iii) Spare parts and tyres	10,000

(c) Petrol and oil whose values were Rs.15,600 and Rs.1,800 were used by hired cars and repairs department respectively. Besides, the owner of the garage drew petrol and oil worth Rs.3,000 for his personal car;

(d) Repairs Department performed work during the year as under:

(i) on owner's car Rs.600

(ii) on hire cars Rs.7,500

(e) Spare parts used by the Repairs Department in the year cost Rs.4,000 and by the hired cars Rs.750;

(f) Depreciation on hired cars to be provided at 30% per annum;

(g) Licences and taxes amounting to Rs.200 on owner's car have been paid and included in Rent, Rates and Taxes;

(h) Rent, Rates and Taxes to be distributed as under:

(i) Repairs Department 1/2

(ii) Spare Parts 1/4

(iii) Garage 1/8

(iv) Office 1/8

You are required to prepare a Departmental Trading Account, a Profit and Loss Account for the year ended 31st March, 1985 and a Balance Sheet as on that date.

UNIT-VII

Unit Structure:

Lesson - 7.1 Single Entry System

Lesson - 7.2 Single Entry System - Conversion Method

LESSON - 7.1 SINGLE ENTRY SYSTEM

Single entry system is an imperfect way of keeping accounting records. Under this system cash book and personal accounts are maintained and, nominal and real accounts are not maintained. Of course, this system is suitable for small businesses as it saves time and cost of recording and maintaining accounting records but suffers from the following defects:

1. Trial balance can't be prepared and as such arithmetical accuracy of the accounting entries cannot be established.
2. It is difficult to finalize the accounts. So true profits and financial position cannot be known.
3. Assets accounts are not maintained under this system and as such control over assets can't be exercised.

Ascertained of Profit

Profit can be ascertained under this system, using either of the following methods:

1. Statement of Affairs method
2. Conversion method

Statement of Affairs Method

Profit, as a rule, is the difference between closing and opening balances of capital, after adjusting for drawings and additional capital introduced. Capital balance can be ascertained by preparing "Statement of Affairs", which is nothing but a summarized statement of assets and liabilities. Statement of affairs is like a balance sheet for all practical purposes, but is not prepared from trial balance. It is prepared from existing cash book, personal accounts and previous statement of affairs. Capital balance in a `statement of affairs' is a balancing figure (i.e.) net of assets over liabilities (Capital = Total assets - Total liabilities).

A specimen format of statement of affairs is given below:

Statement of Affairs as on

	Rs.		Rs.
S. Creditors	---	Cash on hand	---
Bills payable	---	Cash at Bank	---
Capital (Balance fig)	---	Sundry debtors	---
		Bills payable	---
		Stock	---
		Fixed assets	---
		(-) Depreciation	---

After ascertaining opening and closing balances of capital by preparing the statement of affairs, one at the beginning and another at the end, a 'statement of profit' is prepared to know the profit for the accounting period.

A specimen format of statement of profit is given below:

Statement of Profit for the year ended ………………

	Rs.	Rs.
Closing balance of capital	---	---
(-) Opening balance of capital	---	---
(-) Interest on capital	---	---
(+) Drawings		---
(+) Interest on drawings		---
(-) Additional capital introduced Profit during the year		---
		---

Example 1

Mr. X keeps his books under single entry system. Ascertain profit from the following data, by preparing a statement of profit.

Capital balance as on 1-1-90	Rs. 80,000
Capital balance as on 31-12-90	Rs.1,20,000
Drawings made during the year 1990	Rs. 12,000
Additional capital introduced during the year 1990	Rs. 10,000

Solution

Statement of Profit for the year 1990

	Rs.	Rs.
Capital balance as on 31-12-90	1,20,000	
(-) Capital balance as on 01-01-90	80,000	
		40,000
(+) Drawings made during the year		12,000
		52,000
(-) Additional capital introduced during the year Profit for the year 1990		10,000
		42,000

Example 2

Mr. Y keeps his books under single entry system. His position as on 31-12-90 was as follows: Cash on hand Rs.8000; Cash at Bank Rs.15000; Sundry creditors Rs.10,000; Sundry debtors Rs.45,000; Stock Rs.35,000; Furniture Rs.25,000.

Prepare a statement of affairs and ascertain capital balance as on 31-12-1990.

Solution

Statement of Affairs as on 31-12-90

	Rs.		Rs.
S. Creditors	10,000	Cash on hand	8,000
Capital	1,18,000	Cash at Bank	15,000
(Balancing figure)		S. Debtors	45,000
		Stock	35,000
		Furniture	25,000
	1,28,000		1,28,000

Example 3

Mr. Z keeps incomplete records relating to his business. His financial position as on 01-01-94 and 31-12-95 is given below. You are required to ascertain profit.

	1-1-94 Rs.	31.12.95 Rs.
Cash	5,000	6,000
Stock	8,000	5,000
Debtors	10,000	20,000
Creditors	8,000	9,000
Machinery	30,000	30,000

Additional Information:

(1) During the year Mr. Z withdrew Rs.4000 from the business.

(2) Mr. Z has decided to depreciate Machinery © 10 percent and create a Reserve for Doubtful Debts @ 5 percent.

Solution

Statement of Affairs as on 1-1-94

	Rs.		**Rs.**
S. Creditors	8,000	Cash	5,000
Capital	45,000	Stock	8,000
(Balancing figure)		Debtors	10,000
		Machinery	30,000
	53,000		53,000

Statement of Affairs as on 31-12-94

	Rs.		Rs.
Creditors	9,000	Cash	6,000
Capital	48,500	Stock	5,000
(Balancing figure)		Debtors 10,000	
		(-) Provision for doubtful debts 5% 500	9,500
	57,500	Machinery 30,000	
		(-) Depreciation 10% 3,000	27,000
	57,500		57,500

Statement of Profit for the year 1994

	Rs.	Rs.
Capital balance as on 31-12-94	48500	
(-) Capital balance as on 01-12-94	45000	3500
(+) Drawings made during the year		4000
Profit for the year 1994		7500

Example 4

Mr. P and Mr. Q are in partnership and share profits and losses in the ratio of 3:2. On 31.12.93 their statement of affairs showed the following position.

Liabilities		Assets	
Capital		Machinery	20000
Mr. P.	20000	Stock	15000
Mr. Q.	20000	Debtors	6000
Creditors	5000	Cash	4000
	45000		45000

On 31.12.93 their assets and liabilities were: Machinery Rs.20000; Stock Rs.25000; Debtors Rs.80000; Cash Rs.2000; Creditors Rs.8000. You are required to ascertain profit after charging depreciation on machinery @ 10 percent and interest on capital @ 10 percent. Show the Balance Sheet on 31-12-94.

Solution

Statement of Affairs as on 31-12-94

Liabilities	Rs.	Assets	Rs.
Creditors	8,000	Machinery 20,000	
Capital of Mr. P & Mr. Q	45,000	(-) Dep. 2,000	18,000
(Balancing figure)		Stock	25,000
		Debtors	8,000
		Cash	2,000
	53,000		53,000

Statement of Profit for the year 1994	**Rs.**
Capital balance of Mr. P & Mr. Q as on 31.12.94	45000
(-) Capital balance of Mr. P & Mr. Q as on 31.12.93	40000
	5000
(-) Interest on capital (40000 @ 10%)	4000
Profit for the year 1994	1000

Statement of Capital Balance as on 31.12.94

		P (Rs.)	Q (Rs.)
Add	Opening balance of capital	20000	20000
	Interest on capital	2000	2000
	Profit Rs. 1000		
	(Appropriated in the ratio of 3:2)	600	400
		22600	22400

Balance Sheet as on 31-12-94

Liabilities		Assets	
Capital		Machinery 20,000	
Mr. P	22,600	(-) Dep. 2,000	18,000
Mr. Q	22,400	Stock	25,000
Creditors	8,000	Debtors	8,000
		Cash	2,000
	53,000		53,000

Example 5

On 1.4.94, Mohan started a business with the following assets.

Cash	Rs.10000
Stock of goods	Rs.10000
Furniture	Rs.20000

On 31.3.95 his assets and liabilities were as follows:

Cash	Rs. 8000
Stock of goods	Rs. 14000
Debtors	Rs. 20000
Furniture	Rs. 20000
Bills Receivable	Rs. 6000
Loans	Rs. 4000
Creditors	Rs. 8000

Of the Debtors, Rs.1000 was bad. Provision for doubtful debts were to be created at 5% on Debtors. Reserve for discount on Debtors and on Creditors at 5%. Write off 2% on Bills Receivable. The proprietor had withdrawn Rs.2400 during the year. Charge interest at 5% on capital as well as on drawings. Depreciate furniture @ 10% p.a.

Solution

Statement of affairs as on 1.4.94

Liabilities	Rs.	Assets	Rs.
Capital	40,000	Cash	10,000
(Balancing figure)		Stock	10,000
		Furniture	20,000
	40,000		40,000

Statement of Affairs as on 31.3.95

Loans		4,000	Cash		8,000
Creditors	8,000		Stock		14,000
(-) Reserve for			Debtors	20,000	
discount on Crs.	160	7,840	(-) Bad debts	1000	
Capital		51,729		19,000	
(Balancing figure)			(-) Provision for D/D 5%	950	
				18,050	
			(-) Reserve for Dis. on Debtors 2%	361	17,689
			Furniture	20,000	
			(-) Dep.	2000	18,000
			Bills receivable	6000	
			(-) Unrecoverable	120	5,880
		63,569			63,569

Statement of Profit for the year ended 31.3.95

	Closing balance of capital(as on 31.3.95)	51,729	
Less	Opening balance of capital (as on 1.4.94)	40,000	11,729
Add	Drawings		2,400
			14,129
Add	Interest on drawings (5/100) x 2400		120
Less	Interest on Capital (5/100) x 40000		14,249
			2,000
	Profit for the year ended 31.03.95		12,249

LESSON 7. 2 SINGLE ENTRY SYSTEM - CONVERSION METHOD

Conversion Method

Under conversion method there are two variations (1) Full Conversion and (2) Abbridged Conversion. In Full Conversion single entry system is converted into double entry system. All possible accounts are opened and postings from existing records. (viz., cash book, personal accounts and previous year's statement of affairs) are made. Such a process enables a trader, who keeps his accounts under single entry, to prepare trial balance and thereafter he can finalize his accounts to know the profit. It is a lengthy process and also amounts to duplication of work.

In Abbridged conversion, all accounts are not opened, but necessary information is obtained by preparing consolidated (Total) accounts. This process will enable the trader to prepare Trading and Profit and Loss account and Balance Sheet. Also it will save the trader from the lengthy process of full conversion.

Following are the consolidated (Total) accounts which are prepared to obtain necessary information.

S.No	Name of the account	Information Disclosed
1.	Summary cash (account) book	Total receipts and payments under each head of account.
2.	Total Debtors account	Credit sales or opening /closing balance of debtors
3.	Total Creditors account	Credit purchases or opening / closing balance of creditors.
4.	Total Bills Receivable account	Bills Received during the year or opening/closing balance of B/R
5.	Total bills payable account	Bills payable accepted or opening/ closing balance of B/P

In some problems, the rate of gross profit on cost of goods sold or sales may be given, without giving the opening or closing stock. In such cases a Memorandum Trading Account is prepared to ascertain the opening or closing stock. Apart from preparing these accounts statement of affairs in prepared to ascertain the opening balance of capital.

In this lesson only abridged conversion is dealt with, as full conversion is not in vogue.

Format of the following consolidated (Total) accounts are given below:

Total Debtors Account

Opening Balance	----	Cash/Cheque received	----
Credit Sales	----	Discount allowed	----
Bills Receivable	----	Bad debts	----
(Dishonoured)		Sales returns	----
		Bills receivable received	----
		Closing balance	----

Total Creditors Accounts

Cash paid	----	Opening Balance	----
Cheques issued	----		
Bills payable			
accepted	----		
Discount received	----		
Purchase returns	----		
Closing Balance	----		

Bills Receivable Account

Opening Balance	----	Cash/Cheques received	----
Sundry debtors	----	Bills Discounted	----
(Bills received)		Sundry debtors	
	----	(Bills dishonoured)	----
	----	Closing balance	----

Bills Payable Account

Cash paid	----	Opening balance	----
Cheques issued	----	Sundry creditors	----
Sundry creditors		(bills accepted)	
(For bills not			----
Honoured)	----		----
Closing Balance	----		

Example 1

The following information is available from the incomplete records maintained by Mr. X for his business. You are required to prepare trading and profit and loss account for the year ended 31-12-1990 and the balance sheet as on that date.

Assets-Liability position of Mr. X as on 01-01-1990 Building Rs.20000. Machinery Rs.60,000; Furniture Rs.10,000; Debtors Rs.20,000; Creditors Rs.10,000; Stock Rs.20,000; Cash 5000.

Transactions during the year

Total assets	70,000
Cash sales	10,000
Cash purchases	15,000
Cash paid to creditors	35,000
Cash received from debtors	60,000

Fresh capital introduced	5,000
Salary paid	8,000
Wages paid	5,000
Discount allowed	3,000
Discount received	2,000
Business expenses	10,000
Other information :	
Closing creditors	15,000
Closing stock	50,000

Create 5% provision for bad and doubtful debts.

Depreciate Machinery @10% p.a

Solution

Given below is the list of information which are needed to do the problem and the means of getting the information.

Information Needed	How to obtain the same
1. Opening capital	Preparing opening statement of affairs
2. Closing debtors	Preparing total debtors account
3. Credit purchases	Preparing total creditors account
4. Closing balance of cash	Preparing summary cash book

Statement of Affairs as on 01.01.1990

Creditors	10,000	Building	
Capital	1,25,000	Machinery	10,000
(Balancing figure)		Furniture	10,000
		Debtors	20,000
		Stock	40,000
		Cash	5,000
	1,35,000		1,35,000

Total Debtors Account

Creditors	10,000	Building	
Capital	1,25,000	Machinery	10,000
(Balancing figure)		Furniture	10,000
		Debtors	20,000
		Stock	40,000
		Cash	5,000
	1,35,000		1,35,000

Total Creditors Account

Cash paid to creditors	35,000	Opening Balance	10,000
Discount received	2,000	Credit purchases	42,000
		(Balancing figure)	
Closing creditors	15,000		
	52,000		52,000

Summary Cash Book

Opening balance of cash	5,000	Cash paid to creditors	35,000
Cash sales	10,000	Cash purchases	15,000
Cash received from		Salary paid	8,000
Debtors	60,000	Wages paid	5,000
Fresh Capital introduced	5,000	Business expenses	10,000
		Closing balance of cash	7,000
		(Balancing figure)	
	80,000		80,000

After obtaining the above information the problem is worked as below:

Trading and Profit and Loss Account for the year ended 31.12.1990.

Dr.	Rs.		Rs. Cr.
To Stock	20,000	By Sales	70,000
To Purchases		By Closing stock	50,000
(42,000+15,000)	57,000		
To Wages	5,000		
To Gross profit	38,000		
	1,20,000		1,20,000
To Business expenses	10,000	By Gross Profit	38,000
To Salary	8,000	By Discount	2,000
To Discount	3,000		
To Provision for bad & doubtful debts	850		
To Depreciation	6,000		
To Net Profit	12,150		
	40,000		40,000

Balance Sheet as on 31-12-90

Capital & Liabilities			Assets		
Capital	1,25,000		Building		20,000
<u>Add :</u> Fresh			Machinery	60,000	
Capital introduced	5,000		(-) Depreciation	6000	54,000
	1,30,000		Furniture		10,000
Add Net profit	12,150	1,42,150	Stock (closing)		50,000
Creditors		15,000	Debtors	17,000	
			(-) Provision for		
			Doubtful debts	850	16,150
					7000
		1,57,150			1,57,150

Example 2

Sumana keeps her books under single entry system. Her capital as at 01.011982 was Rs.60,000. An abstract of her cash transactions for the year ended 31.12.1982 was as follows:

	Rs.		Rs.

To Balance b/d	10,000	By Cash purchases	15,000
Cash Sales	40,000	Wages	20,000
Collection from Debtors	60,000	Payment to creditors	28,000
Capital further introduced	10,000	B/P Paid	14,000
B/R Collected	20,000	Salaries	8,000
		General Expenses	4,000
		Drawings	15,000
		Plant Purchased	10,000
		Balance c/d	26,000
	1,40,000		1,40,000

Other particulars of her assets and liabilities as on 01-01-1982 and 31-12-1982 were as follows:

	01-01-1982 Rs.	**31-12-1982 Rs.**
Plant	20,000	30,000
Furniture	2,000	2,000
Bills payable	8,000	10,000
Bills receivable	9,000	13,000
Sundry debtors	22,000	25,000
Sundry creditors	15,000	16,000
Stock-in-trade	20,000	15,000

You are required to draft a Trading and Profit and Loss Account for the year ended 31-12-1982 and a Balance Sheet as on date after providing for 5% interest on capital and 2 ½ % of further introduction, 5% reserve for doubtful debts, 2 ½ reserve on bills receivable, 10% depreciation on plant and 6% depreciation on furniture.

Solution

Following information are needed to solve the problem and the means of finding them is listed below.

Information needed	How to obtain it
1. Bills received during the year	Prepare total bills receivable account
2. Credit sales	Prepare total debtors account
3. Bills accepted during the year	Prepare total bills payable account
4. Credit purchase	Prepare total creditors account

Total Bills Receivable Account

	Rs.		**Rs.**
To Balance b/d	9,000	Cash	20,000
To Total Debtors a/c	24,000		
(Bills received)		By Balance c/d	13,000
(Balancing figure)	33,000		33,000

Total Debtors Account

	Rs.		Rs.
To Balance b/d	27,000	By Bills receivable	24,000
		By Cash	60,000
To Credit sales	82,000	By Balance c/d	25,000
(Balancing figure)	1,09,000		1,09,000

Total Bills Payable Account

	Rs.		Rs.
To Cash	14,000	By Balance b/d	8,000
To Balance c/d	10,000	By Total creditors a/c	16,000
		(Balancing figure)	
		(Bills accepted)	
	24,000		24,000

Total Creditors Account

	Rs.		Rs.
To Bills payable	16,000	By Balance b/d	15,000
To Cash	28,000	By Credit purchase	45,000
To Balance c/d	16,000	(Balancing figure)	
	60,000		60,000

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

	Rs.		Rs.
To Opening stock	20,000	By Sales	
To Purchases		Cash 40,000	
Cash 15,000		Credit 87,000	1,27,000
Credit 45,000	60,000		
To Wages	20,000	By Closing stock	15,000
To Gross Profit	42,000		
	1,42,000		1,42,000
To Salaries	8,000	By Gross Profit	42,000
To General Expenses	4,000		
To Interest on Capital	3,250		
To Reserve for bad debts	1,250		
To Reserve on B/R	325		
Depreciation as on			
Plant 2500			
Furniture 120	2,620		
To Capital a/c (NP transferred	22,555		
	42,000		42,000

Balance Sheet as on 31-12-1982

(in Rupees)

Liabilities			Assets		
Capital	60,000		Plant	30,000	
+ Capital	10,000		- Depreciation	2,500	27,500
- Net Profit	22,555		Furniture	2000	
+ Interest on Capital	3,250		-Depreciation	120	1880
	95,805		Bills receivable	13,000	
- Drawings	15,000	80,805	- Reserve	325	12,675
Bills payable		10,000	Sundry debtors	25,000	
Sundry Creditors		16,000	- Reserve for		
			Bad debts	1250	23,750
			Stock in trade		15,000
			Cash		26,000
		1,06,805			1,06,805

Example 3

A merchant has not kept any book except cash book and personal ledger. Prepare his final accounts with the help of the following details. Also find out his opening capital (on 01-01-86). Summary of Cash book -received from debtors Rs.45650; Drawings Rs.3000; Paid to creditors Rs.33600; Salaries Rs.2500; Rent Rs.1600; Advertisement expenses Rs.400. His other assets and liabilities were:

	31-12-1985 **Rs.**	**31-12-1986** **Rs.**
Debtors	5,250	6,450
Creditors	3,700	5,100
Prepaid rent	20	---
Unpaid rent	---	25
Cash	5,000	8,000

On 31-12-1986 the stock was valued at Rs.5000 and the value of stock on 31-12-1985 (i.e. opening) was not known. The merchant however states that he has sold goods at cost + 25^o

Solution

The algorithm of solving the problem is listed below.

Step 1 : Finding closing balance of cash	- by preparing summary cash book
Step 2 : Finding credit sales	- by preparing total debtors account
Step 3 : Finding credit purchases	- by preparing total creditors account

Step 4 : Finding opening stock	- by preparing a memorandum trading account
Step 5 : Finding opening balance of capital	- by preparing a statement of affairs as on 01- 01-85
Step 6 : Finalization of Accounts	

Summary Cash Book

	Rs.		Rs.
To Balance b/d	5,000	By Drawings	3,000
Debtors	45,650	By Creditors	33,600
		By Salaries	2,500
		By Rent	1,600
		By Advertisement	400
		By Balance c/d	9,550
	50,650		50,650

Total Debtors Account

	Rs.		Rs.
To Balance b/d	5,250	By Cash	45,650
To Credit sales	46,850	By Balance c/d	6,450
(Balancing figure)	52,110		52,110

Total Creditors Account

	Rs.		Rs.
To Cash	33,600	By Balance b/d	3,700
		By Credit purchase	35,000
To Balance c/d	5,100	(Balancing figure)	
	38,700		38,700

Memorandum Trading Account

	Rs.		Rs.
To Opening Stock	7,480	By Sales	46,850
(Balancing figure)		By Closing Stock	5,000
To Purchases	35,000		
To Gross Profit	9,370		
	51,850		51,850

Note:

Let the cost be	Rs. 100	If 125 is sales, profit is 25.
Profit	Rs. 25	If 46850 is sales, profit is
Sales	Rs. 125	25 x 46850/125 = Rs. 9,370

Statement of Affairs as on 01-01-86 (Fig. in rupees)

	Rs.		Rs.
Creditors	3,700	Creditors	5,000
Capital	14,050	Debtors	5,250
(Balancing figure)		Stock	7,480
		Prepaid rent	20
	17,750		17,750

Trading and Profit and Loss Account

	Rs.		Rs.
To Opening stock	7,480	By Sales	46,850
To Purchases	35,000	By Closing Stock	5,000
To Gross profit	9,370		
	51,850		51,850
		By Gross Profit	9,370
To Salaries	2,500		
To Rent 1600			
+ Prepaid less 20			
+ Outstanding year 25	1,645		
To Advertisement	400		
To Net profit	4,825		
	9,370		9,370

Balance Sheet as on 31-12-86

	Rs.			Rs.
Capital	14,050		Cash	9,550
+ NP	4,825		Debtors	6,450
	18,875		Stock	5,000
(-) Drawings	3,000	15,875		
Creditors		5,100		
Unpaid rent		25		
		21,000		21,000

QUESTIONS

1. What is Single Entry System? List out its defects.
2. How profit is arrived under Single Entry System?
3. Distinguish between Statement of Affairs and Balance Sheet.

Problems - Statement of Affairs Method

1. From the particulars given below, find out the profit or loss for the period ending 31-12-1985;

	Position as on 01-01-85 Rs.		Position as on 31-12-85 Rs.
Cash	800	Cash	1,400
Bank	4,700	Bank	2,300
Stock	8,200	Stock	5,900
Debtors	5,100	Debtors	5,900
Furniture	6,000	Furniture	8,000
Goodwill	12,000	Goodwill	12,000
Creditors	2,000	Creditors	4,000
Liability for expenses	3,200	Bills receivables	8,000
Bills receivables	5,000	Bills payable	5,000

Bills payable	4,000	Prepaid expenses	2,000

During the year,the proprietor had withdrawn Rs.4500 for personal expenses.

1. Sri Kaushik, a trader keeps his books by the Single Entry Method. His financial position as on 01-01-87 and 31-12-87 were as follows:

	Position as on 01-01-87 Rs.	Position as on 31-12-87 Rs.
Cash on hand	1,500	1,600
Bank balance Dr:01-01-87 Cr:31-12-87	1,200	1,800
Stock-in-trade	4,000	4,650
Sundry debtors	3,400	3,800
Sundry creditors	2,400	3,600
Plant and machinery	6,000	8,000
Furniture	1,200	1,600

During the year, Sri Kaushik had withdrawn Rs.75 per month for his personal use. From the above information ascertain his profit or loss for the year and also give his statement of affairs as on 31-12-87, after taking into account the following further information:

(a) Depreciate Plant and Machinery by 15% and Furniture by 121/2% p.a.(assume the addition is on 30-06-87).

(b) Of the debtors Rs.100 are bad and to be written off.

(c) Create a Reserve for Discount on Debtors at 2% and a reserve for Doubtful Debts at 5%

(d) Allow interest on capital at 5% and charge interest on drawings at 6% p.a.

2. Kelo and Dhelo are partners in a firm sharing profits or losses at Kelo 60% and Dhelo 40%.

Their Statement of Affairs as at 31- 03-1982, is given below:

Liabilities	Rupees	Assets	Rupees
Sundry creditors	40,000	Plant	40,000
Capital Accounts		Furniture	15,000
Kelo 50,000		Stock	25,000
Dhelo 30,000	80,000	Debtors	30,000
		Cash	10,000
	1,20,000		1,20,000

The partners keep their books by single entry system. On 31-03-83, the position of the business was as follows: Plant Rs.50000; Furniture Rs.20000;Stock Rs.40000; Debtors Rs.45000; Cash Rs.11000 and Sundry creditors Rs.30000.

On 30-09-82, Kelo and Dhelo withdraw from the business Rs.6000 and Rs.4000 respectively. Plant and furniture are to be depreciated at 10% and 20% respectively. A Bad Debt Reserve at 21/2% is to be raised against Sundry Debtors and interest on capital is to be allowed at 5% p.a. and interest on drawings to be charged at 12% p.a.

Problems on Conversion Method

3. M. Mohan carries on grocery business and does not keep his books on double entry basis. The following particulars have been extracted from his books.

	1st July,1975 Rs.	30th June,1976 Rs.
Plant and Machinery	25,000	25,000
Stock in trade	22,000	19,500
Sundry debtors	8,000	22,500
Sundry creditors	12,500	10,000
Cash in hand	400	800
Bank balance	6,250	7,000

The following cash transactions took place during the year ending 30th June, 1976.

Received from debtors	1,60,000	Payments for purchases	28,850
Received from cash sales	31,250	Payments to creditors	1,32,000
		General expenses	21,450
		Wages	15,000
		Drawings	6,800
	1,91,250		2,04,100

During the year Mohan had taken goods from the business for his own consumption which accounted to Rs.1900 for the whole year and had not paid any amount into the business for them. You are required to prepare the Final Accounts after writing off 10% depreciation on Plant and Machinery.

5. The following information is obtained from Gopal's incomplete accounts. Prepare Trading and Profit and Loss Account for the year and the Balance sheet as on 31-12-1971.

	01-01-71 Rs.	31-12-71 Rs.
Creditors	15,770	12,400
Outstanding general expenses	600	330

Sundry Assets	11,610	12,040
Stock	8,040	11,120
Cash on hand and at Bank	6,960	8,080
Debtors	?	17,870
Other Details are:		Rs.
Cash and discounts credited to debtors		64,000
Return from debtors		1,450
Bad debts		420
Sales-cash and credit		71,810
Discount allowed by creditors		700
Returns to creditors		400
Capital introduced into bank		8,500
Cash purchases		1,030
Receipts from debtors paid into bank		62,500
Expenses paid by cash		9,570
Purchase of Machinery by cheque		430
Withdrawn from bank into cash		9,240
Drawings by cheque		3,180
Cash payments into bank		5,000
Cash on hand at end		1,200
Payments to creditors by cheque		60,270

6. J. Portlock whose accounts are recorded by single entry only, with Rs.1000 lent to him by his wife and Rs.2000 of his own, acquired a retail business of which he took possession on 01-01-77. Of the acquisition price, Rs.750 was attributed to goodwill; Rs.250 to furniture, fixtures and fittings; Rs.1750 to stock and Rs.250 was retained as a working capital of which Rs.200 was paid into the bank.

During the year Portlock's takings amounted to Rs.11500 of which Rs.10900 was paid into the bank, the remainder being in part utilized for cash payment. The payments out of the bank and cash during the year were as under:

Purchases	7,800
Salary, Head Assistant	250
Wages	820
Trade expenses	360
Rent, Rates and Taxes	
Business Proportion	296
Personal	148
Payments made for domestic purposes	120
Drawings	1,200

At close of the year Portlock's stock was of the value of Rs.1875. He owned sundry creditors for goods Rs.675 and there was owing to him for goods sold Rs.750. The bank balance was Rs.275. Provide 5% for depreciation on furniture, fittings and fixtures. Interest at 5% p.a. on wife's loan. Rs.50 for doubtful debts. Prepare cash account, bank account, Profit and Loss Account for the year ended 31-12-1977 and a Balance Sheet as on the date.

7. Kumar started a business as a general merchant on i st January, 1984. He opened a bank account for the business with Rs.25000 and immediately spent Rs.10000 on furniture and fittings. The only record kept were cash sales which amounted in 1984 to Rs.37500 and in 1985 to Rs.45000. There were no credit sales. The following facts were ascertained.

(a) All expenses of the business had been met by cheques and an analysis of the bank pass book showed the following payments in the two years

	Rs.
Purchases (of which Rs.37000 related to 1984)	63,700
Rent, Rates and Taxes	5,200
Salaries	12,000
Advertising	1,400
Other expenses	2,800

(b) The value of the stock on 31-12-1985 was Rs.15000. No stock was taken on 31-12-1984,
but a uniform rate of gross profit may be assumed.

(c) Liabilities outstanding on 31-12-1985, were

	Rs.
Purchases	7,500
Advertising	500
Other expenses	170

(d) Amounts paid in advance on 31-12-1985 were:

Rates	Rs.100
Other expenses	Rs. 50

(e) All business expenses arose equally in the two periods.

(f) Goods were taken from stock for private consumption, the estimated cost being Rs.500 in
1984 and Rs.750 in 1985.

(g) Private dividend of Rs.2750 had been paid into bank.

The Fixtures are to be depreciated over 10 years in equal instalments. On the basis of the following information you are required to prepare

(i) Trading and Profit and Loss Account for each of the years 1984 and 1985.

(ii) Balance sheet as at 31-12-1985.

UNIT – VIII

Unit Structure:

Lesson - 8.1 Partnership Accounts

Lesson - 8.2 Dissolution of a Firm

LESSON - 8.1 PARTNERSHIP ACCOUNTS

Partnership is a form of organization for doing business. Under an agreement, two or more persons join together to do a business and share its profit. The business may be run by all or by one among them acting for all.

Partnership accounts include not only finalization of accounts but also solving problems that are special in nature to partnership organization viz., appropriation of profits, admission of partner, death and retirement of partner, dissolution of partnership, insolvency of partners etc. Partnership accounts are governed by general principles of accountancy, partnership agreement (deed) and Partnership Act, 1932.

The terms of the agreement among partners may be either verbal or in writing. If it is in writing, it is known as Partnership Deed. It is desirable to have it in writing. Following are the usual contents of the Partnership Deed.

Contents of Partnership Deed

1. Names and addresses of the firm and partners.
2. Nature of the business.
3. Date of commencement of partnership.
4. Duration of partnership.
5. Amount of capital contributed or to be contributed by each partner
6. Amount of drawings allowed by the firm to each partner.
7. Rules regarding operation of bank accounts.
8. Interest on partners capital and drawings.
9. Ratio in which profits and losses are to be shared.
10. Interest on loan by the partners to the firm.
11. Salaries, commission, etc. if payable to partners.
12. Methods of keeping accounts and audit.
13. Rights, duties and liabilities of the partners.
14. Accounting treatment in case of admission, retirement, death etc of a partner.

15. Mode of settlement of accounts on dissolution of the firm.
16. Method of settling disputes amongst the partners.

In case the Partnership Deed is silent on certain matters, the relevant provisions of the Partnership Act shall be applicable. Following are the provisions of the Partnership Act, which have a direct bearing on the accounting treatment of certain items, in case the Deed is silent on these utters.

1. Partners share profits or losses equally.
2. No interest is charged on partners' capital.
3. No interest is charged by the firm on partners' drawings.
4. No partner is entitled to salary or commission.
5. 6% interest is charged on partners' loan.

Appropriation of Profit

In a proprietary organization, the entire profit belongs to the proprietor alone, but in a partnership it has to be shared among all partners. So the profit shown by the profit and loss account is to be apportioned among partners according to the terms of partnership deed, or in case it is silent, according to the provisions of the Act.

Sometimes the Deed may provide salary to a partner, who is managing the firm, interest on partners' capital and interest on partners' drawings. These items are to adjusted and the remaining profits are to be appropriated among the partners. In this context, a Profit and Loss (Appropriation) Account is prepared to appropriate profits among partners.

Format of Profit and Loss (Appropriation) Account

		Rs.			**Rs.**
To Salary to partner			By Profit & Loss a/c (Net profit)		-------
	X — Y —	------	By Interest on drawings X — Y —		-------
To Interest on capital	X — Y —	-------			
To Reserve fund					
To Capital account	X — Y —	-------			
(Profits transferred)		------- -------			

Fixed and Fluctuating Capital

Capital accounts of partners are maintained either under fixed capital system or under fluctuating capital system. Under fixed capital system, a capital account and a current account is opened for each partner. A partner's original contribution is shown in his fixed capital account and all other entries like his share of profit, salary, drawings, interest on capital and interest on drawings are shown in his current account whereas in fluctuating capital system a partner's original contribution as well as other items are shown in his capital account. Here there is only one capital account for each partner.

Example 1.

On January 1, 1993, X, Y, Z entered into a partnership contributing Rs.3,00,000, Rs.2,00,000 and Rs.1,00,000 respectively and sharing the profits in the ratio 2:2:1. X and Y are entitled to an annual salary of Rs.30,000 and Rs.15,000 respectively. 5% interest on capital is to be allowed. Interest on drawings is to be charged at 6%. The drawings of X, Y and Z are Rs.1500, Rs.1000, Rs.500 per month respectively drawn at the end of every month. Profits for the year ended 1993, before the above adjustment were Rs.1,50,000. Show how the profit is distributed and also prepare the capital accounts (a) if ithey are fluctuating (b) if they are fixed.

Solution

Profit and Loss (Appropriation) Account (Fig.in rupees)

		Rs.			**Rs.**
To Partner's Salary			By Net Profit		1,50,000
	X 30,000 Y 15,000	45,000	By Interest on drawings	X 495 Y 330 Z 165	990
To Interest on capital	X 15,000 Y 10,000 Z 5,000	30,000			
To Capital account	X 30,396 Y 30,396 Z 15,198	75,990			
		1,50,990			1,50,990

Date	**Particulars**	**X**	**Y**	**Z**	**Date**	**Particulars**	**X**	**Y**	**Z**
1993	To Drawings	18000	12000	6000	1993				
1993 Dec. 31	To Interest on drawings	495	330	165	Jan. 1 Dec. 31	By Bank By Salary By Interest On Capital By P & L (App) A/c	3,00,000 2,00,000 15,000 30,396	2,00,000 15,000 10,000 30,396	1,00,000 5,000 15,198
		3,56,901	2,43,066	1,14,033					
		3,75,396	2,55,396	1,20,198			3,75,396	2,55,396	1,20,198

Capital Accounts (*If the capitals are fluctuating)*

(Fig. in Rupees)

Capital Accounts (*If the capitals are fixed)*

Fixed Capital Accounts *(Fig. in rupees)*

Date	Particulars	X	Y	Z	Date	Particulars	X	Y	Z
1993 Dec.31	To Balance c/d	3,00,000	2,00,000	1,00,000	1993 Jan.1	By Bank	3,00,000	2,00,000	1,00,000
		3,00,000	2,00,000	1,00,000			3,00,000	2,00,000	1,00,000

Current Accounts *(Also known as Drawings Account* *(Fig. in Rupees)*

Date	Particulars	X	Y	Z	Date	Particulars	X	Y	Z
1993 Dec.31	To Drawings	18,000	12,000	6,000	1993	By Salary	30,000	15,000	---
	To Interest on drawings	495	330	165	Dec. 31	By Interest on Capital	15,000	10,000	5,000
	To Balance c/d	56,901	43,066	14,033		By P & L (App) A/c	30,396	30,396	15,198
							75,396	55,396	20,198
		75,396	55,396	20,198	1994 Jan. 1	By Balance b/d	75,396	55,396	20,198

Note:

Calculation of interest on drawings:

If drawings are made at regular intervals and that too in fixed amounts, then interest on drawings can be calculated on the basis of average period. The calculation of average period depends whether they are made at the beginning of the month or at the end of the month. Suppose, fixed amounts are drawn at the beginning of the month, then the average period is calculated as follows:

= (Total periods in months + 1)/2

On the other hand, if fixed amounts are drawn at the end of the month the average period is calculated as follows:

= (Total periods in month – 1)/2

In the above problem, fixed amounts are drawn at the end of every month. So interest on drawings is calculated as below:

Average Period	= 12-1 /2
	= 5.5 months
Interest on X's drawings	= 1500 x 5.5 x 6/100
	= Rs.495
Interest on Y's drawings	= 1000 x 5.5 x 6/100
	= RS.330
Interest on Z's drawings	= 600 x 5.5 x 6/100
	= Rs.165

Admission of a Partner

A person can be admitted into a partnership firm if all the existing partners agree to his admission.

A new partner is admitted to improve the business, as he may bring in additional capital or may possess business acumen. When admitted, the new partner has a right to his share of profit, as agreed, as well as to his share of assets in the firm.

In case of admission of a new partner, the following accounting problems are encountered with:

1. Calculation of new profit sharing ratios and the sacrificing ratios.
2. Calculation of goodwill and its treatment.
3. Revaluation of assets and liabilities.
4. Distribution of undistributed reserves, profits or losses.
5. Adjustment of capital accounts.

I. Calculation of new profit sharing ratios and the sacrificing ratios

Calculation of new profit sharing ratios will depend on the terms of agreement among partners admitting the new partner. There are two variations in this regard.

1. The new partner is given his share of profit and the remaining share of profit is presumed to be divided between the old partners in the old profit sharing ratio.

2. He may acquire it in some agreed ratio from old partners.

Sacrificing Ratio

Sacrificing ratio is the difference between old profit sharing ratio and new profit sharing ratio. It will tell how much of share of profit is sacrificed by old partner due to admission of a new partner and giving him a share of profit. The following cases explain the calculation of new profit sharing ratios and sacrificing ratios.

Case 1

The new partner is given his share of profit and the remaining share of profit is presumed to be divided between the old partners in the old profit sharing ratios.

X and Y are partners sharing profits and losses in the ratio of 3:2. They admit 'Z' to the partnership for 1/3 of profits. Calculate the new profit sharing ratio and sacrificing ratio.

Solution

'Z' is given 1/3 profits.

Therefore remaining share of profits = 1 – 1/3

= 2/3

2/3 of profits are to be shared between X and Y in the old profit sharing ratio.

Therefore,

X's share = 2/3 x 3/5 = 2/5

Y's share = 2/3 x 2/5 = 4/15

Z's share = 1/ 3

Therefore,

New profit sharing ratio X:Y:Z: 2/5 : 4/15 : 1/3

= 6:4:5

Profit ratio between X and Y remains the same. So sacrificing ratio of X and Y is nothing but the old profit sharing ratio.

Case 2(a)

A and B are partners sharing profits and losses in the ratio of 5:3. C is admitted to the partnership and he acquires 3/16 share of profit from A and 1/16 share of profit from B. Calculate new profit sharing ratios among all partners and the sacrificing ratios between old partners.

A's new share of profit = 5/8 – 3/16

= 10-3/16

= 7/16

B's new share of profit = 3/8 – 1/16

= 6 – 1/16

= 5/16

C's new share of profit = 3/16 + 1/16

= 3 + 1/16

= 4/16

New profit sharing ratios= A:B:C

= 7:5:4

Sacrificing ratios between A and B

A gives up (sacrifices) 3/16 share

B gives up (sacrifices) 1/16 share

Therefore

Sacrificing ratio = 3:1

Case 2(b)

M and N are partners sharing profits and losses in the ratio of 3:1. They admit '0' for 1/5 share in profits which he acquires equally from M and N. Calculate new profit sharing ratio and sacrificing ratio.

O gets 1/5 share.

(i.e.) 1/2 of 1/5 = 1/10 he gets it from M and N each.

Therefore,

M's new share = 3/4 – 1/10

= 15-2/20

= 13/20

N's new share = 1/4 - 1/10

= 5-2/20

= 3/20

O's share = 1/5 or 4/20

Therefore

New profit share ratio = M:N:O = 13:3:4

As the old partners give up their shares to new partners equally, the sacrificing ratio between M and N is 1:1.

Case 2(c)

P and Q are partners sharing profits and losses in the ratio of 3:2. They admit R for 1/5 share of profit which he acquires wholly from 'P'. Calculate the new profit sharing ratio and sacrificing ratio.

P's new share = 3/5 – 1/5

= 2/5

Q's new share = 2/5 (No change)

R's share = 1/5

New profit sharing ratio = 2:2:1

Here, P, alone gives his 1/5 share to R. So sacrificing ratio for P is 1/5.

Calculation and Treatment of goodwill

Goodwill is an intangible asset. The ability of a business to earn excess profit is due to its reputation. This reputation expressed in monetary terms is goodwill. A number of factors are responsible for good reputation like location, product, management, etc.

Goodwill is valued usually at the time of sale of business. But in the following cases also goodwill is valued.

1. When profit sharing ratios among existing partners is changed
2. Admission of a partner
3. Death or retirement of a partner
4. Amalgamation of two firms.

Following are the methods of valuing goodwill:

1. Average profits method
2. Super profits method
3. Capitalization method

I. Average Profits Method

In this method, goodwill is valued by multiplying the average profits of last few years by an agreed number.

Goodwill = Average profits x No. of years' purchase.

Example 1 Compute the value of goodwill on the basis of three years' purchase of the average profits of last 4 years. The profits of the last 4 years are:

1990 - Rs. 80,000

1991 - Rs. 90,000

1992 - Rs. 82,000

1993 -. Rs. 86,000

Solution

Average profits of last four years

80,000 + 90,000 + 82,000 + 86,000 /4

3,38,000/4 = Rs. 84,500

Value of goodwill = Rs. 84,500 x 3 = Rs. 2,53,500

Another variation of average profit method is weighted average method. Here weights are assigned to each year's profit and the weighted average profits is calculated. Here goodwill is

Goodwill = weighted average profit x No. of years purchase

Example 2

Compute the goodwill of a firm on the basis of 3 years' purchase of weighted profits of last four years (assign weights 1, 2, 3 and 4 serially to the profits).

Profits of last 4 years are:

1990 - Rs. 40,000

1991 - Rs. 45,000

1992 - Rs. 50,000

1993 - Rs. 55,000

Solution

Year	**Annual Profits**	**Weights**	**Product**
1990	40,000	1	40,000
1991	45,000	2	90,000
1992	50,000	3	1,50,000
1993	55,000	4	2,20,000
		10	5,00,000

Weighted average profit = Total product /Total weight

= 5,00,000 /10 = Rs. 50,000

Value of goodwill = Wt. average profit x No. of years purchase

= 50,000 x 3 = Rs. 1,50,000.

2. Super Profits Method

Super profits are profits earned in excess of normal profits.

Goodwill under this method = Super profit x No. of years' purchase

Normal profit = Capital employed x normal rate of return

Example 3

From the following information, calculate goodwill using super profits method.

a) Capital employed in the business Rs.6,00,000

b) Normal rate of return 10%

c) Profits for the last 3 years were

Rs.75,000; Rs.80,000; Rs.85,000

d) Goodwill is 4 years purchase of super profit

Average profits = 75,000 + 80,000 + 85,000/3

= 2,40,000/3 = Rs. 80,000

Normal profit = Capital employed x normal rate of return

= 6,00,000 x 10/100 = Rs. 60,000

Super profit = Rs. 80,000 - Rs. 60,000 = Rs. 20,000

Goodwill = Rs. 20,000 x 4 = Rs. 80,000

Capitalization Method

Under this method goodwill is the difference between capitalized value of average profits at normal rate of return and actual capital employed.

Example

Solution

From the following, calculate goodwill:

a) Normal rate of return 10%

b) Average profits for last 3 years

Rs.75,000; Rs.80,000; Rs.85,000

c) Total assets Rs.7,00,000 and total liabilities Rs.2,00,000

Solution

Average profits = 75,000 + 80,000 + 85,000 3 /3

= Rs. 80,000

Capitalized value of average profits

= average profit x 100 / Normal rate of return

= 80,000 x 100/10

= Rs. 8,00,000

Capital employed = Total tangible asset - Total liabilities

= Rs. 7,00,000 - Rs. 2,00,000

= Rs. 5,00,000

Goodwill = Capitalized value of average profit at normal rate of return –

capital employed

= Rs. 8,00,000 Rs. 5,00,000

= Rs. 3,00,000

Treatment of Goodwill

When a new partner is admitted into a firm, the old partners give up a part of their share of profits in favour of the new partner. Also the new partner is going to enjoy the goodwill of the firm which was built up by the old partners. So the old partners have to be compensated either by payment of money by the new partner or by way of extra credits in their capital accounts.

There are three ways by which goodwill is dealt with when a new partner is admitted. They are

1. Premium Method
2. Revaluation Method
3. Memorandum Revaluation Method

1. Premium Method

Under this method, the new partner brings his share of goodwill and the same is shared by old partners in their profit sacrificing ratios. If the payment is made privately to old partners no entry is required in the books of accounts. But if the payment is made through the books the—following entries are passed.

1. Bank/cash a/c Dr –

To goodwill a/c

[The amount of goodwill brought in by the new partner as premium]

2. Goodwill a/c Dr –

To old partner's capital a/c (individually) –

[Goodwill brought in by new partner credited to old partners in their sacrificing ratios]

Sometimes the old partners may be allowed to withdraw their amount of goodwill (full or a part of it). The following entry is passed.

Old partners capital a/c Dr –

(individually)

To cash

[Amount of goodwill withdrawn by old partners]

Example

X and Y are partners in a business, sharing profits and losses @ 3:1. They admit Z for 1/5 share. Z brings 1 s.10,000 as his capital and Rs.8,000 as goodwill. Pass Journal entry to record the transactions

(a) when goodwill amount is returned in the business

(b) when the entire amount of goodwill is withdrawn

(c) when 50% of the goodwill is withdrawn

Solution

(a) When goodwill is returned in the business

Bank/Cash a/c Dr 18000

To Z's capital a/c 10000

To goodwill a/c 8000

[Amount brought in by 'Z' for capital and goodwill]

Goodwill a/c Dr 8000

To X's capital a/c 6000

To Y's capital a/c 2000

Amount goodwill brought in by new partner credited to old partners' capital account their sacrificing ratios]

(b) In case the amount of goodwill is withdrawn, then apart from passing the two

entries, the following additional entry is to be passed for withdrawal.

X's capital a/c Dr. 6000

Y's capital a/c Dr. 2000

To cash/bank a/c 8000

[The goodwill credited is withdrawn]

(c) In case 50% of the goodwill is withdrawn, the withdrawal entry is as below

X's capital a/c Dr

Y's capital a/c Dr

To cash/bank a/c 4000

[50% of goodwill credited is withdrawn]

Revaluation Method

When the incoming partner is not in a position to pay in cash for goodwill, then goodwill is raised in the books, by crediting the old partners' capital account in their old profit sharing ratio. There are two possibilities here

1. No goodwill account appears in the books at the time of admission
2. When there is goodwill account at the time of admission

1. No goodwill account appears in the books at the time of admission

In such a case goodwill is to be brought into books at its agreed value by debiting the goodwill account and crediting the capital accounts of old partners in their old profit sharing ratio. Here the goodwill account will appear in the balance sheet. The following journal entry is passed.

Goodwill a/c Dr	-	
To old partners capital account	(individually)	-

[Goodwill is raised by debiting goodwill a/c and crediting old partners capital account in their old profit sharing ratio]

Example

X and Y are partners sharing profits and losses in the ratio of 3:1. They admit 'Z' for 1/5 share. 'Z' brings in Rs.20,000 for his capital, but is not in a position to bring cash for goodwill. The value of goodwill is agreed at Rs.12,000. No goodwill account appears in the books. Pass necessary entries.

Cash/bank a/c Dr	20000	
To Z's capital account		20000

[Being the amount brought in by Z for his capital]

Goodwill a/c Dr	12000	
To Xs capital a/c		8000
To Y's capital a/c		4000

[Goodwill account being raised in the books at its value by crediting the old partners' capital account in their old profit sharing ratio]

2. **When there is goodwill account at the time of admission**

In case at the time of admission of a partner there appears goodwill account in the books, then adjustment for goodwill in the old partners capital account is made only for the difference between the agreed value of goodwill and the amount of goodwill appearing in the books.

If the agreed value of goodwill is more than the goodwill account appearing in the books, then goodwill account is to be further increased by crediting the old partners capital account in their old profit sharing ratio.

If the agreed value is less than the goodwill appearing in the books then the excess value of goodwill is written back by debiting the old partners capital account in the old profit sharing ratio.

Example

X and Y are partners of a firm sharing profits and losses in the ratio of 3:2. They admit Z for 1/5 share in profits. Z brings in Rs.20,000 as his capital. The value of goodwill is estimated at Rs. 20,000. Give journal entries under the following circumstances.

1. When there is no goodwill appearing in the books of the firm
2. When the goodwill account appears at Rs.10,000 in the books of the firm
3. When the goodwill account appears at Rs.30,000 in the books of the firm

Solution

(a) when there is no goodwill appearing in the books

Cash/Bank a/c Dr 20,000

To Z's capital account 20,000

[Being the capital introduced by Z]

Goodwill a/c Dr 20,000

To X's capital account 12,000

To Y's capital account 8,000

[Goodwill account is raised by crediting capital accounts of X and Y in their old profit sharing ratio]

(b) when the goodwill account appears at Rs.10000 in the books of the firm (Agreed value is more than the book value)

Cash/Bank a/c Dr 20000

To Z's capital account 20000

[Being the amount brought in by Z as capital]

Goodwill a/c Dr 10000

To X's capital a/c 6000

To Y's capital a/c 4000

[Goodwill account is raised to its agreed value of crediting the capital accounts of X and Y in their old profit sharing ratio]

(c) When goodwill account appears at Rs.30,000 (Agreed value is less than the book value)

Cash/Bank a/c Dr 20000

To Z's capital a/c 20000

[Being the amount brought in by Z as his capital]

X's capital a/c Dr 6000

Y's capital a/c Dr 4000

To goodwill a/c 10000

[Goodwill account appearing in the books is written off to the extent of Rs.10,000 to make it appear at Rs.20,000 by debiting the old partners capital account in their old profit sharing ratio].

Memorandum Revaluation Method

If all partners decide not to show the goodwill account in the books, then they can write back the same by passing the following entry.

All partners capital a/c (individually) Dr

To goodwill a/c –

[Goodwill a/c is written back by debiting the partners capital account, including the new partner in the new profit sharing ratio].

Example

A and B are partners sharing profits and losses in the ratio of 5:4. They admit 'C' and the new profit sharing ratio is 4:3:2. 'C' brings Rs.20,000 as his capital. The value of goodwill is estimated at Rs.36,000. Give necessary entries in the books of the firm on C's admission assuming that the partners do not want goodwill to appear in the books.

1) Cash/bank a/c Dr 20000

To C's capital a/c 20000

[Being the cash brought in by 'C' as his capital]

2) Goodwill a/c Dr 36000

To A's capital a/c 20000

To B's capital a/c 16000

[Goodwill account raised in the books on C's admission by crediting the old partners' capital account in their old profit sharing ratio (i.e.) 5:4]

3) A's capital a/c Dr 16000

B's capital a/c Dr 12000

C's capital a/c Dr 4000

To goodwill a/c 36000

[Goodwill account is written back by delivering the partners capital account in their new profit sharing ratio]

Revaluation of Assets and Liabilities

At the time of admission of a partner into a partnership firm the assets and liabilities of the firm is revalued. The logic behind this exercise is to see that the new partner is not gaining due to understated assets and overstated liabilities or losing due to overstated assets and understated liabilities.

A revaluation (also known as Profit and Loss Adjustment Account) is opened and necessary entries are passed to bring the assets and liabilities to its real value at the time of admission. Then the profit or loss arising out of revaluation of assets and liabilities is transferred to the capital accounts of the old partners in their profit sharing ratios.

The following entries are passed to record the revaluation of assets and liabilities.

1) For increase in the value of assets

Assets a/c Dr –

To revaluation a/c

2) For decrease in the value of assets

Revaluation a/c Dr –

To assets a/c

3) For increase in the value of liabilities

Revaluation a/c Dr –

To liabilities a/c

4) For any decrease in the value of liabilities

Liabilities a/c Dr –

To revaluation a/c

5) For transfer of profit on revaluation

Revaluation a/c Dr –

To old partners capital a/c (individually)

6) For transfer of loss on revaluation

Old partners' capital a/c (individually) Dr –

To revaluation a/c

Sometimes the partners may decide not to alter the value of assets and liabilities but at the same time revalue the assets and liabilities and account for its profit/loss on revaluation. In such a circumstance, a Memorandum Revaluation Account is prepared. First, entries are posted in this account for any increase/decrease in the value of assets/liabilities as explained before and the profit/loss is transferred to capital accounts of old partners. Then the entries posted for any increase or decrease in assets/liabilities are reversed and so the assets and liabilities are again brought to its original value. Any profit/loss arising out of reversal of entries for increase/decrease in the value of assets and liabilities are transferred to capital account of all partners in their new profit sharing ratio.

Journal entries in this regard are:

In case of profit on revaluation

1. Memorandum Revaluation Account Dr –

To Old partners capital account

(individually)

[Profit on revaluation transferred to old partners in their old profit sharing ratio]

2. All partners' capital account (individually) Dr –

To Memorandum revaluation a/c

[Profit previously credited is now returned back by debiting all partners capital accounts in their new profit sharing ratios]

In case of loss on revaluation, the above entries are reversed.

3. **Adjustment of undistributed profits, reserves or losses**

When a new partner is admitted, profits, reserves or losses appearing in the books at the time of admission is to be distributed to old partners in the old profit sharing ratio. The following journal entries are relevant in this regard. For distributing profits and reserves

Profit and loss a/c Dr -

Reserve a/c Dr -

To old partners capital a/c (individually)

[Distribution of profits and reserves at the time of admission of a new partner to old partners in their old profit sharing ratio]

For distributing losses

Old partners capital a/c –(individually)

To profit & loss a/c (debit balance) –

[Losses at the time of admission of a partner distributed to old partner in the old profit sharing ratio]

4. Adjustments of capital accounts

At the time of admission of a partner, the partners may decide to have a balance in their capital accounts in proportion to their profit sharing ratio. So if they have excess or shortage of capital in relation to their profit sharing ratio, adjustment in their capital accounts are to be made. In case any partner has excess capital, the following entry is passed to correct his capital account in proportion to his profit sharing ratio:

Partners capital a/c Dr -

To cash/bank a/c –

[Excess capital withdrawn by the partner who is having excess capital] In case his capital falls short of the amount of capital, calculated in proportion to his profit sharing ratio, the following entry is passed:

Cash/Bank a/c Dr -

To Partners capital a/c –

[Cash is brought in by the partner to make his capital account in proportion to his profit sharing ratio]

Illustration 1

The following was the balance sheet of A, B and C who were equal partners.

Balance sheet of A, B and C as on June 1, 1982

Capital Accounts	Rupees		Rupees
A	16,800	Building	19,500
B	12,600	Furniture	2,400
C	6,000	Stock	11,400
Creditors	6,000	Debtors	10,800
Bills payable	3,300	Cash	600
	44,700		44,700

They agreed to take D into partnership and give him 1/4 share in the profits on the following terms:

1. That 'D' should bring in Rs.9,000 for goodwill and Rs.15,000 as capital.
2. That 1/2 of the goodwill shall be withdrawn by the old partners.
3. The stock and furniture be depreciated by 10%
4. That a provision of 5% on debtors be created for doubtful debts.
5. That a liability for Rs.1,080 be created against bills discounted.
6. That the value of the building, having appreciated, should be valued at Rs.27,000.

Give journal entries and prepare Revaluation Account and the opening Balance Sheet of the reconstituted firm;

(i) in case the partners decide to show the assets and liabilities at the new value.

(ii) in case the partners decide not to alter the value of asset& and liabilities except cash.

Solution

Case 1

If the partners decide to show the assets and liabilities at the new value.

Journal Entries

Cash a/c Dr 24,000
To D's capital a/c 15000
To goodwill a/c 9000
(Cash brought in by the new partners D as his capital and goowill]

Goodwill a/c Dr 9000
To A's capital a/c 3000
To B's capital a/c 3000
To C's capital a/c 3000
[Being the goodwill brought in by 'D' in cash distributed to old partners in their sacrificing ratio].

A's capital a/c Dr 1500
B's capital a/c Dr 1500
C's capital a/c Dr 1500
To cash 4500
[Half of the goodwill credited withdrawn by old partners]

Revaluation a/c Dr 3000
To stock a/c 1140
To furniture a/c 240
To reserve for bad debts a/c 540
To liability for bills discounted1080
[Entry passed to decrease the value of assets or increase the value of liabilities]

Buildings a/c Dr 7500
To revaluation a/c 7500
[Entry passed to increase the value of building]

Revaluation a/c Dr 4500
To A's capital a/c 1500

To B's capital a/c 1500
To C's capital a/c 1500
[Profit on revaluation transferred to old partners in the old profit sharing ratio]

Balance sheet of A, B, C and D as on 1st June, 1982

Creditors	Rs.	Cash	20,100
Bills payable	6,000	Stock (11400 - 1140)	10,260
Liability for bills	3,300	Debtors 10800	
discounted	1,080	(-) Reserve 540	10,260
Capital accounts A	19,800	Furniture (2400 - 240)	2,160
Capital accounts B	15,600	Building	27,000
Capital accounts C	9,000		
Capital accounts D	15,000		
	69,780		69,780

Revaluation Account ***(Fig. in Rupees)***

To Stock	1,140	By Building a/c	7,500
To Furniture	240		
To Reserve for bad debts	540		
To Liabilities for bills discounted	1,080		
A's Capital a/c 1500			
B's Capital a/c 1500			
C's Capital a/c 1500	4,500		
(Profit on revaluation credited to capital a/c)			
	7,500		7,500

Cash Account ***(Fig. in Rupees)***

To Balance b/d	600	By A's Capital a/c	1,500
To D's Capital a/c	15,000	B's Capital a/c	1,500
To Goodwill a/c	9,000	C's Capital a/c	1,500
		(half of goodwill withdrawn)	20,100
	24,600		24,600

Capital Accounts ***(Fig. in Rupees)***

	A	B	C	D		A	B	C	D
To Cash	1,500	1,500	1,500	-	By Balance b/d	16,800	12,600	12,600	---
To Balance c/d	19,800	15,600	9000	15,000	By Cash a/c	---	---	---	15,000
					By Goodwill a/c	3,000	3,000	3,000	---
					By Revaluation a/c	1,500	1,500	1,500	---
	21,300	17,100	10,500	15,000		21,300	17,100	10,500	15,000

Case 2

If the partners decide not to alter the assets and liabilities except cash.

Journal Entries:

1. Cash a/c Dr 24,000
To goodwill a/c 9,000
To D's capital a/c 15,000
[Cash brought in by D for his capital and goodwill]

2. Goodwill a/c Dr 9,000
To A's capital a/c 3,000
To B's capital a/c 3,000
To C's capital a/c 3,000
[Goodwill brought in by D is distributed to old partners in their sacrificing ratio]

3. A's capital a/c Dr 1500
B's capital a/c Dr 1500
C's capital a/c Dr 1500
To cash 4500
[Half of the goodwill withdrawn by old partners]

4. Memorandum Revaluation Dr 4500
To A's capital a/c 1500
To B's capital a/c 1500
To C's capital a/c 1500
[Profit on revaluation distributed to old partners]

5. A's capital a/c Dr 1125
B's capital a/c Dr 1125
C's capital a/c Dr 1125
D's capital a/c Dr 1125
To Memorandum Revaluation a/c 4500
[Profit revaluation account is written back by debiting all the partners capital account in their new profit sharing ratio]

	A (Rs.)	B (Rs.)	C (Rs.)	D (Rs.)		A (Rs.)	B (Rs.)	C (Rs.)	D (Rs.)
To Cash a/c	1,500	1,500	1,500	-	By Balance c/d	16,800	12,600	6,000	---
To Revaluation a/c	1,125	1,125	1,125	1,125	By Cash a/c	---	---	---	15,000
To Balance c/d	18,675	14,475	7,875	13,875	By Goodwill a/c	3,000	3,000	3,000	---
					By Revaluation a/c	1,500	1,500	1,500	---
	21,300	17,100	10,500	15,000		21,300	17,100	10,500	15,000

Memorandum Revaluation Account

	Rs.		Rs.
To Stock	1,140	By Buildings	7,500
To Furniture	240		
To Provision for bad debts	540		
To Provision for bills discounted	1,080		
To A's capital a/c 1500			
To B's capital a/c 1500			
To C's capital a/c 1500	4,500		
Profit on revaluation	7,500		7,500
To Reversal of entries on credit side	7,500	By Reversal of entries on the debt side	3,000
		By A's capital a/c 1125	

		By B's capital a/c 1125	
		By C's capital a/c 1125	
		By D's capital a/c 1125	4,500
	7,500	(Profit on revaluation is written back)	7,500

Balance sheet as on 1st June, 1982

Liabilities	Rs.	Assets	Rs.
Creditors	6,000	Cash (600 + 24000 - 4500)	20,100
Bills payable	3,300	Debtors	10,800
Capital Accounts		Stock	11,400
A - 18675		Furniture	2,400
B - 14475		Buildings	19,500
C - 7875			
D - 13875	54,900		
	64,200		64,200

Illustration 2

The following is the balance sheet of A, B and C showing profits and losses in the proportion of 6/14, 5/14 and 3/14 respectively.

	Rupees		Rupees
Creditors	18,900	Cash	1,890
Bills payable	6,300	Debtors	26,460
General reserve	10,500	Stock	29,400
A's capital a/c	35,400	Furniture	7,350
B's capital a/c	29,850	Land and Buildings	45,150
C's capital a/c	14,500	Goodwill	5,250
	1,15,000		1,15,000

They agreed to take D into partnership and give him 1/8 th share on the following terms:

1. That furniture be depreciated by Rs.920
2. That stock be depreciated by 10%
3. That a provision of Rs.1320 be made for outstanding repair bills
4. That the value of land and buildings being appreciateu be brought upto Rs.59850.
5. That the value of goodwill be brought to Rs.14070.
6. That D should bring in Rs.14700 as his capital.
7. That after making the above adjustments the capital accounts of the old partners are adjusted on the basis of the proportion of D's capital to his share in the business (i.e.) actual cash to be paid off or brought in by the old partners as the case may be.

Pass the necessary journal entries and prepare the balance sheet of the new firm.

[B.Com (Hons) Part I, Delhi]

Journal Entries:

1. Revaluation a/c Dr 5180

To furniture a/c 920
To stock a/c 2940
To provision for outstanding repairs 1320

[Being the assets (viz. furniture and stock) revalued and a provision is made for outstanding repairs]

2. Land and building a/c Dr 14700
To Revaluation a/c 14700

[Being the appreciation in the value of land and building]

3. Revaluation a/c Dr 9520
To A's capital a/c 4080
To B's capital a/c 3400
To C's capital a/c 2040

[Profit on revaluation credited to partners capital a/c]

4. Goodwill a/c Dr 8820
To A's capital a/c 3780
To B's capital a/c 3150
To C's capital a/c 1890

[Value of goodwill is raised to Rs.14070 by crediting the old partners capital accounts in their profit sharing ratio]

5. General reserve a/c Dr 10500
To A's capital a/c 4500
To B's capital a/c 3750
To C's capital a/c 2250

[General reserve is distributed to old partners on admission of DI

6. A's capital a/c Dr 3660
B's capital a/c Dr 3400
To cash a/c 7060

[Excess amount in the capital accounts of A & B withdrawn]

7. Cash a/c Dr 1320
To C's capital a/c 1320

[Cash brought in by C to meet the shortfall in his capital account]

Revaluation Account

	Rupees		Rupees
To Furniture	920	By Land and Buildings	14,700
To Stock	2,940		
To Provision for repairs	1,320		
To A's Capital a/c 4080			
To B's Capital a/c 3400			
To C's Capital a/c 2040	9,520		
Profit on revaluation	14,700		14,700

Capital Accounts

	A (Rs.)	B (Rs.)	C (Rs.)	D (Rs.)		A (Rs.)	B (Rs.)	C (Rs.)	D (Rs.)
To Cash a/c	3,660	3,400	---	---	By balance c/d	35,400	29,850	14,550	---

To Balance c/d	44,100	36,750	22,050	14,700	By cash a/c	---	---	---	14,700
					By Revaluation a/c	4,080	3,400	2,040	---
					By goodwill a/c	3,780	3,150	1,890	---
					By general reserve	4,500	3,750	2,250	---
					By cash	---	---	1,320	---
	47,760	40,150	22,050	14,700		47,760	40,150	22,050	14,700

Cash Account

	Rupees		Rupees
To Balance b/d	1,890	By A's capital a/c	3,660
To D's capital a/c	14,700	By B's capital a/c	3,400
To C's capital a/c	1,320	By Balance c/d	10,850
	17,910		17,910

Balance sheet as on ………………..

Liabilities	**Rs.**	**Assets**	Rs.
Creditors	18,900	Cash	10,850
Bills payable	6,300	Debtors	26,460
Provision for outstanding		Goodwill	14,070
repairs	1,320	Stock (29400 - 2940)	26,460
Capital Accounts		Furniture (7350 - 920)	6,430
A - 44100		Land and buildings	59,850
B - 36750			
C - 22050			
D - 14700	1,17,600		
	1,44,120		1,44,120

Calculation of capital balances.

For 1/8 share D's capital is	Rs. 14,700
A's capital (3/8)	Rs. 44,100
B's capital (5/16)	Rs. 36,750
C's capital (3/16)	Rs. 22,050

RETIREMENT OF A PARTNER

A partner of a firm may decide to retire due to various reasons like ill-health, old age etc. He retires on the basis of retirement terms of a partner set out in the Partnership Deed. When a partner retires, the other partners enter into a fresh agreement and continue the business.

When a partner retires, the following accounting problems are to be looked into.

1. Calculation of new profit sharing ratio and profit gaining ratio.
2. Treatment of goodwill.
3. Revaluation of assets and liabilities.
4. Distribution of reserves/profit or losses.
5. Adjustment of capital accounts of continuing partners.

6. Ascertaining amount payable to the retiring partner and the mode of payment of the amount.

1. Calculation of new profit sharing ratio and profit gaining ratio of continuing partners

When a partner retires from a firm, the continuing partner may agree upon the new profit sharing ratio among themselves, otherwise they acquire the share of profit of the retiring partner in their profit sharing ratio. Profit gaining ratios is the difference between new profit sharing ratios and old profit sharing ratio of old partners.

Case 1

A, B and C are partners sharing profits and losses in the ratio of 4:3:3. B retires. Calculate the new profit sharing ratio, also calculate profit gaining ratio.

Solution

New profit sharing of A and C is 4:3 as there in no agreement on future profit sharing ratio, it is presumed the continuing partners purchase the retiring partner's share in their old profit sharing ratio (i.e.) 4:3. Therefore, the profit gaining ratio is also 4:3 between A:C.

Case 2

A, B and C are partners and share profits and losses in the ratio of 3:2:2. B retires from the partnership. A and C decide to share the future profits equally. Ascertain new profit sharing ratio and profit gaining ratio.

New profit sharing ratio between A and C is 1:1.

Profit gaining ratio for A $= 1/2 – 3/7$

$= (7-6)/14 = 1/14$

Profit gaining ratio for B $= 1/2 – 2/7$

$= (7-4)/14 = 3/14$

Profit gaining ratio between A & C is 1:3.

2. Goodwill Treatment

When a partner retires from a firm, the other partners stand to gain a share of his future profits. So the retiring partner has to be compensated by way of extra credit for his share of goodwill. There are four ways for treating goodwill at the time of retirement. They are

1. Goodwill is raised in the books for its full value by crediting all partners capital account in the old profit sharing ratio.

2. Goodwill raised in the books as above is written off by debiting the capital accounts of the continuing partners in the new profit sharing ratio.
3. Goodwill may be raised in the books only to the extent of retiring partner's share and is written off by debiting the continuing parterns' capital accounts in the profits giving ratio.
4. Without raising goodwill, capital accounts of partners are adjusted for goodwill.

Example

A, B and C are partners in a firm sharing profits and losses in the ratio of 3:2:1. 'B' retires from the firm. The future profit sharing ratio of A and C is 2:1. The value of goodwill is estimated at Rs.42,000. Pass entries for the treatment of goodwill in each of the above cases.

Case 1

Goodwill is raised in the books for its full value by crediting all partners' capital accounts in their profit sharing ratio. Here the goodwill account will appear in the balance sheet an asset.

Goodwill a/c	Dr 42000
To A's capital a/c	21000
To B's capital a/c	14000
To C's capital a/c	7000

[Goodwill is raised for its full value by crediting all the partners' capital a/c in the old ratio]

Case 2

Goodwill raised and written off

a) Goodwill a/c	Dr	42000	
To A's capital a/c			21000
To B's capital a/c			14000
To C's capital a/c			7000

[Goodwill raised to its full value crediting the capital accounts in the old ratio]

b) A's capital a/c	Dr	28000	
B's capital a/c	Dr	14000	
To goodwill a/c			42000

[Goodwill raised is written off by debiting the capital accounts of continuing partners in the new ratio]

Case 3

Goodwill raised to the extent of the retiring partners share and written off.

a) Goodwill a/c Dr 14000

To B's capital a/c 14000

[Goodwill raised to the extent of retiring partner's share]

b) A's capital a/c Dr 7000

C's capital a/c Dr 7000

To goodwill a/c 14000

[Goodwill raised is written off in the profit giving ratio]

Case 4

Without raising goodwill account in the book, when adjustment for goodwill is made.

A's capital a/c Dr 7000

C's capital a/c Dr 7000

To B's capital a/c 14000

[Retiring partner's capital account is credited with his share of goodwill by debiting the capital accounts of continuing partners in their profit sharing ratio]

3. **Revaluation of Assets and Liabilities**

When a partner retires the assets and liabilities are revalued so that he does not suffer or gain because of over/under stated assets and liabilities. Profit or loss arising on the revaluation of assets and liabilities is distributed to all partners in their profit sharing ratio. In case the continuing partners decide to show the value of assets and liabilities in the old value and not in the revalued value, they prepare Memorandum Revaluation Account.

4. **Distribution of Reserves/Profits or Losses**

Any balance of reserves/profits or losses on the date of retirement of a partner is distributed to all partners (including the retiring partner) in the old profit sharing ratio. The following entries are used in this regard.

For distribution of reserves/profits

Reserves/Profit & Loss a/c Dr

To all partners capital a/c (individually)

For distribution of losses

All partners capital account (individually) Dr

To profit & Loss (Dr) a/c

5. Adjustments of capital accounts of continuing partners

The continuing partners may decide to have their balance of capital accounts in proportion to their profit sharing ratio. In such a case they bring in cash or withdraw cash in order to make their capitals in proportion to the profit sharing ratio.

6. Ascertaining the account payable to the retiring partner and the mode of payment of the amount

The capital account of the retiring partner is prepared on the date of retirement to arrive at the amount due to him. The usual credit entries in his account are:

1. Credit balance of his capital a/c
2. Credit balance of his current a/c
3. His share of goodwill
4. His share of accumulated profits and reserves
5. His share of profit on revaluation
6. His share of profit upto the date of retirement
7. Interest on capital upto the rate of retirement
8. His share of joint life policy

The usual debit entries in the account are

1. Debit balance of his capital account
2. Debit balance of his current account
3. His share of accumulated losses
4. His share of loss on revaluation
5. His share of loss upto the date of retirement
6. His drawings upto the date of retirement
7. Interest on his drawings upto the date of retirement

The account, after passing all relevant entries, is closed on the date of his retirement, and the balance (usually credit) is transferred to his loan account. Later the loan account is paid off as per the terms of retirement.

Illustration 3

C, P and S were partners sharing profits 2/5, 3/10 and 3/10 respectively. Their balance sheet on 31st December 1983 was as follows.

Liabilities	Rs.	Assets	Rs.
Capital Accounts		Building	18,000
P 16000		Plant	14,000
B 12000		Motor Car	4,000
C 10000	38,000	Stock	10,000
Reserve	5,000	Debtors 7000	
Bills payable	2,000	(-) Provision 1000	6,000
Creditors	8,000	Cash at Bank	1,000
	53,000		53,000

P retires on that date on the terms:

(a) The goodwill of the firm is to be valued at Rs.7000

(b) Stock and building are to be appreciated by 10%

(c) Plant and motor car are to be depreciated by 10%

(d) Liability for the payment of gratuity to workers Rs.2000 is not recorded in the books,

but the same is to be provided for

(e) Provision for bad debts is no more necessary

(f) It is decided not to maintain goodwill account in the books

(g) The amount payable to P is to be paid in 3 equal annual instalments beginning from

You are required to prepare

(i) Revaluation account

(ii) Partners' capital accounts

(iii) New balance sheet of M/s. L and S

(iv) P's loan account for 1984

Solution

Revaluation Account

	Rs.		Rs.
Dec. 31, 1983		Dec. 31, 1983	
To Plant	1,400	By Stock	1,000
To Motor Car	400	By Buildings	1,800
To Liability for payment of gratuity	2,000	By Provision for bad	2,000
	3,800		3,800

[

Note: There is no profit or loss on revaluation]

Capital Accounts

	C (Rs.)	P (Rs.)	S (Rs.)		C (Rs.)	P (Rs.)	S (Rs.)
Dec. 31, 1983				Dec. 31, 1983			
To Goodwill (goodwill written back)	4,000		3,000	By Balance b/d	16,000	12,000	10,000
To Balance c/d	16,800	----	10,600	By Goodwill	2,800	2,100	2,100
To P's loan a/c	----	15,600	----	By Reserve	2,000	1,500	1,500
	20,800	15,600	13,600		20,800	15,600	13,600

Balance sheet of M/s. L and S as on 31-12-1983

Liabilities	Rs.	Assets	Rs.
Capital Account		Buildings	19,800
C 16,800		Plant	12,600
S 10,600	27,400	Motor Cars	3,600
P's loan account	15,600	Stock	11,000
Bills payable	2,000	Debtors	7,000
Creditors	8,000	Cash at Bank	1,000
Liability for payment of gratuity	2,000		
	55,000		55,000

P's loan account for 1984

	Rs.		Rs.
Jan. 1, 1983		Jan. 1, 1983	
To Cash	5,200	By Balance b/d	15,600
Dec. 31, 1984		Dec. 31, 1984	
To Balance c/d	11,440	By Interest	1,040

Illustration 4

The Balance sheet of X, Y and Z, sharing profits in proportion to their capitals was as follows on December 31, 1975.

Liabilities	Rs.	Assets		Rs.
Sundry creditors	27,600	Cash at Bank		22,400
Capital Accounts		Sundry debtors	20000	
X - 90000		(-) Reserve for bad Debts	400	19,600
Y - 60000		Stock in trade		32,000
Z - 30000	1,80,000	Machinery		34,000
		Land and building		1,00,000
	2,07,600			2,07,600

Y retires and the following adjustment of the assets and liabilities have been agreed upon before the ascertainment of the amount payable by the firm to Y.

1. Insurance charged to profit and loss account includes unexpired insurance of Rs.300.

2. Provision for bad debts to be raised to 5%.

3. Land and buildings to be appreciated by 20%.

4. A bill for repairs for Rs.5300 is due on December 31, 1975.

5. Goodwill of the firm is fixed at Rs.43200 and Y's share of the same is to be adjusted into the account of X and Z who are going to share future profits in the proportion of 3/4 and 1/4 respectively, without raising the goodwill account.

6. That the entire capital of the firm as newly constituted is fixed at Rs.112000 between X and Z in proportion of 3/4 and 1/4 either withdrawing or contributing in cash by the continuing partners as the case may be.

7. The amount due to Y is to treated as his loan account.

Pass journal entries to give effect to the above and prepare the balance sheet of X and Y.

Journal entries:

1. Revaluation a/c Dr 5900
   To reserve for bad debts 600
   To outstanding bill for repair 5300
   [Reserve for bad debts is increased by Rs.600 and the outstanding bill for repair is brought to book on Y's retirement]

2. Land and buildings a/c Dr 20300
   To Revaluation a/c 20000
   To unexpired insurance 300
   [Land and buildings revalued upwards by 20000 and unexpired insurance brought to books]

3. Revaluation a/c Dr 14100
   To X's capital a/c 7200
   To Y's capital a/c 4800
   To Z's capital a/c 2400
   [Profit on revaluation transferred to old partners in their profit sharing ratio viz. 3:2:1]

4. X's capital a/c Dr 10800
   Z's capital a/c Dr 3600
   Y's capital a/c 14400
   [Y's share of goodwill in the firm is adjusted by debiting the continuing partners' accounts in their future profit sharing ratio]

5. X's capital a/c Dr 2400
   Z's capital a/c Dr 800
   To bank 3200
   [Cash withdrawn by the continuing partners in excess of their capital]

6. Y's capital a/c Dr 79100
   To Y's loan a/c 79100
   [Y's capital account is transferred to Y's loan account on his retirement]

Revaluation Account

Dec. 31, 1975		Dec. 31, 1975	
To Reserve for bad debts	600	By Land and buildings	20,000

To Outstanding bills for Repair	5,300	By Unexpired insurance	300
To X's Capital a/c 7200			
To Y's Capital a/c 4800			
To Z's Capital a/c 2400	14,400		
(Profit on revaluation)	20,300		20,300

Capital Accounts

	X (Rs.)	Y (Rs.)	Z (Rs.)		C (Rs.)	P (Rs.)	S (Rs.)
Dec. 31, 1983				Dec. 31, 1983			
To Goodwill	10,800	---	3,600	By Balance b/d	90,000	60,000	**30,000**
To Y's loan a/c	2,400	79,200	800	By Revaluation a/c	7,200	4,800	2,400
To Balance c/d	84,000	---	28,000	By X's Capital a/c	---	10,800	---
				By Y's Capital a/c	---	3,600	---
	97,200	79,200	32,400		97,200	79,200	32,400

Cash at Bank

	Rs.		Rs.
Dec. 31, 1975		Dec 31, 1975	
To Balance b/d	22,000	By X's Capital a/c	2,400
		By Y's Capital a/c	800
		By Balance c/d	18,800
	22,000		22,000

Balance sheet of M/s. X and Z as on 31-12-1975

	Rs.		Rs.
Capital accounts		Cash at bank	18,800
X 84000		Unexpected insurance	300
Y 28000	1,12,000	Sundry debtors 20000	
Y's Loan account	79,200	Less: Reserve for bad debts 1000	19,000
Outstanding bills for repair	5,300	Stock in trade	32,000
Sundry debtors	27,600	Machinery	34,000
		Land and Buildings	1,20,000
	2,24,100		2,24,100

Illustration 5

A, B and C are partners in a firm. On 31-12-1990 B relieves from the firm. After making all adjustments the balance due to him is Rs.9705. On 31-12-1990 Rs.705 is paid to him. The continuing partners agree to pay the balance in 3 annual instalments charging 5% interest, starting from 31-12-1991. Write up his loan account,

1. If the loan amount is paid in 3 equal instalments together with interest
2. If the loan amount is paid in 3 equated instalments.

Solution

(1) If the loan is paid in 3 equal instalments together with interest

B's Loan Account (Fig. in rupees)

1990, Dec. 31		1990, Dec. 31	
To Cash	705	By B's Capital a/c	9,705
To Balance c/d	9,000		
	9,705		9,705
1991		1991	
Dec. 31 To Cash	3,450	Jan. 1 By Balance b/d	9,000
Dec. 31 To Balance c/d	6,000	Dec. 31 By Interest a/c	450
	9,450		9,450
1992		1992	
Dec. 31 To Cash	3,300	Jan. 1 By Balance b/d	6,000
Dec. 31 To Balance c/d	3,000	Dec. 31 By Interest	300
	6,300		6,300
1993		1993	
Dec. 31 To Cash	3,150	By Balance	3,000
		By Interest	150
	3,150		3,150

(2) If the loan is paid in 3 equated installments.

B's Loan Account (Fig. in rupees)

1990, Dec. 31		1990, Dec. 31	
To Cash	705	By B's Capital a/c	9,705
To Balance c/d	9,000		
	9,705		9,705
1991		1991	
Dec. 31 To cash	3,304.87	Jan. 1 By Balance b/d	9,000
Dec. 31 To Balance c/d	6,145.13	Dec. 31 By Interest a/c	450
	9,450.00		9,450
1992		1992	
Dec. 31 To Cash	3,304.87	Jan. 1 By Balance b/d	6,145.13
Dec. 31 To Balance c/d	3,147.52	Dec. 31 By Interest	307.26
	6,452.39		6,452.39
1993		1993	
Dec. 31 To Cash	3,304.87	By Balance b/d	3,147.57
		By Interest	157.30
	3,304.87		3,304.87

[Annuity table shows that Re.1can buy an annuity of 0.367208 at 5% for 3 years. Therefore the equated installment is Rs.3304.82 (9000 x 0.367208)]

Death of a Partner

When a partner dies, the partnership comes to an end, but other partners may carry on the business by entering into a new agreement. The amount due to the deceased partner is ascertained as per the terms of Partnership Deed and as similar lines when a partner retires. The amount due to the deceased partner on the date of death is paid to the executors of the deceased partner, immediately or in instalments. Retirement of a partner is a planned event and usually a partner will retire on the date of closing of the accounts of the firm. On the other hand a partner may die on any date during the accounting period. So he is entitled to his share of profit upto the date of death. The profit for the accounting period during which a partner dies, is ascertained on the date of death, (without closing the books) on the basis of average profits of past years, which is set in the Partnership Deed. Then his shares of profit upto the date of death is arrived at and credited in his account. In case of death, treatment of goodwill, revaluation of assets and liabilities, distribution of reserves/profits etc are done on similar lines when a partner retires. But goodwill is valued on the basis of the terms provided in the Partnership Deed in this regard. Moreover Sec.37 of the Partnership Act, is a relevant section in case of death, which says, the executors of the deceased partners would be entitled, at their choice, to interest at 6% p.a. on the amount due from the date of death to the date of payment or to that portion of profit which is earned by the firm with the help of the amount due to the deceased partner. A retiring partner is also eligible for such a benefit under this section.

Another important accounting aspect in case of death of a partner is the treatment of Joint Life Policy. The firm takes a life insurance policy on the joint lives of its partners in order to pay off the executors of the deceased partner without affecting the financial position of the firm.

Accounting for Joint Life Policy is done in three different ways. They are

1. Premium paid is treated as an expense
2. Joint life policy is shown in the balance sheet at its surrender value by treating it as an asset.
3. Joint life policy is treated as an asset and a reserve viz. joint life policy reserve is maintained.

1. Premium paid is treated as an expense

When premium paid is treated as an expense it is written off at the end of the year, by transferring it to Profit and Loss Account. In case a partner dies, the policy amount is credited to all partners including the deceased partner in their profit sharing ratio. The relevant entries are:

a) When premium is paid

Premium on JLP a/c Dr -

To Bank/cash -

[Payment of JLP premium]

At the end of the year the premium account is closed by transferring it to Profit & loss a/c.

b) Profit and loss account Dr -

To Premium on JLP a/c -

[Profit and loss account is cleared)

On the death of a partner, the policy amount receivable is credited to all partners in their profit sharing ratio.

Insurance Co. a/c Dr -

To Partners' capital a/c (individually) -

[Policy amount receivable is distributed to all partners in their profit sharing ratio]

When policy amount is received, the following entry is made:

Bank a/c Dr -

To Insurance Co. -

[Receipt of policy amount from Insurance Co.]

2. JLP is treated as an asset at its surrender value

When JLP is treated as an asset, then the following entry is passed at the time of payment of JLP premium

JLP a/c Dr -

To Bank a/c -

[Payment of premium is debited to JLP a/c and it is treated as an asset]

At the end of the year, the amount in excess of surrender value is transferred to profit and loss account. The relevant entry is

Profit and loss a/c Dr

To JLP a/c -

[Premium paid in excess of surrender value is treated as loss and transferred to profit and loss a/c]

So every year joint life policy account appears in the balance sheet at its surrender value.

On the death of a partner the policy amount in excess of the surrender value is a gain and is distributed to all partners in their profit sharing ratio. The relevant entries are

a) Insurance Co. a/c Dr -

To JLP a/c

[Amount due by the insurance company on the death of a partner]

b) JLP a/c Dr -

To All partners' capital a/c (individually) -

[Balance of amount in the JLP a/c is distributed to all partners in their profit sharing ratio]

c) Bank a/c Dr -

To Insurance Co. a/c

[Receipt of money from the Insurance Company]

3. **Joint Life Policy is treated as an investment and a reserve viz. JLP reserve, is maintained**

The relevant entries are

a) Joint life policy a/c Dr -

To Bank -

[Payment of premium]

b) Profit and loss a/c Dr -

To JLP reserve a/c

[An amount equal to the premium paid is debited to profit and loss account and a joint life policy reserve account is created]

Then JLP account and JLP reserve account are mutually adjusted so as to leave a balance in each account equal to the surrender value of the policy. The following entry is passed for this:

Joint life policy reserve a/c Dr -

To Joint life policy account

[Mutual adjustment entry so that both the accounts show a balance which is equal to the surrender value]

The above entries are passed every year. On the death of a partner, the balance of joint life policy reserve account is closed by transferring it to Joint Life Policy Account, and the amount received as the policy amount is credited to all partners in their old profit sharing ratio and joint life policy account is also closed. The following entries are passed.

a) Joint life policy reserve account Dr -

To joint life policy account

[On the death of a partner JLP reserve is closed by transferring it to Joint life policy account]

b) Insurance Co. a/c Dr -

To Joint life policy a/c

[Policy amount due on the death of a partner]

c) Joint life policy a/c Dr -

To all partners capital a/c (individually) -

[Joint life policy account is closed by transferring it to all partners' capital a/c in their profit sharing ratio]

d) Bank a/c Dr -

To Insurance Co. a/c –

[Receipt of policy amount from the Insurance Co.]

Illustration 6

X, Y and Z carried on business in partnership, profits being divisible to X 1/2; Y 1/3; Z 1/6. The balance sheet on 31-12-1986 showed their capitals to be

X - Rs. 20,000; Y - Rs.15,000; Z - Rs.10,000

On 31-03-1987 X died and you are asked to prepare the executor's account of X having regard to the following facts:

1. The firm insured the partners' life severally X for Rs.10000, Y for Rs.7500 and Z for Rs.5000. The premiums have been charged to profit and loss account and the surrender value on 31-03-1987 amounted in each case to one-half of the sum assured.
2. Capitals carried interest at 6% p.a.
3. X's drawings from 01-01-1987 to the date of death were Rs.3500.
4. X's share of profits for the portion of the current financial year for which he lived was to be taken at the sum. Calculate on the average of the last three completed years and goodwill was to be raised on the basis of two years purchase of the average profits of those three years. The annual profits of last three years were Rs.7500, Rs.8000 and Rs.9000 respectively.

Workings: X's claim

(1) Joint life policies

X's policy - Rs.10000; 1/2 of 10000 = Rs.5000

Y and Z policies Surrender value = 1/2 (7500 + 5000)

= 1/2x 12500

= 6250

X's share = 6250 x 1/2

= Rs.3125

(2) Interest on capital

Rs. 20000 x 6/100 x 3/12 = 300

(3) Share of profit

X's share of profit for 3 months on the average profits of last 3 years

Average profit = (7500 + 8000 +9000)/3

= Rs.8167

X's share = 8167 x 1/2 x 1/4

= Rs.1021

(4) Share of goodwill

Average profits x 2 = 8167 x 2

= 16334

X's share of goodwill = Rs.8167

(16334 x 1/2)

Solution

Executor's Account of X

	Rupees		Rupees
March 31, 1987		March 31, 1987	
To drawings	3,500	By balance b/d	20,000
To balance c/d	24,113	By joint life policy	5,000
		By interest on capital	300
		By goodwill	8,167
		By profit and loss suspense a/c	1,021
		By Y and Z's capital a/c	3,125
		(Share of surrender value of X and Y policies)	
	37,613		37,613

Illustration 7

JLP

A, B and C sharing profits and losses in the ratio of 5:3:2 took out a Joint life policy for Rs. 1,00,000 paying an annual premium of Rs.5000 starting from 1st January, 1990. The surrender value of the policy was as follows:

1990 - NIL

1991 - Rs.1000

1992 - Rs.2500

1993 - Rs.4000

1994 - Rs.6000

B died on 25th May, 1994 and the policy money was received on 30th June, 1994. Show the account relating to joint life policy under various treatments.

Solution

Case 1 When premium is written off:

Profit and Loss Account

Dr. Cr.

1990 Dec., 31	To premium on joint life policy	5000
1991 Dec., 31	To premium on joint life policy	5000
1992 Dec., 31	To premium on joint life policy	5000
1993 Dec.. 31	To premium on joint life policy	5000
1994 Dec., 31	To premium on joint life policy	5000

Joint Life Policy Account

1994 June, 30		1994 June, 30	
To transfer to capital A/c A B C	50,000 30,000 20,000	By Bank (Amount received from Insurance Co.)	1,00,000
	1,00,000		1,00,000

Case 2 Surrender value is treated as an asset

	Rs.		**Rs.**
1990 Jan. 1		1990 Jan. 1	
To Bank	5,000	By Profit and Loss a/c	5,000
	5,000		5,000
1991 Jan. 1		1991 Dec. 31	
To Bank	5,000	By Profit and Loss a/c	4,000
		By Balance c/d	1,000
	5,000		5,000
1992 Jan. 1		1992 Dec. 31	
To Balance b/d	1,000	By Profit and Loss a/c	3,500
To Bank	5,000	By Balance c/d	2,500
	6,000		6,000
1993 Jan. 1		1993 Dec. 31	
To Balance b/d	2,500	By Profit and Loss a/c	3,500

To Bank	5,000	By Balance c/d	4,000
	7,500		7,500
1994 Jan. 1		1994 June 30	
To Balance b/d	4,000	By Bank	1,00,000
To Bank	5,000	Amount received from	
	7,500	Insurance Co.)	
1994 June 30			
To Transfer to capital accounts			
A	45,500		
B	27,300		
C	18,200		
	1,00,000		1,00,000

Case 3

Premium to be written off through Joint Life Policy reserve account Joint Life Policy Account

Joint Life Policy Account

	Rs.		Rs.
1990 Jan. 1		1990 Jan. 1	
To Bank	5,000	By Profit and Loss a/c	5,000
	5,000		5,000
1991 Jan. 1		1991 Dec. 31	
To Bank	5,000	By Joint Life Policy Reserve	4,000
	5,000	By Balance c/d	1,000
1992 Jan. 1		1992 Dec. 31	
To Balance b/d	1,000	By Joint Life Policy Reserve	3,500
To Bank	5,000	By Balance c/d	2,500
	6,000		6,000
1993 Jan. 1		1993 Dec. 31	
To Balance b/d	2,500	By Joint life policy reserve	3,500
To Bank	5,000	By Balance c/d	4,000
	7,500		7,500
1994 Jan. 1		1994 June 30	
To Balance b/d	4,000	By Bank	1,00,000
To Bank	5,000	By Joint life policy reserve	9,000
	7,500		
1994 June 30			
To Transfer to capital accounts			
A	50,000		
B	30,000		
C	20,000		
	1,09,000		1,09,000

Joint Life Policy Reserve Account

	Rs.		Rs.
1990 Dec. 31		1990 Jan. 1	

To Joint Life Policy a/c	5,000	By Profit and Loss a/c	5,000
	5,000		5,000
1991 Dec. 1		1991 Dec. 31	
To Joint Life Policy a/c	4,000	By Profit and Loss a/c	5,000
To Balance c/d	1,000		
	5,000		5,000
1992 Dec. 31		1992 Dec. 31	
To Joint Life Policy a/c	3,500	By balance c/d	1,000
To Balance c/d	2,500	By Profit and Loss a/c	5,000
	6,000		6,000
1993 Dec. 31		1993 Dec. 31	
To Joint Life Policy a/c	3,500	By Balance b/d	2,500
To Balance c/d	4,000	By Profit and Loss a/c	5,000
	7,500		7,500
1994 Dec. 31		1994 June 30	
To Joint Life Policy a/c	9,000	By Balance b/d	4,000
		By Profit and Loss a/c	5,000
	9,000		9,000

LESSON 8.2 DISSOLUTION OF A FIRM

Dissolution of a firm means the dissolution of partnership between all the partners in the firm. In case of admission, retirement or death of a partner, the partnership is dissolved, but the remaining partners continue the business after entering into a new agreement. When a firm is dissolved there will not be any business afterwards. The assets are disposed off, liabilities are paid and all accounts are closed, by settling the partners' capital accounts.

Dissolution of a firm takes place in the following cases:

1. Dissolution by Agreement.

A firm is dissolved in case

a) when all partners give consent for its dissolution, or

b) as per the terms of agreement.

2. Compulsory Dissolution:

A firm is compulsory dissolved on the following grounds:

a) When all the partners or all excepting one partner becomes insolvent

b) When all partners excepting one decide to retire from the firm

c) When all the partners or all excepting are partner dies

d) When the business becomes illegal.

3. Dissolution on the happening of a certain event:

a) Expiry of the period for which the firm was formed

b) When the venture or project is completed

4. Dissolution by court: A court may order a partnership firm to be dissolved on a suit filed by a partner in the following cases.

a) Where a partner becomes insane.

b) Where a partner becomes permanently incapable of doing business.

c) Where a partner willfully and consistently commits breach of agreement relating to the management of the firm.

d) Where a partner's conduct is likely to adversely affect the business to the firm.

e) Where a partner transfers all his share to a third party.

f) Where the business of the firm can't be carried out except at a loss.

g) On any other grounds which the court thinks just and equitable.

Settlement of Accounts

Rules

In case of dissolution, business ceases to exist, and as such, assets are to be disposed off and after settlement of all its claims, accounts are to be closed. As per Sec.48 of the Indian Partnership Act, the following rules are to be observed:

1. Losses are to be paid first out of profits, next out of capital, and lastly by the partners, individually, in proportion to their profit sharing ratios.
   2. The assets of the firm, including the contribution made by the partners to make up the deficiency of capital are to be applied in the following order:

      a) to pay debts of the firm to third parties.

      b) to pay partners' loans and advances.

      c) to pay capital accounts of the partners.

In case after paying all the above claims, if any surplus is there, it should be distributed among the partners in their profit sharing ratios.

Payment of firm's debts and personal debts

The assets of the firm are applied to pay the debts of the firm first and if any surplus is left it is used to pay the personal debts. Likewise, personal asset of a partner is applied to pay personal debts and if any surplus is left it will be applied to pay the debts of the firm.

Accounting Treatment

When a firm is dissolved all accounts are to be closed. For this purpose a new account called 'Realization Account' is opened. All assets except cash is transferred to this account. Similarly all outside liabilities are transferred and closed. When assets are realized it is passed through this account, likewise when liabilities are paid it is passed through the books. Profit or loss on realization of assets and settlement of liabilities shown in the account are distributed to all partners in their profit sharing ratio. Partners' loan account is settled separately and closed. Reserves and profit and loss accounts are transferred to capital account of all partners in their profit sharing ratio and closed. Then capital accounts of partners are balanced and paid off. Cash Account is automatically closed when all the entries affecting the cash account are posted.

Journal Entries

1. To transfer all assets (except cash and bank) at their book values

Realization a/c Dr -

To Assets account (individually) –

[Note: If there is a provision for bad debts, Debtors Account should be transferred at gross amount. Provision for bad debts is to be treated like an outsider liability]

2. To transfer outsiders liability at their book value

Outsiders liability a/c Dr -

To Realization a/c

3. When assets are sold Cash/Bank a/c Dr -

To Realization a/c

4. When a partner takes over an asset

Partners capital a/c Dr -

To Realization a/c

5. When liabilities are paid

Realization a/c Dr -

To Bank/cash a/c

6. When a liability is taken over by a partner

Realization a/c Dr

To partners' capital a/c

7. For any unrecorded asset sold

Bank/cash a/c Dr

To Realization a/c

8. For any unrecorded liability paid by firm

Realization a/c Dr

To Bank/cash a/c

9. For expenses of realization

Realization a/c Dr

To Bank/cash a/c

10. If a partner pays the realization expenses on behalf of the firm

Realization a/c Dr

To partners' capital a/c

At this stage realization account is to be closed and profits or losses on realization is to be transferred to partners capital account in their profit sharing ratio.

11. For transfer of profits on realization

Realization account Dr

To Partners' capital a/c (individually)

12. For transfer of losses on realization

Partners' capital a/c Dr

To Realization a/c

13. For payment of partners' loan account

Partners' loan account Dr

To Bank/cash a/c

14. For transferring accumulated profits/reserves to partners' capital accounts in their profit sharing ratio.

Profit & loan account (or) reserves Dr

To partners' capital account (individually)

15. For transferring accumulated losses (debit balance of profit and loss account) to partners capital account.

Partners' capital account Dr -(individually)

To Profit and Loss a/c

16. For transferring current account of partners to their capital accounts

a) If it has credit balance

Partners current a/c Dr

To Partners' capital account

b) If it has debit balance

Partners' capital account Dr

To Partners' current a/c

17. Lastly capital accounts of partners are closed

a) If it has a credit balance

Partners' capital account Dr

To Cash/Bank a/c

a. If it has a debit balance

Cash/Bank a/c Dr

To partners' capital a/c

[Cash/Bank account will get automatically closed if all entries effecting cash/bank are posted]

Illustration 8

Dissolution

P and Q are partners sharing profits and losses in the ratio of 3:1. Their balance sheet as on 31-12-1992 is given below.

Balance Sheet of M/s P and Q as on 31-12-92

Liabilities		Assets	
Sundry creditors	35,000	Cash at bank	10,000
Mrs. P's loan	12,000	Stock in trade	8,000
Q's loan	18,000	Sundry debtors 25000	
Reserve fund	6,000	Less Provision 1000	24,000
P's capital	10,000	Fixtures and fittings	2,000
Q's capital	5,000	Machinery and plant	25,000
		Investments	9,000
		Profit and loss account	8,000
	86,000		86,000

The firm was dissolved on 31-12-1992 and the following was the results.

(a) P took over investments at an agreed value of Rs.10000 and agreed to pay off the loan to Mrs. P.

(b) The assets realized the following:-

Stock	Rs. 7000
Debtors	Rs. 22000
Fixtures and fittings	Rs. 1000
Machinery and Plant	Rs. 23000

(c) Expenses of realization amounted to Rs.875

(d) The sundry creditors were paid off less 21/2% discount.

Journalize the entries to be made on the dissolution and show Realisation account, Bank account and Partner's capital accounts.

Solution:

Journal entries

1992 Dec.31

1. Realization a/c	Dr	69000	
To stock-in-trade a/c			8000
To sundry debtors			25000
To furniture and fittings			2000
To machinery and plant			25000
To investments			9000

[Various assets transferred to realisation account and closed on dissolution]

2. Sundry Creditors	Dr	35000
Mrs. P's Loan	Dr	12000
Provision for doubtful debts	Dr	1000

To Realisation a/c 48000

[Various circulations and provision for doubtful debts transferred to realization account and

closed]

3. Reserve fund a/c Dr 6000

To P's capital a/c 4500

To Q's capital a/c 1500

[The reserve fund transferred to partners' capital accounts in their profit sharing ratio and closed]

3. P's capital a/c Dr. 6000

Q's capital a/c Dr. 2000

To profit and loss account 8000

[Profit and loss account is closed by transferring to the capital account of P and Q]

4. Bank a/c Dr 53000

To realisation a/c 53000

(Amount realized from sale of assets)

5. P's capital a/c Dr 10000

To realization a/c 10000

[Investments taken over by P at an agreed value of Rs.10000]

6. Realization a/c Dr 875

To Bank 875

[Expenses on realisation]

7. Realization a/c Dr 34125

To bank 34125

[Sundry creditors paid less 21/2 discount]

8. Realization a/c Dr 12000

To P's capital a/c 12000

[Mrs.P's loan agreed to be paid by P]

9. P's capital a/c Dr 3750

Q's capital a/c Dr 1250

To realization a/c 5000

[Loan on realization transferred to partners' capital account in their capital ratio]

1992 Dec.31

10. Q's loan a/c Dr 18000

To bank a/c 18000

[Payment of Q's loan]

11. P's capital a/c Dr 6750

Q's capital a/c Dr 3250

To bank a/c 10000

[Final payment of partners on dissolution]

Realization Account

1992 Dec. 31	Rs.	1992 Dec. 31	Rupees
To Stock-in-trade	8,000	By Sundry creditors	35,000
To Sundry debtors	25,000	By Mrs. P's loan	12,000
To Furniture & fittings	2,000	By Provision for bad debts	1,000
To Machinery & plant	25,000	By Bank (assets realization)	53,000
To Investments	9,000	By P's Capital (Investments)	10,000
To Bank	34,125	By P's Capital a/c 3750	
To Bank (expenses)	875	By Q's capital a/c 1250	
To P's capital (Mrs. P's loan)	12,000	(Loss on realization)	5,000
	1,16,000		1,16,000

Capital Accounts

	P. (Rs.)	Q. (Rs.)		P. (Rs.)	Q. (Rs.)
Dec. 31, 1992			Dec. 31, 1992		
To Profit and loss a/c	6,000	2,000	By Balance b/d	10,000	5,000
To Realization a/c	10,000	---	By Reserve fund	4,500	1,500
(investment taken)			By Realization a/c	12,000	---
To Realization (loss)	3,750	1,250	(Mrs. P's loan)		
To Bank	6,750	3,250			
	26,500	6,500		26,500	6,500

Q's loan account

1992 Dec. 31	Rs.	1992 Dec. 31	Rupees
To Bank	18,000	By Balance b/d	18,000
	18,000		18,000

Bank Account

1992 Dec. 31	Rs.	1992 Dec. 31	Rupees
To Balance	10,000	By Realization	34,125
To Realization	53,000	By Realization (expenses)	875
(assets realization)		By Q's loan	18,000
		By P's capital a/c	6,750
		By Q's capital a/c	3,250
	63,000		63,000

Illustration 9

Kalyanasundaram, Meenakshisundaram and Somasundaram are three partners in a firm sharing profits and losses in the ratio of 5:4:3. On March 31, 1978, they decided to dissolve the firm when their state of affairs was as follows:

Balance Sheet

Liabilities	Rs.	Assets	Rs.
Sundry creditors	10,860	Cash at Bank	710
Capital accounts		Investments	12,400
Kalyanasundaram	20,000	Debtors	7,950
Meenakshisundaram	9,000	Stock	9,240
Somasundaram	73,030	Machinery	12,000
		Buildings	20,500
		Leaseholds	37,300
		Goodwill	12,790
	1,12,890		1,12,890

Kalyanasundaram agreed to take over the buildings at Rs.32,000 and Meenakshisundaram took over goodwill, stock and debtors at book values, leaseholds at Rs.29,250 and machinery at Rs.5,780. Meenakshisundaram also agreed to pay the creditors. Somasundaram took the investments at the agreed value of Rs.11,500.

Show the Realisation account, Partners' capital accounts and the Bank account.

Solution:

Realization Account

March 31, 1978	Rs.	March 31, 1978	Rs.
To Investments	12,400	By Sundry creditors	10,860
To Debtors	7,950	By Kalyanasundaram capital (bldgs. taken over)	32,000
To Stock	9,240	By Meenakshisundaram capital (Assets taken over)	65,010
To Machinery	12,000	By Somasundaram capital (Investments taken over)	11,500
To Buildings	20,500	By Kalyanasundaram capital (Loss on realization)	1,529
To Leaseholds	37,300	By Meenakshisundaram capital (Loss on realization)	1,223
To Goodwill	12,790	By Somasundaram capital (Loss on realization)	918
To Meenakshisundaram Capital	10,860		
	1,23,040		1,23,040

Bank Account

March 31, 1978	Rs.	March 31, 1978	Rs.
To Balance b/d	710	By Somasundaram capital a/c	60,612
To Kalyanasundaram capital a/c	13,529		
To Meenakshisundaram capital a/c	46,373		
	60,612		60,612

	K. Sundaram (Rs.)	M. Sundaram (Rs.)	S. Sundaram (Rs.)		K. Sundaram (Rs.)	M. Sundaram (Rs.)	S. Sundaram (Rs.)
March 31, 1978				March 31. 1978			
To Realization a/c	32,000	---	---	By Balance b/d	20,000	9,000	73,030
(Assets taken over)							
To Realization a/c	---	65,010	11,500	By Realization	---	10,860	---
(Assets taken over)				(creditors)			
To Realization a/c	1,529	1,223	918	By Bank a/c	13,529	46,373	---
(loss on realization)							
To Bank	---	---	60,612				
	33,529	66,233	73,030		33,529	66,233	73,030

Capital Accounts

Dissolution - Insolvency of a partner

If at the time of dissolution, a partner of a firm having debit balance in his capital account becomes insolvent and could not pay the deficiency in his capital account, then the firm suffers a loss. This loss (due Ito insolvency of a partner) is a special loss and has to be shared by the solvent partners in the ratio of their capitals. The above principle was laid down in the famous case Garner Vs Murray.

Sec.48 (b) (ii) of the Indian Partnership Act, expresses the same view as far as sharing the loss due to insolvency of a partner is concerned. The above rule laid down in Garner Vs Murray is applicable only if the Partnership Deed is silent as to the mode of sharing the loss due to insolvency of a partner.

The method of distributing the loss (using Garner Vs Murray rule) due to the insolvency of a partner to the solvent partners depends on the method of keeping the capital accounts of the partners.

In case capital accounts of the partners are kept under fixed capital method, the loss is to be distributed to the solvent partners in the ratio of their fixed capitals.

In case the capital accounts of partners are kept under fluctuating capital method, then the loss due to insolvency of a partner is to be distributed to solvent partners in the ratio of their capital accounts after distributing profits/reserves appearing in the balance sheet but before adjusting the profit or loss on realization. So, in case realization loss is distributed to partners then the solvent partners have to bring in cash equivalent to their share of realization loss.

Illustration 10

X, Y and Z are partners sharing profits and losses in the ratio of 4/9, 2/9 and 1/3. On 1st January 1981, they agreed to dissolve the partnership, their balance sheet was as follows:

Liabilities	Rs.	Assets	Rs.
Profit and Loss	4,500	Buildings	45,000
Reserve fund	12,600	Machinery	15,000
Bills payable	4,100	Furniture	3,700
Sundry debtors	9,000	Stock	19,400
Loan from X	4,000	Debtors	31,000
Capital accounts		Investments	24,000
X 3000		Bills receivable	5,600
Y 46000		Cash at bank	6,500
Z 68000	1,17,000	Cash at hand	1,000
	1,51,200		1,51,200

The assets realised investments Rs.20400; Bills receivable and debtors Rs.28200; stock Rs.14500; Furniture Rs.2050. Machinery Rs.8600; Buildings Rs.26450; All the liabilities were paid off. The cost of realization was Rs.600. Z has become bankrupt and Rs.1024 only was recovered from estate once and for all. Partners were finally paid off. Show the realization account, the bank account and the capital accounts of the partners (i) when the capitals are fixed (ii) when the capitals are fluctuating.

Solution

Realization Account

1981 Jan. 1	Rupees	1981 Jan. 1	Rupees
To Buildings	45,000	By Bills payable	4,100
To Machinery	15,000	By Sundry creditors	9,000
To Furniture	3,700	By Bank (assets realized)	1,00,200
To Stock	19,400	By X's Capital a/c 19600	
To Debtors	31,000	By Y's Capital a/c 9800	
To Investments	24,000	By Z's Capital a/c 14700	44,100
To Bills receivable	5,600	(realization loss)	
To bank (creditors and B/P paid off)	13,100		

To Bank (expense on realization)	600		
	1,57,400		1,57,400

(a) When capital accounts are fixed

Capital Accounts

	X (Rs.)	Y (Rs.)	Z (Rs.)		X (Rs.)	Y (Rs.)	Z (Rs.)
To Realization	19,600	9,800	14,700	By Balance b/d	68,000	46,000	3,000
To Z's capital a/c	2,968	2,008	----	By Profit & loss	2,000	1,000	1,500
(Z's deficiency Distributed to X and Y)				By Reserve fund	5,600	2,800	4,200
				By Bank a/c (realization loss brought in by solvent partners)	19,600	9,800	----
To Bank a/c	72,632	47,792	----	By Bank a/c	----	----	1,024
				By Xs capital a/c (Z's deficiency in the ratio 34/53)	----	----	2,968
				By Y's capital a/c (Z's deficiency in the ratio 23/53)	----	----	2,008

Bank Account

1981 Jan. 1	Rupees	1981 Jan. 1	Rupees
To Balance b/d	6,500	By Realization a/c (payment to creditors and bills payable)	13,100
To Cash in hand	1,000	By Realization a/c (cost of realization)	600
To Realization a/c (assets realized)	1,00,200	By X's loan a/c	4,000
To X's Capital a/c (realization loss brought in)	19,600	By X's capital a/c	72,632
To Y's Capital a/c (realization loss brought in)	9,800	By Y's capital a/c	47,792
To Z's Capital a/c	1,024		
	1,38,124		1,38,124

X's Loan Account

1981 Jan. 1	Rupees	1981 Jan. 1	Rupees
To Bank	4,000	By Balance b/d	4,000
	4,000		4,000

(b) When capital accounts are fluctuating:

Capital Accounts

	X (Rs.)	Y (Rs.)	Z (Rs.)		X (Rs.)	Y (Rs.)	Z (Rs.)
To Realization	19,600	9,800	14,700	By Balance b/d	68,000	46,000	3,000
To Z's Capital a/c	3,000	1,976	----	By Profit & loss	2,000	1,000	1,500

(Rs.4976 in the ratio of 75600:49300)				By Reserve fund	5,600	2,800	4,200
To Bank a/c	72,600	47,824	----	By Bank a/c (realization loss brought in)	19,600	9,800	----
				By Bank a/c	----	----	1,024
				By Xs Capital a/c	----	----	3,000
				By Y's Capital a/c	----	----	1,976
	95,200	59,600	14,700		95,200	59,600	14,700

Bank Account

1981 Jan. 1	Rupees	1981 Jan. 1	Rupees
To Balance b/d	6,500	By Realization a/c	13,100
To Cash in hand	1,000	By Realization a/c	600
To Realization a/c	1,00,200	By X's Loan a/c	4,000
To X's Capital a/c	19,600	By X's Capital a/c	72,632
To Y's Capital a/c	9,800	By Y's Capital a/c	47,792
To Z's Capital a/c	1,024		
	1,38,124		1,38,124

X's Loan Account

1981 Jan. 1	Rs.	1981 Jan. 1	Rs.
To Bank	4,000	By Balance b/d	4,000
	4,000		4,000

Insolvency of all partners

In case all partners became insolvent it is not possible to pay the liabilities of the firm in full. So liabilities, usually creditors, are not transferred to realization account on dissolution. Cash realized from sale of assets and surpluses from private assets of partners are used to pay off the liabilities to the extent possible. Liabilities unpaid are a gain for the firm and are transferred to a newly opened account viz *'Deficiency Account'*. Then capital accounts of partners are closed after adjusting for realization profit/loss, receipts from private estates etc, by transferring the balances in the capital accounts to deficiency account. The deficiency account is then automatically closed.

Illustration 11

Arun and Anandan were equal partners whose firm was dissolved on December 31, 1982.

Balance Sheet as on December 31, 1982

Liabilities	Rs.	Assets	Rs.

Creditors	3,200	Machinery	1,200
Arun's capital a/c	400	Furniture	300
		Debtors	500
		Stock	400
		Cash	100
		Anandan's capital a/c	1,020
	3,600		3,600

Assets realized the following: Machinery Rs.600; Furniture Rs.100; Debtors Rs.400; Stock Rs.300; realization expenses were Rs.140. Arun was declared insolvent. Anandan's private estate yielded a surplus of Rs.140 only. Give necessary accounts to close the books of the figure.

Solution

Realization Account

Dec. 31, 1982	Rs.	Dec. 31, 1982	Rs.
To Machinery	1,200	By cash	1,400
To Furniture	300	(Assets realized)	
To Debtors	500	By Aruns' Capital a/c 570	
To Stock	400	By Anandan's Capital a/c 570	1,140
To Cash		(realization loss)	
(realization expense)	140		
	2,540		2,540

Capital Accounts

(Fig. in Rupees)

	Arun	Anand		Arun	Anand
Dec. 31, 1982			Dec. 31, 1982		
To Balance b/d	----	1,020	By Balance c/d	400	----
To Realization a/c	570	570	By Cash	----	140
			By Deficiency	170	1,450
			(Balancing figure)		
	570	1,590		570	1,590

Creditors Account

Dec. 31, 1982	Rs.	Dec. 31, 1982	Rs.
To Cash	1,580	By Balance b/d	3,200
To Deficiency a/c	1,620		
(Balancing figure)			
	3,200		3,200

Cash Account

Dec. 31, 1982	Rs.	Dec. 31, 1982	Rs.
To Balance b/d	180	By Realization a/c	140
To Realization a/c	1,400	(realization exp.)	
(Assets realized)		By Creditors	1,580

To Anandan's Capital a/c	140	(Balancing fig)	
	1,720		1,720

Deficiency Account

Dec. 31, 1982	Rs.	Dec. 31, 1982	Rs.
To Arun's Capital a/c	170	By Creditors	1,620
To Anand's Capital a/c	1,450		
	1,620		1,620

Gradual realization of assets - Piecemeal Distribution

When a firm is dissolved assets are realized and liabilities are paid off. In case any surplus is left after payment of liabilities, it is used to pay partners' capital accounts. Assets are sold gradually and so payments to various parties is also made gradually. While making payments, first outside liabilities are paid and after paying outside liabilities in full, partners' loan accounts are paid. If any surplus is left after payment to partners' loan accounts, partners capital balances are paid.

When paying outsiders' liabilities, if two or more creditors are there and the account available is not sufficient to pay them in full, then they are paid in proportion to their dues. Likewise while paying partners' loan accounts the same procedure is followed. Then lastly partners' capital accounts are returned.

Partners capital accounts are paid gradually as and when assets are realized. There are two methods available for the payment cash to partners for the return of their capitals.

1. Proportionate Capital Method
2. Maximum Loss Method

Whatever method is used for payment of cash to partners' capital accounts, the unpaid balance of capital accounts, after making final payments to partners, must be in the ratio of profit sharing.

1. **Proportionate Capital Method**

Under this method the partner who is having excess capital in relation to his profit sharing ratio is paid first by the excess amount only. This process will continue till the capital accounts of all the partners are in proportion to their profit sharing ratios. Thereafter realized amounts are Paid to partners in the ratio of their profit sharing.

2. **Maximum Loss method**

Under this method, every realization is assumed as the final realization and accordingly the loss to partners is arrived at. The loss is transferred to all partners in their profit sharing ratio. Then from the respective capital accounts of partners, the distributed share of loss is deducted, if the balance amount shows a positive amount then it represents the amount paid to each partners. Sometimes a partner's capital account is less than the amount of loss distributed. In such a case his balance amount will show a negative amount. This amount represents loss due to insolvency of the partner and the other solvent partners have to share this amount in the ratio of their capital accounts. The balance left in the capital accounts of solvent partners represents the amount paid to them. This process is continued to all subsequent realizations.

Piecemeal Distribution

Illustration 12

A, B and C share profits and losses in the proportion of 1/2, 1/3 and 1/6. Their Balance Sheet on 31-12-1994, is as follows.

	Rs.		Rs.
Creditors	50,000	Land and Buildings	70,000
A's loan	10,000	Plant and machinery	40,000
A's capital	50,000	Stock	25,000
B's capital	10,000	Debtors	20,000
C's capital	40,000	Cash	5,000
	1,60,000		1,60,000

The partnership is dissolved and the assets are realized as follows:

	Rs.
1st realization	40,000
2nd realization	30,000
3rd realization	54,000
4th realization	7,000

Prepare a statement how the distribution is to be made.

Solution

Proportionate Capital Method

(Fig. in rupees)

		Creditors	A's loan a/c	A's capital	B's capital	C's capital
Amount due		50,000	10,000	50,000	10,000	40,000
Cash in hand paid to creditors		5,000	---	---	---	---
Balance due		45,000	10,000	50,000	10,000	40,000
Amount of 1st realization paid to creditors		40,000	---	---	---	---
Balance due		5,000	10,000	50,000	10,000	40,000
Amount of 2nd realization	30,000					
Paid to creditors	5,000	5,000	---	---	---	---
	25,000	NIL				
Paid A's loan a/c	10,000		10,000			
	15,000	---	----	50,000	10,000	40,000
Paid to C	15,000	---	---	---	---	15,000
Amount due				50,000	10,000	25,000
Amount of third realization	54,000					
Paid to C	8,333					8,333
	45,667			50,000	10,000	16,667
Paid to A and C	45,667			34,250	----	11,417
Amount due				15,750	10,000	5,250
Amount of fourth realization	7,000					
(-) Paid to A and C	1,000			750	----	250
	6,000			15,000	10,000	5,000
(-) Paid to A, B and C	6,000			3,000	2,000	1,000
Balance unpaid or loss on realization	----			12,000	8,000	4,000

Working Notes

Capital Account

Capital Balances (Rs.)	(a)	50,000	10,000	40,000
Profit sharing ratios		3	2	1

Proportionate capitals (Rs)	(b)	15,000	10,000	5,000
(taking B's capital as the basis)				
Excess capital (Rs.) (a - b)		35,000	----	35,000
Proportionate capital as between	(c)	50,000	----	16,667
A and C, taking A's capital as the basis				
Excess capital (a - c)		----	----	24,333

Therefore C is to be paid first by Rs.24,333. Next A and C are to be paid their profit sharing ratio till the capital balances of all the partners are in proportionate to their profit sharing ratio. Then all partners are to be paid in proportion to their profit sharing ratios.

Illustration 13

A, B and C were partners sharing profits and losses as in the ratios of 5:3:2. On December 31, 1985, their Balance Sheet was as follows:

	Rs.		Rs.
Sundry creditors	20,000	Cash at bank	2,000
A's loan	10,000	Stock	28,000
B's loan	4,000	Sundry debtors	30,000
Capitals		Furniture and fittings	4,000
A 15000			
B 12000			
C 3000	30,000		
	64,000		64,000

The firm was dissolved on the 1st January, 1986. The assets realized were as follows:

	Stock	Debtors	Furniture's	Expenses
January, 31	5,000	6,000	1,500	500
February, 28	7,000	4,000	----	800
March. 31	10,000	15,000	----	1,500
April. 30	4,000	3,000	2,000	500

Cash received was paid to the rightful claimants. Give accounts to clear the books of the firms.

Working Notes

The cash available each month is follows:

	Stock		Debtors		Furniture's		Expenses		Cash available
January, 31	5000	+	6000	+	1500	-	500	=	12000
February, 28	7000	+	4000	+	---	-	800	=	10800
March, 31	10000	+	15000	+	---	-	1500	=	23500
April, 30	4000	+	3000	+	2000	-	500	=	8500

Distribution of Cash

(Fig. in Rupees)

		Creditors	A's loan a/c	B's loan a/c	A's capital	B's capital	C's capital
Balance due		20,000	10,000	4,000	15,000	12,000	3,000
Cash in hand paid to creditors		2,000	---		---	---	---
Balance due		18,000	10,000	4,000	15,000	12,000	3,000
January, 31 - Net realization Rs.15000 paid to creditors		12,000	---	---	---	---	---
Balance due		6,000	10,000	4,000	15,000	12,000	3,000
February 28 – Net realization	10200						
Paid to creditors	6,000 4,200	6,000	---		---	---	---
Rs. 4200 paid to A's and B's loan in the ratio of their loans		---	3,000	1,200			
March 31, Net realization Rs.23,500		---	7,000	2,800	15,000	12,000	3,000
		----	7,000	2,800	---	---	---

A's loan and B's loan paid 9800							
Balance due (a)		----	----	----	15,000	12,000	3,000
Cash available for partners 13700							
Maximum less distributed Rs.16300 (30000 - 13700) to A, B and C in the profit sharing ratio		----	----	----	8,150	4,890	3,260
Amount at credit		----	----	----	6,850	7,110	-260
Deficiency of C shared by A and B in their capital ratios of 15:12		----	----	----	-144	116	+260
Amount at credit and available cash paid 13700 (b)		----	----	----	6,706	6,994	----
Balance of capitals (a - b)		----	----	----	8,294	5,006	3,000
April 30 - Net realization Rs.8500							
Maximum loss distributed to A,B and C (16300 - 8500) = 7800		----	----	----	3,900	2,340	1,560
Amount at credit and available cash paid Rs.8500		----	----	----	4,394	2,666	1,440

Realization Account

(Fig. in Rupees)

1986, Jan. 1		1986, Jan. 1	
To Stock	28,000	By Creditors	20,000
To Sundry debtors	30,000	By Cash - Assets realized	
To Furniture & fittings	4,000	Stock - 5000 Debtors - 6000 Furniture – 1500	12,500
To Cash - creditors paid	2,000	1986, Feb. 28	
To Cash - creditors & expenses	12,500	By cash - Assets realized Stock – 7000 Debtors - 4000	11,000
1986, Feb. 28	6,800	1986, March 31	
To Cash - creditors & expenses	1,500	By Cash - Assets realized Stock – 10000 Debtors - 15000	25,000
1986, March 31		1986, April 30	
To Cash - expenses	500	By Cash - Assets realized Stock – 4000 Debtors - 3000 Furniture - 2000	9,000
		By Loss transferred A's capital 3900 B's capital 2340 C's capital 1560	7,800
	85,300		85,300

Cash Account

(Fig. in Rupees)

1985, Jan. 1		1986, Jan. 1	

To Balance b/d	2,000	By Creditors	2,000
1985, Jan. 31		1985, Jan. 31	
To Realization a/c assets realized	12,500	By Realization a/c creditors & expenses	12,500
		1985, Feb 28	
1985, Feb 28 To Realization a/c assets realized	11,000	By Realization a/c creditors & expenses	6,800
		1985, March 31	
		By A's loan 3,000	3,000
1985, Feb 31		By B's loan	1,200
To Realization a/c	25,000	By Realization a/c expenses	1,500
assets realized		By A's loan	7,000
		By B's loan	2,800
		By A's Capital	6,706
		By B's Capital	6,994
1985, April 30		1985, April 30	
To Realization a/c	9,000	By Realization expense	500
assets realized		By A's Capital a/c	4,394
		By B's Capital a/c	2,666
		By C's Capital a/c	1,440
	59,500		59,500

A's Loan Account

1986		1986	
Feb. 28 To Cash	3,000	Jan. 1 By Balance b/d	10,000
March 31 To Cash	7,000		
	10,000		10,000

B's Loan Account *(Fig. in Rupees)*

1986		1986	
Feb. 28 To Cash	1,200	Jan. 1 By balance b/d	4,000

March 31	To Cash	2,800		
		4,000		4,000

Capital Account *(Fig. in Rupees)*

1986 March 31				1986 Jan. 1			
To Cash	6,706	6,994		By balance b/d	15,000	12,000	3,000
1986 Apr, 30							
To Cash	4,394	2,666	1,440				
	15,000	12,000	3,000		15,000	12,000	3,000

Illustration 14. A, B and C share profits in the proportion of 1/2, 1/3 and 1/6. Their Balance Sheet is as follows:

Liabilities	Rs.	Assets	Rs.
Capital Accounts		Assets less liabilities	80,000
A 30000			
B 30000			
C 20000	80,000		
	80,000		80,000

The partnership is dissolved and the assets realized are as follows'

	Rs.
First realization	10,000
Second realization	15,000
Third realization	25,000

Prepare a statement showing how the distribution should be made applying Garner Vs. Murray principle.

Note: Maximum Loss Method is used to distribute cash to capital accounts when Garner Vs Murray principle is to be followed.

Solution

		A	**B**	**C**
Balance of capital	(a)	30,000	30,000	20,000
First Realization Rs. 1,00,000				

Maximum loss (80000 - 10000) 70000 distributed to partners in their profit sharing ratios	(b)	35,000	23,333	11,667
Amount at credit	(c)	-5,000	6,667	8,333
A's loss shared by B and C in their capital ratios 3:2	(d)	+5000	-3,000	-2,000
Amount at credit and available cash paid	(e)	-	3,667	6,333
Balance of capital (a - e)	(f)	30,000	26,333	13,667
Second Realization Rs.15000				
Maximum balance distributed (70000 - 15000) = 55000	(g)	27,500	18,333	9,167
Amount at credit and available cash paid	(h)	2,500	8,000	4,500
Balance of capital (f - h)	(i)	27,500	18,333	9,167
Third Realization Rs.25000				
Maximum possible loss distributed (55000 - 25000) = 30000	(j)	15,000	10,000	5,000
Amount at credit and available cash paid (i - j)	(k)	12,500	8,333	4,167
Balance in capital account left unpaid and hence loss (i-k)		15,000	10,000	5,000

QUESTIONS

1. Define Partnership. Explain its nature and characteristic feature.
2. Differentiate between dissolution of a Partnership and dissolution of a firm.
3. What is the rule laid down in Garner Vs Murray case?

Problems on Admission

4. The following is the Balance Sheet of a partnership firm on 31-12-1991.

Liabilities	Rs.	Assets	Rs.
Capitals		Sundry Assets	33,000
X	18,000	Cash	5,000
Y	12,000	Goodwill	6,000
Reserves	6,000		
Creditors	8,000		
	44,000		**44,000**

Z is admitted as a third partner on 01-01-1992 with a fifth share in the future profits of the firm. He is to bring Rs. 10000 in cash of which Rs.2000 is to be treated as premium for goodwill. Show journal entries if

(a) Goodwill account is to appear in the balance sheet at full value

(b) Goodwill account is fully wiped off the balance sheet.

5. Ram and Raghu share profits -irr-the proportion of three-fourth and one-fourth. The Balance Sheet of the firm on 31 December, 1989 was us under:

Liabilities	Rupees	Assets	Rupees
Sundry creditors	4,150	Cash at bank	2,250
Capital accounts		B/R	300
Ram	3,000	Book debts	1,600
Raghu	1,600	Stock	2,000
		Furniture	100
		Building	2,500
	8,750		8,750

On January 1990 Peter was admitted into partnership on the following terms:

a) Peter pays Rs.1000 as capital and Rs.500 as goodwill for 1/5 share. Half of the amount of goodwill is to be withdrawn by Ram and Raghu.

b) Stock and furniture be reduced by 10% and 5% respectively. Provision for doubtful debts be created on book debts and B/R at 5%.

c) Value of buildings be increased by 20%.

d) A liability to the extent of Rs.100 be created in respect of a claim for damages against the firm.

e) An item of Rs.65 included in sundry creditors is unlikely to be claimed.

You are required to prepare a Profit and Loss Adjustment Account and Balance Sheet of the new firm.

6. Rama and Sugriva are partners in a firm carrying on the business of Ravana bath. They shared profits and losses in the ratio of 3:2. The following was their balance sheet on 31-12-1976.

Liabilities	Rupees	Assets	Rupees
Capital accounts		Goodwill	20,000
Rama	1,00,000	Plant	45,000
Sugriva	75,000	Furniture & fitting	12,500
Creditors	85,000	Investments (cost)	25,000
Bills payable	5,000	Stock	57,500
		Bills receivable	10,000
		Cash in hand and at bank	40,000
	2,65,000		2,65,000

On 1st January, 1977 they agreed to admit Vibhishana as a partner on the following terms:

a) The new profit sharing ratio shall be Rama 2/5ths, Sugriva 2/5ths and Vibhishana 1 /5ths.

b) Vibhishana is to bring his capital of Rs.50,000 in cash and to pay his share of goodwill in the firm. Goodwill for this purpose is to be valued at 2 years purchase of the previous 4 years profits.

The profit for the previous 4 years were:

1971 - 25,000

1972 - 22,500

1975 - 25,000

1976 - 27,500

c) The other assets are to be revalued as follows:

	Rs.
Plant	52,500
Furniture & fittings	10,000

Investments	22,000
Stock	63,000
Debtors	50,000

It was decided for the purpose of Balance sheet that the value of assets except cash shall remain unchanged. You are required to pass the necessary journal entries recording the above transactions and to prepare the opening balance sheet of the new firm.

Problem on Retirement

7. A, B and C are partners in a trading concern sharing profits and losses equally. C decided to retire with effect from 31-12-1982. The following is the summarized balance sheet of the firm as on that date:

	Rs.		Rs.
Capital Accounts		Buildings	20,000
A 25000		Plant and machinery	10,000
B 20000		Patents	15,000
C 15000	60,000	Stock	12,500
Trade creditors	20,000	Debtors	15,000
		Cash at bank	7,500
	80,000		80,000

The following revised value of assets were agreed upon: goodwill Rs .20000; Building Rs .27500; Plant and machinery Rs.9000; Patents Rs.13250. It was also agreed to create a bad debts reserve at 5% on debtors. Show the revaluation account, capital accounts of A and B (assuming any balance due to C is transferred to his loan account) and opening balance sheet of A and B.

8. Problems on Death

Jaswant, Karji and Charji were partners in the firm of Fire Works Company, their profits sharing proportion being 4, 3 and 2 respectively. Their Balance Sheet as at 30th June 1977, on which date Jaswant died is as follows:

	Rupees		Rupees
Bank Overdraft	5,000	Cash	1,000
Creditors	2,000	Debtors	10,000
Workmen's Accident Fund	9,000	Stock	16,000
Partners Account:		Motor Car	2,000
Jaswant - 7,000		Furniture	1,000
Karji - 4,000		Plant and Machinery	20,000
Charji - 3,000	14,000	Land & Factory	30,000
Capital Accounts			
Jaswant - 20,000			
Karji - 20,00			
Charji - 10,000	50,000		
	80,000		80,000

The partnership agreement provided that on the death of a partner:

(i) The firm shall be continued by the other partners,

(ii) Goodwill to be computed on the basis of two years' profits on the average of the three preceding years,

(iii) Fixed and Floating Assets to be revalued and

(iv) The amount ascertained to be due to the deceased partner's legal representative to be retained as Loan to the firm, one-third of the amount plus interest at 6 percent per annum of the balance outstanding being paid on 30th June each year until fully repaid.

The profit of three preceding accounting years which ended on 31st March, were Rs.30,000; Rs.45,000 and Rs.60,000 respectively. On revaluation as at 30th June 1977, the amounts for Land and Factory, Plant and Machinery, Furniture, Motor Cars and Stock came to Rs.60,000; Rs.80,000; Rs.3,000; Rs.5,000 and Rs.21,000 respectively. While the Debtors were considered good at the book figure less 10 percent reserve for doubtful debts.

You are asked to give effect to the foregoing in the books of the firm and prepare: (a) Revaluation Account

(b) Revised Balance Sheet as at 30-06-1977

(c) The legal representative's loan account for the three years ended 30-06-1980 [Calculation to be made to the nearest rupee].

9. Problem on Dissolution

Chopra, Shan and Patel were carrying on business as manufacturers of sports goods. The profit sharing ratio was 3:2:1 respectively. Their balance sheet on 30th June, 1984 was as under.

Liabilities	Rupees	Assets	Rupees
Creditors	1,50,000	Plant & Machinery	1,60,000
Mrs. Chopra's loan	1,30,000	Stock	1,50,000
Repairs & renewals	12,000	Debtors 2,00,000	
Capitals		- Provision 10,000	1,90,000
Chopra 1,00,000		Prepaid insurance	4,000
Shah 1,50,000		Investments	30,000
Patel 20,000	2,70,000	Cash	28,000
	5,62,000		5,62,000

On this date the firm was dissolved. The assets realized as under:

Plant and Machinery	1,00,000
Stock	1,20,000
Debtors	1,60,000

The investments were taken over by Chopra at a value of Rs.20000. He also agreed to pay Mrs.Chopra's loan. During the course of realization it was found that a bill for Rs.5000 previously discounted by the firm was dishonoured and has to be paid. Expenses came to Rs.8000. Prepare (i) Realization Account (ii) Partners' Capital Account and (iii) Cash Account.

10. Problem on Dissolution:

X, Y and Z were in partnership sharing profits and losses equally and agreed to dissolve the firm on 30-06-93. On that date their Balance Sheet stood as follows:

Liabilities	Rupees	Assets	Rupees
Capital accounts		Sundry Assets	25,000
X 17,000		Profit & Loss a/c	6,000
Y 12,000	29,000	Capital accounts	4,000
Creditors	6,000		

	35,000		35,000

The assets were realized at 50% of their book value. Realization expenses amounted to Rs.2500. Z becomes insolvent and recovered Rs.1000 from his private estate.

Close the books of the firm under (i) Fixed Capital Method (ii) Fluctuating Capital Method applying Garner Vs Murray principle.

11. Dissolution - when all partners are insolvent

A and B are in equal partnership. Their balance sheet stood as:

Liabilities	Rupees	Assets	Rupees
A's capital	600	Machinery & Plant	1,475
Creditors	3,900	Furniture	400
		Debtors	500
		Stock	625
		Cash at Bank	300
		B's drawings	1,200
	4,500		4,500

The assets were realized as follows:

Stock Rs.350; Furniture Rs.200; Debtors Rs.500; and Machinery Rs.700. A's private estate is not sufficient even to pay his private debts, whereas in B's private estate there is a surplus of Rs.50.

Prepare a Realization Account, Bank Account, Profit and Loss Account and Creditors Account showing what dividend is paid to creditors.

12. Problem on Insolvency

A, B, C and D are partners sharing profits and losses in the ratio of 2:3:3:2.

Liabilities	Rupees	Assets	Rupees
Creditors	20,000	Sundry assets	30,000
B's loan	5,000	Cash at bank	1,000
Capital accounts		Loss	15,000
A	10,000	Drawings	
B	6,000	B - 2000	
C	6,000	C - 2000	4,000
D	3,000		
	50,000		50,000

The profit of partners was as follows:

	Private Estate	Private Liabilities
	Rs.	Rs.
A	10,000	15,000
B	20,000	6,000
C	5,000	4,000
D	8,000	9,000

The assets realized Rs.26000 and expenses of dissolution come to Rs.1000. Prepare the ledger accounts giving effect to the dissolution.

13. Problem on Piece-meal Distribution

A, B and C share profits and losses in the proportion of 1/2, 1/3 and 1/6. Their balance sheet is as follows:

A's capital	3,000	Assets less liabilities	8,000
B's capital	3,000		
C's capital	2,000		
	8,000		8,000

The partnership is dissolved and the assets realized as under:

First realization	1000
Second realization	1500

Third realization	2500
	5000

Prepare a statement showing the distribution of cash to partners using

(1) Proportionate Capital Method

(2) Maximum Loss Method.